

HOUSE FINANCE COMMITTEE

April 1, 2014

1:39 p.m.

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CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 1:39 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

Michael Hanley, Commissioner, Department of Education and Early Development; Diane Blumer, Commissioner, Department of Labor and Workforce Development; Angela Rodell, Commissioner, Department of Revenue; David Teal, Director, Legislative Finance Division; Michael Barnhill, Deputy Commissioner, Department of Administration; Gary Bader, Chief Investment Officer, Treasury Division, Department of Revenue; John Boucher, Senior Economist, Office of Management and Budget, Office of the Governor; Chris Christensen III, Associate Vice President for State Relations, University of Alaska.

PRESENT VIA TELECONFERENCE

Robynn Wilson, Audit Supervisor, Tax Division, Department of Revenue.

SUMMARY

HB 278 EDUCATION: FUNDING/TAX CREDITS/PROGRAMS

HB 278 was HEARD and HELD in committee for further consideration.

#hb278

HOUSE BILL NO. 278

"An Act increasing the base student allocation used in the formula for state funding of public education; repealing the secondary student competency examination and related requirements; relating to high school course credit earned through assessment; relating to a college and career readiness assessment for secondary students; relating to charter school application appeals and program budgets; relating to residential school applications; increasing the stipend for boarding school students; extending unemployment contributions for the Alaska technical and vocational education program; relating to earning high school credit for completion of vocational education courses offered by institutions receiving technical and vocational education program funding; relating to education tax credits; making conforming amendments; and providing for an effective date."

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Co-Chair Stoltze discussed the meeting agenda. He noted there would be a separate conversation related to the Teachers' Retirement System (TRS). He asked the departments to comment on the committee substitute [Work Draft 28-GH2716\G].

MICHAEL HANLEY, COMMISSIONER, DEPARTMENT OF EDUCATION AND EARLY DEVELOPMENT, walked through the changes in the CS. He began with the "testing out" component on page 2 of the bill. He detailed that the House Finance Committee had reinserted the governor's language that would allow students to test out [of courses] and identified specific subject areas that would apply. He believed limiting the subject areas was less burdensome on districts. He

supported the change. He pointed to language on page 4 requiring districts to include information regarding students in military families in an annual report to the Department of Education and Early Development (DEED). He referenced the state's large military presence and opined that the provision was appropriate.

Co-Chair Stoltze interjected that the committee could potentially deal with the subject in another piece of legislation (HB 318).

Commissioner Hanley continued to address the bill. He believed several changes to the bill's charter school component still met the governor's intent for equity and integrity in the charter school application process. He spoke to a self-imposed rule that presented an additional challenge for smaller communities specifying that if charter school enrollment fell between 120 and 150 the school would receive 95 percent of the funding. Language suggested by the governor had been removed that would have decreased the number of students to 75 and allow for full funding. The administration felt the governor's language was important; it did have a fiscal component because it incorporated a few additional schools that would receive full funding as opposed to partial funding.

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Commissioner Hanley moved to page 9 of the bill that included an additional component for the board report to the legislature. He believed the component empowered the state board to engage directly with the legislature. He trusted that the term "method of education spending" was used intentionally. He noted that typically the state board of education was a policy and practice board (with a focus on pedagogies on strategies for education) and did not usually delve into how money was spent; however, he believed the language provided flexibility on where money was spent.

Commissioner Hanley spoke to residential stipends on page 11. The language that allowed an annual open application period had been maintained in the CS; whereas the boarding stipend had been removed. He relayed that the previous year the legislature had passed legislation allowing for a variable-term boarding school program. As a result, an application period had been opened and four new schools had

been added to the existing four residential schools. The department believed the additional stipend represented true costs or near true costs for housing students. The department also believed the situation was a challenge for school districts; the state was not fully meeting the cost to room and board the students; however, the bill did not remove the funding. There were four programs currently working with the funding.

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Commissioner Hanley addressed a funding change on page 14 of the bill. He referred to testimony by David Teal, Director, Legislative Finance Division, related legislative intent associated with education funding. He believed the intent was to remove the top tiers in the chart on page 14. He pointed to line 19 pertaining to schools with 750 students and above; the multiplier was 0.84. He noted that the multiplier decreased as school size increased due to economies of scale (schools were funded less as their size grew). Schools with 400 to 750 students would be funded at 0.92. He relayed that previously schools with 250 to 400 students were funded at 0.97. The CS removed the top two tiers and funded schools (that had previously received less funding) at 0.97. He detailed that the change allowed funding to go to districts with larger schools with particular challenges that were not traditionally recognized in funding formulas. The change represented an increase of \$13.5 million; \$12.5 million of the amount would go towards Anchorage, Fairbanks, and Mat-Su; the remaining \$1 million would be split between eight districts that had at least one large school.

Commissioner Hanley turned to page 15 where teacher tenure had been changed from three years to five years. He opined that an administrator should have the ability to determine a teacher's effectiveness within three years; however, the bill expanded the opportunity for teachers to prove themselves before receiving tenure. He looked at a provision on page 16 that would allow for the review of teacher tenure every five years. He observed that the review would keep teachers fresh and effective. He pointed to language that a district may terminate tenure. He wondered about the meaning and wondered if clarification may be needed. He was not concerned about the issue, but believed clarity may be necessary.

Co-Chair Stoltze noted the comment.

Commissioner Hanley anticipated that the provision would bring legal challenges at the local level if tenure was on the line. He suggested clarity related to language: "the teacher did not adequately assist the school district with the implementation..." (page 15). He relayed that typically teachers had a longer tenure than school principals; he wanted ensure that the teachers were adequately assisted with the school. He thought clarity was needed on the issue.

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Commissioner Hanley spoke to the repeal of Section 48 that spoke to Bureau of Indian Affairs schools; it was no longer in effect when school districts joined. He observed that the High School Graduation Qualifying Exam (HSGQE) had been removed from the bill. He believed it was the intent to recognize that other bills may contain relevant education provisions.

Co-Chair Stoltze commented that the language would have been taken out if the bill was "stopping in this body."

Commissioner Hanley relayed that the administration would like to see the HSGQE removed [from law]. Co-Chair Stoltze believed it was the will of the committee. He referred to the committee's passage of HB 220.

Commissioner Hanley turned the discussion over to Commissioner Blumer to address the Technical Vocational Education Program (TVEP) component of the bill.

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DIANE BLUMER, COMMISSIONER, DEPARTMENT OF LABOR AND WORKFORCE DEVELOPMENT, addressed Section 28 and relayed that the department would like to see a longer sunset date [than June 30, 2017] for certainty and stability for TVEP recipients.

Co-Chair Stoltze noted that the shorter sunset date had been included and no other changes had been made to the program. He asked if she would prefer the shorter sunset date or to open the program to a "free-for-all."

Commissioner Blumer relayed that the department would like to see a longer sunset, but did not want to open the program up for a free-for-all. She reiterated that the department would like a longer sunset to allow the reporting structure to be implemented related to new articulation language. She pointed to large projects on the horizon including the potential LNG project, mining, and infrastructure. She asked the committee to reconsider reinstating the 20 percent provision withholding funds for recipients that did not report fully or in a timely manner; it was the only mechanism the department had to enforce the requirement.

Co-Chair Stoltze intended to reinstate the item as an amendment; the change had been made erroneously.

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ANGELA RODELL, COMMISSIONER, DEPARTMENT OF REVENUE, spoke to the tax credit changes beginning in Section 36, page 22. She relayed that the language encompassing the tax changes was the same for each type of education opportunity credit. There was one major change that included the addition of the Science, Technology, Engineering and Math program provided by a nonprofit agency or school district. The department did not object to the change. She pointed to item 10 and noted that childhood early learning programs were provided by a nonprofit organization; for-profit language had been removed. The administration was fine with the language. She wanted to ensure there was consistency in terminology related to nonprofits (e.g. agency, organization, or corporation); she noted there was a defined term for a nonprofit "organization" under Section 47, page 33.

Co-Chair Stoltze wanted the language to work. Commissioner Rodell replied that the department also wanted it to work.

Co-Chair Stoltze asked about the Base Student Allocation (BSA) component of the bill. Commissioner Hanley noted that the governor had included an increase of \$85 to the BSA. The CS increased the \$85 by \$100 for a total of \$185 for the current year. There would be an annual increase of \$58 for the subsequent two years.

Co-Chair Stoltze remarked that the increases would be \$185 [in the current year], \$243 [in the second year], and \$301

[in the third year]. Commissioner Hanley responded in the affirmative.

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Representative Gara thanked the department for providing the BSA model. He stated that Fairbanks was facing an \$8 million deficit; the proposed increase would raise approximately \$6.5 million for the district. Juneau was facing a \$4 million deficit; the proposed increase would raise just under half of the deficit. Kenai was facing a \$4.5 million deficit; the proposed increase would raise \$3.3 million for the district. He thought the increase would mean another year of layoffs in the mentioned districts. He asked if he was incorrect.

Co-Chair Stoltze asked the department to addendum the bracketing as money that would go to the districts.

Commissioner Hanley replied that according to Representative Gara's numbers the districts would not have full funding and would require the districts to make cuts. Based on conversations with districts over the past year he believed numbers were constantly changing. He had not spoken to districts recently about their specific needs, but he had heard generally across the state that districts were facing cuts.

Representative Gara remarked that the increase appeared to roughly match the deficit of approximately \$23 million in his Anchorage district in the first year, but the increase of close to \$4.3 million in the second and third year was not close to what the district would need to hold even. He asked if DEED was comfortable with the decision.

Commissioner Hanley replied that the governor had put in \$85 as a starting point; the governor trusted the legislature to determine the necessary BSA number. He detailed that the governor had communicated that in the past three years he had been entrenched in the idea that money would not be put into the BSA and that funds would be targeted; however, he had changed his strategy and was willing to put money into the BSA.

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Representative Gara understood that the state was facing budget deficits; however, there had been three years of cuts. Districts were facing additional cuts in future years. He pointed to teacher, guidance counselor, and curriculum cuts. He wondered how schools would move forward under the circumstances.

Commissioner Hanley replied that the ball was in the legislature's court. He reiterated his earlier statement that the governor had put forward an increase of \$85 to start the conversation.

Representative Gara asked if the department was blaming the legislature for coming up with a higher BSA number than the department had presented. Commissioner Hanley replied in the negative. He elaborated that the governor had used the \$85 figure as a starting point.

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Representative Costello asked about one-time funding from recent years. She wondered if DEED or another entity tracked how districts spent the one-time funding. Commissioner Hanley replied that the funds had been distributed in the past few years through the formula's Adjusted Average Daily Membership (AADM). He noted that the funding did not go into the BSA. Without clear intent language specifying the department to do so, it had not tracked the funding. He pointed to \$25 million provided to districts to address energy costs and explained that it was up to the districts to determine how the funding was used.

Representative Costello asked if the department would need specific direction from the legislature to track the funding. She was interested to know how the funds were spent and noted that it was not easily determined. Commissioner Hanley replied that DEED would follow the legislature's intent; it did not want to insert itself in places it should not. He relayed that at times the department had been given direction on how money should be distributed and other times there had been accountability measures to report out.

Representative Costello understood that when the legislature allocated money it was distributed to the districts; whether it was special needs, intensive special needs, geographic differential, AADM, or one-time funding,

the districts had complete control and autonomy on how the dollars were directed. She believed the decision was solely up to the local school district. Commissioner Hanley replied that her understanding was accurate generally speaking.

Representative Wilson spoke to the removal of the top tiers [page 14] and efficiencies that may have been in schools with enrollment above 400 or 750. She asked whether economy of scale still existed when the enrollment number was reduced to 250 students and every student counted for at least 0.97. She mentioned items such as broadband that were based on something separate from the student.

Commissioner Hanley replied in the negative. The component was relatively new and the department had not followed through on identifying efficiencies. The change allowed for additional funding for schools that had a smaller multiplier. He could not speak to the direct impact at present.

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Representative Wilson addressed teacher tenure on page 16. She asked Commissioner Hanley to reiterate the department's concerns.

Commissioner Hanley did not have a concern about reopening the issue. He thought clarification was needed related to the tenure termination language. He explained that current language read that a teacher's tenure could be terminated, but it did not necessarily mean the employee would lose their job. He wondered where that left the employee. He asked if an employee could earn the tenure back after a probation period or if they would start from the beginning.

Representative Wilson asked for verification that a teacher could transfer their tenure from one district to another. Commissioner Hanley believed so. He would follow up on the question.

Representative Wilson believed that each district had the option to decide differently on the issue.

Representative Guttenberg asked about page 16, line 19. He pointed to a deletion and observed that the sentence no longer made sense grammatically. Commissioner Hanley

replied that the figure changed from 12.56 percent to 32.56 percent (included on line 32).

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Representative Guttenberg asked about teacher tenure on page 16, line 9. He believed that the bill language essentially meant that there would be no teacher tenure. Under the section if a teacher did not adequately assist a school district with an implementation of a school-wide change to the instructional model it was grounds for tenure termination. He remarked that a teacher may not be involved in the specific curriculum. He believed the provision was arbitrary.

Commissioner Hanley agreed; he believed the language needed clarity. He questioned whether a teacher implementing the strategies in a classroom was sufficient.

Representative Guttenberg looked at the change in formula on page 14. He assumed that increasing the multiplier for large schools meant there were few efficiencies based on school size. He wondered about the basis of the change to remove the top two tiers. He wondered what it had done for other schools and what inefficiencies existed for smaller schools.

Commissioner Hanley could not speak to the specific language.

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Representative Guttenberg wondered where a person doing the research would go to determine the calculation. He wondered how a person would calculate where efficiencies existed.

Co-Chair Stoltze asked if the question was about the value of a student.

Representative Guttenberg disputed the remark and reiterated his question related to value, efficiencies, and school size.

Commissioner Hanley answered that the department could help someone with the pursuit, but it was necessary to look back at where the numbers in the bill had originally come from. He believed the intent was to recognize economies of scale.

He did not know why 750 had been selected related to the number of students. He believed it represented the number and size of schools in the state and how to adequately fund them. The actual multipliers did become a term of value.

Representative Costello thought school districts were struggling to find ways to increase efficiency and that they had reached a point where cutting teachers was their only solution. She spoke to the Anchorage School District cutting 200 teachers. She commented on the district's diversity and families moving from smaller to larger districts in order to take advantage of opportunities. She believed the question had been asked and the districts had answered that more efficiencies could not be located and districts were now cutting into the marrow of the purpose of education. She had received calls from constituents who were upset that their child was not counted as one [a whole student].

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Vice-Chair Neuman discussed TVEP. He mentioned federal withholdings related to the Workers' Compensation Employment Act. He spoke to training individuals in order to help them find employment to support their families. He looked at changes in the CS and noted that there was one full page of new recommendations on how to regulate \$11 million for TVEP. He did not believe the change was streamlining the process. He believed a new division would be needed to look at the provision [due to the workload it would create]. He pointed to language pertaining to data collection on page 18, line 10 related to the percentage of former participants who had jobs, the median wage, former participants who were employed, and other. He wondered why the data was needed and how it would be used. He opined that the data collection would be a full-time job. He thought it would be easier to include language that the commissioner shall make a determination to ensure that the funds were distributed in an equitable fashion that addressed employment needs statewide. He believed the state tried to overregulate and provide over accountability. He asked the Department of Labor and Workforce Development (DLWD) to provide comment on the issues.

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Commissioner Blumer clarified that the funds came out of the Unemployment Insurance Trust Fund from the employees' portion. She communicated that the numbers 1 through 5 of the criteria had been set in 2009. The TVEP funds were set out to keep individuals from being on unemployment and drawing from the fund. The articulation agreement components had been added to encourage regional training centers to work with the local school districts to equip the state's youth with employability skills after high school. She highlighted that nationally students were underequipped for the workforce after high school graduation and some two-year degree programs. The intent of the articulation agreement was to provide students with dual credit and to give them technical education experience to help them move more quickly into the workforce. She addressed whether the reporting structure could be put on the DLWD commissioner to increase efficiency. She believed criteria was needed because the money was designated by the legislature and formula funded; she thought clear guidelines were needed for the reporting structure. She noted that the 20 percent mechanism she discussed earlier was the only way the department could have any leverage to receive the information. She reiterated that the department already did items 1 through 5; therefore, she did not believe adding the two additional components would require new staff.

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Vice-Chair Neuman noted that the funds came out of a person's federal withholdings through the Federal Employment Compensation Act. He wondered what the information would be used for.

Commissioner Blumer replied that the department provided the data to the legislature annually. She detailed that the department was working to identify some of the items it wanted regional training centers to look at to ensure that trainees were moving into employment. Most of the measures had been implemented in 2009; only the articulation agreement had been added in the bill.

Vice-Chair Neuman would continue to work with the commissioner to provide additional streamlining.

Representative Munoz pointed to the change in employer rate from 12.56 percent to 32.56 percent. She noted that the

bill allowed compensation through the formula to reimburse the school districts, but it did not direct reimbursement to other TRS employers including DEED. She detailed that the impact was estimated to be around \$700,000 to DEED. She asked for comment from the department.

Commissioner Hanley deferred the question to others.

Representative Munoz noted that there would also be an impact on the University of Alaska and other affected agencies.

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Representative Gara spoke to the revenue generated by the BSA including \$22 million for Anchorage and \$6.9 million for Fairbanks for the first year. He asked for verification that the funds would only be available if the additional \$25 million to be distributed through the BSA formula remained in the operating budget.

Commissioner Hanley would follow up on the question.

Representative Gara was bothered that the commissioner did not know the answer. He pointed to page 11 and spoke to the current public education fund that distributed money to school districts, boarding schools, correspondence study, and for transportation (items the BSA was used for). He noted that the bill included a provision that the funds could be spent on TRS. He was concerned that the funds would be taken from classrooms. He wondered if the department shared the concern.

Commissioner Hanley believed that the intent was for money to be placed into and withdrawn from the fund for TRS; the portion of TRS currently paid by the state would be paid by school districts. He deferred the question to David Teal for further detail.

Representative Gara wondered if the committee would hear from someone else related to the Public Employees' Retirement System (PERS)/TRS portions of the bill.

Co-Chair Stoltze replied that the bill was associated primarily with TRS, but there were some PERS elements.

Representative Gara pointed to new language associated with the educational credits on page 22 that let companies receive tax credits by putting money into private nonprofit elementary or secondary schools (line 27). He wondered if the provision applied to private or religious schools. He surmised that it would allow state money to go to private schools.

Commissioner Rodell replied in the affirmative. She elaborated that the provision mirrored the federal deduction that was currently in place. She agreed that the provision could allow for a donation to a private nonprofit that may have a religious affiliation.

Representative Gara noted that it was allowable under federal law, because there was no ban under federal law on public money being used for private or religious schools, but there was a ban under the Alaska State Constitution. He wondered how the provision did not violate the constitution.

Commissioner Rodell deferred the question to the Department of Law.

Representative Costello asked if the education tax credits were transferable.

ROBYNN WILSON, AUDIT SUPERVISOR, TAX DIVISION, DEPARTMENT OF REVENUE (via teleconference), replied that the education tax credits were not transferrable under existing law or under the bill.

Vice-Chair Neuman discussed the education tax credits. He relayed that if a company owed the state corporate taxes it would receive nontransferable tax credits if it gave money to a private nonprofit for a vocational education purpose.

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Representative Guttenberg asked about the recommendations for reports from the state (page 9). He noted that curriculum and information relevant to efforts made to improve the education system were already included under items 2 and 3. He asked for clarification on the addition of item 4 pertaining to recommendations for changes in the method of education spending, district cost factors, efficiencies, and other.

Commissioner Hanley replied that he was not sure of the intent of item 4. He observed that the component included recommendations to the legislature as opposed to previous components that only reported on the state board's actions. He believed it was broad enough to incorporate all of the components.

Representative Guttenberg asked for verification that there was not currently an annual report of recommendations. Commissioner Hanley replied that an annual report was presented to both education committees.

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Representative Guttenberg surmised that an assessment of the district efficiencies and cost factors (e.g. heating, maintenance, transportation, and other) was an intensive report to conduct annually. He wondered if the information was already included in the report.

Commissioner Hanley replied that the information was not currently included in the report. He detailed that the report included work the state board had conducted in the areas, but it did not include recommendations. Cost factors fell under the purview of local school districts and were not typically included in the report.

Representative Guttenberg asked for verification that the district cost factors were accumulated at the district school board level. Commissioner Hanley replied that the cost factors were accumulated at the local level.

Representative Guttenberg asked how the cost factors were accumulated into a calculation for state funding. He noted that currently a formula determined amounts to be received by district based on need. He understood that no two districts were equal. He wondered whether there was oversight to determine whether the method was accurate.

Commissioner Hanley replied that the geographic cost factors associated with revenue were determined by the legislature; however, the actual district cost was driven by conversations between the districts and the legislature. The actual costs at the local level were not monitored by the state.

Representative Guttenberg stated that the gasoline in Kivalina was over \$13 per gallon. He wondered how the increased costs for communities were reflected in the overall formula.

Commissioner Hanley replied that the geographic cost factor was designed to reflect costs in a community; however, he doubted that it would reflect the annual changes in fuel costs. The idea of the geographic cost factor was to recognize and compensate for the increased costs in rural areas.

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Co-Chair Stoltze referred to the bracketing change related to the large school students. He asked what percentage of the total student population the large school students comprised. Commissioner Hanley replied that the large five school districts accounted for slightly over 80 percent of the state's students.

Co-Chair Stoltze remarked that the provision impacted above 80 percent of the state's students. He pointed to the significance of counting the students as whole students.

Representative Edgmon asked about smaller schools and unknown expenses. He stressed that the cost structure in rural Alaska was exponentially higher than in urban areas that had natural gas and other efficiencies. He was not opposed to the change in Section 17. His district included a portion of 10 school districts and he was troubled that the costs would increase for small schools with fewer students. He appreciated the additional BSA funding, but he was worried that the bill did not recognize the expenses. He wondered if the department kept a handle on the various cost structures in smaller schools compared to larger schools.

Commissioner Hanley replied in the negative.

Representative Guttenberg asked for verification that DEED would be tracking the data as a result of the new language on page 9 of the bill. Commissioner Hanley did not read the provision in that way. He surmised that the board would present recommendations for changes in the method of education spending. He did not believe the board was being asked to specifically recommend where to direct funds. He

thought the provision outlined a method of spending (e.g. that money should be focused on the classroom, infrastructure, teachers, or other). He was unsure the board had the capacity to address the issue on a deeper level.

Representative Guttenberg surmised that the change would be included in a fiscal note. Commissioner Hanley replied that the department had not intended to generate a fiscal note on the item.

Representative Guttenberg thought that that intent of the provision may need clarity.

Representative Wilson understood that districts needed to provide significant information through audits and other methods. She noted that DEED had extensive information on its website. She observed that the website did not include a specific form that included information on energy. She wondered if the department had considered including a form on its website with more clarifying information. She wondered if it would be possible for DEED to compile the information without creating additional work for districts.

Commissioner Hanley replied that DEED had not pursued the idea because it was a burden on districts. He questioned how much information was really needed. He added that the department could pursue the issue if the information was needed. He communicated that districts needed the flexibility to move funds around as energy costs increased. The department had not felt the need to monitor districts that closely.

Representative Wilson clarified that she did not want to monitor districts that closely. She detailed that the education task force had looked at drivers of the formula and it was difficult to determine needs; a \$25 million one-time increment had been provided to address rising energy costs; however, costs continued to rise. She did not know how the legislature would address the entire formula without the information. She believed it would be helpful if the department could provide the cost driver information in one place.

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Co-Chair Stoltze discussed the intent to address TRS.

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, addressed three cost drivers including Medicaid, education, and retirement; HB 278 dealt with education and retirement. Under the legislation, K-12 costs would increase by approximately \$900 million to \$1 billion over the upcoming 10 years. He shared that TRS retirement costs would be approximately \$4.3 billion during the upcoming 10 years. He detailed that the governor's plan would decrease the TRS costs to approximately \$4.2 billion during the same timeframe; the TRS costs would decrease to \$3.3 billion under HB 278. He communicated that essentially the \$900 million in savings under the HB 278 TRS plan offset the education increase in the bill. Offsetting the education increase was important due to annual deficits of \$2 billion to \$2.5 billion under a no-growth scenario. The state's \$15 billion in reserves were estimated to be depleted by 2024. He believed the no-growth scenario was optimistic because Medicaid costs were projected to increase by approximately \$2 billion during the upcoming 10 years.

Mr. Teal relayed that the state was looking at consuming \$2 billion for Medicaid, \$1 billion for education, and another \$3 billion or more for retirement in the upcoming 10 years, which represented roughly one-third of the state's savings. He emphasized that the figures did not factor in PERS. He relayed that action by the legislature was not required if the state could afford the current TRS payments. He detailed that if the state maintained the current TRS path, the TRS problems would be fixed within 25 years. He believed the appropriate question was whether the state could afford to make the current TRS payments. He stated that the goal was to extend the life of the reserves, which would be accomplished with HB 278, but not with the governor's proposed plan. He added that over the upcoming 10 years the governor's plan spent almost the same amount on TRS as the current payment plan.

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MICHAEL BARNHILL, DEPUTY COMMISSIONER, DEPARTMENT OF ADMINISTRATION, believed the legislature was owed a deep debt of gratitude for its assistance to TRS since 2008. He

detailed that since 2008 the legislature had appropriated about \$1.7 billion to TRS. He believed the level of support was impressive. He pointed to other states where municipalities were going bankrupt under the pressure of unfunded liabilities from defined benefit systems. The department appreciated the additional \$1.4 billion proposed in the CS and believed it was needed; it was more than the governor's \$1.1 billion proposal. However, the department did not know where the money would come from.

Co-Chair Stoltze asked where the department thought the money would come from. He noted that the governor had a fund source. He asked if the department thought the legislature had a different fund source. Mr. Barnhill replied that if the funding source was not different than the governor's that helped clarify the issue. Co-Chair Stoltze replied that it was not.

Mr. Barnhill addressed the complexity of the (retirement and education) issues. He relayed that the governor respectfully believed that the two issues should be treated separately. He pointed to similarities between the governor's plan and the Legislative Finance Division (LFD) plan presented in the CS. Both plans sought an appropriation in excess of \$1 billion and both had a certain amount of money on a go-forward basis from FY 16 moving forward that would be used in the form of state assistance alongside the BSA formula. The issue came down to philosophy, where there was a significant difference between the governor's plan and LFD plan. He detailed that LFD plan contemplated the possibility that the TRS trust fund would exhaust in the early 2050s. He elaborated that the type of plan could be referred to as a "pay-go" plan. Whereas, the governor's plan proposed fully funding the TRS trust fund in order to secure promises made to defined benefit teachers. He stressed the importance of the philosophical difference. He communicated that the governor was unwilling to contemplate the possibility that the state could run the TRS trust fund dry in the future; therefore, he had put forward a plan that from an actuarial perspective would fully fund the system. Under the assumptions made, there was not a risk that the trust fund would run dry. He noted that the administration found it problematic that under the bill's plan there could be an economic downturn at any time that would threaten the economic security of the TRS trust fund; the governor's plan did not begin with that assumption.

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Mr. Barnhill communicated that many people were impacted by TRS; currently there were approximately 6,500 active defined benefit teachers across the state and close to 12,000 defined benefit TRS retirees. When dependents were factored in there were over 30,000 people impacted by current decisions on TRS. The administration did not want to send the message that it would be okay to let the trust fund exhaust prematurely.

Co-Chair Stoltze asked if the administration had useful information to provide the committee. Mr. Barnhill replied in the affirmative.

Representative Gara asked for clarification on the document being discussed.

Mr. Barnhill was addressing version G of HB 278. He looked at pages 11 and 12 that made changes to the AADM formula. The administration believed the intent was to provide funding for the increased employer contribution rate for school district employers. He explained that under existing law the school district employer contribution rate had been capped at 12.56 percent of payroll; the bill would increase the cap to 32.56 percent and would provide funding for the increased rate through changes to the AADM on page 12, lines 17 through 25. The formula would provide funds to the school districts to make the increased payment. He turned to Section 21 on pages 14 and 15. When the money was appropriated through the amended AADM formula to the Public Education Fund, the DEED commissioner could withhold the funds from school districts and pay the money directly to the Department of Revenue (DOR) for investment. The purpose of the section was to capture the full-time value of the funds for investment at the beginning of a year as they were invested at present.

Mr. Barnhill relayed that the TRS actuarial rate was high (it would be over 70 percent in the coming year); the difference between 72 percent of payroll and the employer contribution rate cap of 12 percent was 60 percent. Currently the legislature appropriated the entire difference through state assistance in the operating budget; the funds were sent to the Department of Administration and were then provided to DOR for immediate

investment. He relayed that by routing an additional 20 percent through the school districts there was a concern that the funds would come back to the state in equal installments over a 10-month period and that DOR would lose the ability to invest the funds over the 10-month period. He detailed that the provision resolved the issue by designating that the money would be given directly to DOR.

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Mr. Barnhill moved to Section 25 on page 16 where the employer contribution rate cap was increased from 12.56 percent to 32.56 percent. The bill also included an alternative rate on lines 23 to 27. The Legislative Finance Division had explained to the administration that the alternative rate (pension benefits divided by salary) would not take effect until 2050. He addressed an earlier question from Representative Gara about how the rate increase would impact the state (the state and the University of Alaska were both members of TRS). Based on information collected by the Division of Retirement and Benefits, state assistance had been paid on behalf of the state in the amount of \$2.3 million and \$16.2 million on behalf of the university in FY 13. He detailed that approximately one-third of the total would need to be included in each of the two entity's budgets under the legislation (approximately \$700,000 for the state and \$5 million for the university).

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Mr. Barnhill addressed Section 27 on page 17 that would implement the pay-go provision. The section amended AS 14.25.085 that was originally enacted into law in 2008 as part of SB 125; the section had provided that for TRS the state could appropriate the difference between the actuarial rate and 12.56 percent in the form of state assistance. To date the appropriations amounted to approximately \$1.7 billion. Under changes proposed in the bill no appropriation would be made if the balance of the trust funds (the amount appropriated to the trust fund appropriated from the reserve account established by the bill) and employee and employer contributions were insufficient to pay anticipated benefits for the upcoming year. He believed the change was fairly radical. He reiterated that the section contemplated a pay-go approach to TRS.

Mr. Barnhill addressed Section 33, page 19, lines 21 and 22 that established the Alaska Retirement Management Board (ARMB) as the trustee of a new Teachers' Pension Reserve Fund (created in Section 35 and established as a sub-fund of the general fund). Section 34 amended AS 37.10.220 related to the powers of ARMB. Page 31, lines 5 and 6 removed the power of ARMB to conduct past service liability rate making, which the board had done since 2005. Page 22, lines 7 and 8 authorized ARMB to manage the Teachers' Pension Reserve Fund.

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Co-Chair Stoltze wondered whether bond raters would have concern about the state's pension reserve even if the state was making the payments and had a record of making payments.

GARY BADER, CHIEF INVESTMENT OFFICER, TREASURY DIVISION, DEPARTMENT OF REVENUE, deferred the question to Commissioner Rodell.

Co-Chair Stoltze requested that DOR enable Mr. Teal on behalf of the House and Senate to make inquiries of some of the state's bond rating agencies. Mr. Bader deferred to Commissioner Rodell.

Co-Chair Stoltze asked if Mr. Bader could foresee a problem with the request. Mr. Bader replied in the negative.

Co-Chair Stoltze asked that Mr. Teal act as a fact checker to help the legislature make an independent determination.

Representative Wilson did not appreciate the administration insinuating that the committee did not take teacher retirement seriously because it did not agree with the governor's plan. She believed the legislature was taking the issue more seriously because it was working to put the payment plan in statute. She wondered where the administration planned to obtain \$500 million annually for the fund and how many years the annual payments would be needed.

Mr. Barnhill replied that the governor's plan called for \$343 million for TRS annually from FY 16 to FY 36. He referred back to his testimony that the legislature was

owed a huge debt of gratitude for the commitment it had shown TRS.

Co-Chair Stoltze referred to Mr. Barnhill's testimony that there was not a gulf of disagreement between the governor and the legislature.

Mr. Barnhill believed the statement was fair. He detailed that the amount of money under the legislative plan beginning in FY 16 was \$157 million grading up over time; whereas, the governor's plan was \$343 million. He stated that the difference was small in terms of numbers, but the philosophy was significantly different. He concluded that there was a respectful disagreement between the governor's and legislature's proposals.

Representative Wilson asked where the administration believed the \$343 million would come from. Mr. Barnhill deferred the question to the Office of Management and Budget.

JOHN BOUCHER, SENIOR ECONOMIST, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF THE GOVERNOR, answered that some of the cost drivers the administration was working to address (e.g. retirement, Medicaid, growing prison populations, and investment in infrastructure) would be challenges for the administration going forward. In the immediate future the general fund (primarily through petroleum revenue) would be the driving force in addition to the state's reserves. The administration believed that the combination of the two fund sources would cover the costs until gas production began.

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Representative Wilson stated that she did not hear an answer to her question. She equated the plans to taking out a home mortgage. She detailed that one plan looked at the state's ability to afford a 15-year loan or a 40-year loan based on its revenue. She opined that selecting the 40-year plan did not mean she took the debt less seriously; it just used what she believed the state could afford. She believed that if the state chose the 40-year debt option it could continue to make major payments; the plans would be very similar if the \$343 million could be infused annually. She was interested in an apples-to-apples comparison. She wondered if there was anything preventing the

administration from using the 40-year plan while providing \$343 million installments to reduce the debt quicker.

Mr. Boucher replied that the bill did not prohibit extra money from going to the fund should the legislature or the governor propose it. He believed the administration just had a different target in terms of where it would like to be in 25 years related to a healthy, in-tact reserve fund (versus exhausting the funds). He stated that there was a downside to not having a trust fund in place to pay down the ongoing debt.

Representative Wilson understood that the governor's plan used a shorter timeframe. She surmised that HB 278 would require an annual infusion of \$343 million in order to make its timeframe shorter. She asked for verification that the plans would get to the same place.

Mr. Boucher answered that the governor's plan to allocate \$343 million to TRS was based on the \$1.2 billion appropriation in the first year; if a higher number was used the \$343 million figure would drop. He referred to the home mortgage scenario and explained that a larger down payment would change the ongoing level payment. He explained that by short-funding the fund the models indicated that the trust would be exhausted. He concluded that if the trust fund were to go bankrupt the only ongoing revenue would be contributions from employers.

Co-Chair Stoltze asked if bankrupt was the correct word. Mr. Boucher clarified that exhausted was a more appropriate term.

Representative Wilson surmised that the fund would only be exhausted if the \$343 million was not paid in. She shared that she had purchased a car based on her husband's projected overtime payments; subsequently, he had not received as much overtime as planned and they had to cut in other areas to account for the car payment. She wanted to ensure that the state was paying what it could afford (accounting for Medicaid, education, and other). She hoped that the legislature could find the \$343 million for annual infusions that would pay the debt off in a quicker timeframe. However, until she knew where the money was coming from she did not want to give the appearance that the funds would be available one year and not available the

next. She opined that the funds may not be as easy to come by as believed.

Co-Chair Stoltze referred to another one of the governor's bills (SB 138). He wondered where the funds would come from.

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Mr. Barnhill noted that Representative Wilson made a fair point about different terms used to amortize the unfunded liability; sometimes the unfunded liability was likened to a home mortgage. The administration had considered various amortization terms (20 to 40 years); it had selected the term because it believed the state could afford it. He pointed to another option of amortizing a debt through an interest-only loan where the interest was paid off at the end of the loan term and the borrower was faced with paying the principal in-full or foreclosing on the property. He believed the proposal by LFD was closer to an interest-only loan than it was to a fully amortizing loan under any particular term. The administration had submitted the numbers to its actuary and was waiting for the judgment. He believed it queued up a policy discussion about whether the state wanted to address the issue with an interest-only approach where the entire principal would be due at the end of the loan period.

Representative Gara was uncomfortable taking everyone's interpretation of the bill. He discussed that at the beginning of the year the governor had proposed a \$3 billion pay-down of PERS/TRS (roughly \$2 billion would be a pay-down and \$1 billion would be the annual payment). He understood that the idea was to put a substantial sum down in order to reduce future annual payments. He thought the proposal had covered both PERS and TRS. He expressed confusion in relation to the current debate about TRS.

Co-Chair Stoltze clarified that the proposal in HB 278 would bifurcate the \$3 billion between PERS and TRS. He added that it would appropriate more to the TRS side.

Representative Gara asked for verification that the governor's original plan had not split PERS and TRS payments (roughly \$2 billion would be a pay-down and \$1 billion would be the annual payment). Mr. Barnhill replied that the summary was roughly accurate. He detailed that the

governor's plan was \$3 billion with \$1.88 billion allocated to PERS and \$1.12 billion to TRS. Each allocation encompassed the FY 15 payment that was due. Under the ARMB level dollar methodology, \$900 million of the total would be the FY 15 payment. Under the previous percentage of pay methodology \$703 million would be the FY 15 payment.

Representative Gara wondered when the PERS and TRS debt had been split up. Mr. Barnhill replied that the change had occurred in the new CS.

Co-Chair Stoltze noted that there had been an awareness of discussion.

Mr. Barnhill added that there were different ways of addressing PERS and TRS. He relayed that the employer contribution rate cap in TRS was intended for the state to pay nearly the entirety of the past-service liability.

Co-Chair Stoltze equated it to a single-payer system. Mr. Barnhill replied that the current structure reflected an understanding that the debt was the state's liability.

[3:25:21 PM](#)

Representative Gara believed that all presentations to-date had involved a combined way to address PERS and TRS together.

Co-Chair Stoltze replied that there had not been a governor's bill to analyze; there had been a budget submission.

Representative Gara referred to the discussion about the governor's plan to put \$343 million into TRS and the plan in HB 278 to put \$157 million into TRS. He thought the governor's only plan had been the \$3 billion budget plan. He wondered where the governor's plan had been related to the \$343 million into TRS.

Mr. Barnhill replied that the governor's plan was as he had described earlier in the meeting. The governor had proposed a \$3 billion payment to PERS/TRS and to appropriate \$500 million annually (\$157 million to PERS and \$343 million to TRS) from FY 16 to FY 36.

Representative Gara wondered whether the PERS and TRS sections in the bill would impact the BSA in any way. Mr. Barnhill clarified that the bill contained no provisions related to PERS. He replied that the change in the capped rate from 12.56 percent to 32.56 percent also included a change to the AADM formula that was intended to provide the difference in funding (it was intended to hold the school districts harmless).

Representative Gara asked for the section where school districts would be made whole by the funding. Mr. Barnhill directed attention to Section 16, page 12, lines 17 through 25. Co-Chair Stoltze noted that the administration was not a proponent of the approach, which he believed added to the veracity of Mr. Barnhill's statement.

Representative Gara looked at page 11. He stated that there was currently a public education fund for the types of things the BSA was used for. He pointed to language that would allow the fund to be used for BSA-type classroom items, transportation, or TRS (without specifying an amount). He wondered what would prevent the funding from going entirely to TRS so that less money went to schools.

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Mr. Barnhill pointed to Sections 15 and 21. The change to the AADM was intended to provide funding to school districts to make up the 20 percent difference (from 12.56 percent to 32.56 percent). When the legislature appropriated the money it would go to the Public Education Fund. Under Section 21 the DEED commissioner could provide it directly to DOR for investment. As he understood, the intent was to protect the time-value of the funds by investing them at the beginning of the year (as they were currently) rather than sending the funds to school districts and bringing the money to DOR in 10 equal installments over the course of a year.

Representative Gara did not see anything limiting the amount of money that could be taken out of the public education fund for TRS. Mr. Barnhill did not believe it was the intent to take any more funding out above the 20 percent.

Representative Gara understood the intention, but wanted to ensure the bill clarified the intent.

Co-Chair Stoltze stated that the bill recognized retirement as a cost driver of education. He stated that the legislature had intent and a track record of holding the school districts harmless. He believed the items were indisputable.

Mr. Barnhill believed the comments were fair.

Co-Chair Stoltze discussed that the committee would hear from Mr. Teal.

Representative Munoz stated that through the formula the legislation included reimbursement for the additional cost to districts, but did not address additional costs to the university, DEED, the Southeast Regional Resource Center, or the Special Education Services Agency. She believed a better understanding of the total costs was needed. She stated that the costs would clearly have an impact on future operating budgets. She stated that in the current year the university had taken an \$11 million cut; she surmised that the bill would mean an additional \$5 million to \$7 million cut. She was concerned that under the bill's plan the payoff would increase from 20 years to 40 years, but at the end of the 40 years the trust funds would be gone and the obligation would remain. The benefit payments were estimated to be around \$3.5 billion for PERS and TRS. She wondered how to contemplate covering future costs without the benefit of the trust funds.

Mr. Bader replied that when the trust funds were exhausted the contribution rate (based on payrolls at the time) should be sufficient to cover benefits. The trust fund would essentially go to zero, but the employer contribution rate should be enough to cover benefits. He added that if the contributions were not sufficient, the state would have missed an opportunity to have earnings of the trust fund pay the benefits. The crux of the governor's proposal was that benefits would be paid out of earnings and not solely from employer contributions after the initial deposit into the fund.

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Representative Munoz asked what the trust funds had earned in the past year. Mr. Bader replied that the funds had earned 18.7 percent in the past calendar year.

Representative Munoz asked about the dollar amount of the earnings. Mr. Bader responded that he would need a calculator to provide the dollar amount. He detailed that the earnings were substantially higher than what was anticipated in the ARMB earnings assumption.

Co-Chair Stoltze asked about the fund's historic earnings. Mr. Bader answered that historic earnings depended on the specific time period. He detailed that returns for the TRS fund over 20 years were about 7.9 percent. Returns for a period of 3 years were much higher than the 8 percent earnings assumption. Whereas, returns were significantly lower in 5-year period that included 2008. He elaborated that the administration believed the governor's proposal that would put money into the trust fund for investment over a long period of time was preferable way to obtain earnings due to volatility that existed in investment returns. He explained that investing the money on an annual basis (instead of over the long-term) ran the risk of a significant market decline.

Representative Munoz wondered what the approach did to the state's creditworthiness and how it would impact the state's ability to seek financing for a gasline.

Commissioner Rodell believed the plan before the committee would raise flags with ratings agencies. She noted that the agencies may just flag the change in a report initially. She believed it would cause credit concerns because the change would be viewed as a backing away from a commitment made by the state; therefore, there was concern about how the change would impact the state's ratings in the long-term. She opined that agencies would take some time to react because they would watch to ensure that the issue was on-going as opposed to something that may be corrected. Placing items in statute led to a more immediate concern from ratings agencies. She relayed that DOR had envisioned that the state was taking care of current liabilities so that in 2018 the state would be in the best financial position possible (to make the most flexible and lowest-cost decisions) when it looked for a final investment decision on the gasline. She was concerned that actions considered under the bill would tie the state's hands and would eliminate its flexibility to make the best decision for the gasline and other decisions due to a deferred liability.

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Co-Chair Stoltze requested that DOR enable Mr. Teal on behalf of the House and Senate to make inquiries of some of the state's bond rating agencies.

Commissioner Rodell replied that DOR could set up conversations with ratings agencies. She offered to invite state analysts as well. She provided the caveat that ratings agencies were operating under a stricter regulatory environment and would not necessarily respond to direct proposals. For example, it was unlikely the agencies would provide an answer if they were asked whether they would downgrade the state's rating if it took certain actions. However, it was possible to obtain good information about how the agencies viewed liabilities, pensions, debt capacity, and other.

Co-Chair Stoltze asked Commissioner Rodell to work with the committee on the issue. Commissioner Rodell was happy to facilitate any conversations.

Co-Chair Stoltze asked for verification that DOR would not be an impediment to the agencies' ability to provide information. Commissioner Rodell replied in the affirmative.

Representative Munoz referred to a prior conversation where Commissioner Rodell had discussed her experience in the Commonwealth of Virginia, Chicago, and possibly Puerto Rico. She recalled the commissioner's comment that some of the jurisdictions had implemented a system similar to the one under consideration by the committee. She believed the commissioner had stated that the system had been unsuccessful. She asked for further detail.

Commissioner Rodell replied that she did not work directly with Puerto Rico, but was familiar with the case history. She detailed that Puerto Rico had closed its defined benefit system in 2000; it had subsequently run into budget problems and began to rely on the trust fund to pay benefits. At present the trust funds for the public employees were 4.5 percent funded. For a variety of other reasons Puerto Rico had to borrow funds on a regular basis to manage its own cash liquidity needs; its credit rating was currently at BB (junk-grade). The rating meant that

bond funds were no longer allowed to buy Puerto Rico's debt. She detailed that Puerto Rico had recently sold debt the same week as the State of Alaska. Alaska had sold a one-year note at 0.001 percent; Puerto Rico had to sell 30-year debt with a term maturity for one year of cash at 8.78 percent.

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Commissioner Rodell provided a second example that pertained to the State of Illinois. She detailed that Illinois had an open benefit plan; its issue related to over extension and not funding pensions as a mechanism to fund other state priorities. Due to the actions, the state's unfunded liability had grown considerably, which impacted the state's ability to borrow; its rating was currently an A- (speculative grade). The state was looking at cutting benefits. She believed Alaska had been given significant credit for continuing to fund pensions even under revenue volatility.

Representative Munoz asked about an actuarial analysis of the proposal. Commissioner Rodell replied that Buck, the ARMB actuary was in the process reviewing the proposal. She hoped to receive the results shortly.

Co-Chair Stoltze asked about the size of Puerto Rico's permanent fund, earnings reserve, and statutory and constitutional budget reserve accounts. Commissioner Rodell replied that Puerto Rico's accounts were at zero.

Co-Chair Stoltze surmised that the lack of funds could be part of the reason for Puerto Rico's BB rating. Commissioner Rodell agreed.

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Representative Costello spoke to her understanding of the administration's proposed plan that would have the state make larger contributions of \$343 million per year for a shorter period of time. She believed the plan meant the state would coast on earnings. She stated that under HB 278 the state would make a larger upfront contribution and contributions would pay for the liability. She asked how coasting on earnings was more reliable and secure than a statutory commitment to pay the liability with contributions.

Commissioner Rodell replied that she was more confident in putting money in the trust fund and providing it with 10 to 20 years to earn the needed money and to deposit additional contributions. She relayed that the strategy equated to forward funding. She had more confidence in the ability of the trust funds to have and earn the money under ARMB management. She was concerned that under the contribution scenario the needed contributions could compete with other funding items. She believed a system where earnings were generated removed the subject from future political dialogue about what to fund.

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Representative Costello observed that the administration had not commented on the interest earning reserve account established in the bill. She wondered if it was insignificant from the administration's perspective.

Mr. Bader replied that \$100 million was never insignificant, but compared to the scale of the total proposal it did not match the importance of the philosophy behind the other component in the bill. He elaborated that the bill contemplated that the state would invest money in a way that would generate the required rate of return to fund the system. The funds could not be invested identically to the trust funds because the department would have to consider that the legislature may call on the funds at some point. He believed the legislature would be disappointed with the department if there were long-term illiquid funds that were inaccessible. He added that the funds could be invested to earn close to what the ARMB believed the other funds would make.

Mr. Boucher added that when neutral parties looked at things like the reserve fund that they did not allow the accrued interest in the models due to the risk of reappropriation for other purposes. He stated that if the primary goal was to address the unfunded liability it would be no different than having the \$100 million in the constitutional budget reserve fund from the actuary's perspective. He agreed that the money would earn, but it would be difficult to convince any actuary that the money or the earnings were dedicated towards paying the unfunded liability.

Representative Costello stated that under the governor's proposal the \$343 million would be offered as a budget item that would compete against all other demands on the general fund including the operating and capital budgets, cash calls for the gasline, education, and Medicaid; whereas, the HB 278 plan would include the funding in statute. She asked for verification that Commissioner Rodell saw the plan under HB 278 as less certain option.

Commissioner Rodell replied in the affirmative. She stated that the legislature had a history of funding the items and recognizing the importance of the requests. She was concerned that if the legislature wrote it in statute that "it might have needed to be something different."

Mr. Boucher understood that in the current proposal the amount dedicated to TRS (outside of the education formula) would be approximately \$156 million and would grow annually. He surmised it would be a built-in annual increment until at least 2050. He believed the item would grow to over \$600 million. Although the governor's plan was more expensive upfront, it would remain at \$343 million annually. From a budgetary standpoint, the administration believed that a more predictable, stable, and higher payment that would ultimately fully fund the trust fund was a better alternative.

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Representative Costello saw the two proposals being couched as philosophical in nature. She believed the conversation was about whether the legislative or the administrative branches provided bond raters with more assurance. She looked at the challenge in light of other challenges facing the state. She understood that under ideal circumstances it would be best to pay down more upfront to shorten the payoff period; however, the state had other budgetary concerns as well, which made the pay-as-you-go plan appealing instead of a plan that was based on earnings. She believed that both plans had risk. She opined that it was not possible to address a \$12 billion unfunded liability without risk. She asked for verification that under the governor's plan it was conceivable that additional payments may be necessary even after the scheduled end-date.

Mr. Boucher replied that there was the risk. He spoke to the difference between the two approaches. He discussed

that a world with the trust fund was similar to a current situation with the constitutional budget reserve fund; there were ongoing bills that were paid and incoming cash flow. A trust fund to pay benefits provided a much less risky situation than relying on employers to consistently make payrolls and contributions to pay benefits on a monthly basis.

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Co-Chair Stoltze asked Mr. Teal to address the committee. He noted that items highlighted by Representative Munoz had come from an LFD document. He noted that the items would be included in a fiscal note.

Representative Munoz requested to hear from the university. She believed the amount in the [LFD] memo was lower than the university's estimate.

Co-Chair Stoltze asked for verification that Chris Christensen III, Associate Vice President for State Relations, University of Alaska was present on a lobbying function.

CHRIS CHRISTENSEN III, ASSOCIATE VICE PRESIDENT FOR STATE RELATIONS, UNIVERSITY OF ALASKA, replied that he was representing the university. He relayed that the bill would have an impact of approximately \$7.2 million on the university (the amount was higher than the \$5 million mentioned earlier in the meeting). He highlighted that the FY 15 operating budget had received a \$15.9 million unallocated reduction; the budgets covered less than 40 percent of fixed cost increases the university would have in the coming year for items such as pay raises and the opening of four new buildings. He communicated that the university would need to reallocate \$28 million internally through cuts to operations, existing programs, or by raising new revenue. He commented on the large size of the figure. He stated that under the bill's proposal if TRS was unfunded it would create a hole of \$35 million that the university would have to begin covering on July 1, 2014. He did not know where the funds would come from. The university had created a defined contribution Optional Retirement Plan (ORP) in 1990; 16 years prior to the creation of other state defined contribution plans. He detailed that the plan was optional but many faculty members had opted in over the years because they wanted a

portable plan they could take elsewhere, which was why the impact would only be \$7.2 million. He communicated that it had always cost the university and state less money for university employees to be enrolled in ORP as opposed to TRS or PERS; the state had saved approximately \$90 million since the plan's creation. He detailed that 24 years earlier the Board of Regents had decided to start getting a handle on the university's retirement costs. The university requested funding for the rate increase if adopted.

Co-Chair Stoltze requested that the university keep the legislature involved in the conversation in the future. He appreciated having the information on the record.

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Mr. Teal spoke to the fiscal note. He communicated that there were two issues with the university's funding level. There was no intention for there to be a reduction to university funds. The bill's intention was to include fiscal notes that restored funding to the four agencies in addition to school districts. He stated that the formula addressed school districts; there were four agencies that could not be affected by the formula. He relayed that a couple of ways to get funds to the entities included using current statutes to pay off their share of the unfunded liability and to leave the rate the same. He stated that there were ways to get the entities money to pay just as was done for school districts. He did not know what option the committee may choose, but it was not a new issue. He knew that the university was preparing the fiscal note.

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Mr. Teal recognized that Mr. Bader, Mr. Boucher, and Mr. Barnhill all understood the issue. He addressed the testimony that the governor's plan secured promises and that the trust fund would not be exhausted prematurely. He believed the statements implied that the plan under HB 278 did not secure retirement. He understood existing concerns about the retirement plan. He reassured the committee that any plan under consideration was intended to pay benefits when due. He stressed that the benefits were not in danger. The plans used the same numbers with different philosophies. He believed the governor's plan was solid because it intended to pay benefits when due, but no legislation had been proposed to change the schedule of

payments. He paraphrased earlier testimony that the administration did not want the plan in statute and wanted to have flexibility. He believed flexibility implied that the administration wanted the ability to pay less than the \$343 million or the statutory rate. He relayed that without a change in statute the state would owe the full statutory rate. He detailed that paying \$343 million did not comply with statutes. He explained that under the governor's plan the legislature could always choose to reduce the amount paid; if the state needed liquidity for a gasline or other projects it could choose to reduce payments to statute. He believed there was protection built in under the plan in HB 278; the rate was set in statute. He believed the mortgage analogy used by the committee was appropriate; the legislature could choose to pay more.

Co-Chair Stoltze asked Mr. Teal to respond to the proposal in the CS.

Mr. Teal replied that the flexibility of having the rates in statute was that state assistance was relatively low. The legislature could choose to pay higher annual payments than the amount the bill would set in statute. He relayed that payments did go up with payroll, but \$600 million in 2050 was less than the \$150 million to \$160 million that would be paid at present; the cost rose with inflation. He elaborated that the numbers in real terms would remain at the \$150 million to \$160 million level. The second protection was a cash infusion plus contributions on an annual basis that should pay benefits until the state could move to a pay-as-you-go plan. Additionally, the bill created a reserve fund as another backup; if the trust fund was insufficient money would be transferred from reserves. He confirmed that from an actuarial perspective the trust fund would not be counted as part of the system reserve. He asked how annual appropriations could be counted as a given. He did not believe there was any guarantee that \$343 million would be paid annually under the governor's plan.

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Mr. Teal opined that using reserve was not essential; it was a helpful buffer, but was not the underlying issue. The bill included a provision that made the state the payer of last resort. He disputed the administration's testimony that the trust fund could run out of money prematurely. He elaborated that the fund would run out of money when

benefits could be paid strictly with contributions at a rate of 32 percent or lower. The state would become a payer of last resort if anything happened; there were several layers of protection built in for the trust fund and future benefits. He disagreed with the administration's comparison of the bill's plan to an interest-only loan. He stated that unfunded liability made sense in a big-balance approach to the system, which meant having a large trust fund and using earnings to make the payments. He opined that there was nothing wrong with the approach.

Mr. Teal addressed relying on contributions rather than earnings. He stated that the big balance related to the timing of contribution payments; it was possible to make payments at present, to build up a balance and then coast or to pay them later when benefits were due. Under the pay-go plan there was not a balance, which resulted in an unfunded liability. He contended that it was a nonsense number because there was a plan to pay the benefits with contributions, not with the trust fund. He reiterated that the plans constituted a difference in philosophy; one coasted on earnings and the other assumed that contributions were more reliable. He stated that the latter was more stable and predictable. He relayed that there would be a balance of \$10 billion or more if the state relied on earnings; reliance on an 8 percent return meant that the state could pay benefits as long as it earned \$800 million per year. He stressed that if there were zero earnings in one year the state would be \$800 million short, which meant a contribution from the state would be required. He questioned where the money would come from. The numbers in the plans were very similar because costs were very similar. He reiterated that one plan required significant money upfront and coasting versus what he characterized as the more affordable route of lower contributions. He did not believe there was a great difference between the plans. He relayed that the plans became identical if the legislature chose to allocate \$343 million annually instead of the required amount. He questioned how bond rating agencies would react if the state fell off its schedule.

Co-Chair Stoltze hoped the committee would get to discuss the issue with bond raters. Mr. Teal hoped to have the DOR commissioner involved in a conversation with the bond rater. Co-Chair Stoltze replied that it was the intention.

Mr. Teal concluded that both plans under consideration would work. The choice pertained to which plan was more affordable.

[4:14:53 PM](#)

Representative Gara referred to PERS. He did not believe that either plan under consideration was bad. He communicated that he had supported a plan similar to the governor's in the past. He opined that one of the benefits of infusing an extra \$2 billion cash infusion (plus another \$1 billion that was already owed) the state's annual payments would be significantly lower. The cash infusion would bring annual payments down to \$500 million for 20 years. He believed the plan would leave money to fund infrastructure, children's services, and other important items. He surmised that if nothing was done the annual ARMB recommended payments would be well over \$1 billion per year, which meant less money for other items. His concern with the bill's plan was that it began with a low payment of roughly \$100 million for TRS; however, the PERS component would also need to be paid. He referred to earlier testimony that in the future the TRS portion would exceed \$600 million per year and payments would go on for a longer period. He noted that in the mortgage world people preferred to take out shorter mortgages if they could afford it. He surmised that the governor's plan left more money on the table to address the state's needs over the long-term.

Mr. Teal chose not to address the PERS issue because it was not included in the bill. He confirmed that the bill called for TRS payments that escalated over time; however, he stated that the payments in real dollars did not escalate by much. He added that they would increase due to increases in payroll and inflation. He stated that in real dollars \$600 million 40 years out was worth less than \$160 million in current dollars. He argued that the governor's plan took \$343 million off the table every year; whereas the bill's plan left \$200 million more per year on the table (which would decline over time). He explained that the whole point was that people chose a lower term mortgage if they could afford it. He agreed that the cheapest way to solve the problem was to pay the entire unfunded liability off at present. He remarked that people chose 30-year mortgages not because they were cheaper, but because they were more affordable. That was the call the legislature had to make.

He noted that the issue centered on how much money should be left on the table for other things.

4:20:07 PM

Representative Gara did not believe Mr. Teal was wrong, but he preferred the governor's approach. He would also be more comfortable if the governor's plan was included in legislation. He contended that the \$500 million annual payment under the governor's approach would be reduced in real dollars just like the \$600 million in the future was less in real dollars. The problem was that the state's revenue was not increasing with inflation. He noted that state revenue was declining and wondered how it played into the issue.

Mr. Teal replied he had been instructed to find a plan that worked. He noted that any model that did not pay benefits was a nonstarter. He communicated that the situation was different than that in Illinois or Puerto Rico. He emphasized that the payment plan needed to work. He detailed that the needed return under the pay-go plan was as low as 4.8 percent. He believed the earnings estimates under the bill's plan were actually understated. He observed that if earnings exceeded expectations the state could contribute less later on. He did not want to begin with an assumption that the state would earn optimistic returns. He had been instructed to keep a cash infusion below \$3 billion due to concern about maintaining reserves. Third, benefits were fixed; the governor's plan had to pay the same benefits that any other plan had to pay. Given a down payment and the fact that the debt would be paid off the question became how much was required on an annual basis and for how long, which was the only difference between the plans. The concern was not so much about which plan was cheapest in the long-term, but about which was cheapest for the next 10 to 15 years when there may be a cash call for a gasline and other items. The plan in the bill reduced annual costs at the consequence of higher payments later on.

4:24:19 PM

Co-Chair Stoltze asked if members had any additional questions about the TRS component of the bill.

Representative Holmes directed attention to pages 13 and 14. She observed that the section changed the percentage of a district's basic need used to calculate required local contributions from 45 to 40 percent. She asked for detail on the proposed change.

Mr. Teal answered that as TRS payments were run through the foundation formula the funds were added to basic need. He detailed that basic need would be increased in every district and was totaled by \$150 million or more per year. In most communities the required local effort was unrelated to BSA and basic need in any way; the payment was 2.65 mills multiplied by a property. He detailed that in the North Slope Borough, Skagway, and Valdez due to expensive nonresidential property it became a huge amount of money; therefore, the amount was limited to 45 percent of basic need. He elaborated that if basic need was going to be increased by the large sum; 45 percent of basic need would be increased. He explained that the school districts received their share of the \$150 million, but it did not add to the total they had to spend. Reducing the required local contribution from 45 percent to 40 percent allowed school districts to escape paying tax on the TRS portion.

Representative Holmes asked for verification that the provision was not intended to change the amount of local contribution once the funds were funneled through the formula. The intent was to hold required local contributions steady. Mr. Teal replied in the affirmative. He added that it only applied to three communities.

Representative Wilson surmised that the districts would look at the 2.65 mills or the 40 percent; whichever was more. She wondered if the 2.65 mills could be lowered. Mr. Teal replied in the affirmative. He elaborated that if the communities paid 2.65 mills they would pay significantly more money; the 40 percent would cap their local contribution. He confirmed that the 2.65 mill rate could be changed; it would not change the amount received by school districts, but would shift costs from local to state or vice versa. He expounded that if the mill rate was increased costs would be shifted from state to local government; whereas, a reduced rate meant the state would pay more.

Representative Wilson wondered whether the change from 45 percent to 40 percent would alter the amount the three

districts received from the state. Mr. Teal replied in the negative. He detailed that it was a rough attempt to keep the district's current contributions the same. Basic need was increased; the districts would receive the same amount of money, only the share would differ. He elaborated that 40 percent of basic need plus TRS was equal to 45 percent of what the districts currently received.

Representative Wilson surmised that the adjustment was necessary because the TRS component had been added. Mr. Teal replied in the affirmative.

4:30:08 PM

Representative Gara spoke to the amounts of money the BSA raised for various districts under the bill. He referred to an \$8 million deficit in the Fairbanks school district. He asked for verification that the bill raised roughly \$6.5 million [for Fairbanks]. Mr. Teal did not know.

Representative Gara referred to projections that under the bill the BSA increase would result in an extra \$6.5 million for Fairbanks. He wondered if LFD had looked at the figures. Mr. Teal replied that he had only looked at totals.

Co-Chair Stoltze interjected that concise documents including the information would be provided to the committee.

Representative Gara asked for verification that the money projected to be raised assumed that the \$25 million included in the operating budget (and distributed as if it was BSA funding) remained.

Mr. Teal replied in the affirmative. He noted that the bill was seen as "what does this bill do." He did not know what the legislature would decide on the money in the operating budget.

Co-Chair Stoltze surmised that Mr. Teal assumed the money was new. Mr. Teal replied that his assumption was that the bill raised the BSA by \$185. He elaborated that if the operating budget conference committee took the Senate position that included \$100 million outside the BSA there would be substantial money designated for school districts. However, if the decision was made that the \$185 increase

allowed other funding to be reduced to zero, it would back off \$25 million of the increase.

Representative Gara asked if the \$25 million was no longer in the budget the BSA increase under the bill would be roughly \$100 less than projections. Mr. Teal replied that the BSA increase in the bill was \$185. He relayed that if the operating budget outside of the formula money were removed the effective increase would fall to \$85.

Co-Chair Stoltze remarked that irrespective of other actions there would be \$185 in the BSA; with the additional increment the figure would increase to \$243. The BSA would increase by \$301 in two years' time.

[4:34:24 PM](#)

Mr. Teal replied in the affirmative.

Co-Chair Stoltze stated that the increases would all be permanent, but were "not subject to the vagaries of year-to-year appropriations."

Representative Gara noted that no one legislator spoke for another legislator; however, he had concerns about a statement he had heard that the \$25 million would be removed. He surmised that if the \$25 million was removed the BSA increase in the bill would be \$85. Mr. Teal replied in the affirmative.

Co-Chair Stoltze asked members to provide amendments to his office by 5:00 p.m. that day.

HB 278 was HEARD and HELD in committee for further consideration.

#

ADJOURNMENT

[4:38:21 PM](#)

The meeting was adjourned at 4:38 p.m.