

SENATE FINANCE COMMITTEE
January 24, 2014
9:04 a.m.

[9:04:41 AM](#)

CALL TO ORDER

Co-Chair Kelly called the Senate Finance Committee meeting to order at 9:04 a.m.

MEMBERS PRESENT

Senator Pete Kelly, Co-Chair
Senator Kevin Meyer, Co-Chair
Senator Anna Fairclough, Vice-Chair
Senator Click Bishop
Senator Mike Dunleavy
Senator Lyman Hoffman

MEMBERS ABSENT

Senator Donny Olson

ALSO PRESENT

David Teal, Director, Legislative Finance Division.

SUMMARY

SB 119 BUDGET: CAPITAL

SB 119 was HEARD and HELD in committee for further consideration.

SB 120 APPROP: OPERATING BUDGET/LOANS/FUNDS

SB 120 was HEARD and HELD in committee for further consideration.

SB 121 APPROP: MENTAL HEALTH BUDGET

SB 121 was HEARD and HELD in committee for further consideration.

FY15 Budget Overview: Legislative Finance Division

#sb119
#sb120
#sb121

SENATE BILL NO. 119

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

SENATE BILL NO. 120

"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."

SENATE BILL NO. 121

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

[9:05:26 AM](#)

Co-Chair Kelly discussed the meeting's agenda.

^FY15 Budget Overview: Legislative Finance Division

[9:05:51 AM](#)

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, spoke to a presentation titled "FY15 Budget Overview"(copy on file). He stated that the Legislative Finance Division (LFD) was statutorily charged with budget review functions, which included the overview publication that was intended to get the committee off to good start for the subcommittee process; the document had been delivered to members' offices the prior Wednesday. He pointed out that the state was facing a deficit in the current fiscal year and that it had one the prior year as well.

Mr. Teal discussed slide 1 titled "Figure 1. December 2013 Revenue Forecast with Projected Expenditures (\$ millions)" and thought that it appeared that the FY15 deficit may be the first of many deficits that the state would face in the next 10 years. He stated that the FY14 pre-transfer deficit was about \$2.2 billion, which represented about 45 percent of the state's unrestricted General Fund revenue; the state's revenue was about \$5 billion. He pointed out that the \$2.2 billion deficit was reduced by transfers. He stated that the revenue forecast appeared to be slightly pessimistic so far and that both the price and production were a little above the projected amounts; he thought that the forecast might be about \$300 million too low. He related that if you took off the \$300 million and assumed that the deficit at the end of FY14 was about \$1.6 billion, it would still take one-third of the Statutory Budget Reserve (SBR) Fund to eliminate the deficit.

Mr. Teal stated that for FY15, the governor's fiscal summary showed a deficit of about \$1 billion; however, this figure was before the legislature added capital projects. He assumed that the legislature would add capital spending to the governor's proposal. In addition to the capital proposals, there would be \$700 million to \$1 billion of retirement assistance that the governor proposed to pay for with the Constitutional Budget Reserve (CBR) Fund rather than General Funds. He related that not accepting the governor's proposal in full and using general funds for the retirement contributions would represent another \$700 million. He stated that the governor's budget showed about a \$1 billion deficit; however, if you added \$400 million in capital projects and used \$700 million for retirement assistance, the budget would be back in the neighborhood of a \$2 billion deficit.

[9:10:05 AM](#)

Co-Chair Meyer noted that Mr. Teal was referring to the unfunded liability and the obligation of the state for \$700 million. He noted that one of the options the governor had suggested was doing a \$3 billion cash infusion, but believed that it was not shown in the budget as spending. He inquired if the \$3 billion would be accurately depicted as spending rather than a fund transfer. Mr. Teal responded that technically, the governor's presentation was correct and that the CBR was not considered unrestricted General Funds but was considered other funds; the governor's budget

showed the \$3 billion in the other funds column as an expense. He added that the governor also showed the \$3 billion as a transfer that withdrew from the CBR and that it appeared to be a net zero; however, it was only a net zero after transfers. He pointed out that LFD tended to look at the pre-transfer numbers because it was thought that it was more in line with cash flow. He stated that when trying to live within your means, cash flow mattered more than the post transfer numbers that eliminated a deficit by withdrawing money from a savings account. He thought that both the pre and post-transfer numbers were useful and had different purposes. He believed that it was valid to look at the infusion as \$3 billion taken from reserves that the state expected to spend perhaps for other purposes.

Mr. Teal relayed that the state constitution required that the CBR be repaid anytime money was drawn from it and that the second issue was how it would be repaid. He offered that at some point in the future, the legislature would have to use General Funds to pay off the liability to the CBR; in this sense, it was not a General Fund expenditure currently, but it would be in the future. He pointed out that the state constitution only stated that the CBR would be paid, but did not specify when; as a result, 10 or 15 years could go by before it was paid back.

Senator Bishop inquired if the \$3 billion, or whatever the draw was, would at some point in time show up as General Fund spending. Mr. Teal replied in the affirmative.

Senator Hoffman thought that the prior year, the legislature had anticipated a draw from the SBR of \$250 million; this amount had to be adjusted and was substantially higher than \$250 million. He inquired if the draw from the SBR as of June 30 in the current year had been closer to \$500 million. Mr. Teal responded that the state was currently looking at a draw from SBR of about \$1.9 billion after transfers; the cash-flow deficit was about \$2.2 billion.

Senator Hoffman inquired what the anticipated deficit had been. Mr. Teal replied that he was unsure of what the deficit had been projected to be at the end of the last session, but thought that it was about \$1 billion less.

Co-Chair Kelly inquired if Mr. Teal was referencing the deficit from the SBR. Mr. Teal responded that they were the

same answer because the deficit would be filled first from the SBR.

Co-Chair Kelly inquired if the anticipated deficit had been \$250 million. Senator Hoffman stated that his point was that the deficit turned out to be substantially higher than was anticipated because of lower oil prices and lower throughput; the state was farther behind than it had originally anticipated.

9:15:30 AM

Mr. Teal stated that there was a deficit in FY13 of \$250 million and that anticipated FY14 deficit was about \$1 billion; however, the FY14 deficit would be closer to \$2 billion. He referenced slide 1 one of the presentation and related that similar deficits were projected throughout the forecast period. He noted that the forecast expenditures were based on zero growth in agency operations, a flat \$800 million per year capital budge, and that the state was basically looking at a no growth budget with the exception of retirement assistance. He furthered that the slide was not reflective of the governor's proposal, but kept the state where it was with an increasing amount of General Funds towards retirement assistance. He noted that the slide's budget stayed relatively flat and went from \$6.7 billion to \$7 billion by the end of the period. He observed that the slide's blue line showed revenue going up a little and then down a little over the same period; he believed that deficits would be nearly \$2 billion and sometimes up to \$2.5 billion over that time period.

Mr. Teal thought that some may wonder how likely it would be that the legislature would adopt a no-growth budget. He noted that he was not before the committee to tell it what to do or the chances of success, but that he could say that adopting a no-growth budget would be very difficult. He relayed that it was difficult to reduce budgets, let alone having a no-growth budget for many years. He reported that the annual rate of growth in agency operating budgets had been over 7 percent annually for the last 8 years.

Co-Chair Kelly noted that the prior year's budget was not a 7 percent increase and that there were indicators that it was the will of the committee to drastically slow down the rate of growth. Mr. Teal responded that the FY14 growth had

been quite a bit lower than the previous year and that the governor's FY15 proposal was almost a no growth budget.

Co-Chair Kelly clarified that he did not want to criticize the legislators that came before him for the expanded budgets and that he did not know that he would not have been in the exact same boat.

Mr. Teal pointed out that the former members may have had big budgets, but that they also saved a "pile" of money and had they not set aside \$15 billion, the current situation would be much worse than it was.

9:19:27 AM

Mr. Teal addressed slide 2 titled "Figure 2. Budget Reserves (CBR and SBR) under the December 2013 Revenue Forecast and Indicated Expenditure Assumptions(\$millions)" and stated that he could depict what would happen if the revenue forecast was correct and if a no growth budget with the exception of retirement costs was achieved; he offered that it was not a pretty sight. He asserted that even if the state constrained budget growth, reserves of about \$15 billion would disappear by 2024; at this time, the state would be in for a hard landing because without reserves, it would have to cut \$2.5 billion from its budget in a single year or borrow the funds in order to make it through. He reported that there were several options available for reaching a sustainable budget or achieving a softer landing. He stated that the options included broad-based taxes such as income and sales tax, as well as eliminating the Permanent Fund Dividends; both of these options had proven to be unpopular in the past with both legislators and citizens. He stated that capital budget reductions were also a possibility for achieving a sustainable budget and pointed out that the state had always viewed the capital budget as the "shock absorber" for the budget. He pointed out that capital budgets may be high currently, but that they would drop drastically when the revenues shrank; however, while this was true, recent budgets had contained many phased projects. As a result of the phased projects, the flexibility of reducing the capital budget like in past was no longer there, assuming that the legislature wanted to continue fund those types of projects.

Mr. Teal alluded that no one wanted to pull the plug on the Susitna-Watana Hydroelectric Project, the Knik Arm Bridge

and Toll Authority, Fairbanks natural gas, or the instate gasline; however, if spending was not reduced on those capital projects, capital budgets would be very difficult to reduce. He offered that one of the state's toughest decisions would be deciding whether it could afford all of the major and smaller capital projects and whether it would have to reduce capital spending and in some cases, take back money that had been appropriated for some of the big projects; he added that this was a decision that the committee would have to make.

Mr. Teal stated that a third option was to review agency budgets and reported that LFD had prepared look-back graphs the last several years. He relayed that the purpose of these graphs were to clearly show what programs and allocations had increased, while at the same time looking at what value the state had received for that money. He reported that the look-back graphs were also prepared to allow the legislature to look at where the spending occurred so that it could be unwound if necessary. He related that reducing the budget was not an easy task any way you looked at it, particularly when over 60 percent of revenue was spent on the 3 cost drivers of Medicaid, pre-K through 12 education, and retirement assistance; he thought that given the revenue forecast, these 3 items tended to be almost the entire revenue stream if they were allowed to continue growing the way they had in the past.

[9:24:41 AM](#)

Co-Chair Kelly noted that the 3 items in reference had grown rather quickly and thought that a graph had showed that the 3 main drivers would eat 99 percent of the operating budget by a certain year; he inquired what year that was. Mr. Teal responded that it was 2024, but that it was more important to look at the trend rather than what year or the number on the top of the graph. He stated that revenue was going down and the expenditures on the 3 main drivers were going up.

Co-Chair Kelly recalled giving a presentation in 1998 to a class at the university. He remembered that PERS and TERS and was not an issue at the time, but that the state had been dealing with education and Medicaid. He thought that at the time, Medicaid had been expanding by sometimes \$120 million per year and that it was only a matter of years

before that driver ate the budget; as a result, he understood what Mr. Teal was trying to portray.

Senator Dunleavy inquired if Mr. Teal had looked at Scott Goldsmith's work with the Institute of Social and Economic Research. Mr. Teal responded in the affirmative.

Senator Dunleavy inquired how closely Mr. Teal's assumptions paralleled Mr. Goldsmith's. Mr. Teal replied that they paralleled fairly closely. He noted that Mr. Goldsmith was looking at attaining a sustainable budget and thought that Mr. Goldsmith's approach was to convert oil reserves to some sort of cash flow; he thought that approach was interesting, but that he did not think of the issue quite so long term. He opined that 10 years out was a long time and thought that simply trying to keep in line with revenue over those 10 years would be hard enough.

Senator Dunleavy inquired if Mr. Teal's assumed structural deficits paralleled closely to Mr. Goldsmith's. Mr. Teal responded in the affirmative.

Co-Chair Meyer inquired if the state was better off not doing the \$3 billion cash infusion from the CBR that the governor was suggesting; he further inquired if it would make the CBR last longer if the \$3 billion was left alone. Mr. Teal responded that any plan to take money from reserves would reduce future state assistance and that the governor's plan was to reduce the assistance to \$500 million per year. He spoke to slide 2 and related that you could see a constant, rapid drop and that the money ran out in FY23. He explained that if one took the \$3 billion and put it into retirement, the future retirement expenditures would be dropped to \$500 million per year. He continued that if the \$3 billion infusion were enacted in the model on slide 2, the slope of the graph for reserves was a little lower than it used to be because there were lower deficits in future years; however, there was a \$3 billion drop and therefore, the cash infusion would not extend the life of the reserves.

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Senator Hoffman directed the committee's attention to slide 2 and questioned what Mr. Teal was assuming would be capital spending on the out years. Mr. Teal responded that the assumption was \$800 million per year, but noted that it

was merely an assumption. He input a \$600 million capital budget and the governor's proposal into the chart to demonstrate what it would look like for the committee; he noted that it did extend the life of the reserves. He stated that there were other options regarding retirement and that one that he had discussed with the chairmen was a more "pay as you go" kind of approach; adopting this idea just for PERS would represent another change. He relayed that there were options and that he did not think it was that gloomy. He added that he was fairly optimistic because he believed the revenue forecast was slightly pessimistic.

Co-Chair Kelly inquired if Mr. Teal could plug in a \$50 million per year reduction to the operating budget into the chart on slide 2 to see what that would look like. Mr. Teal input the figures and noted that the change that he was showing was actually a 2 percent reduction per year; it made the scenario much better, but was actually represented a reduction of \$75 million to \$80 million per year. He showed the committee what a 1 percent reduction per year would look like and stated that in this scenario the state's reserves would still be going down, but would probably extend until the early 30s [2030s]. He thought that the operating budget was critical and that it was the growth in the operating budget that had put the state at its current budget levels; reducing the operating budget by even \$50 million per year would leave the state much better off in the future.

Mr. Teal stated that he did not look at the chart on slide 2 and think that there was an inevitable crash in 2023. He shared that in 1998 and other years, the legislature and the governor had stepped up and held back budgets. He offered that some could say that oil prices had bailed the state out, but opined that it had not been just the price of oil; expenditures had been restrained when they needed to be restrained.

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Mr. Teal continued to address slide 2 and stated that it was focused more on the future than on the FY15 budget itself. He noted that Ms. Rehfeld had been to the committee and discussed the FY15 budget. He stated that he had no quarrels or differences with Ms. Rehfeld's presentation, but noted that she was trying to outline the governor's policy. He did not have much to say regarding the

governor's policy and plans, and related that his presentation was more technically oriented. He thought that you could not make good FY15 decisions without looking ahead; furthermore, regardless of what the committee chose to do, LFD would be ready to assist with getting through the FY15 budget or taking a longer-term view of state revenues and expenditures. He noted that most of his presentation was taken straight from the overview, which could be found in the copy room and on the web. He stated that the overview had the fiscal summary, a review of the language sections, and a write-up for each of the agencies for subcommittee work.

Co-Chair Kelly inquired if members had larger questions about the budget for Mr. Teal to address.

Senator Dunleavy observed that the committee could shift priorities around within the operating budget. He stated that putting more money into education was fine, as long as other areas within the operating budget were reduced and the overall number was not exceeded. Mr. Teal replied that if the state wanted to hold the line and spent more money in one area, it would need to spend less on other things.

[9:36:02 AM](#)

Vice-Chair Fairclough thought that the conversation was intellectual and wondered if there needed to be criteria set as budgets were looked at. She pointed out that Alaska had many years of oil providing its revenue and thought that looking too far out in the future might result in the state not making the best decisions with the dollars that it had today. She wondered what the state was doing to analyze every dollar that it invested and stated that there was no magic bullet. She recalled serving on a fiscal policy subcommittee and stated that it had documented every project that it could find that was out there in order to review any options that Mr. Teal had provided; she offered that none of those options were palatable to Alaskans. She opined that Alaskans wanted the state to protect the permanent fund and did not, in her opinion, support a state-income tax by a margin of 50 percent plus 1; furthermore, Alaskans did not support a sales tax on top of other municipal taxes. She opined that given the options that Alaskans were opposed to, there was very little opportunity except to examine the reserves and invest them

in a way that had a greater rate of return in order to start digging the state out of the hole it was in.

Vice-Chair Fairclough noted that the following Tuesday, the committee would start talking about investment opportunities and noted that an issue was whether Alaskans should invest in a natural gas pipeline; it was yet to be determined if this was a good move for Alaska. She thought that if the committee took the gas pipeline under advisement, it would be an opportunity to invest where the state might see a greater rate of return on a longer horizon like a 20-year commitment. She noted for those who might be afraid of a 20-year commitment that if the Alaska was in the project as a partner with a company that would see profits over the 20 years, the state would receive that profit too and its dollars would be generated twice; the state's dollar would generate in its ownership interest, as well as revenue to shareholders.

Vice-Chair Fairclough wondered if there was something that the state was not considering in the financial markets, if the committee or LFD was reviewing opportunities regarding what the Department of Revenue (DOR) was doing in the state's subaccounts, if there was another way to use the dollars that were in front of the committee to dig quicker on behalf of Alaska, and what kinds of financial resources needed to be utilized to look at every dollar the state was investing. She thought maybe the committee should look at the formula driven areas to see if it was getting the investment return from a financial perspective. She spoke about education and related that the state was getting a big bang for its buck in trying to reach all students and provide them with the best opportunities. She stated that the committee would "shift in forward", that it needed to go "faster than 25 miles an hour, but we don't need to break the speed limit."

Vice-Chair Fairclough opined that if the state was running just to stay away from the fiscal cliff in 2024, it would not be making the best decisions. She recalled watching the state go up and down with the price of oil and oil production. She wondered if the state's horizon should be 1 year, which she thought was a mistake, or if 10 years was the right timeframe. She expressed concern that looking at 2024 and the fiscal cliff was not making her think positively about what the best decision for Alaska was currently. She supported holding the line, but wondered

what the committee could do in its jurisdiction to help guide Alaska in making good, prudent decisions and inquired what the committee's strategic plan was.

[9:41:23 AM](#)

Co-Chair Kelly stated that when looking at the horizons, the price of oil versus production, and other factors that the state rose and fell on, he came to the conclusion that regardless of the price or production a \$6 billion operating budget was not justified. He didn't think that a \$6 billion operating budget was survivable under any scenario. He recalled speaking with DOR and relayed that they had been very optimistic regarding the dollars that would come to the state treasury from a gasline, although it had been the mantra for years that a gasline would not provide much in revenue.

Vice-Chair Fairclough interjected that ownership in a gasline would provide good revenue. Co-Chair Kelly agreed.

Co-Chair Kelly offered that even with ownership in a gasline, the state would not survive a \$6 billion operating budget that was growing in addition to other unknowns. He opined that the state was probably in for some down times on its returns on investments due to market factors. He thought that capital budgets, investments, and other things were all necessary for the committee to look at the future, but that those were revenue areas; whereas, mostly the committee members, "for now" were facing expenses that needed to be addressed. He added that his comments were not meant to disagree with anything that Vice-Chair Fairclough had said, but that her comments had made him think about the issue further.

Vice-Chair Fairclough noted that Scott Goldsmith had stated that an operating budget level of 5.5 [billion dollars] was a sustainable number and wondered how long the state would have to hold that level if it was achieved.

Co-Chair Kelly corrected that the 5.5 [billion dollars] was in reference to the total capital and operating budgets and was not just the operating budget.

Vice-Chair Fairclough noted that regardless of what the number was, her point was the time value of money and how long it would be before that number started going up. She

inquired if the state would have to hold the 5.5 [billion dollars] for 1 year, 3 years, 5 years, or forever. She noted that Mr. Goldsmith was basing his assumptions purely on the revenues that were in the ground and the assets that were there under current assumptions. She inquired how Alaska could change the dynamics and if there were any levers within "that" proposal that would allow the state to do something different.

Vice-Chair Fairclough provided an example that in the past, there had been a proposed \$2000 charge for out-of-state fishermen who wanted to harvest a king salmon in Alaska; she clarified for the record that she was not suggesting using this example and observed that it was extreme. She offered that the calculation might have been based off the current king salmon tags that were taken. She concluded that the state did have options and expressed a desire to solve the problem. Mr. Teal stated that the number was roughly \$5.5 billion per year, which he had achieved in his the model by assuming zero growth and a zero capital budget; however, it did not matter because spending was the same whether it was capital or operating. He noted that the point was that the total spending was about \$5.5 billion per year; furthermore, if you looked at what this did to the reserves on slide 2, the problem went away. He concluded that his model, which just examined revenues and expenditures year-by-year, reached very similar conclusions to Mr. Goldsmith's longer-term view of the world.

Mr. Teal addressed earlier comments about possible investment opportunities for the state and thought that the discussions were extremely valuable; however, he suggested that the committee should consider that it did not have much time for those discussions. He pointed out that the longer the delay and the closer Alaska got to that fiscal cliff, the fewer options there would be. He reported that Alaska currently had billions of dollars to invest, but that as money was spent and deficits continued, the reserves would get lower and lower; as result, Alaska would not have the same investment capital available.

Mr. Teal addressed Vice-Chair Fairclough's earlier comments regarding needing to move faster and agreed with them. He stated that now was the time for the discussions because if they were started in 2022, the options would no longer be available.

9:48:15 AM

Senator Hoffman thought that when looking at the drawdown of CBR and SBR, people needed to realize that the state did not have a balanced budget without reserves; he opined that that the average Alaskan did not realize this and that it was a problem. He offered that the vote on SB 21 the prior year had been meant to flatten out the oil decline and turn it around; furthermore, he and everyone else were unsure when it would turn around or flatten out. He opined that SB 21 had been one of the solutions the prior year and that in the current year, the state was looking at indefinite deficit spending unless something happened; he reiterated that average Alaskan did not realize this.

Co-Chair Kelly thought that Senator Hoffman raised a good point.

Vice-Chair Fairclough responded to comments by Senator Hoffman. She noted that the issue was confusing because Alaska had a changing tax regime and that the "number" looked very similar to the state's deficit. She offered that the production and price of oil were "driving almost all of this"; furthermore, the production had fallen, but the price had risen. She stated that when looking at the global market, it appeared as though unless there was a war or some other event, that oil prices may go down as America became more energy independent and that Alaska's gas may be less or more valuable if it could be brought to a spot market and shipped. She offered that Alaska had to have a healthy industry and related that it was disheartening to hear SB 21 tied to "this"; she acknowledged that SB 21 was part of "it," but that the bill was also part of the solution as well. She noted that the committee had asked its finance people to be conservative and that it wanted to have budget numbers that exceeded projection versus the other way around where the state did not have the money. She stated that she did not mind being on the other side of the conversation on SB 21 and discussing it, but believed that currently, at a price of \$105 per barrel of oil, the state was performing better; furthermore, it was anticipated that these numbers would stay the same.

Vice-Chair Fairclough continued to address earlier comments by Senator Hoffman and noted that the committee could do the comparison and discuss SB 21, but believed that the

only way that ACES could perform better was in the progressivity portion if oil prices spiked.

Senator Hoffman shared that his point was that the average Alaskan did not realize that in the future, the committee did not foresee a balanced budget without reserves; furthermore, unless things changed, someday the state would have no reserves.

Co-Chair Kelly observed that there were disturbing reports that the Chinese economy might tank, which could drive the price of oil down dramatically if it happened.

[9:52:45 AM](#)

Senator Bishop noted that depending on the modeling, the state could be out of funding at some point in the future. He pointed out that the Alaska was focused on oil and gas and wondered how the state would capitalize and spend its capital dollars on projects going forward.

Senator Bishop observed that mining was not being discussed much in relation to the budget issues, but thought that the industry had added the most jobs in Alaska in the last several years. He pointed out that Alaska was a resource-rich state that was 50 years behind the rest of the world on discoveries. He thought that mining would be a huge opportunity going forward for Alaska's economy and was a real bright spot. He stated that there were positives going forward and that mining ought to be a central driver. He believed that the state should be focused on projects that would add revenue to the state treasury going forward.

Co-Chair Kelly noted that one of the problems that the state always had was that increasing economic development did not always do things for the treasury because Alaska did not have the structures in place, such as taxes or fees that provided significant revenue to the state. He thought that tobacco provided the second highest amount of money to the state treasury, which in his opinion was pretty "zany."

[9:55:24 AM](#)

Co-Chair Kelly discussed the following meeting's agenda.

SB 119 was HEARD and HELD in committee for further consideration.

SB 120 was HEARD and HELD in committee for further consideration.

SB 121 was HEARD and HELD in committee for further consideration.

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ADJOURNMENT

9:56:08 AM

The meeting was adjourned at 9:56 a.m.