

HOUSE FINANCE COMMITTEE  
March 30, 2015  
1:46 p.m.

1:46:20 PM

CALL TO ORDER

Co-Chair Thompson called the House Finance Committee meeting to order at 1:46 p.m.

MEMBERS PRESENT

Representative Mark Neuman, Co-Chair  
Representative Steve Thompson, Co-Chair  
Representative Dan Saddler, Vice-Chair  
Representative Bryce Edgmon  
Representative Les Gara  
Representative Lynn Gattis  
Representative David Guttenberg  
Representative Scott Kawasaki  
Representative Cathy Munoz  
Representative Lance Pruitt  
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Laura Pierre, Staff, Senator Anna MacKinnon; Elizabeth Nudelman, Director, School Finances and Facilities, Department of Education and Early Development; Sheri Thomas, Bristol Bay School District; Pam Leary, Director, Treasury Division, Department of Revenue; Jerry Burnett, Deputy Commissioner, Treasury Division, Department of Revenue.

PRESENT VIA TELECONFERENCE

Mark Foster, CFO, Anchorage School District, Anchorage; David Nees, Self, Anchorage; Deena Paramo, Superintendent, Mat-Su Borough School District, Mat-Su.

SUMMARY

HB 68 ELECTRONIC DISTRIB. OF REPORTS

HB 68 was SCHEDULED but not HEARD.

HB 86 PCE ENDOWMENT FUND INVESTMENT

HB 86 was HEARD and HELD in committee for further consideration.

SB 64 SCHOOL BOND DEBT REIMBURSEMENT

CSSB 64(EDC) was REPORTED out of committee with a "do pass" recommendation and with one previously published indeterminate fiscal note: FN1 (EED).

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Co-Chair Thompson discussed the agenda for the day.

#sb64

CS FOR SENATE BILL NO. 64(EDC)

"An Act relating to school bond debt reimbursement; and providing for an effective date."

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LAURA PIERRE, STAFF, SENATOR ANNA MACKINNON, discussed the bill sponsored by the Senate Finance Committee that would sunset the school bond debt reimbursement program for five years. She detailed that after the five-year period the program would be reinstated at reduced levels. She elaborated that currently the state reimbursed for standard major maintenance and school construction at 70 percent and at 60 percent for nonstandard construction and maintenance. The legislation would reduce state reimbursement to 50 percent and 40 percent respectively.

Representative Kawasaki noted that some ballots had already been mailed for an upcoming Anchorage election. He referred to the legislation's retroactive date of January 1, 2015 and wondered if there would be any legal implications if the bill passed.

Ms. Pierre replied that Legislative Legal Services had advised that the retroactive date was legal. However, the

bill would need to be signed prior to the election date of April 7, 2015.

Co-Chair Thompson noted that Representative's Edgmon and Munoz had joined the meeting.

Representative Wilson wondered why major maintenance and school construction had not been included given that they were 100 percent grant funded. She noted that the state was paid back for a portion on other items.

Ms. Pierre answered that the bill was specific to school construction and major maintenance projects. The Department of Education and Early Development (DEED) had other programs that it reimbursed for other school projects.

Representative Wilson understood. She stated "since we're looking at school construction debt, whether it's through a grant program or 70/30 or 60/40 - was that considered as part of this bill - and for maybe some reason that I don't know, that they went with just the bonding and not these other two programs."

Ms. Pierre replied in the negative. The Senate Finance Committee specifically wanted to address debt service.

Co-Chair Thompson noted that DEED staff were available for questions.

Vice-Chair Saddler asked if the bill would prevent the legislature from appropriating funds to a school in the event of an emergency (e.g. damage from a flood, earthquake, or other). Ms. Pierre replied in the negative.

Co-Chair Neuman asked for an explanation of major maintenance and how that type of program was generally funded. He asked for detail on how programs for school bond debt reimbursement for new schools could also go for maintenance. He noted that there were separate maintenance programs.

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ELIZABETH NUDELMAN, DIRECTOR, SCHOOL FINANCES AND FACILITIES, DEPARTMENT OF EDUCATION AND EARLY DEVELOPMENT, answered that DEED had two primary funding programs for school facilities. The bill addressed the debt program,

where municipal school districts applied for a project; criteria that allowed projects to be reimbursable was designated in statute. She detailed that the program could be used in the event of needed construction for unhoused students, life-safety issues requiring major maintenance, necessary changes for improvement of instruction, and other. The project was required to meet the criteria and to apply for the debt program; if requirements were met, the project would be either 60 or 70 percent reimbursable. The reimbursable rate was based on whether the space qualified within the department's calculation. She detailed that once the requirements had been met, the municipality was responsible for selling the debt and moving forward on the construction process. Additionally, the municipality was responsible for submitting a request for reimbursement on an annual basis (for either 60 or 70 percent).

Ms. Nudelman highlighted that the second funding program was a grant program. The program was available to Regional Education Attendance Areas (that did not have the legal capacity to bond) and municipal school districts. All school districts could apply through the grant program. She stated that the grant applications were due annually on September 1; districts were required to apply on the construction list or the major maintenance list depending on the project. She elaborated that the department ranked the projects on each list from 1 to 150 (beginning with 1 as the neediest project). The lists were provided by DEED for the governor's budget and on to the legislature for its consideration. She summarized that the bond debt reimbursement program was available to municipalities and the grant program was available to all districts.

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Co-Chair Neuman asked for clarification that the bill applied to two separate bond debt programs: bond debt reimbursement to municipalities for school construction and major maintenance for indebtedness.

Ms. Nudelman answered in the affirmative. She detailed that the debt program covered construction and major maintenance.

Representative Gara asked what qualified for 70/30 and 60/40 reimbursement (under the legislation the

reimbursement rate would change to 50/50 and 40/60 respectively in five years).

Ms. Nudelman replied that each project had to qualify under the statutory requirements as an educational project in one of the categories the program provided for. She explained that if a project would add space or replace space there was a DEED calculation providing for a certain square footage per Average Daily Membership. She elaborated that projects were eligible for the 60/40 reimbursement if the new space was larger than the space calculation allowed for. She added that if the new space met the DEED space guidelines it would be eligible for the 70/30 reimbursement.

Representative Gara asked for verification that the distinction was purely related to the department's space guidelines and was not related to a distinction between major maintenance and new construction. Ms. Nudelman replied that the space issue only arose in new construction projects. She explained that there was not a space criteria related to major maintenance projects such as roof repair, fixing out of date code issues, or repairing a boiler. The only time the 70/30 or 60/40 came into play was for construction or major renovation projects.

Representative Gara asked for verification that general maintenance was 70/30. Ms. Nudelman replied in the affirmative.

Representative Gara understood the need for the state to save money and the proposal to go from 70/30 and 60/40 down to 50/50 and 40/60 respectively. However, he did not believe it was reasonable to let schools dilapidate for five years [before the reimbursement rate was reinstated at the lower rate]. He communicated that it had been over 30 years since the last major maintenance was done on any of the Anchorage schools; the schools had been built between 1956 and 1970. He asserted that it may be much more expensive to repair the schools in five years' time due to their decreased condition. Additionally, interest rates were currently near record lows; when interest rates rose, schools and debt would be more expensive.

Ms. Nudelman agreed that it may cost more in the future to repair a project that further deteriorated during the five-

year period. She relayed that she could not guess what interest rates would be in five years.

Co-Chair Thompson did not expect the department to project what kind of shape schools would be in five years from the present day.

Representative Gara spoke to a scenario in which projects were delayed for five years. He asked what the difference would be in the state's annual debt service if the school construction and maintenance currently on the ballot were allowed, compared to what it would be if the projects were blocked from moving forward. He relayed that Dillingham and other municipalities had bond related ballot propositions for the current year. He wondered about the difference in the state's annual debt service payments if the projects moved forward or if they were blocked.

Ms. Nudelman replied that the department's fiscal note was indeterminate. She elaborated that voters would first be required to authorize the debt. The department had not been able to aggregate the cost.

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Co-Chair Neuman stated that currently the state was paying approximately \$108 million in debt service towards new school construction and major maintenance. He wondered what the debt payment would be in five years if the state continued to pay down the current debt but did not provide any additional debt reimbursement during the given time period.

Ms. Nudelman believed the department had submitted the information.

Co-Chair Thompson asked his staff to copy and distribute the information to committee members.

Vice-Chair Saddler asked if the bill would prevent the legislature from appropriating funds to any clear needs that arose in school construction or maintenance. Ms. Nudelman replied in the negative.

Vice-Chair Saddler asked how much money the state had spent on school construction and maintenance over the past 10 years. He asserted that the state had spent significant

funds on the capital budget over the past 10 years. Ms. Nudelman replied that she did not have the information on hand.

Vice-Chair Saddler requested the information from the department. He wondered whether the department believed the state had been neglecting school construction and debt reimbursement over the past 10 years.

Ms. Nudelman replied that the two programs had processed numerous projects for school districts; the state had reimbursed the projects. She elaborated that the debt program had been open to any projects that qualified and the grant program had reimbursed as far down the list as the governor and legislature deemed appropriate.

Vice-Chair Saddler believed it appeared that municipal districts got to "double dip" with debt reimbursement due to their capacity to issue bonds; whereas, Regional Education Attendance Areas did not. He observed that urban districts also had the capacity to utilize the grant program as well. He asked for historical detail.

Ms. Nudelman answered that she had read the program back to the 1970s. She detailed that the state and legislature had taken action to meet the times; the grant program had been used and revised. She explained that it had simply been a choice; as the debt program became available, the grant program also remained open to municipalities.

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Representative Kawasaki wondered about the submittal process for the program. He referred to a memorandum addressed to the superintendent of the Anchorage School District notifying the district of approved projects pending legislative approval. He relayed that his school district had talked about the issue. He wondered how long it typically took for an applicant to receive approval from DEED.

Ms. Nudelman answered that the requirement to submit an application to DEED prior to going to voters for bond authorization, had been removed. She detailed that a municipal district could apply prior to or after voter approval. Therefore, she did not know the precise timelines. She added that typically most districts applied

to the department for debt as a first step to determine the eligibility of their project. She relayed that there were also several other major components that needed to be met after a project was deemed eligible.

Representative Kawasaki asked if there were other school districts currently in the queue that had applied. Ms. Nudelman was not aware of any other districts aside from Anchorage that had a letter seeking the department's determination on the project and its eligibility for the 60 or 70 percent reimbursement. She had heard that perhaps other districts had considered submitting an application; however, ultimately a voter approved initiative was required.

Representative Kawasaki wondered how far in advance a typical school district would seek the 60 versus 70 percent eligibility determination from DEED. He imagined that typically it was well before a municipality began advertising for elections. He wondered if the process typically began a couple of months prior to an election or much earlier.

Ms. Nudelman answered that the process could take place after an election; therefore, the timeframe varied. She elaborated that under current statute, a municipal school district could plan a project, go to the voters, and then ask for department approval.

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Representative Guttenberg wondered whether there had been an analysis about the cost-effectiveness of legislation. He believed it boiled down to what the expense of the projects would be in five years versus at present and a cost at a range of interest rates.

Co-Chair Thompson noted that Representative Guttenberg was asking for a prediction of interest rates in five years.

Representative Guttenberg wondered if an analysis had been done on the cost effectiveness. He noted that bond issuers modeled a range of costs and estimates. Ms. Nudelman replied in the negative.

Representative Guttenberg asked for clarification that Ms. Nudelman was only referring to the department. Ms. Nudelman replied in the affirmative.

Representative Guttenberg asked if any consideration had been given to expanding the bill to cover other things like highways, roads, bridges, or state buildings that used bonds.

Ms. Pierre replied in the negative. She addressed his previous question and relayed that when the Senate Finance Committee considered the legislation its goal had been to avoid incurring any additional debt. She elaborating that sun-setting the program for five years would prevent the state from incurring additional debt during the time period. She relayed that since the program's inception the state had paid out over \$3 billion.

Representative Guttenberg was concerned that the state's fiscal situation may not be considerably improved in five years. He hoped the worst case scenario would mean the state was facing the same thing with additional costs in five years' time. He elaborated that the state may not have the capacity to pay for the program in the future; it could be debatable whether the state currently had the capacity.

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Co-Chair Thompson referred to a handout titled "School Construction Debt Retirement" dated February 13, 2015 (copy on file). He noted that if the state incurred no additional bond debt it would take until 2034 for the state to pay off existing bonds; by that time it would have paid \$1,212,000,713. He remarked that the figure was significant.

Representative Gara stated that the way the bill was written the state's annual debt service would decrease a little each year for five years; however, the chart did not factor in that schools would come forward at the end of the five-year period with two to four times as many projects. He discussed holding off on elementary school projects in Anchorage and the rest of the state and reasoned that there would be a huge balloon in applications for bond debt in five years. He highlighted that the chart showed a \$6 million decrease in the annual debt service in six years. He stressed that the decrease would not occur and could

balloon out to over \$100 million. He wondered if the department had done any analysis on what the impact would be in five years when the state resumed paying for new bond debt.

Ms. Nudelman replied that the bill did not come from the governor. She relayed that the department had not reviewed the question.

Co-Chair Neuman remarked that the cost of the debt in five years was not known. He disputed the comment that the cost may exceed \$100 million. He elaborated that it was a known quantity that municipalities had the ability to apply and legislators had the ability to introduce legislation. He reasoned that a legislator could introduce legislation if they felt their school district's population had grown by thousands. He believed that asking the department to speculate was not applicable. He thought the questioning was out of order.

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Representative Gara remarked that he had not heard in any answers during the meeting that the bill would save the state money. He stressed that there was no financial information to rely on; no one had looked at what would happen if the state waited five years to fund [maintenance or construction] a 60-year old school. He emphasized that waiting five years to fund maintenance would mean schools would have many projects needing bond funding. He agreed that the cost of the bonds was not known; however, he believed it was pretend to say that the costs would go away. He stated that the legislation would only move the costs out into the future. He asserted that costs would rise if interest rates and damage to schools increased. He believed it was more responsible to adjust the reimbursement rate. He opined that the schools would still have needs in five years and that the state would probably have even less money than it had currently. He reiterated that the bill did not save money. He added that he did not support the retroactivity clause. He agreed that the state could no longer afford the 70/30 reimbursement rate given the state's current fiscal situation.

Ms. Pierre answered that the state could not afford to continue the program at present. Additionally, the legislation did not prevent districts from continuing to

bond or to prioritize needed projects. However, the districts would not receive money from the state.

Representative Gara believed that if localities had to pay 100 percent of the costs [for school maintenance and construction] the costs would be passed on to property tax payers. He opined that it would mean a massive property tax increase.

Representative Wilson asked for verification that the debt belonged to the municipalities and not the state. Ms. Pierre answered in the affirmative.

Representative Wilson noted that the state paid 70 percent of the debt in the 70/30 debt reimbursement scenario. She asked for verification that the state had the option to stop paying the debt. Ms. Pierre answered in the affirmative. She detailed that the state had the option to stop paying or short-fund the debt. She noted that the state had continued to pay the debt out of a moral obligation more than anything.

Representative Wilson surmised that it was all about the current debt. She wondered why the state would not choose to discontinue funding the debt altogether until it had more money. Ms. Pierre answered that she did not know of any conversation that had taken place on the idea.

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Representative Wilson did not see the cost as the state's obligation. She thought the state had been more than generous with the 70/30 and 60/40 reimbursement. She believed the state's obligation was to pay only if it had the money. She stressed that the state did not currently have the money. She believed the state could communicate that it would stop providing the funding and that municipalities would be responsible for the payment. She concluded that there either needed to be a moratorium on state reimbursement for five years or the state could discontinue payment. She thought a conversation on discontinuing payment would have been prudent.

Co-Chair Thompson believed that if the state did not pay and a municipality could not pay the entire amount that the state's bond rating would plummet.

Representative Wilson thought that it was determined prior to bond approval that municipalities could pay the entire amount. She hoped that the state was not allowing bonds to be approved if municipalities could not pay.

Representative Edgmon highlighted the collateral damage the bill could bring to a smaller school. He detailed that the Bristol Bay Borough School District was facing some serious structural challenges (a portion of the school was 45 years old and the other portion was 25 years old). He guessed that seasonal earnings from the borough's raw fisheries tax could float a bond, but it would not leave sufficient funds for other things. He communicated that the roof on the Naknek school had serious problems; fortunately there had not been a heavy snow load in the past couple of years. He relayed that in the event of heavy snowfall the roof could potentially collapse. He elaborated that the borough had been trying to get into the reimbursement program since 2012; it had received a letter from DEED that it qualified for the 60/40 split. Additionally, the borough had put up \$500,000 for design work. He believed the issue illustrated the dilemma of a smaller district getting caught in between other things going on. He stressed that the grant program was highly competitive and that it could take years for a school to make it to the top of the list. He underscored that the cost-benefit analysis was not currently known on a situation where the state allowed schools to get to a point of irreparable damage. The issue was of great concern to him. He asked what would happen if the roof on the Bristol Bay school collapsed. He wondered how the state would deal with the problem if \$2 million or other was needed in the middle of February.

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Ms. Nudelman replied that the local school district would need to decide where to relocate the students. She imagined that quickly thereafter the borough and the legislature would be presented with the decision on the best avenue to rectify the situation.

Representative Edgmon reasoned that the legislature could put money in the supplemental budget, which would be the following February; if the school could be renovated during the subsequent construction cycle it may be able to open the following September, which was almost 1.5 years of the downtime for the school.

Ms. Nudelman did not disagree with the timelines.

Representative Edgmon was concerned by the issue. He noted that the state would still be facing a \$1.2 billion liability if the current program was stopped in its tracks with a retroactive date of January 2015. He appreciated the presence of a couple of board members from his school district.

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Vice-Chair Saddler referred to criteria for the debt reimbursement and grants program. He asked Ms. Nudelman what she meant by necessary improvements to construction when discussing program eligibility.

Ms. Nudelman clarified that she had referred to "improvement to instruction." For example, a school could be eligible for the program if it needed to add room for special education services or other.

Vice-Chair Saddler believed there was a hierarchy of needs for education funding as there was for anything. He wondered how much of the debt reimbursement and grant money spent had gone towards life-safety projects.

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Ms. Nudelman did not want to guess. She reported that on the grant list all of the projects were considered. She detailed that a leaking roof that put a structure in harm's way would rank higher than some other projects. She relayed that the debt program was open to all projects; there was not a limit on the number of projects. She communicated that the limit was voter authorization.

Vice-Chair Saddler asked for verification that prioritization was not given to falling down roofs as opposed to renovations, improved cameras, or class systems.

Ms. Nudelman replied that raters ranked projects with points on a list of approximately 15 questions; questions included emergency and a life and safety category. She relayed that the life and safety category was heavily weighted. She shared that it would not completely negate a

non-life safety project from receiving enough points in other categories to rank alongside a life safety project.

Vice-Chair Saddler relayed the committee had heard of 60 year old schools that were falling down. He wondered how many 60 year old schools were operating in Alaska.

Representative Gara interjected that he had said nothing about schools falling down.

Vice-Chair Saddler asked how many 60 year old schools were operating in Alaska. Ms. Nudelman replied that she did not have the precise number. She stated that there were plenty of 60 year old schools in Alaska; plenty of them were delivering excellent education. She relayed that it depended on the useful life of the components and where they fell on the renewal schedule for the schools. She could not tell the committee if a school was in average or good condition based on its age.

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Vice-Chair Saddler asked if there was a median age of the school structures in Alaska. Ms. Nudelman that she would need to do some research for the information. She added that the state's schools were renovated; therefore, the age of the initial school and subsequent renovations needed to be considered.

Vice-Chair Saddler requested the information. He wondered what kind of metrics DEED had about the age and condition of Alaska's schools. Ms. Nudelman responded that DEED had a database of all of the state's school facilities. She detailed that the information was available on the department's website. She elaborated that the information about each facility based on school district was on the website. Additionally, the website showed the original facility date and any major remodels.

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Co-Chair Neuman believed committee questions had been asking a lot of the department. He asked if the schools belonged to the state or the school district.

Ms. Nudelman replied that approximately 95 percent of the schools belonged to the school districts. She elaborated

that some of those schools belonged to the school district and others belonged to the municipal government. There were very few schools that perhaps were once Bureau of Indian Affairs schools that may belong to the state. She expounded that schools in Regional Education Attendance Areas typically belonged to the school district; schools in municipality typically belonged to the municipality.

Co-Chair Neuman stated that the bottom line was that the state did not own the schools or decide when a school needed repair or replacement. Ms. Nudelman replied in the affirmative; statute clearly laid out who was responsible for school buildings.

Co-Chair Neuman wondered if a municipality's inability to pay its portion of a bond had any effect on the state's debt or credit rating. Ms. Nudelman replied that school districts were their own entities and received their own bond ratings through bonding sources. She elaborated that a school district would be looked at to determine if it could carry the debt.

Co-Chair Neuman clarified that it was not the state's responsibility. Additionally, he referred to Representative Edgmon's earlier question about what would occur if a school's roof collapsed. He wondered about the state's responsibility under the scenario.

Ms. Nudelman replied that the school would be owned by the municipality. She did not know of anything that would involve the state under the scenario.

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Representative Guttenberg asked how relevant the bill was if Ketchikan succeeded in its law suit against the state. Ms. Nudelman replied that the issues were separate. She added that there were many unknowns.

Ms. Pierre answered agreed.

Representative Gara apologized for getting "amped up." He relayed that Ms. Pierre had done a fine job presenting the bill. He understood that Senator MacKinnon was working to find a way to deal with the state's fiscal crisis as were other legislators. He expressed frustration with the information available on the topic.

SHERI THOMAS, BRISTOL BAY SCHOOL DISTRICT, spoke against the legislation. She read a prepared statement:

The Bristol Bay Borough and the Bristol Bay Borough School District have spent a significant amount of time and money developing a bonded reimbursable facility upgrade project. We started this project back in 2012. As a small borough it is taking a lot of time for us to work out all of the details. We are now ready to take this to the voters before the original deadline of May 1. Our facilities have been well cared for, but the buildings have reached or exceeded their lifespan. Our project is to focus on bringing our systems back to an efficient and sustainable state. We are currently spending over \$2,900 per student a year on energy costs due to the outdated inefficient systems and declining enrollments. We struggled with meeting the 70 percent instructional funding requirements. Our community would need to have access to the debt reimbursable program in order to make this project a reality. Our borough does not have the resources to support a project of this magnitude.

We feel that retroactively changing the date to January 1 will effectively cancel our project. We would appreciate any consideration that you would make toward allowing the original May 1 date to stand. Additionally, we fear that the five-year moratorium on the new projects will have an adverse fiscal effect on the state's economy forcing many architects, engineers, and construction companies to go elsewhere for work. We hope you have studied what the impact will be and would advocate for a review of the moratorium duration.

MARK FOSTER, CFO, ANCHORAGE SCHOOL DISTRICT, ANCHORAGE (via teleconference), asked the committee to consider looking at the retroactivity provision in the bill. He relayed that the school district had been working over one year on compiling a bond proposal that had approved by the school board in September 2014 and the Anchorage Assembly in November 2014 (all of which was long before the legislative proposal to eliminate new debt reimbursement). He detailed that DEED had declared all of the projects on the Anchorage 2015 school bond list as eligible for debt reimbursement in the December 2014 determination. He relayed that currently

voters were operating in an environment where it was unclear that state reimbursement would occur. The Anchorage School District believed clarity and moving the date forward to allow its bond proposition to advance would be advantageous for all concerned. He emphasized that the bonds the district put forward addressed items that were frequently referred to as deferred maintenance (i.e. improving roofs and replacing worn out flooring, ceiling, walls, and doors). He stated that the improvements represented the kinds of things that accumulated over years that maintenance cycles could only keep up so much until the time came to renovate facilities. The school district worried that if the burden was completely shifted to local municipalities a problem similar to one experienced by the University of Alaska Fairbanks (UAF) may be created (the UAF deferred maintenance had been mounting over the years). He reiterated the district's request for the committee to consider changing the retroactivity provision back to the original legislation.

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DAVID NEES, SELF, ANCHORAGE (via teleconference), spoke in favor of the current version of the bill. He elaborated that the six-year plan for ASD included roughly \$500 million for projects in the upcoming five years; the cost would put the state an additional \$350 million in debt. He reasoned that it was necessary to stop somewhere. He stated that if the bill allowed various bonds that were floating in municipalities it would never "get off this merry-go-round." He stated that a five-year timeout allowed everyone to rethink how to take care of maintenance in schools. He continued that prior to the bond debt reimbursement program instituted by former Governor Jay Hammond in 1972, cigarettes had paid for school maintenance. He elaborated that tax was still collected by the state and could be rededicated to pay for school maintenance; it brought in approximately \$27 million annually, which was almost precisely what the state paid out annually in deferred maintenance. He believed the spending needed to stop.

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DEENA PARAMO, SUPERINTENDENT, MAT-SU BOROUGH SCHOOL DISTRICT, MAT-SU (via teleconference), communicated that the school bond debt reimbursement program was a great example of a highly effective state government program

working for its people. She shared that the Mat-Su Borough had recently benefitted from a bond package that built six new educational facilities in the community. She continued that the program was part of an integral part of a sound facility management strategy as major maintenance had its place in providing operational efficiencies. She cited that according to the National Center for Educational Statistics, facilities maintenance produced savings by decreasing equipment replacement costs over time, decreasing renovation costs due to a reduced need for large-scale repair projects, and decreasing overhead costs such as utility bills due to increased efficiency. She highlighted that the Mat-Su Borough School District had implemented an effective preventative maintenance program aiming to extend the useful life of its facilities. However, even with preserving its current assets, the educational infrastructure did have a standard life expectancy; therefore, the district was appreciative that the legislation would reinstate the program after five years.

Ms. Paramo communicated that the Mat-Su district was growing and had needs to support unhoused students. She informed the committee that over the past ten years the district had grown by 232 students per year; it currently used 80 modular units to serve as additional classrooms. She stated that given the program's importance, the district did not support the discontinuance of the school bond debt reimbursement program altogether; however, the district's board of education understood the immense financial challenges facing the state. She thanked the committee for its ongoing support and consideration of education. She reiterated that the program was an effective and efficient use of state resources. She guaranteed that after the five-year moratorium the Mat-Su district would be before the state with a school bond debt reimbursement program application to support the needs of its growing community.

Co-Chair Thompson CLOSED public testimony. He notified the committee that going forward any amendments to bills had to be submitted 24 hours in advance of a bill hearing.

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Representative Gara MOVED to ADOPT Amendment 1:

By: Representative Gara  
Page 1, lines 4 - 9:  
Delete all material.

Page 1, line 10:  
Delete "Sec. 2"  
Insert "Section 1"

Re-number the following bill sections accordingly.

Page 7, line 1:  
Delete "["

Page 7, line 2, through page 13, line 13:  
Delete all material and insert:

"(18) subject to (h), (i), and (j)(2), (3), and (5) of this section, 40 [50] percent of payments made by a municipality during the fiscal year for the retirement of principal and interest on outstanding tax exempt bonds, notes, or other indebtedness authorized by the qualified voters of the municipality on or after January 1, 2015 [MAY 1, 2015], to pay costs of school construction, additions to schools, and major rehabilitation projects and education-related facilities that exceed \$200,000, are reviewed under AS 14.07.020(a)(11), and are not reimbursed under (o) of this section; (19) subject to (h), (i), and (j)(2) - (5) of this section, and after projects funded by the tax exempt bonds, notes, or other indebtedness have been approved by the commissioner, 50 percent of payments made by a municipality during the fiscal year for the retirement of principal of and interest on outstanding tax exempt bonds, notes, or other indebtedness authorized by the qualified voters of the municipality on or after January 1, 2015, to pay costs of school construction, additions to schools, and major rehabilitation projects and education-related facilities that exceed \$200,000, are approved under AS 14.07.020(a)(11), and are not reimbursed under (o) of this section."

Re-number the following bill sections accordingly.

Page 13, line 16:  
Delete "Sections 1, 2, 4, and 5 of this Act are"  
Insert "Section 1 of this Act is"

Page 13, line 18:  
Delete all material.

Renumber the following bill section accordingly.

Page 13, line 19:  
Delete "Sections 1, 2, 4, 5, and 7 of this Act take?  
Insert "Section 2 of this Act takes"

Co-Chair Neuman OBJECTED.

Representative Gara believed the 70/30 school debt reimbursement program was something the state could afford in times of financial surpluses. He believed a good case could be made that it was not affordable in the current fiscal climate. However, he opined that the five-year moratorium would not get the state out of its fiscal crisis. The amendment would switch to the 50/50 reimbursement program immediately instead of waiting five years. He reasoned that interest rates were currently at a near all-time low. He rationalized that it would be more expensive to wait five years to conduct maintenance on projects that were needed already. He believed the danger in some schools would increase. He communicated that over the long-term the amendment would save the state the same amount of money. He believed that without the amendment the state would see a significant balloon of bond reimbursement requests put forth by school districts. Additionally, he believed the state would be spending more in six to eight years on annual debt service. He reasoned that fixing maintenance problems up front would be less expensive. He noted that no one had done an analysis on what would happen to schools if they waited five years to do maintenance or what the impact would be in five years on the state's annual debt service. He underscored that the state would be paying for the costs when the moratorium ended; however, the costs would include additional bonds. He noted there would probably be less oil in the pipeline in the future. He concluded that the bill would achieve a goal of reducing the state's financial liability and spending. He believed it would probably save the state money in the long-term. The amendment would reduce the state's reimbursement level by 20 percent in both of the two categories. Additionally, the bill would remove the retroactivity provision and the five-year moratorium. He understood that the intentions of the bill were to save the state money. He believed the

amendment would save the state more money and would do better by the state's school districts.

Co-Chair Thompson replied that there was a \$3.5 billion deficit in the current year. He stated that the debt could grow to \$4 billion if oil dropped to \$45 or less per barrel. He believed that the bill represented a way to prevent from adding more debt to the state.

Co-Chair Neuman spoke to his objection. He stated that no one knew if there would be more or less oil or what school costs would be in the future. He discussed that the bill would implement a five-year moratorium on the state's portion of school debt reimbursement for municipalities. He continued that the state could not currently afford the reimbursement program; there were many other programs that needed to be funded. He did not support removing the five-year moratorium.

Representative Wilson spoke against the amendment. She believed DEED should be approving the bonds on additional criteria apart from voter approval. She had heard rumors that paying 70/30 did not get the necessary analysis. She believed the five-year moratorium would allow time to look into the program. She believed that if a school had a leaky roof the municipality should pay to fix it (instead of waiting five years for the reinstatement of the reimbursement program). She did not think municipalities would let damage happen to schools for five years just because the state was not paying the 70 percent. She opined that it needed to be determined how the items would be paid for in the future. She stated that there was no guarantee the program would be made available again in the future. She hoped that if the program was reinstated in five years that there would be more requirements for reimbursement eligibility.

[3:01:57 PM](#)

Vice-Chair Saddler testified in opposition to the amendment. He commented that someone else's money was much easier to spend. He believed the state had been fairly generous and responsible in funding school construction and maintenance. He understood that local school districts would continue to have the ability to bond if they saw a clear need for life safety. He acknowledged that it would be more expensive for municipalities; he believed they

would focus more on life safety needs and less on renovation that may not be necessary. He believed there would continue to be a secondary avenue towards funding through the state for construction and maintenance for schools with significant needs. He stated that the bill's goal was to reduce expenditures due to the fiscal deficit facing the state. He referred to testimony by Ms. Paramo that a five-year hiatus would focus people's attention. He believed the amendment could have the unintended consequence of prompting a land rush of districts hurrying to issue bonds.

Representative Guttenberg spoke in support of the amendment. He did not believe any school district rushed to increase its mill rate. He recognized that the opportunity to receive 70 percent reimbursement was enticing; however, schools did not just put any project on the list. There was nothing in the bill that prevented a district from paying 100 percent on a bond. He believed a reduction to 50/50 was appropriate. He thought that the current bill may have the result of increasing property taxes, which he did not want. He did not have a problem paying for tax increases for education and new schools, but he believed the state needed to be at the table as well.

Representative Gara addressed Vice-Chair Saddler's comments on a potential rush on bond issuances. He believed schools may hurry to get bonds on the ballot if they were given until December 31 followed by a five-year freeze. On the other hand, the amendment would continue the school debt reimbursement program, but it would reduce the 70/30 reimbursement to 50/50. He asserted that no one would rush to receive the lower reimbursement any more than they would under the existing program. He stressed that the amendment would save money. He reasoned that the debt would not be any smaller in five years because schools would wait on projects until the reimbursement was offered again.

Co-Chair Neuman MAINTAINED his OBJECTION.

A roll call vote was taken on the motion to adopt Amendment 1.

IN FAVOR: Edgmon, Gara, Guttenberg, Kawasaki, Munoz  
OPPOSED: Wilson, Gattis, Pruitt, Saddler, Neuman, Thompson

The MOTION to Adopt Amendment 1 FAILED (5/6).

Co-Chair Neuman noted that committee decorum did not guarantee the right of the maker of an amendment to provide closing comments. He detailed that House floor rules did provide that right.

[3:07:38 PM](#)

Representative Kawasaki MOVED to ADOPT Amendment 2:

BY: Representative Kawasaki

Page 1, line 5, following "law,":

Insert "and except as provided in AS  
14.11.100(a)(18),"

Page 1, line 8:

Delete "January 1"

Insert "November 15"

Page 6, line 21:

Delete "January 1"

Insert "November 15"

Page 6, line 29:

Delete "January 1"

Insert "November 15"

Page 7, line 1:

Delete "["

Page 7, lines 2 - 11:

20 Delete all material and insert:

"(18) subject to (h), (i), and G)(2), (3), and (5) of this section, 50 percent of payments made by a municipality during the fiscal year for the retirement of principal and interest on outstanding tax exempt bonds, notes, or other indebtedness authorized by the qualified voters of the municipality at a regularly scheduled municipal election on or after January 1 [MAY 1 ], 2015, but before November 15, 2016, to pay costs of school construction, additions to schools, and major rehabilitation projects and education-related facilities that exceed \$200,000, are reviewed under AS 14.07.020(a)(11), and are not reimbursed under (o) of this 6 section."

Page 12, line 6:  
Delete "January 1"  
Insert "November 15"

Page 12, line 14:  
Delete "January 1"  
Insert "November 15"

Page 12, line 16, following "section":  
Insert";  
(18) subject to (h), (i), and (j)(2), (3), and (5) of this section, 50 percent of payments made by a municipality during the fiscal year for the retirement of principal and interest on outstanding tax exempt bonds, notes, or other indebtedness authorized by the qualified voters of the municipality at a regularly scheduled municipal election on or after January 1, 2015, but before November 15, 2016, to pay costs of school construction, additions to schools, and major rehabilitation projects and education-related facilities that exceed \$200,000, are reviewed under AS 14.07.020(a)(11), and are not reimbursed under (o) of this section."

Page 12, line 17:  
Delete "(18)"  
Insert "(19"

Page 12, line 26:  
Delete "(19)"  
Insert "(20)"

Page 13, line 4, following "law,":  
Insert "and except as provided in AS 14.11.100(a)(18),"

Page 13, line 7:  
Delete "January 1"  
Insert "November 15"

Page 13, line 9:  
Delete "The"  
Insert "Except as provided in AS 14.11.100(a)(18), the"

Page 13, line 12:  
Delete "January 1"

Insert "November 15"

Page 13, lines 14 - 17:  
Delete all material.

Renumber the following bill sections accordingly.

Page 13, line 19:  
Delete "Sections 1, 2, 4, 5, and 7"  
Insert "Sections 1, 2, 4, and 5"

Representative Wilson OBJECTED.

Representative Kawasaki explained that the amendment would enable municipalities with a last chance to put projects forward. He detailed that many school districts (including Fairbanks, Anchorage, and Bristol Bay) had been given the impression that there would be a state funding match. He elaborated that the projects did not come in solely every year. He referred to discussion that there could be rush to push projects through. He referenced the administration's testimony that the process the projects went through could take months to years in advance of an election. He relayed that his community understood that it would be financially difficult in the current year and had communicated that it would not come to the legislature with capital projects. He reminded the committee that school board members had come forward in the November/December 2014 timeframe notifying legislators that they would need a bond proposition in the fall election cycle (instead of asking for cash). One of the projects would be the fourth and final phase of the Barnette Magnet School renovation. Other projects included the installation of district-wide fire sprinkler systems for \$750,000 (the upgrade was necessary for most of the outdated schools using the local water utility, Wood River/Tanana mechanical upgrades, and a roof replacement for Joy Elementary School (the project would replace major parts of the roof that had been part of a 1989 addition). He underscored that the projects had been vetted and discussed by the school board; the projects had also been entered into the school bond major maintenance by district request. He added that Barnette had not made it into the list of qualifying schools in the current year, but its project was certainly needed. He believed it was important for the state to keep its word related to the bond reimbursement. The amendment would extend the program out

to the fall election cycle (most of the communities had fall elections including Fairbanks, Mat-Su, and Juneau).

Representative Wilson spoke to her objection. She stressed that the state did not have any money. She added that the state was not obligated to pay any of the bonds. She believed the state could tell districts that due to its deficit it could not pay the 70 percent reimbursement in the current year. She stated that municipalities understood that there was a chance the state may not have the ability to pay the 70 percent. She stressed the need to make changes based on the state's budget outlook. She believed the legislation's five-year moratorium offered a milder option versus discontinuing the reimbursement indefinitely.

A roll call vote was taken on the motion.

IN FAVOR: Kawasaki, Gara, Guttenberg

OPPOSED: Munoz, Pruitt, Saddler, Wilson, Edgmon, Gattis, Neuman, Thompson

The MOTION to adopt Amendment 2 FAILED (3/8).

Co-Chair Neuman MOVED to REPORT CSSB 64(EDC) out of committee with individual recommendations and the accompanying fiscal note. There being NO OBJECTION, it was so ordered.

CSSB 64(EDC) was REPORTED out of committee with a "do pass" recommendation and with one previously published indeterminate fiscal note: FN1 (EED).

[3:13:23 PM](#)

AT EASE

[3:17:58 PM](#)

RECONVENED

#hb86

HOUSE BILL NO. 86

"An Act relating to investment of the power cost equalization endowment fund; and providing for an effective date."

[3:18:04 PM](#)

PAM LEARY, DIRECTOR, TREASURY DIVISION, DEPARTMENT OF REVENUE, provided a PowerPoint presentation titled "State of Alaska Department of Revenue HB 86 PCE Endowment Fund Investment" (copy on file). She relayed her intent to discuss the fund history and the bill. She turned to slide 2 and communicated that the fund's purpose was to fund the Power Cost Equalization and Rural Electric Capitalization Fund, which helped to reduce the cost of energy in areas with high electrical costs. The fund also covered the costs associated with its management. She continued that 7 percent of the monthly average market value of the fund for the previous three fiscal years may be appropriated. She relayed that the fund had been created in 2000 with an appropriation of \$100 million from the Constitutional Budget Reserve (CBR). In 2002 the Power Cost Equalization Fund (PCE) received \$89.6 million from proceeds of the sale of the four dam pool hydroelectric project; it had received two subsequent appropriations of \$182.7 million in 2007 and \$400 million in 2012. The fund balance at the end of February 2015 was \$986 million.

Ms. Leary discussed the bill's purpose on slide 3. She explained that the bill would remove the stated nominal return target of at least 7 percent of the statute. The bill would allow the commissioner of the Department of Revenue (DOR) to invest the fund in a manner that would meet the fund's objectives by providing flexibility as it related to the rate and the risk associated with certain types of investments. She explained that the bill was important because it would enable the DOR commissioner to invest in less risky investments, when appropriate, that would continue to meet the financial needs of the program. She relayed that the bill had a zero fiscal note.

[3:20:56 PM](#)

JERRY BURNETT, DEPUTY COMMISSIONER, TREASURY DIVISION, DEPARTMENT OF REVENUE, highlighted that one of the fundamentals of asset management was to seek the highest rate of return with appropriate risk levels. He drew attention to the 2015 capital market expectations for return and risk from Callan Associates (slide 4). He noted that Callan Associates was the financial advisor to the Alaska Retirement Management Board and to the Alaska Permanent Fund Corporation (APFC). He pointed to the arithmetic and geometric return and standard deviation (projected risk). He remarked that the geometric return was

less than the arithmetic return. He highlighted the 19 percent standard deviation for the broad domestic equity category, meaning that two-thirds of the time returns were expected to be within 19 percent of the 9.15 percent arithmetic return (-10 to 29). He explained that the arithmetic return over time was used to calculate the geometric average (some years would be well below the arithmetic average, while some years would be well above). He noted that the [10-year] geometric return for broad domestic equity was 7.6 percent. He remarked that 7.6 percent was one of the highest returns on the chart; emerging market equities had a return of 7.9 percent, but with a 28 percent standard deviation).

Mr. Burnett discussed that when constructing a portfolio to achieve a 7 percent return (given the 2015 capital markets), nearly 90 percent of assets should be equities. He explained that based on a 19 percent standard deviation, a -10 percent return would occur in one out of six years. He discussed that equity markets had been positive for six years in a row; therefore, it was fairly likely that negative returns would occur sometime in the next several years. He relayed that DOR did not feel comfortable building or recommending a portfolio that was 90 percent equities because it was currently beyond the risk tolerance. He elaborated that in 2002 a portfolio achieving an 8 or 9 percent return could have been constructed with similar risk as at present. He noted that it varied from year to year. He communicated that inserting 7 percent in statute could create a situation where the department was managing to a risk that was beyond what was reasonable for the markets. He stated that APFC had an expected rate of return of approximately 6.17 percent in the current year. The department wanted to have the ability to manage appropriate risk while achieving the highest rate of return within the risk tolerance rather than to a fixed number. He noted that the Treasury Division managed over 40 unique asset allocations; the Power Cost Equalization Fund was the only major fund that had a specific target return identified in statute.

[3:24:59 PM](#)

Representative Edgmon asked why a lower number was not identified. Mr. Burnett did not believe a lower number should be identified. For example, if the target return was 5 percent, the asset allocation may be less risky than what

was responsible over time. He relayed that no number would be durable; what may be good at present may be very bad at another time. He noted that in 1982, money market rates had been at 10 or 11 percent and mortgage bonds could be purchased with 18 percent interest rates. He explained that a portfolio constructed for that time may be very different. He reiterated that it was not possible to set a durable number that made sense in the long-term.

Representative Edgmon asked for verification that it would be at the discretion of DOR and its fund managers to manage the target year after year. He surmised that the target may be 6 percent in some years and 5 percent in others. He wondered why the department had not elected to pick a target that was more commensurate with the state's other long-term endowments such as the CBR.

Mr. Burnett answered that DOR would look at an asset allocation that was durable and would set the expected rate of return off of a reasonable risk asset allocation rather than looking at setting an allocation to a specific target number. Management factored in that the fund needed a certain amount of income annually; there was a payout rule that was 7 percent of the prior three years' monthly rolling average balance. The fund was managed to meet its intent, but the asset allocation was not set to a hard number.

Representative Edgmon asked what assurance he would have as a rural legislator that the fund was being managed for the long-term. Mr. Burnett answered that the returns were available for review. Additionally, the DOR commissioner and staff were available to discuss the strategy and returns. He noted that the legislature had annual hearings on fund performance. He explained that other funds did not have target returns identified in statute. He cited the CBR, the Alaska Permanent Fund, and the Higher Education Fund as examples. He explained that the flexibility provided more assurance in an environment like the present that the commissioner would not try to set to a 7 percent level, which may result in lost money the following year.

[3:28:45 PM](#)

Representative Edgmon stated that the PCE endowment fund was large enough that if managed in a conservative manner it should be able to satisfy the annual outlay of PCE costs

(approximately \$42 million to \$45 million). He wondered what return the fund would target. He noted that the fund was close to \$1 billion and small number of 4 or 5 percent was needed. He surmised that management would want to stick to a target rate over time. He wanted to ensure that money managers would not have free reign to ride the market and make more risky investments when they were not needed.

Mr. Burnett replied that each of the funds managed by DOR had a purpose including expected payout, duration and other. The department set new asset allocations annually on July 1 based on capital market expectations; the allocation did not necessarily change every year. Department staff analyzed risk and program needs on a full-time basis. He noted that under the legislation the commissioner would manage the fund to meet the needs of the PCE program.

Representative Edgmon surmised that the probability was that the department would be managing the fund for a rate below 7 percent. Mr. Burnett replied that it was most likely that the fund would be managed for a rate below 7 percent in 2015. He could not predict the target rate for 2016.

Representative Guttenberg asked how the objectives for the PCE fund were defined. He wondered about the definition and objective of the Rural Electric and Capitalization Fund. He believed the objectives may be different or in conflict if the 7 percent target was removed from statute. He was concerned about what the state was "letting out of the box."

Mr. Burnett responded that determining asset allocations was based on the legal purpose of each of the funds. He explained that the PCE fund's purpose was to equalize the power cost per kilowatt hour, making grants and power cost equalization available to eligible electric utilities. He relayed that a payout rule of 7 percent of previous years was currently in statute. He communicated that the PCE fund had earned about 20 percent in 2014 and an average of 14 percent over the past five years; since inception it had earned just over 6 percent. He explained that the department would look at the fund's specific purpose just like it did for each of the other funds it managed. He added that there was nothing unique about the fund and its purpose that created a different look. The department

considered the fund's legal requirements, its purpose, its timeframe, and other.

[3:33:59 PM](#)

Ms. Leary added that 7 percent had been the target; however, having the target identified in statute had resulted in a return of -13.87 percent in 2009. The return had been negative 4 years out of 15; it had also been as high as 21.8 percent with the same target. She elaborated that a target may come to fruition, but may not. She clarified that capital market expectations were only expectations based on known economic factors; there generally tended to be a 10-year expectation.

Representative Guttenberg asked if the department's responsibility would fit inside the successes of the permanent fund. He wondered how the end result would differ if the department had moved its management into the permanent fund portfolio.

Mr. Burnett replied that the permanent fund had some unique assets that the Treasury Division would not consider holding due to their illiquidity. He explained that because the PCE fund was non-dedicated it had to be available and liquid at some level at all times. He stated that DOR would not make the recommendation, but if the legislature chose to change the purpose of the fund [the portfolio could invest in illiquid assets]. He furthered that the permanent fund was a constitutionally dedicated fund and held assets that could not provide money for 5 to 10 years (e.g. private equity or long-term real estate investments), which would never be considered for a state-managed fund. Additionally, the permanent fund may hold assets that Treasury was not allowed to hold under Securities Exchange Commission rules.

Co-Chair Thompson asked committee members to be cognizant of the time and relayed that the bill would be heard again at a later date.

Vice-Chair Saddler wondered if the bill had been prompted by the desire to revert to more a prudent investment rule, the declining revenue stream required by lower energy prices, or by fear of the coming market correction. Mr. Burnett answered that there had been no consideration of the declining need for a revenue stream. The decision had

been based on a prudent investment rule and the unwillingness to take on risks beyond what were prudent.

Vice-Chair Saddler stated that when the AKLNG gasline project came to fruition 25 percent of its royalties would be dedicated towards the energy needs of rural Alaskans off the Railbelt. He asked if the bill would allow the PCE endowment fund management to adjust to the reality of a new funding source with the same purpose.

Mr. Burnett answered that if the money went into the fund it would allow for changes. He elaborated that the purpose of the fund, the realities of the marketplace, and the fiscal realities of the state were all taken into consideration by the department.

[3:38:00 PM](#)

Representative Edgmon clarified that it was 20 percent of the royalty revenues [that would be dedicated to rural Alaska energy needs when the AKLNG project came to fruition].

Representative Munoz asked if the fund was managed in-house or by outside managers. Mr. Burnett replied that the fixed income component was managed internally; the rest was managed by external managers.

Representative Munoz asked if the management fees were typical. Mr. Burnett agreed. Representative Munoz asked about 14 percent earnings from the previous year. Mr. Burnett clarified that the earnings had been 20.7 percent the previous year and averaged 14.5 percent over the past five years. He added that the fund had grown quite rapidly over the past several years.

Representative Munoz asked for the growth in dollars. Ms. Leary replied that earnings had been \$171 million in 2014.

Representative Munoz spoke to a payout of roughly \$45 million to communities. She wondered if the balance of the earnings was deposited directly into the fund or for other purposes as well. Mr. Burnett answered that the earnings that were not used for fund management or the PCE program remained in the fund.

Representative Gattis asked why the PCE fund had not originally been set up like the other state-managed funds. Mr. Burnett answered that he did not recall the discussion on the original language related to the fund's investment purposes. He relayed that the fund had been implemented in 2002. He was not certain that any changes had been made to the fund's investment since inception. He relayed that it was not the first year DOR had requested the change; the department had identified the issue as problematic in previous administrations as well.

Representative Gattis asked if it was the first time a bill had been presented. Mr. Burnett replied in the negative.

Representative Gattis surmised that a bill had failed in the past and the department was giving it another attempt. Mr. Burnett replied in the affirmative. He thanked the committee for hearing the bill.

Ms. Leary informed the committee that DOR had a great website that included significant information about the PCE fund and other funds managed by the Treasury Division. Additionally, the website included cash management and all aspects of the division.

HB 86 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson discussed the agenda for the following day.

Vice-Chair Saddler informed committee members that the Department of Health and Social Services budget subcommittee would hear a Medicaid 101 presentation the following morning.

#

ADJOURNMENT

[3:42:54 PM](#)

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