

HOUSE FINANCE COMMITTEE
January 28, 2014
1:32 p.m.

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CALL TO ORDER

Co-Chair Austerman called the House Finance Committee meeting to order at 1:32 p.m.

MEMBERS PRESENT

Representative Alan Austerman, Co-Chair
Representative Bill Stoltze, Co-Chair
Representative Mark Neuman, Vice-Chair
Representative Mia Costello
Representative Bryce Edgmon
Representative Les Gara
Representative David Guttenberg
Representative Lindsey Holmes
Representative Cathy Munoz
Representative Steve Thompson
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Joseph Schmidt, Commissioner, Department of Corrections;
Ron Taylor, Deputy Commissioner, Department of Corrections;
Leslie Houston, Deputy Commissioner, Department of
Corrections; Angela Rodell, Commissioner, Department of
Revenue; Michael Pawlowski, Deputy Commissioner, Strategic
Finance, Department of Revenue; Pam Leary, Director,
Treasury Division, Department of Revenue.

SUMMARY

FY 15 GOVERNOR'S BUDGET OVERVIEW: DEPARTMENT OF CORRECTIONS

2013 FALL REVENUE FORECAST OVERVIEW and STATE SAVINGS
ACCOUNT UPDATE: DEPARTMENT OF REVENUE

HB 265 BUDGET: CAPITAL

HB 265 was HEARD and HELD in committee for further consideration.

HB 266 APPROP: OPERATING BUDGET/LOANS/FUNDS

HB 266 was HEARD and HELD in committee for further consideration.

HB 267 APPROP: MENTAL HEALTH BUDGET

HB 267 was HEARD and HELD in committee for further consideration.

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#hb267

HOUSE BILL NO. 265

"An Act making appropriations, including capital appropriations and other appropriations; making appropriations to capitalize funds."

HOUSE BILL NO. 266

"An Act making appropriations for the operating and loan program expenses of state government and for certain programs, capitalizing funds, and making reappropriations; making appropriations under art. IX, sec. 17(c), Constitution of the State of Alaska, from the constitutional budget reserve fund."

HOUSE BILL NO. 267

"An Act making appropriations for the operating and capital expenses of the state's integrated comprehensive mental health program."

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Co-Chair Austerman called the meeting to order.

^FY 15 GOVERNOR'S BUDGET OVERVIEW: DEPARTMENT OF CORRECTIONS

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JOSEPH SCHMIDT, COMMISSIONER, DEPARTMENT OF CORRECTIONS, provided a PowerPoint presentation "FY2015 Overview House Finance Committee" (copy on file).

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Commissioner Schmidt began with slide 2: "Mission"

The Alaska Department of Corrections enhances the safety of our communities. We provide secure confinement, reformative programs, and a process of supervised community reintegration.

He reported that the Department of Corrections (DOC) had a three-part mission statement which included secure confinement, reformative programs, and community integration. The department conducted valuable assessments to ensure proper confinement for inmates, provided reformative programs to help keep inmates active during incarceration, and assisted with community reintegration to reduce recidivism.

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Commissioner Schmidt continued with slide 3: "DOC at a Glance"

- Alaska is one of six states in the nation that operates a unified correctional system
- In FY2013, DOC booked 39,203 offenders into its facilities, including 3,726 Title 47 bookings
- As of June 30, 2013, 6,056 offenders are in prison, a community residential center (CRC), or on electronic monitoring (EM)
- As of June 30, 2013, 5,988 offenders are on probation or parole
- Thirteen facilities statewide (Goose Creek and Pt. MacKenzie combine in FY2015) with a total capacity of 5,352 beds
- Thirteen field probation offices statewide
- Eight contract CRCs with a capacity of 839 beds
- EM operates in six communities with a capacity of 385
- Fifteen regional and community jail contracts with a total capacity of 157 beds

- Reformative Programming

Commissioner Schmidt relayed that the State of Alaska was one of six states that had a unified system meaning that the state housed all of the misdemeanants and felons serving a sentence of any length. He also informed the committee that DOC booked over 39,000 offenders, approximately 4,000 of whom were non-criminals such as inebriates. He emphasized that there was a number of repeat offenders in the system. He cited that of the 6,056 current offenders, 754 were in CRC's and 381 were on EM. The approximately 5,000 remaining offenders occupied prison beds. He reported that another 6,000 offenders were on probation or parole. One of the things DOC was doing to reduce the current year's budget was to roll the 128 beds at the Point Mackenzie correctional farm facility into the Goose Creek Correctional Center. Work crews would be transported from Goose Creek to the farm. He elaborated that 95 percent of EM participants were finishing without incident or coming back to jail. He was looking into expanding the EM program due to its proven success. He read the remaining items on the slide.

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Commissioner Schmidt presented slide 4: "Secure Confinement." He stated that the map depicted the various institutions and community jails.

Commissioner Schmidt described slide 5: "Supervised Release." He indicated that the map showed where the state had its EM programs, field probation offices, and halfway houses.

Commissioner Schmidt detailed slide 6: "Standing Population and Crime Type." He noted the shift from violent to non-violent offenders since 2002. He reported that the percentage of non-violent offenders increased from 44 percent to 56 percent over the past eleven years which resulted in the state incarcerating a larger number of non-violent offenders than violent offenders. He affirmed the importance of relaying incarceration trends to the public.

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Commissioner Schmidt revealed slide 7: "Percent of Offenders by Length of Stay from Admission." He pointed out that the percentage of offenders remaining imprisoned for 37 months or more had almost doubled in eleven years. He surmised that non-violent offenders were serving longer sentences costing the state more money. The slide also showed that the number of people getting between a one and two-year sentence was significantly smaller than in previous years.

Commissioner Schmidt discussed slide 8: "Percent of Incarcerated Offenders by Gender." He mentioned an increase in incarcerated females from 9.46 percent in 2003 to 12.41 percent in 2013. He warned that the state would be faced with providing additional jail facilities if the incarcerated female population continued to grow at the current rate of 6.01 percent. He signified that 15 percent of the state halfway house population was female, female probation cases accounted for 21 percent of the state's caseload, and 27 percent of EM program participants were female.

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Commissioner Schmidt introduced slide 9: "Institutional Inmate Population 2004-2021." He pointed out that the red line represented the state's total number of inmate beds and the blue line signified the projection of inmate population based on a 2.7 percent growth rate. He reported that the dip in the red line was due to the caging of the Point Mackenzie farm facility (120 beds). He stated that the 120 beds at the farm facility would be moved back to Goose Creek when needed. The graph did not account for any increases for the EM program or the successes in probation supervision. He stated that the trends would affect the graph's data.

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Commissioner Schmidt discussed slide 10: "Goals"

- Protect the public
- Reduce recidivism
- Delay the need for construction of a new prison
- Ensure that incarcerated offenders spend their time in custody productively

- Work collaboratively with outside stakeholders to achieve these goals

He emphasized that protecting the public was the most important responsibility of the department. He was pleased with the success of prisoners who moved through the state's system avoiding recidivism. He advocated working collaboratively with communities and concluded that when community members are engaged everyone wins.

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Co-Chair Austerman noted that Representative Gara entered the room.

RON TAYLOR, DEPUTY COMMISSIONER, DEPARTMENT OF CORRECTIONS, discussed slide 11: "Reentry Outcomes: Successfully Increasing the Percent of Probationers and Parolees who Satisfy Court Ordered Conditions of Release." He directed the committee's attention to the graph which depicted an increase in the last two years of probationers and parolees satisfying court ordered conditions of release. He spoke of the main drivers of prisoner re-entry and reported that parole violations had declined.

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Mr. Taylor detailed slide 12: "Re-Entry Outcomes: Reducing Criminal Recidivism." He noted that from 2006 to 2010 recidivism decreased. He believed it would continue to decline based on the successes reported on the previous slide.

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Mr. Taylor discussed slide 13: "Reformative Outcomes: Offenders Completing an Institutional or Community-Based Substance Abuse Treatment Program." He reported that the department was ensuring that its programming was aligned with its Risk-Needs Assessment. He stated the importance of programming as it related to recidivism. He referenced the Criminal Attitudes Program which saw a 7 percent decline in recidivism. He suggested the need for additional outpatient care for substance abuse.

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Mr. Taylor detailed slide 14: "Reformative Outcomes: Polygraphed Sex Offender Probationers." He cited that over the last three years polygraph testing has proved to be a useful tool in reducing recidivism.

Mr. Taylor detailed slide 15: "Reformative Outcomes: Offenders Who Receive General Education Development (GED) While Incarcerated." He acknowledged that the department needed to institute renewed efforts to provide the GED to incarcerated individuals.

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Mr. Taylor discussed slides 16 and 17: "Challenges and Issues"

- Meet 24/7 operational needs while striving to remain within fiscal parameters
- Connect soon to be released offenders to community-based resources
- Since 2001, medical care costs in Anchorage have increased by 63.0%, compared to 52.1% nationwide (*Alaska Economic Trends, July 2013*)
- Increases in chronic health issues and an aging inmate population continue to increase the need for higher acuity and specialized medical care

Mr. Taylor affirmed that meeting the needs of offenders while staying within the state's budget was a challenge. He expressed concerns about providing services to a growing female inmate population and the rising costs of prisoner medical care. He opined that the department was doing a fine job of keeping costs contained and was staying within its fiscal parameters.

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LESLIE HOUSTON, DEPUTY COMMISSIONER, DEPARTMENT OF CORRECTIONS, skipped to slide 19: "Alaska Grown." She reported that over the last four years the department had emphasized educating food services staff and increased its purchasing of Alaska grown produce.

Ms. Houston advanced to slide 20: "Inter-Department Resource Sharing"

- DHSS/ Pharmacist Relief Services
- DHSS/Food Service for Bethel, Juneau, and Nome Youth Facilities
- DOLWD/Provide minimum custody inmate labor for seafood processing
- DOTPF/Currently providing laundry services to the Alaska Marine Highway System; and, developing new agreements to provide services to assist DOTPF with brush clearing, snow removal, and potential for AMHS garments.

Ms. Houston communicated that the department looked to resource sharing as a means of reducing costs.

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Ms. Houston discussed slides 21 and 22: "Giving Back"

- Prisoners at Hiland Mountain Correctional Center (Eagle River) contributed 90 homemade quilts, 30 hats, and 30 scarves to Mat-Su Valley elders.
- A team of six inmates from Hiland Mountain Correctional Center provided community work service in assisting the Eagle River Parks and Recreation Department with clean-up of the Beach Lake Chalet and area trail maintenance over a period of six days.
- Throughout the summer and fall of 2013, prisoner volunteers from Palmer Correctional Center (minimum) cleaned approximately 93 miles of roadways in the Mat-Su, picking up 12,200 pounds of trash.
- Prisoners at Palmer Correctional Center's (Sutton) hobby wood shop constructed approximately 700 wooden toy cars and trucks for donation to local charities.
- Wildwood Correctional Center (Kenai) began a "Cell Dog" program where dogs from a local shelter are sent to live with volunteer inmates who provide basic obedience training and socialization to better prepare the dogs for adoption.
- A group of prisoners at Wildwood Correctional Center organized a fundraiser among the prison population to benefit a local child with pediatric cancer. The effort raised \$1,375 which was forwarded to the family.
- Prisoners at Wildwood Correctional Facility donated hand-made knit hats to benefit the local Relay for

Life, which honors cancer victims. The pink hats were either given as prizes or auctioned.

- An arts-and-crafts program at Yukon-Kuskokwim Correctional Center (Bethel) resulted in crocheted hats and headbands finished and donated to the Pre Maternal Home, the Tundra Women's Coalition, and local schools.

Ms. Houston asserted the department wanted to demonstrate some of the good that inmates provided to communities.

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Ms. Houston forwarded to slide 24: "FY 15 Operating Changes." She detailed that DOC was seeking an increase in funds of \$935.6 thousand for salary and health insurance adjustments associated with all bargaining unit contracts. She indicated a decrease in the current level of service costs of \$2.5 million from closing the housing at Pt. Mackenzie Correctional Farm and from moving inmates to Goose Creek. She also reported \$1.6 million in reductions from inmates not needing as many medical services as were budgeted. She cited a net increase of \$65 thousand in federal funds for the Residential Substance Abuse Treatment Program, previously a pass-through grant from the Department of Public Safety to DOC. In the current year the funding was given directly to DOC eliminating the need for a pass-through relationship. She outlined an increase of \$120 thousand from the Mental Health Trust for a pilot mental health program that DOC would be taking up that focuses on fetal alcohol syndrome and culturally relevant mental health programming.

Ms. Houston reviewed slide 25: "FY2015 Adjusted Base to FY 15 Governor's Request." She reported that the slide went into greater detail on the adjustments to the base for FY 15.

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Ms. Houston discussed slide 26: "FY2015 Operating Reallocations." She reviewed the Goose Creek Correctional Center authorization changes as well as the out-of-state contractual authorization changes.

Ms. Houston presented slide 27: "Core Service Budget Allocation Comparison." She stated that the slide showed

the budget allocation comparison of the FY 14 management plan to the FY 15 governor's budget request, the net change of which was a decrement of \$2.9 million.

Ms. Houston turned to slide 28: "FY 15 Operating Budget Distribution by Core Service." She commented that the largest portion of the department's budget was allocated to secure confinement.

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Ms. Houston directed the committee's attention to a snapshot of the department's FY 15 capital budget in slide 29: "FY2015 Capital Budget." She relayed that 100 percent of DOC's \$5.0 million capital budget went to deferred maintenance. She mentioned that slides 30 through 33 were prepared by the Legislative Finance Division.

Ms. Houston directed attention to slide 30: "Department of Corrections Share of Total Agency Operations (GF Only)." Next she advanced to slide 31: "Department of Corrections Percent of Total Department's Budget by Fund Group (All Funds)." She reviewed the designation for each color depicted on the chart.

Ms. Houston stated that slide 32: "Department of Corrections Continued Growth Compared to 10-Year Plan (GF Only)" was very similar to slide 33: "Department of Corrections Continued Growth Compared to 10-Year Plan (All Funds Only)." Both slides showed the budget growth compared to the 10-year plan. She anticipated that the budget growth would more likely be in line with the 10-year plan due to the Goose Creek Correctional Center phasing in over the next two fiscal years.

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Co-Chair Austerman asked if slide 6 reflected the growth in prisoner population.

Commissioner Schmidt explained that slide 6 did not show population growth but indicated the population percentages of non-violent and violent prisoners.

Co-Chair Austerman wondered if it was the same comparison numbers-to-numbers. Commissioner Schmidt answered in the affirmative. He informed the committee that the slides the

department used previously were based on calendar year-end. Currently, DOC compiled its data by fiscal year-end, June 30.

Co-Chair Austerman asked about slide 12. He wondered how Alaska's recidivism rates compared to national rates. Mr. Taylor replied that recidivism rates were declining nationally. He stated that the decline was due to a greater focus on reentry outcomes.

Co-Chair Austerman remarked that he would prefer the data in slide 13 compiled in a percentage format. Commissioner Schmidt acknowledged his preference.

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Co-Chair Stoltze asked the commissioner to characterize the type of offense non-violent criminals committed and whether or not the department used additional classification measures to decipher between non-violent and violent crimes.

Commissioner Schmidt replied that classification was based only on the crime committed. Any crime against a person including any sex offense was considered violent.

Co-Chair Stoltze asked what type of crime caused the numbers to grow.

Commissioner Schmidt replied that sex-offender sentences had doubled in the previous ten years. Sex offenders made up approximately 14 percent of the state's prisoner population. He agreed to provide the committee with further information.

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Co-Chair Stoltze commented that slide 8 indicated a growth in female offenders. He asked if the same growth rate for females applied to Alaska Native females.

Commissioner Schmidt offered to provide the information at a later date.

Co-Chair Stoltze acknowledged the efforts to support Alaska grown products. He wanted to see a tracking system in place to ensure the use of Alaska grown products.

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Vice-Chair Neuman referred to slide 13. He informed the committee about a meeting he had attended that addressed theft in the Matanuska-Susitna Valley. He found out that most crimes in the valley were burglaries committed to support drug habits. He asked the commissioner how many inmates had enrolled in drug treatment programs and how many were on a waiting list.

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Commissioner Schmidt stated that the department was lapsing monies in its programs because, although DOC designed the program plans, the service providers determined the time tracks. He reported that the state had certain protections built into its service contracts to avoid being charged for services not provided. However, funding lapses and gaps in service resulted because of limited service provider availability. The state's contracts did not address the gaps of time where services were not available but funding was lapsing. The department did not want to spend money or transfer money just to avoid a lapse. The department would return unused funds, explain the circumstances, and request full funding in the following budget cycle. He understood that it did not make sense to expand a program when funds went unused. Nevertheless, he indicated the department had a plan. He requested that Mr. Taylor elaborate.

Mr. Taylor cited that capacity numbers were 900 for outpatient programs and 180 for residential substance abuse treatment programs. The problem with only looking at capacity numbers was that a prisoner's ability to get into a program was also determined by counselor availability and whether or not there was a long waitlist for services. Regarding need, the department had an outside consultant evaluate the state's overall program design. It was difficult for the department to determine the exact number needing services because the program was voluntary. However, it was clear that there was a need for substance abuse services inside the state's system based on last year's 6,000 risk assessments that were evaluated. Many parolees sought treatment in their communities as a condition of their probation or parole. In some instances inmates were not required but recommended to participate in a treatment program.

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Vice-Chair Neuman referred to the second bullet point on slide 16. He suggested the Alaska Mental Health Trust and the Department of Health and Social Services fund a position to assist inmates transitioning out of incarceration to prequalify for Medicaid. His idea would connect inmates to services necessary to be successful once released from jail. He asked if the commissioner thought the idea would be effective in reducing recidivism.

Commissioner Schmidt affirmed the value of Representative Neuman's suggestion to reduce recidivism. He revisited program capacity. He confirmed that there was a need beyond what the department was providing. However, he indicated there was reconciling that needed to be completed from the previous year before requesting additional program funding.

Vice-Chair Neuman remarked that the state needed to be tapping into federal assistance funds for inmate programs that would otherwise be funded by the state.

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Co-Chair Stoltze made a humorous remark.

Representative Gara referenced the importance of recidivism because it saved the state money and it kept communities safer. He was unclear about the state's success in reducing recidivism because the state only looks at the first three years following a prisoner's release. He wondered what the results would show after four or five years.

Commissioner Schmidt specified that most reoffenders acted within the first six months of release. The potential of reoffending tapered off dramatically after one, two, and three years. The judicial council led the charge in setting a three-year monitoring period.

Representative Gara noted DOC's vocational training efforts for its inmates. He asked if the department tracked prisoner employment rates and other outcomes following vocational training and incarceration. He wanted to make sure vocational training expenditures were being wisely spent.

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Commissioner Schmidt replied that DOC did not track the information the representative was looking for, but would request the information through the Department of Labor and Workforce Development.

Representative Gara reiterated the importance of knowing whether or not the training provided to inmates was effective.

Representative Gara assumed the costs associated with longer sentencing for non-violent criminals increased proportionately. He asked for an analysis that confirmed his conclusion. He also wanted to know which crimes constituted longer sentences. The commissioner offered to provide the requested information.

Representative Gara clarified that he wanted to know which crimes had been assigned increased sentences. Commissioner Schmidt reconfirmed that he would provide the information to committee members.

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Co-Chair Austerman agreed with Representative Gara in reference to tracking vocational training in the state's correctional facilities. He believed a recommendation from the department on how to track the information would be helpful. He asserted that if the outcomes of training were poor, then providing the training would not be justified. The commissioner agreed that the department needed to know how many offenders were working after being released before it could uncover the contributing factors.

Co-Chair Austerman stated his concerns with future budget cuts and indicated the importance of being able to evaluate the soundness of expenditures. The more information provided the better.

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Representative Wilson asked if judges were imposing different sentences than established prison terms associated with various crimes. Commissioner Schmidt stated

that he would compile data so that he and Representative Wilson could start a conversation about sentencing terms.

^2013 FALL REVENUE FORECAST OVERVIEW and STATE SAVINGS ACCOUNT UPDATE: DEPARTMENT OF REVENUE

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ANGELA RODELL, COMMISSIONER, DEPARTMENT OF REVENUE, provided a PowerPoint presentation titled "Fall 2013 Revenue Forecast" (copy on file). She began her presentation by reminding the committee that the forecast was not a description of the potential revenues for Alaska including heavy oil production or exploration activities by Repsol and British Petroleum (BP). The Department of Revenue (DOR) tried to create a reliable revenue forecast from which the legislature could make decisions regarding the following year's budget and Alaska's future.

She advanced to slide 3: "Unrestricted Revenue Forecast 2012-2022." She noted the revenue forecast reflected the actual revenue for FY 12 and FY 13. There were four primary factors that influenced the forecast including oil prices, production, deductible lease expenses, and transportation costs. In FY 12 the state saw an oil price of \$112.65 that declined to \$107.57 in FY 13. The price was projected to decline to \$105.68 in FY 14 and \$105.06 in FY 15. Production in FY 12 was 579 thousand barrels per day and declined in FY 13 by over 40 thousand barrels down to 531 thousand barrels per day. The department forecasted a continued decline to 508 thousand barrels per day in FY 14 and leveling off at about 498 thousand barrels per day in FY 15. Deductible lease expenses were approximately \$4.4 billion in FY 12 with a slight increase to \$4.9 billion in FY 13. In 2014 there was a more substantial increase of deductible lease expenditures to \$6.6 billion and even further to \$7.2 billion in FY 15. The substantial increase in lease expenditures reflected correlating increases in activity on the North Slope and potential future production. General fund (GF) unrestricted revenues for FY 2012 were \$9.4 billion and declined to \$6.9 billion in FY 13. The department forecasted FY 14 revenues at \$4.9 billion decreasing to \$4.5 billion in FY 15. She noted that there was a substantial decline in the production tax value per taxable barrel. In FY 12 the value calculation was \$79.33 per barrel value. It receded by more than \$12 to \$67.76 in FY 13. The value decreased even further in FY

14 to \$54.67 and in FY 15 to \$49.04 production tax value per taxable barrel.

Commissioner Rodell continued with slide 4: "Contributors of Change in FY 13 Revenue - Actual." She pointed out that between FY 12 and FY 13 daily production dropped by 47.8 thousand barrels and \$5.08 price per barrel. Deductible lease expenditures increased by \$519 million and transportation costs rose by \$0.95 per barrel. The components contributed to the decline of the average production tax value per barrel.

Commissioner Rodell moved to slide 5: "Fall 2013 Highlights"

- Oil price and production levels have been reduced relative to the 2013 Spring Forecast.
- Correspondingly, unrestricted revenues have been revised down from the Spring 2013 Forecast.
- Revenue impacts largely due to changes in oil price, production, lease expenditures, and tariffs.
- Substantial (~\$10 billion) increase in spending on the North Slope over the next 10 years.
- Oil companies project increased North Slope production following the increased activity.
- DOR continues to prudently assess future production and the forecast is not intended as a comprehensive assessment of all the potential activity or projects under evaluation.
- State investment earnings are strong

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Commissioner Rodell presented slide 6: "General Fund Unrestricted Oil Revenues." She reported that petroleum revenue made up the largest portion of oil revenues; production tax accounted for 58.5 percent and net royalty accounted for 25.5 percent in FY 13. The corporate income tax revenues remained steady at 6.3 percent. Property tax revenue was the smallest component of petroleum revenue at 1.4 percent. The total petroleum revenue for FY 13 was \$6.3 billion. Total petroleum revenue forecasts were \$4.3 billion in FY 14 and \$3.9 billion in FY 15.

Commissioner Rodell advanced to slide 7: "General Fund Unrestricted Other Revenues." She reported non-petroleum

revenue; revenues from mining, tobacco, and other taxes. Corporate income tax was the largest component of non-petroleum revenues at 19.5 percent in FY 13 with an expected decrease to 15.4 percent in FY 14 and an increase to 21.3 percent in FY 15. Mining tax remained steady as well as insurance premiums, tobacco tax, and motor fuel taxes. The department administered over 20 different taxes. The department rolled all of the lesser tax revenue types into one category, "other taxes." She emphasized the importance of investment income totaling \$86 million in FY 14. This differed slightly from the state savings account presentation because it included principle balances as of December 31, 2013 versus DOR's numbers in the revenue sources book which were captured two months prior. Total non-oil revenue was approximately \$577 million in FY 13.

Commissioner Rodell drew the committee's attention to slide 8: "Total Revenue Forecast - FY 13, 14, and 15." She reported the designated GF revenue forecasted for FY 14 was \$329 million and \$327.6 million in FY 15. Under "Other Restricted Revenue" Permanent Fund earnings made up the majority of the investment revenues in the amount of \$3.5 billion in FY 14 and 15 projections. Federal revenues were expected to increase slightly due to moving beyond sequestration.

Commissioner Rodell pointed to slide 9: "General Fund Unrestricted Revenue Price Sensitivity FY 14-16." The chart showed the state's sensitivity of revenues to oil prices based on the state's production forecast for FY 14, 15, and 16. She indicated the state has narrowed the volatility of revenue and believed there was greater potential for revenue. The forecast showed that if the price of oil per barrel was \$50 dollars the state's revenues would be \$2.3 billion and at \$150 per barrel revenues would be approximately \$9.4 billion.

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Commissioner Rodell referred to slide 10: "Fall 2013 Total Revenue Forecast." She noted the department reviewed the prior ten years of historical data in comparison to what it had forecasted. It focused on examining the ability to forecast accurately or within a specific margin of error. Ultimately the department wanted to reduce its margin of error when calculating projections.

Commissioner Rodell discussed slide 11: "Fall 2013 Production Forecast and Methodology." She reported that the department was working diligently to reduce the margin of error between the state's production forecast and actual production.

Commissioner Rodell advanced to slide 12: "Production History and Forecast." The slide depicted which fields have produced the most barrels of oil. She stated that more and more production was coming online from fields outside of Prudhoe Bay and Kuparuk - fields such as Endicott and Alpine. The development of such fields would be a very important component in forecasting future oil production.

Commissioner Rodell summarized slide 13: "ANS Oil Production Forecast." The state's intent was to improve its forecast by studying previous forecasts. She pointed out that the 2005 predictions for 2013 were much higher at more than 800 thousand barrels of oil per day. FY 13 actual numbers came in at 538 barrels of oil per day.

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Commissioner Rodell moved to slides 14 and 15: "ANS oil Production Forecast." She explained that previously the state used three categories for forecasting; oil from currently producing wells, oil from projects that were under development (UD), and oil from projects that were under evaluation (UE). The department took all the information provided by the oil companies, compiled the data, and worked with the Department of Natural Resources to produce a forecast. The old method did not account for the highly speculative nature of the UD and UE numbers. In order to to be more prudent in what it included in its projections the state changed its method to include numbers from two categories; new oil production (a combination of UD and UE numbers adjusted for risk) and current production numbers. The state created a trend line using the new method currently in place.

Commissioner Rodell turned to slides 16 and 17: "ANS Oil Production - Actuals and Forecast." She cited the trend line for actual production calculated on historical performance. The state took the data, did a risk adjustment, calculated a floor as if there was no new oil production, and derived a new forecast. She presented slide 18: "North Slope Production Forecast." She stated

that the slide designated two categories; currently producing oil and new oil. It also showed upside potential had the state completed the forecast using its old methodology.

Commissioner Rodell introduced slide 19: "Fall 2013 Price Forecast," and slide 20: "Alaska North Slope Crude West Coast Price." She commented that the department was examining ways to reduce the volatility of the state's oil price forecast. She reviewed factors that affected the price of oil over the prior two years. She referenced the Arab Spring, production in the lower 48, and the European Union's summit to address its banking crisis. She stated that the price remained in the band shown on the slide between \$100 and \$120 dollars per barrel. Since April 2013 prices have lowered due to negotiations with Syria and Iran as well as China moving into a recession.

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Commissioner Rodell referenced slide 21: "key Oil Price Drivers"

- Supply & Demand
 - There are two main factors to monitor.
 - Global spare capacity, since it is both a reflection of supply and demand. In other words, the Organization of Petroleum Exporting Countries (OPEC) spare capacity (flipping a switch) is key.
 - Cost of developing new oil supply.
 - Department is developing a probability and statistical model incorporating spare capacity and cost of developing new supply to help forecast ANS prices in the future.

Commissioner Rodell relayed slide 22: "Price Forecast Methodology"

- Price Forecasting Session
 - Held a day long oil price forecasting session on October 1, 2013.
 - Speakers provided insight into oil markets, probability and analysis, modeling, and financial aspects of commodity markets.
 - 39 participants from state government, academia and the private sector.

- DOR, DNR, DOL, OMB, University, Legislative Finance and outside participants.
- o Participants were asked to forecast real ANS prices for the West Coast.
 - Real prices were converted to nominal using a 2.5% inflation assumption.
- o Median price path was chosen for each time period.

Commissioner Rodell moved to slide 23: "Historical ANS West Coast FY Oil Price Bands." She noted that the volatility in oil price bands has narrowed in the previous two years. In 2007 the actual price per barrel was \$61.60 with the band ranging from \$45.00 to \$75.00. In 2009 the band was much more variable due to the global recession at the time.

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Commissioner Rodell advanced to slide 25: "Comparison - Fall vs. Spring 2013 Forecasts." She pointed out that the higher forecast for FY 14 generated in spring 2013 was driven by the negative activity occurring in the Middle East. Prices started to recede as concerns about Syria and Iran subsided resulting in a lower forecast generated in fall 2013. Oil price and production projections declined by 3.6 and 3.5 percent respectively from spring to fall 2013. The oil production projection changed in large part due to an extended summer maintenance season. She noted the unrestricted GF revenue forecast for FY 14 declined by 30 percent from spring to fall 2013 projections.

Commissioner Rodell reported that similar adjustments were made to the spring and fall forecasts for FY 15.

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Commissioner Rodell referred to slide 26: "Contributors of Changes in FY2014 Revenue Forecast," and slide 27: "Contributors of Changes in FY 15 Revenue Forecast." She pointed out the detailed changes in FY 14 including an increase in lease expenditures of \$454 million and a rise in transportation costs due to there being fewer barrels of oil to spread the costs against. Also, the state assumed a 12.5 percent royalty.

The commissioner explained that in the forecast for FY 15 the deductible lease expenditures nearly doubled from

spring to fall 2013 projections, a net change of \$1 billion.

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Commissioner Rodell displayed slide 28: "Major Contributors of Changes in Revenue Forecast (FY 14-15)." She specified that the bulk of the changes in the FY 14 forecast was due to reduced price expectations. The slide reflected a forecast reduction of over \$500 million. In addition, an increase of \$300 million in lease expenditures played a major role in the variance of revenue projections from spring to fall. Production decline and an increase in transportation costs impacted the forecast as well. The close out of capital credits under Alaska's Clear and Equitable Share (ACES) affected the projections by \$200 million. She explained that forecasted revenues decreased because of the adoption of a new tax system. Other contributing factors to the adjusted forecast included property tax and corporate income tax changes and non-oil changes.

Commissioner Rodell drew the committee's attention to slide 29: "North Slope Lease Expenditure Forecast Change (Total North Slope CAPEX)." She pointed out the upward trend in capital lease expenditures from the forecast in spring to fall 2013.

Commissioner Rodell turned to slide 30: "North Slope Lease Expenditure Forecast Change (Total North Slope OPEX)." She reported a much greater increase in the operating expenditures for FY 14. She opined that the increase in expenditures had to do with the ramping up of activity on the North Slope. Expenditure projections into the future tapered off.

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Vice-Chair Neuman asked about the average cost per barrel for standard allowable deductions for capital expenditures (CAPEX) and operational expenditures (OPEX).

Commissioner Rodell replied that total lease expenditures were approximately \$45.99 per barrel. She affirmed that the information is listed in the appendices of the revenue sources book for the public.

Vice-Chair Neuman asked about increases in standard allowable deductions in the prior 4 to 5 years by percentage.

MICHAEL PAWLOWSKI, DEPUTY COMMISSIONER, STRATEGIC FINANCE, DEPARTMENT OF REVENUE, replied that the production decline over the previous two years was much more pronounced than anticipated. At the same time there was an increase in investment. The lease deduction system worked by dividing the expenditures by the number of barrels of oil produced. He explained that if expenditures exceeded barrels of oil, the value of the lease deductions would increase. Until the production curve materially turned around, the lease expenditures per barrel would remain high.

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Vice-Chair Neuman clarified that standard allowable deductions did not alter even with the changes in tax structure. He asked about industry growth resulting from the most recent oil taxation format.

Mr. Pawlowski referred to slide 10 as part of his response. He stated that in 2008, the state saw 15 thousand more barrels of oil produced per day. Since the lease expenditures had not really changed, the fact that there were fewer barrels resulted in the change in deductions per barrel. He signified that there was a dramatic increase in forecast investment. He opined that it was emature to add in barrels of production until the forecast investment proved itself.

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Representative Costello asked about the lease expenditures under SB 21 [Note: Oil tax legislation that passed in 2013] and the capital expenditure credits under ACES. She continued by inquiring if lease expenditures provided information about production versus the capital expenditure credits.

Commissioner Rodell responded that the fundamental change between ACES and SB 21 was that tax credits became directly tied to oil production under the new tax structure. Tax credits under SB 21 would only be applied after production was realized. Since the passing of SB 21 the state had seen a substantial increase in lease expenditures which

translated into companies making more capital investments, thus, increasing production and realizing tax credits. Companies also benefited by being able to better plan based on a more reliable tax regime. She stated that under ACES, company revenues depended more on oil prices than on production. Now companies could focus more on production due to the credits they could count on from the state under SB 21.

Representative Costello discussed the idea of hedging the state's oil.

Commissioner Rodell responded that the state periodically reviewed the option of hedging but was traditionally uncomfortable with it. However, she welcomed a further discussion on the subject.

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Representative Gara clarified that the state changed the way it forecasted oil production. The change was first seen in the Spring 2013 Revenue Sources Book in which speculative oil was calculated at a lower rate and known oil was computed at a higher rate. Commissioner Rodell responded in the affirmative.

Representative Gara asked about the variance in decline rates for North Slope oil production under ACES and SB 21. He restated that he wanted to know about the discrepancy in the million barrels of oil a day and asked why the decline rate was greater now than when the spring 2013 revenue source book came out.

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Commissioner Rodell replied that in calculating the forecast the state used currently producing oil numbers as its starting point as well as conducting risk assessments. Every six months, when the forecast was updated, the state incorporated a new set of knowledge and applied the new methodology for greater consistency between forecasts from spring to fall and fall to spring. The state received feedback about expected dates, current activities, future activities, and run-out rate updates for the producing fields.

Mr. Pawlowski added that what has changed substantially was a consideration of actual data. The decline from FY 12 to FY 13 and from FY 13 to FY 14 was significantly more than the state anticipated. The forecast going forward from present day started from a much lower base than from where the state thought it would begin previously. Slide 26 showed that the state's spring FY 13 forecast had overestimated FY 14 oil production by 18,000 barrels per day. The state revised FY 15 predictions down by 14.4 thousand barrels of oil per day based on actual data. He emphasized the importance of using a consistent methodology from one year to the next and furthered that the forecast was not a total assessment of potential production, it was a component of a revenue forecast. The department had a record of not being conservative or prudent in giving the legislature a long-term production forecast as a base for revenue projections. The department had tried to keep forecasts consistent from year-to-year, but the state had seen much larger declines than predicted. Adjusting the base founded on current actual numbers changed future projections.

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Representative Gara stated that the promise under SB 21 was that there would be new oil production. However, between FY 17 and FY 22 the decline rate was faster using the new forecasting methodology than it was under ACES. He summarized that the production decline under ACES was 130 thousand barrels versus 142 thousand barrels under SB 21. He asked Mr. Pawlowski to explain.

Mr. Pawlowski indicated two areas of opportunity. First, lease expenditures were on a dramatic incline. Second, increased investment translated into increased production. However, the department was cautious about using the numbers to do forecasting at the time.

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Representative Gara discussed the revenue forecasts. He noted that the spring forecast showed revenue of approximately \$3.6 billion dollars in FY 18 and in the most recent forecast revenue was down to \$2.2 billion. In FY 22 the spring forecast equaled \$2.8 million in production tax revenue, whereas, under the new forecasting method revenue

was down to \$2.05 billion. He asked why new revenue was not reflected in the newest numbers for FY 22.

Commissioner Rodell commented that the largest component of petroleum revenue was the production tax. She reported that when there was a decline in production tax, there was also a decline in price. She furthered that the increase in lease expenditures translated into a decline in petroleum revenue, primarily in the production tax which then adjusted the total unrestricted GF revenue available to the state.

Co-Chair Austerman asked if Cook Inlet gas and oil revenues were included in the state's new forecasts.

Commissioner Rodell responded that the state included gas revenues. However, she informed the committee that the oil tax rate for Cook Inlet was zero. The gas tax rate was approximately 18 percent. She noted activity and increased production in Cook Inlet.

Co-Chair Austerman asked if Cook Inlet's revenues were separated out in DOR's forecast book.

Mr. Pawlowski relayed that the state did not separate out revenues for Cook Inlet production. However, he indicated that the department tried to break out Cook Inlet lease expenditures in order to do some calculations.

Co-Chair Austerman asked if DOR kept track of Cook Inlet production. Mr. Pawlowski responded affirmatively but added that the department did not keep track of a distinct number of the revenues from Cook Inlet's production.

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Co-Chair Austerman asked why the department did not keep track of the revenues from Cook Inlet's production. Mr. Pawlowski replied that it was because, until recently, Cook Inlet's production was modest. The department was not paying detailed attention to Cook Inlet's revenue component but would be going forward.

Co-Chair Austerman asked if the state paid out credits on Cook Inlet gas and oil. Mr. Pawlowski replied affirmatively. Co-Chair Austerman believed that it would be helpful for the committee to see actual numbers for Cook

Inlet production and for that information to be made available to the public. Mr. Pawlowski agreed to provide the information.

Co-Chair Stoltze welcomed Commissioner Rodell to her post.

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Representative Guttenberg asked about economic activity that was not included in DOR's report and its relevancy.

Commissioner Rodell responded that economic activity became more relevant to the production forecast when activities moved from the evaluation to the development stage. Evaluation activities included exploration efforts like drilling test holes. Examples of development activities included laying drill pads and drilling wells. She referenced the Liberty field specifying that for an extended time the state included in its projections a tremendous amount of production that never materialized.

Representative Guttenberg referred to slide 5 and asked if the \$10 billion increase in spending on the North Slope over the next ten years was included in the department's forecast calculations.

Commissioner Rodell stated it was a forecasted plan of expenditure given to DNR to incorporate into its plan. Actual expectations were often larger and were adjusted using other information.

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Representative Guttenberg opined that the facilities at Prudhoe Bay were outdated. He was concerned about inefficiencies and related maintenance costs. He inquired as to whether or not the commissioner had seen additional operating expenditures due to the use of antiquated equipment.

Commissioner Rodell replied that she had seen capital rather than operating expenditures allocated for repairs to aged facilities. Producers spent money to extend the life of a facility when the remaining yield of wells on a field proved economically viable. She believed that larger investments would be allocated for new infrastructure.

Representative Guttenberg asked if the commissioner felt she had a clear understanding of the difference between CAPEX and OPEX considering the state was far behind in its audits. Commissioner Rodell reported that her department had a very good sense of operating versus capital expenditures. She confirmed that the department was doing monthly desk audits and had a very good understanding of what the oil companies were doing on a regular basis.

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Commissioner Rodell delivered a PowerPoint presentation: "State of Alaska, An Update on the State's Savings Accounts." She began her presentation with slide 3: "General Fund and other non-segregated investments (GeFONSI)." She reported that the markets had been kind to the state in calendar year 2013. She identified GeFONSI as the base GF from which the state managed its cash from day-to-day. She indicated GeFONSi had a moderate risk profile with a short-to-intermediate investment horizon. She directed the committee's attention to the market value actuals of \$11.8 billion in December 2012 dropping to \$5.7 billion by December 2013. She explained that previously the state kept the Statutory Budget Reserve (SBR) in GeFONSI. However, in 2013 the state moved the funds to a separate asset allocation within the GF to extend the investment term slightly. She reiterated that the reserve continued to rest in the state's GF. She reported that by the end of the calendar year 2013 GeFONSI's year-to-date return was 0.22 percent. The fiscal year-to-date return was 0.28 percent surpassing the state's benchmark.

Commissioner Rodell turned to slide 4: "Statutory Budget Reserve Fund." She acknowledged that the fund had a moderate risk and an intermediate investment horizon. In 2012 the market value balance in the GF was approximately \$5.5 billion. By the end of calendar year 2013 the balance had dropped to \$4.77 billion. She informed the committee that the change was due to the draw used to close out FY 13. The fund's performance was 0.31 percent by the end of FY 13. The year-to-date performance on the SBR was 1.08 percent confirming the value of extending the duration of the fund. The state's fiscal year-to-date return was 1.15 percent, again surpassing the benchmark.

Commissioner Rodell advanced to slide 5: "Constitutional Budget Reserve Fund (Main and Sub)." She cited that the

Constitutional Budget Reserve (CBR) had two funds; a main fund and a subaccount fund. The main account had a moderate risk and an intermediate investment horizon with a balance of \$5.8 billion on December 31, 2013 and a FY 13 return of 0.18 percent. The year-to-date return was (0.25) percent primarily due to the fund's exposure to the bond market. She reported that the department was examining what it could do to mitigate against potential losses as interest rates climbed. The subaccount had a high risk and a moderately long investment horizon. The account performed very well in 2013 with its exposure to the equity market. The subaccount had a return of 11.75 percent for FY 13. The year-to-date return was already at 15.85 percent. The fund amount increased from \$5.5 billion to \$6.3 billion dollars in a one-year period, creating a very healthy reserve.

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Commissioner Rodell discussed slide 6: "Power Cost Equalization Fund." She relayed that the fund in statute required the department to target a 7 percent return, which translated into approximately 9 percent including inflation. The Power Cost Equalization Fund (PCE) had a very high equity concentration of 80 percent. The fund benefited substantially from the equity market performance in calendar year 2013. The fund balance went from \$787 million to \$937 million over the course of a year.

Commissioner Rodell moved on to slide 7: "Public School Trust Fund." She announced that the Public school Trust Fund had a more moderate risk profile. It had an equity allocation of approximately 42 percent. It also benefited from having an investment in equities but not nearly as much of a return as the PCE. It increased its balance from \$487 million to \$536 million in one year. It had a fiscal return of 8.19 percent. Year-to-date it had a return of 10.6 percent. Earnings were moved into the income fund which is invested in short-term instruments.

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Commissioner Rodell detailed slide 8: "PERS and TRS." The targeted return for Public Employees' Retirement System (PERS) was 8 percent. Given its long-term, 30-year investment horizon the state was allowed to take a more expansive asset allocation investing in assets not as liquid as equities or bonds. The PERS account had increased

from \$12 billion to \$14 billion from 2012 to 2013 benefiting from the equity market performance in 2013. The Teacher Retirement System funds went from \$5 billion to \$5.8 billion with returns at 12.6 percent, considerably better than the CBR fund with a shorter time horizon.

Commissioner Rodell advanced to slide 9: "APFC" [Alaska Permanent Fund Corporation]. She asserted that the state had a long-term goal of achieving a real rate of return of 5 percent per year. The fund was designed to be maintained into perpetuity. On December 31, 2012 it had a balance of \$43.6 billion and by the end of 2013 it had a balance of \$49.2 billion. The performance rate of the fund was 10.93 in FY 13. Year-to-date the fund return reached 12.7 percent.

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Commissioner Rodell pointed to slide 11: "FY 14 Investment Revenue Forecast." She indicated that the numbers on the slide were actual performance numbers through December 31, 2013 and included a forecast for the balance of 6 months in FY 14. The state increased the amount of investment income for FY 14 from approximately \$80 million to over \$101.9 million for the unrestricted GF revenue. The CBR subaccount would increase almost \$778 million for FY 14. She reported a total investment revenue of \$4.9 billion, which included PFD revenues, for the state by the end of FY 14.

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Representative Gara addressed slide 4. He understood that \$1 billion was used to balance the budget. He asked about whether some of the money was put into state savings or if it was used as a draw due to state spending.

Commissioner Rodell replied that the \$700 million was used to reconcile state accounts rather than applied to state savings accounts.

Representative Gara directed his attention to slide 8. He noted that in reference to PERS from 2011 to 2013 the balance increased by \$4 million to about \$14 million. He asked whether the balance was keeping pace with or exceeding the liabilities.

Commissioner Rodell replied that the liabilities were increasing faster than the earnings, which explained the governor's proposal to move \$3 billion into the PERS fund. The state's current liability was \$12 billion dollars. She noted that a loss such as the 20 percent loss experienced in 2009 created even more of a burden. The state had to make up both the 20 percent loss and the 8 percent earnings it had anticipated for the same year. She noted that the three-year and the five-year actuals no longer reflected 2009 figures.

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Representative Costello inquired about the use of the Public School Trust Fund.

Commissioner Rodell deferred the question.

PAM LEARY, DIRECTOR, TREASURY DIVISION, DEPARTMENT OF REVENUE, stated that the trust fund provided a component to the formula foundation. One half of one percent of the state's oil revenues were deposited into the principal portion of the trust fund. She explained that as earnings from the fund grew the interest and dividend monies went into the income fund for the education budget.

Representative Costello asked whether the state was forward funding education through the Public School Trust Fund. Commissioner Rodell replied in the negative and deferred Representative Costello to the Office of Management and Budget for information regarding forward funding of education.

Representative Costello asked for clarification about the use of the fund. Commissioner Rodell replied that the fund was set up as a specific entitlement from oil and tax revenue for education appropriations.

Representative Costello asked if the commissioner had read any film scripts since taking on her position at DOR. Commissioner Rodell stated that the department received and reviewed film scripts on a monthly basis.

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Co-Chair Stoltze discussed HB 265.

Vice-Chair Neuman MOVED HB 265 before the committee.

Co-Chair Stoltze informed the committee that he hoped to arrange joint meetings with the Senate Finance Committee early in the session to review the governor's submissions and to bring up questions about the capital budget.

Vice-Chair Neuman MOVED HB 266 and HB 267 before the committee.

HB 265 was HEARD and HELD in committee for further consideration.

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HB 267 was HEARD and HELD in committee for further consideration.

Co-Chair Austerman discussed the schedule for the following day.

ADJOURNMENT

3:42:00 PM

The meeting was adjourned at 3:42 p.m.