

HOUSE FINANCE COMMITTEE  
January 26, 2016  
1:33 p.m.

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CALL TO ORDER

Co-Chair Neuman called the House Finance Committee meeting to order at 1:33 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

Randall Hoffbeck, Commissioner, Department of Revenue; John Tichotsky, Chief Economist, Tax Division, Department of Revenue; Dan DeBartolo, Director, Division of Administrative Services, Department of Revenue.

SUMMARY

HB 256      APPROP: OPERATING BUDGET/LOANS/FUNDS

HB 256 was SCHEDULED but not HEARD.

HB 257      APPROP: MENTAL HEALTH BUDGET

HB 257 was SCHEDULED but not HEARD.

HB 255 BUDGET: CAPITAL

HB 255 was SCHEDULED but not HEARD.

FALL 2015 REVENUE FORECAST BY COMMISSIONER RANDALL HOFFBECK AND CHIEF ECONOMIST JOHN TICHOTSKY

FY17 BUDGET OVERVIEW: DEPT. OF REVENUE

Co-Chair Thompson reviewed the agenda for the current meeting. He acknowledged that Representative Gara had joined the meeting.

^FALL 2015 REVENUE FORECAST BY COMMISSIONER RANDALL HOFFBECK AND CHIEF ECONOMIST JOHN TICHOTSKY

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RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, introduced the PowerPoint presentation: "Fall 2015 Revenue Forecast Presentation." He relayed he would be making some opening statements and turning the presentation over to Dr. Tichotsky.

Co-Chair Thompson indicated that Representative Gattis and Co-Chair Neuman had joined members at the table.

Commissioner Hoffbeck began with slide 3: "Structure of Revenue FY 2013, FY 2014, FY 2015". He mentioned that the department had never included the chart in its previous presentations. He pointed out that it showed two things: unrestricted revenues, and the total value of the pie. He pointed out that in FY 13 the unrestricted revenues were about 44 percent of all revenues in the amount of \$6.9 billion. By FY 14 the unrestricted revenues had shrunk to 31 percent with a total revenue of \$5.4 billion. In FY 15 unrestricted revenues declined to 26 percent or \$2.3 billion. Based on discussions with Mr. Tichotsky and looking at long-term forecasts the new status quo for unrestricted revenue would fall between the numbers from FY 14 and FY 15 [31 percent to 26 percent] rather than 50 percent of total revenue - the previous status quo percentage.

Commissioner Hoffbeck turned to slide 5: "Methods: What Do We Forecast at DOR?":

## Mostly Petroleum and Non-petroleum Revenue

- We directly forecast Petroleum Revenue
  - The largest component, accounting for 75% of state unrestricted revenue in FY 2015
  - "Petroleum Revenue" includes severance taxes, royalties, corporate income tax, and all other revenue from oil companies
  
- We directly forecast Non-petroleum Revenue
- We use someone else's forecast for Investment Revenue
- We use the Federal Revenue authorized for spending as the forecast
  - It is typically 20%-30% more than actually gets spent.
- DOR compiles all different revenue streams and compiles them in the annual Revenue Sources Book

Commissioner Hoffbeck explained that the state was heavily dependent upon oil revenues within the forecast. He relayed that non-petroleum revenues included corporate income taxes, fees, and other taxes. He reported that the department used Callan Associates to forecast investment revenue. He relayed that the state spent 20 percent to 30 percent less of authorized federal revenue due to not completing all eligible projects in any given year.

Co-Chair Neuman wondered if there was an increase of federal funds coming to the state. Commissioner Hoffbeck responded that they were about the same.

Co-Chair Neuman commented that there had been efforts made by the prior administration to be more accurate in its forecast and wondered about the current administration's accuracy. He thought the forecast was considerably higher than the state's actual revenues. He wondered about what policies the Commissioner had implemented to ensure the precision of the revenue forecast. Commissioner Hoffbeck responded that the issue was discussed in the revenue forecast but opined that it was important to know the state's total authorization of federal revenue. The authorizations generally fell into the restricted revenue category which did not impact what was available for state spending. He happily offered to present the information in a different form if the committee wanted him to do so.

Co-Chair Neuman was looking at how the department came up with its forecast.

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Representative Edgmon commented that regarding federal funds, it was his impression that Alaska's take was significantly more under the 5-year federal highway bill. He had also heard in the previous day that money for water and sewer was greater. He was wondering if the state would be receiving more federal revenue in the future.

JOHN TICHOTSKY, CHIEF ECONOMIST, TAX DIVISION, DEPARTMENT OF REVENUE, responded that in terms of forecasted numbers it had not moved the needle.

Commissioner Hoffbeck turned to slide 6: "Oil Revenue Forecasting":

Three Factors for Production Tax Revenue Forecast

REVENUE = (Net value \* Tax Rate) - Credits taken against liability

Net value = (Price\*Production) - Costs

1. Price
2. Production
3. Costs
  1. Capital expenditures
  2. Operating expenditures
  3. Transportation cost

Commissioner Hoffbeck explained that the three components that determined how much the state collected in petroleum property tax was price, production, and cost.

Co-Chair Neuman thought there had been a discussion previously about net value. He remembered the commissioner talking about how changes in gross value might make a difference. He asked him to comment. He did not want to scare the industry. Commissioner Hoffbeck responded that in the past Alaska had a gross value tax under the ELF (Economic Limit Factor) tax system, which came before the PPT (Petroleum Production Tax) tax structure. If the state was on a gross tax system the calculations would be

simplified dramatically. However, the state was currently operating on a net tax system.

Co-Chair Neuman remarked that with a gross tax the calculations would be simplified because there would not be a need to go through all of the deductions. He wondered if ultimately the money the state took in would be the same. Commissioner Hoffbeck stated that it depended on how a gross tax was structured. He suggested that it could certainly be structured so that it would result in a similar revenue stream. Co-Chair Neuman remarked, "That was the point I was trying to make."

Representative Kawasaki reported that at an Alaska Oil and Gas Association (AOGA) lunch he had heard that over the last 15-year time span that costs for production had risen 90 percent. He wondered, in terms of net value calculations, if the audits under Alaska's Clear and Equitable Share (ACES) had been completed. He wondered at what point the finance committee would get to review them. Commissioner Hoffbeck responded that the Department of Revenue (DOR) was currently doing the 2009 audits, which was the beginning of the ACES audits. He added that the first audits had to be out by the middle of March.

Representative Guttenberg asked about transportation costs. He wondered if the court cases concerning the Trans-Alaska Pipeline System (TAPS) evaluation affected the well head price. Commissioner Hoffbeck answered that the recent court case that disallowed some of the strategic reconfiguration costs was requiring the state to go back in to recalculate the related audits - part of the reason the audits were currently delayed. It impacted the amount of deductible transportation costs.

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Representative Guttenberg asked how they were expected to impact future projections. He suggested moving forward rather than backwards. He wondered if it was solidifying the transportation deductions off of the well head evaluation. Commissioner Hoffbeck answered that he believed the court case referenced 2009 through 2011. It would obviously impact the amount of deductible transportation costs for those years.

Commissioner Hoffbeck advanced to slide 7: "Fall 2015 Highlights":

- Input changes relative to the 2015 Spring Forecast.
  - Oil price forecasts have been reduced for all years in the forecast.
    - Long term prices now expected to settle around \$50 - \$70 real.
  - Capital expenditures forecasts have been reduced for all years in the forecast.
  - Oil production forecasts have been reduced for all years in the forecast.
  - Correspondingly, unrestricted revenues have been revised downward.
- Revenue impacts largely due to change in oil price assumptions.
- Lease expenditure (or investment) in the oil fields expected to decline, which will lead to less expected "new" production in the future.
  - Many projects have been deferred until oil prices improve.

Commissioner Hoffbeck relayed that long-term meant over 3 years.

Vice-Chair Saddler mentioned that for many years the oil price and oil revenue forecasts were erroring on the side of the generous. It was always necessary with the legislature to calculate less money than was expected to come in. The previous administration had never felt it necessary to true-up the past couple of revenue forecasts. He wondered if any changes had been made to the calculation method that the commissioner had inherited that would give the legislature any greater or lesser confidence in the accuracy of the forecasts.

Commissioner Hoffbeck stated that the method the current administration used was very similar to what had been used in the past. In the prior year the administration had done a true-up (in November or December of 2015). The spring forecast was adjusted again and the current fall forecast was changed. Every time the administration had made the adjustments it seemed pessimistic. However, oil prices had continued to drive downwards. The administration had a bias to be on the conservative side, particularly on the production side. Even with the administration's bias the

state had not been able to keep up with the drop in oil prices.

Representative Gara mentioned some people had talked about cutting the small producer tax credits. He wanted to know how much the state was spending in terms of deduction allowances. He relayed that there were 2 classes of existing producers under SB 21; producers of the post 2002 fields who paid a lower tax rate, and the producers of the pre 2002 fields who paid a higher tax rate. He reported that the tax rate at \$100 per barrel for the big fields was about 20 percent and the small fields was about 13 percent. He suggested that the lower tax rate fields and the higher tax rate fields received a 35 percent deduction for capital expenditures and a 35 percent deduction for their operating expenditures. He wanted to know how much the deductions were costing the state in revenue. He supposed that not many tax payers received a deduction rate significantly higher than their tax rate. Nor did they get to deduct everything in the first year, they usually amortized. He asked for an estimate from the most recent taxable year regarding how much the state had paid for the two classes of fields in terms of capital and operating deductions. Commissioner Hoffbeck responded that he would provide as much information as possible without disclosing tax payer confidential information. Representative Gara conveyed that an estimate would be fine.

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Co-Chair Neuman suggested including the additional production of oil and gas that it created in revenue.

Representative Gattis thought the question was whether the incentives produced the results the state was hoping for. It was really a financial question. She thought both sides should be presented.

Co-Chair Neuman indicated that a more in-depth look would occur when examining the Governor's legislation.

Mr. Tichotsky stated that he would be looking at an overview of the production forecast. In order to produce a revenue forecast the elements of production, price, and cost were necessary. He turned to slide 9: "Production History and Forecast." He noted the long-term trend from 1977. Production was upwards of 2 million barrels of oil

per day early on. Five years into the future from 2016 showed a plateau of about 500 thousand barrels per day and the natural curve reducing.

Mr. Tichotsky continued to slide 10: "ANS Production Forecast Comparison." He explained that the graph showed the revisions of the forecast between spring 2015 and fall 2015 strictly driven by price. He highlighted that the production was about the same, but it shifted from near-term to slightly farther out.

Co-Chair Neuman commented that the information currently being presented was not the same as the information he had received from Alaska Oil and Gas Association (AOGA). He thought the state had seen a consistent leveling off of production. He wondered why there was such a difference between the red line and the blue line in 2017 and the spring and fall forecast of outgoing years. He also asked about the rapid reduction in the production of oil. Mr. Tichotsky responded that the scale was not very large. Currently, when looking at the production for FY 16 the state seemed to be hitting the new fall forecast figure. A decline could be seen just past 2019. He explained that the department ran the production forecast such that it interviewed the producers to find out their short and long-term plans and integrated the information into the production forecast. Typically the state had solid information going out 5 years, the horizon of the producers. Following the 5-year period production generally declined with uncertainty. In the short-term the difference between the red line and the blue line was price driven and driven by the information collected in September 2015 and October 2015.

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Representative Pruitt assumed that the new field discovered by Armstrong Oil and Gas and Repsol was not included in the numbers Mr. Tichotsky used. Mr. Tichotsky was not able to comment on a company-specific field because of issues of confidentiality. He transitioned to slide 11: "ANS Oil Production Forecast." He explained that generally when the department did a production forecast it took into account the volumes from developed reserves currently producing - fields without major investment. They were not adjusted for risk at all. The department also looked at volumes from undeveloped reserves and additional accelerated developed

reserves - oil from projects that would add incremental oil to existing fields or bring new fields into production. The fields had to have senior management approval, have allocated funds, and be within the budget. The department risk-adjusted these fields because there were two levels of risk that occasionally occurred: either producers over-estimated the number of barrels per day or they ran into timing issues. Often price was a huge driver. Additionally, the department looked at volume from contingent resources, projects likely to occur in the future that did not meet the current requirements. Other projects were discussed but were not included in the department's production forecast because of not meeting certain criteria.

Representative Pruitt clarified that the state needed to make sure that a project was at a certain point prior to incorporating it into the state's forecast. He wondered if he understood correctly. Mr. Tichotsky responded affirmatively. He added that the state would be booking the likelihood of the investment being made and oil being produced.

Representative Pruitt commented that there were projects on the horizon that the state held off on that could eventually be seen in a future forecast. Mr. Tichotsky remarked that Representative Pruitt had an excellent point. The state created rules in order to have certainty in the production forecast. There were things the state was aware of that were not included because they did not pass the state's certainty threshold.

Mr. Tichotsky thought slide 12: "ANS Production Forecast" spoke to Representative Pruitt's point. He drew attention to the two plus signs showing production that occurred. Beginning in 2016 the production forecast that was used was represented by the dark line, the adjusted expected investment case. He noted that if there was little or no investment occurring in the reserves then the state would get the low investment case (basically taking what was currently being produced and taking it down the decline line). There was also the unrisks investment case which showed the oil that could be produced if all the projects that were talked about came online. The department considered the upper bound of what was likely to happen, the lower bound of what could, and then drew a line between the two, which became the basis of the state's production forecast.

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Co-Chair Neuman pointed to the top dotted line on the chart labeled "Unrisked Investment Case." He noted that the line increased out past 2020. He wondered if it was a possible scenario. Mr. Tichotsky answered, "Correct."

Co-Chair Neuman asked if it would be closer to the state's anticipated forecast. Mr. Tichotsky explained that the department used the risked forecast because it tried to take into account things that might not occur. For example there might be an issue where a producer drilled and did not get as many barrels as anticipated, or the project was pushed out because of timing. Co-Chair Neuman understood.

Mr. Tichotsky discussed looking at the upside potential of production on slide 14: "ANS Production Forecast" He explained that the dark blue skin represented the volumes of developed reserves, the currently producing line. The next skin (red area) represented what was past the threshold where senior management was committed to investing the money. The third skin represented the volume from contingent resources. There were further skins that represented upside potential for undeveloped reserves and contingent resources.

Vice-Chair Saddler referred to slide 14. He asked about the upside potential and wondered if it assumed all oil taxes and credits were held steady. He wondered about the state's underlying assumptions on the upside. Mr. Tichotsky responded, "Correct." He furthered that all of the state's assumptions were based in the current tax structure.

Vice-Chair Saddler asked if the upsides could not materialize if the state raised or diminished the tax credits. Mr. Tichotsky remarked that it could be a logical conclusion based on market economics.

Mr. Tichotsky continued to slide 16: "Alaska North Slope Crude West Coast Price." He explained that the chart reflected the price of oil in June 2014 at a high of \$113.17. The current day's price was around \$26.23.

Mr. Tichotsky explained slide 17: "Alaska North Slope West Coast, West Texas Intermediate and Brent Crude Prices 2009 through 2016." There were three different oil markers. The

first was Alaska North Slope Crude (ANS) which was Alaska's marker selling primarily to the West Coast and occasionally to Asia. The second oil marker was West Texas Intermediate (WTI) which was the marker for midland America. During the period of 2011 through 2014 the crude marker was much lower priced than ANS or Brent. Brent was the British water born crude. He reported that the economic research group noticed that ANS tracked Brent crude quite well during the period of 2009 through the present. Whereas, WTI did not. He pointed out that in the lower price environment all three markers converged.

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Mr. Tichotsky turned to slide 18: "Key Oil Price Drivers":

- Supply & Demand
  - There are two main factors to monitor
    - Global spare capacity, since it is both a reflection of supply and demand. In other words, the Organization of Petroleum Exporting Countries (OPEC) spare capacity (flipping a switch) is key.
    - Cost of developing new oil supply.
- Current Events
  - Weak global demand.
  - Cost of supplying the marginal barrel has decreased dramatically.
  - OPEC (Saudi Arabia) maintains market share and accepts lower prices.
  - Cost of supply has fallen as new sources have been defined and developed.
    - Oil shale is a prime example.

Mr. Tichotsky flipped to slide 19: "OPEC's view of supply and demand..." He explained that OPEC's theory was that North American production of shale oil would collapse at \$80, then it changed to \$60, and to an even lower price currently with adequate supplies available on the market. However, looking at OPEC's recent report their view of supply relative to their crude production was one where they saw a recovery of demand in the third quarter of 2016. He was uncertain whether it would materialize. One of his economists was interested in the issue of spare capacity and pointed out that in the 80's there was about 20 percent to 30 percent spare capacity and the world was consuming

less than 50 million barrels per day. Currently, the world consumed over 90 million barrels per day. The spare capacity was no more than 2.5 million barrels per day. The conclusion that could be made, especially looking forward with the U.S. Energy Information Administration (EIA) forecast was that even though currently in a world where consumption lacked production, it could easily turn around. The department's general consensus was that it provided the opportunity and possibility of price volatility.

Vice-Chair Saddler asked about the disparity between production and consumption and whether it had distorted the market share. He understood that Saudi Arabia was trying to hold onto its market share. With the disparity and the low prices as they were he wondered if there were any fundamental changes in where nations were buying their oil around the world. Mr. Tichotsky advanced to slide 20: "It's about spare capacity..." and explained that there were two major issues. The first was that Saudi Arabia was a swing producer and at high prices it could take advantage of the basic concept of spare capacity. However, high prices also promoted unconventional oil development in North America. What was currently viewed as conventional shale plays in mid America really turned around. He would not have anticipated oversupply due to North American production of shale fifteen years ago. However, it was what had affected the current markets creating low price environments and volatility going forward.

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Vice-Chair Saddler was concerned whether Alaska would find its market intact if the price went up. Mr. Tichotsky remarked that Vice-Chair Saddler had a great question. The department had started looking at that question in a high oil price environment when there was a threat of Bakken oil reaching West Coast markets and crowding ANS crude from the market. The North American West Coast market was designed to process ANS crude. Prudhoe Bay went to feed the California and West Coast markets. Other crudes were close mimics. The crude market depended on having a crude similar to maintain refinery efficiencies. What he found was that whatever ANS produced could be used at the market price on the West Coast.

Mr. Tichotsky discussed slide 21: "Base Price Forecast Methodology":

- Price Forecasting Session
  - Held a day long oil price forecasting session on October 6, 2015.
  - Speakers provided insight into oil markets, probability and analysis, modeling, and financial aspects of commodity markets.
  - 37 participants from state government, academia and the private sector.
    - DOR, DNR, DOL, OMB, University, Legislative Finance and outside participants.
- Participants were asked to forecast P10, mean, and P90 real ANS prices out to FY 2025.
  - Real prices were converted to nominal using a 2.25% inflation assumption.
  - Official forecast is based on probabilistic outcomes the price forecast session.

Mr. Tichotski reported that as part of the department's price forecasting methodology it held a price forecasting session on October 6, 2015. There was a vast range of speakers that came to discuss oil price markets. One of the benefits was that because of the Permanent Fund Corporation and the Treasury Department having a strong affiliation with some of the investment houses, the best commodities people presented during the session. The participants spent the day discussing oil markets, probability analysis, and other topics. The department had its own in-house model based on what was referred to as "random walk" which took into account the randomness of oil prices. It also took into account a jumped diffusion. When oil prices went from \$113 to \$20 it was a jump event or a destructive event. Between oil prices modeling, looking at oil markets, and listening to several conversations, participants were given the opportunity to come before the group to give a mean and a low and high probability of oil prices. Real prices were converted using a 2.25 percent inflation rate which was generally used across the state for investments and the revenue forecast. A probabilistic factor was added as well.

Mr. Tichotsky turned to slide 22: "Consensus view that the distribution is wide." He added that the department considered what other folks reported. The slide conveyed that Alaska's view from the October forecast was not unusual. Most other forecasts did not go low enough. The department had not expected prices to collapse to the

extent they did. In general people were looking at volatility and how it extended out between the present and 2019. Alaska's view was a standard view of what was going on in the oil markets.

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Mr. Tichotsky advanced to slide 23: "Fall 2015 ANS Revenue Forecast Prices." He explained what it meant to look at things probabilistically. What the department did with the current forecast was to look at the average. As the price forecast moved forward, because the department did its price forecasting session in October and the report was published in December in the previous year there was a large price difference. To compensate, the department tended to look at what was closer to the "P10's", prices that the department could anchor off from what was actually going on in the current markets. For the long-term the department adjusted back depending on the how the current market looked. The department looked at the "P50" for the current year because of the range of possibilities, what was in the revenue sources book, and what the department had currently.

Vice-Chair Saddler referred to the chart on slide 23. He wondered if it included all of the probabilistic estimates of the reserves and the likelihood of investments. He wondered if it was an extension of the forecast prices for a couple of years based on inflation. Mr. Tichotsky responded that the chart was only looking at the forecast of prices. It did not reflect the revenue forecast.

Vice-Chair Saddler relayed that he had received information from First National Bank of Alaska. They projected an inflation rate of 1 percent to 1.25 percent in Alaska. He wondered about the inflation rate of 2.25 percent. Mr. Tichotsky complimented Vice-Chair Saddler on his excellent question. He responded that given that the state had optionality it tended to use the Callan inflation forecast that was used for investment revenue. It gave Alaska the advantage of having an apples-to-apples comparison of revenue. It was an open question. If the state had an inflationary period it could make a difference in some of the state's decision making. He thought it was a very good point.

Mr. Tichotsky pointed out the chart on slide 24: "What if the oil price is..." for the remainder of FY 2016." He indicated that it reflected one of the favorite questions that the department was asked several years prior. He came up with the chart after the question was asked several times. If someone thought the following six months would bring \$20 per barrel of oil then the average ANS price for FY 2016 would be approximately \$33. If someone thought the price of oil would go to \$60 per barrel of oil then the forecast price would be about \$54 per barrel. Often times, people looked at the current day's price of \$26 which did not reflect the budget price, as six months of pricing was already known. In some years often times when there was a high oil price environment and a low oil price environment in the same fiscal year an average was taken between the two. In the current year the state had not seen prices above \$50.

Mr. Tichotsky explained the graph on slide 25: "Historical ANS West Coast FY Oil Price Bands: Annual Average and Official Spring 2015 Forecast." He indicated that the green tick was the deterministic forecast that was used in the revenue model. However, the department recognized there was a distribution of prices. In the past, for actual prices, it showed the range of prices within one year.

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Mr. Tichotsky continued that Alaska was in the lower range or below the lower range of what was expected. However, it appeared that there would be some price recovery. He reminded members that the calculations included a 2.25 percent inflation rate. Prices that were \$70 nominal in 2025 would be equal to about \$60 or below in real terms.

Co-Chair Neuman asked about the average price per barrel of oil or revenue to the state looking at the 5-year period from 2015 to 2020. Mr. Tichotsky responded that the average price for the following year was about \$50.

Vice-Chair Saddler asked if it was fair to assume that when looking at 2025 the top of the range was the P10 and the bottom of the range was the P90 probability, and the green band reflected the forecasted price. Mr. Tichotsky responded that the lower price was the P10 and the higher price was P90.

Vice-Chair Saddler asked if the price was significantly more likely to be \$40 than \$100 in 2016. Mr. Tichotsky stated that it was most likely to be around \$55 or \$56.

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Representative Gara mentioned the historical fluctuations of oil prices. He asked if there was a fair amount of inaccuracy in price forecasting because it was difficult to do. Mr. Tichotsky stated that his oil price forecast ranged between \$20 and \$100 per barrel. He would rather be mostly right than exactly wrong. He continued that because there was the issue of spare capacity, no longer controlled by Oil Producing and Exporting Countries (OPEC), there would likely be much more price volatility. Some people were estimating between \$50 and \$70 per barrel of oil. There would be events that would help spike up the price of oil. When people asked one of his teachers about what might happen to the price of oil, he responded that it would change. There was a balance between supply and demand and trying to anticipate it. Volatility was more likely due to the spare capacity issue.

Co-Chair Neuman stated that forecasting was not a laughing matter. He emphasized the state's financial issues. He thought the accuracy in the DOR's forecasting was absolutely critical looking out 5 or 10 years. Trying to get the most accurate information to base the state's budget was crucial. Mr. Tichotsky rebutted that there was a lot of volatility in the market making it very difficult to forecast. He emphasized that it was a problem. Co-Chair Neuman was well aware of it.

Vice-Chair Saddler returned to slide 24. He wanted to make sure he was reading the slide correctly. He pointed to the oil price of \$40 as an example. If the oil price was \$40 then the forecast price would be \$43.57. He wondered if he was correct. Mr. Tichotsky responded positively. Vice-Chair Saddler confirmed that the information on slide 24 was helpful.

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Representative Gara thought the governor was correct about figuring out a way to have a more stable revenue stream. He agreed that the budget deficit was not a laughing matter.

Mr. Tichotsky turned to slide 28: "Comparison - Spring 2015 vs. Fall 2015 Forecasts." He conveyed that most of the changes were based on price. Very little was based on production. Looking at the comparison between spring 2015 versus the fall 2015 for FY 16 there was a much lower price, a little less production, and \$600 million less in revenues than anticipated. The state's economists viewed the difference of \$600 million differently than the Office of Management and Budget. Generally with the percentage differences, it was difficult to make predictions.

Mr. Tichotsky compared fall 2015 against the forecast for 2017 there was a \$30 difference in price accounting for a 35 percent change. There was a smaller amount of production and there was a difference of over \$1 billion in the anticipated forecast.

Representative Edgmon referred to a presentation by Enalytica in the previous year about the increasing volatility in predicting oil prices due to OPEC's dominance receding. Also, with the advent of shale oil production in the United States it was difficult to prepare a break-even analysis for the various oil producers. He agreed that it was more difficult to predict oil prices than it might have been when OPEC was in the driver's seat. Mr. Tichotsky stated that the oil prices for 2013 and 2014 were the same to three significant digits. An economist from his team supplied him the price for 2014 he asked his team member to recheck the number. The fellow did and confirmed that the price was the same down to the penny as it was in 2013. The chances of the number being the same was extremely unlikely. What it told him as an economist was that the commodity markets were really stable. However, there was enough of a change in price and the market was restructuring enough that it was a different environment currently.

Representative Edgmon thought he had heard Mr. Tichotsky report that he predicted there would be volatile circumstances through 2019. He asked if he was correct. Mr. Tichotsky explained that the price forecast the DOR provided that the revenue forecast was based on took the median rather than incorporating the volatility. The volatility was being provided as a back story. He suggested that once volatility set in it was difficult to make accurate predictions.

Representative Edgmon commented that if a group of worldwide experts got together to make predictions and were all wrong or considerably off the mark then it would seem that the whole topic of volatility was an abstract conversation. Mr. Tichotsky thought it was useful to know the environment was unpredictable.

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Representative Kawasaki commented that the forecast that came out in March prior to finishing the budget in the previous year painted a rosier picture than anticipated. In looking at the forecasted number, the price per barrel was off significantly. He wondered if the administration was trying to paint a rosier picture of the budget than what it actually was. From a budgeting standpoint it made him very uncomfortable that the forecasts could be extremely inaccurate especially when doing budgets from year-to-year. He speculated that the legislature would have to have a large supplemental budget. Commissioner Hoffbeck asked Representative Kawasaki to turn back to slide 16 which showed some of the dynamic that contributed to a rosier picture than what occurred. He pointed to January 2015 when the oil price recovered for a period of time and the DOR was preparing the spring 2015 forecast update. The forecast was a product of the data that was available at the time the forecast was being made. Mr. Tichotsky added that the department followed a methodology for calculating the price and production of oil during forecasting sessions.

Vice-Chair Saddler asked if the department had the necessary resources in personnel to do the forecasting more accurately. He wondered if there were any structural impediments in being able to provide more accurate forecasts. Commissioner Hoffbeck responded that the economic research group within the department had been stretched fairly thin in the current year and in previous years. The demands on the economic team extended from revenue forecasting to analyzing legislation, to contributing data to year-end reports. He would absolutely love to have a few more people doing economic research. He complimented the many talented people already contributing within the department.

Vice-Chair Saddler remarked that he would appreciate it if the department would forecast more with less. Commissioner Hoffbeck responded, "Yes."

Co-Chair Neuman commented that the commissioner would not be getting more people.

Representative Kawasaki reported other states being in the same predicament of being fairly dependent on oil including Wyoming and North Dakota. He wondered if their forecasts were similar to Alaska's. Mr. Tichotsky answered that there was probably no other state that was so dependent on oil for revenue and where the industry played the role that it did in Alaska's economy. Alaska was not very diversified. The economies of Wyoming and North Dakota were not as dependent on oil. Their economies developed prior to any oil booms. Alaska was the most oil dependent state in the nation. He was unaware of any other state that relied on a forecast for revenue based on oil prices and oil production.

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Representative Pruitt asked about the performance of Alaska's economists compared to other economists historically. Mr. Tichotsky responded that three years prior, when he became the chief economist, the department revisited the way production forecasting was done and revised the system. It was clear that the department was over-forecasting production. He did not believe the state had an apples-to-apples comparison over the time period to look at times when the forecast was fairly accurate. In a stable oil price environment it was very easy from year-to-year to make a good prediction. In terms of production, it was very easy to make a good prediction one year out. It was a very difficult task to make a prediction for multiple years out when mixing production and price. It was also difficult, even daunting, to compare how well the state did in an analysis.

Representative Pruitt asked if there had been things in the past that the legislature required of the economists within the department to do that should be taken off their plates. Commissioner Hoffbeck suggested changing some of the release dates for certain reports because, currently, most of them were released around the same time. He understood the importance of providing current information. However, it would be helpful if release dates could be staggered.

Representative Pruitt wondered if the legislature had imposed unreasonable demands that limited the best utilization of the state's economists. If so, he wanted to help make adjustments. Commissioner Hoffbeck thanked Representative Pruitt for his consideration. He referred to slide 22. The forecast was prepared by another entity. The ranges were not that much different than the ranges prepared by staff.

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Representative Wilson mentioned the tax division being behind with audits for the tax years under Alaska's Clear and Equitable Share (ACES). She wondered about the impact of the audit workload on forecasting and vice versa. She wondered if they worked together. Commissioner Hoffbeck answered that there were two different teams within the Tax Division of the DOR that ran independently.

Representative Wilson noted that the legislature looked to the revenue forecast when budgeting. She wondered how the audits fit in with the forecasts and money for the budget. Commissioner Hoffbeck replied that the department forecasted credits which were embedded within the forecast. The long-term impact of development was forecasted within the productions. The state worked directly with the industry concerning investment plans.

Representative Wilson mentioned legislation having to do with additional taxes. She expressed her concerns about people leaving which would affect the economy further. She wondered if different taxes would be less volatile. She thought additional slides would be helpful. Commissioner Hoffbeck replied that they were dramatically less volatile. Mining might be an exception because of being driven by commodity prices. He spoke to the impacts of changing rates. He asked folks from the Resource Development Council (RDC) to include factual data in their testimonies when they testified on bills.

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Representative Gara followed up on a question asked by Representative Pruitt. He discussed when he had first started in the legislature. He wondered if there were missions and measures that had been established in past years for the DOR that were not the best use of the

department's time. Commissioner Hoffbeck answered that Co-Chair Neuman and Co-Chair Thompson had asked the department to look at the issue the prior summer. He noted that there were some missions and measures that potentially fell into the category mentioned by Representative Gara, but the DOR had fewer than in other departments.

Representative Pruitt wondered if a savings could be found by consolidating or sharing economists amongst departments. He asked if the state was utilizing its economists efficiently. Commissioner Hoffbeck answered that he could not speak for other departments, but the DOR economists were all working hard. He could look into the issue, but he did not believe there would be significant efficiencies because of how much the team had already been tasked with.

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Mr. Tichotsky continued with slide 29: "Contributors of Change in FY2016 Revenue Forecast." He shared that the major contributors of change in the two forecasts included price, a small difference in ANS production, a large difference in price, and a smaller amount of deductible lease expenditures. Transportation costs were close to the same with a slight increase in the fall forecast.

Mr. Tichotsky moved to slide 30: "Contributors of Change in FY2017 Revenue Forecast." There was a larger change in price in 2017. He thought the production profile was pushed out but maintained the plateau of over 500 thousand barrels per day. He noted the \$1 billion decrease in lease expenditures and reported an increase in transportation costs.

Mr. Tichotsky turned to slide 31: "North Slope Capital Expenditure Forecast Change." He reported the capital expenditure forecast change was strongly price driven. The change equated to a decrease of investment between \$500 million to \$1 billion.

Mr. Tichotsky turned to slide 32: "North Slope Operating Expenditure Forecast Change." He relayed that the decrease in operating expenditures were also price driven. He spoke to the curve changing a little because of costs escalating in the future.

Commissioner Hoffbeck advanced to slide 34: "Net Tax Credits vs. Production Tax." He mentioned a similar slide being presented in the previous year's presentation - the impact of credits against production tax.

Commissioner Hoffbeck reviewed slide 35: "Unrestricted Oil Revenue\* and Tax Credits" He explained that the slide had been requested the prior year. The slide reflected the impact of credits against total revenues being generated by the oil and gas industry. The two slides were included for information purposes.

Mr. Tichotsky proceeded to slide 37: "Fall 2015 Total Revenue Forecast." He explained that the division forecasted stable revenues - the average likely revenues - rather than incorporating volatility. However, he emphasized that when looking at the total revenue forecast, both petroleum and investment revenues were extremely volatile. Federal revenue had been relatively consistent from FY 11 when the state had between \$2.4 and \$2.5 billion coming in. He furthered that when the forecast reached \$3.3 billion, the expected revenue, the state only received cash of about \$2.5 billion. He spoke of non-petroleum revenue totaling about \$1 billion for the unrestricted fund. The state had a consistent non-petroleum revenue of about \$500 million.

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Co-Chair Neuman asked if the dotted line represented the present. Mr. Tichotsky responded affirmatively. He relayed that the history column already occurred including half of 2016. The forecasting portion represented 2015 through 2025.

Co-Chair Neuman asked about the differences between the current chart on slide 37 and the charts on slide 31 and 32. He wanted to know if those charts only addressed the North Slope. He noticed on the current chart that the level of the various revenues were staying flat or increasing. Mr. Tichotsky answered that Co-Chair Neuman was correct. He pointed out that the chart on slide 37 showed the total revenue forecast rather than just the unrestricted portion.

Co-Chair Neuman wondered if the projection included all of the governor's proposals on new revenue streams. Mr. Tichotsky answered that it was under the state's existing

taxes. Co-Chair Neuman was confused. He wondered if the state was going up or down. Mr. Tichotsky explained that the forecast showed a steady revenue stream from royalties through 2025.

Co-Chair Neuman noted that it was not matching up with Mr. Tichotsky's prior charts. Mr. Tichotsky agreed. He thanked the chairman for catching his mistake. He would come back to the question at a later time.

Representative Gara wanted to better understand the confusion. He pointed to the green bar representing oil revenue which indicated a rebound in oil prices. He wondered if that was the reason the green band got slightly bigger and stayed stable. Mr. Tichotsky remembered that the combination of having the price rebound even with production falling they cancelled each other out over time. The chart looked at the total revenue and not just the general fund revenue which tended to dive more.

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Co-Chair Neuman stated that he was still confused and wanted accuracy. He noted the dramatic drop on the chart depicting the North Slope capital expenditure forecast change on slide 31. He surmised from the chart that long-term low oil prices were expected well into the future if the industry was not reinvesting in operations or capital. Mr. Tichotsky would recheck the information on the charts. The picture was supposed to be schematic to show how volatile the revenues were. However, when the division forecasted them they did not forecast volatility. There were certain interacting issues including the volatility and depending on pricing which would create dependencies between costs.

Co-Chair Neuman interrupted to say that the bottom line was that no one was going to forecast that accurately. Mr. Tichotsky supposed that the other issue was that when forecasting if a low number was chosen and increased, then more capital expenditures would be reflected in the forecast. The opposite was true in an environment where the price was decreasing which might result in less capital expenditures. It would hit production in the future depending on more or less investment.

Commissioner Hoffbeck stated that the department would recheck the numbers.

Co-Chair Neuman thought it was safe to say that the state should budget to the low end, or the conservative end of the forecast to avoid additional debt.

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Mr. Tichotsky scrolled to slide 38: "FY 2017 General Fund Unrestricted Revenue, with Price Sensitivity." He talked about the change in price and price sensitivity. Because of the way the taxation system worked there were certain areas where the change in oil prices changed revenues less. In an oil environment where prices ranged between \$25 and \$50 per barrel (Alaska's current environment) it was likely that the state's petroleum unrestricted revenue would be between \$1 billion and less than \$2 billion. In an oil environment where prices were above \$80 per barrel the price difference yielded a more dramatic revenue effect. He relayed that in the back of the DOR Revenue Sources Book there were pages that indexed the price of oil to UGF revenue.

Representative Guttenberg suggested that the chart showed UGF revenue with price sensitivity. He wondered whether the chart reflected revenues after deductions for transportation and production. Mr. Tichotsky stated that the chart showed that revenue equaled price multiplied by production minus costs.

Representative Guttenberg wondered if production and transportation costs would appear as a straight line if they were added in the chart or whether price sensitivity would have to be added. Mr. Tichotsky explained that some elements were price sensitive such as items that were volume oriented. For example if production decreased producing less barrels running through the pipeline the tariff would increase. However, the more barrels that were produced, the greater the economy of scale would be in terms of transportation costs.

Vice-Chair Saddler referred to slide 39. He asked about the line for investment revenue. He asked what the figure included. Commissioner Hoffbeck responded that it would include the Constitutional Budget Reserve (CBR) and the Permanent Fund. He did not believe it included the Alaska Retirement Management (ARM) Board earnings.

Vice-Chair Saddler voiced that it looked like the figures matched.

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Representative Gara returned to the chart on slide 38. He offered that constitution stated that 25 percent of all royalties went into the Permanent Fund. He provided some historical information about the royalty changes for certain fields over time. He asked the commissioner what the financial impact would be to the budget if the royalty percentage for all fields was returned to the constitutional 25 percent. Commissioner Hoffbeck had looked at the information and would provide it to the committee.

Co-Chair Neuman added that it be done on the proposed budget as well. Commissioner Hoffbeck stated that the quick rule of thumb was that the average royalty percentage was about 30 percent. He would provide members with the actual numbers.

Representative Gara asked if it was equal to about \$50 million at current prices. Commissioner Hoffbeck responded that Representative Gara was close.

Mr. Tichotsky advanced to the table on slide 39: "Total Revenue Forecast - FY 2015 & 2016." He pointed to the major heading. There were 4 totals for FY 15. The total unrestricted general fund (UGF) revenue was \$2.3 billion in FY 15 and \$1.6 billion was forecasted for FY 16. The total designated general fund (DGF) in FY 15 was \$331 million and over \$300 million in FY 16. The totals for other restricted revenues reflected a slight or significant increase in investment revenues in FY 16 up from FY 15. He noted that the federal revenue total, although reflected in the amount of \$3.2 billion in FY 16 would likely shake out to \$2.5 billion. He pointed to the total state revenue from FY 15. It appeared to be a relatively stable situation but was clearly different within the structure of the state.

Mr. Tichotsky discussed slide 40: "A New View of Revenue." He mentioned credit ratings and whether the glass was half empty or half full. In terms of talking to credit rating agencies, when a person reviewed revenue subject to appropriation and given the categories the numbers were higher than in the past for UGF. The actual number FY 15

was about \$6 billion and in FY 16 it was estimated at about \$5.4 billion.

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Vice-Chair Saddler asked Mr. Tichotsky to clarify the difference between slides 39 and 40 and define "A New View of Revenue." Commissioner Hoffbeck explained that slide 39 reflected total revenue. In the past in looking at revenue available for use some of the earnings was not included. The new view of revenue was breaking out the investment revenues available for appropriation.

Vice-Chair Saddler asked what slide 40 excluded. Commissioner Hoffbeck responded that in the past there would not have been a line for Permanent Fund Earnings. It would not have appeared as available as a UGF revenue. What was not included in the slide were the substantial investments for trust funds and other restricted investment revenues. The take-away was that the realized earnings of the permanent fund was available for appropriation in the current year.

Mr. Tichotsky advanced to slide 41: "General Fund unrestricted Revenues Non-petroleum." He reported generating around \$500 million per year in UGF non-petroleum revenues. A breakdown of the type of taxes could be seen on the slide including: Non-petroleum corporate income tax, mining license tax, insurance premium tax, tobacco tax, motor fuel tax, and other taxes.

Commissioner Hoffbeck reemphasized that the numbers did not represent any tax changes but were status quo numbers.

Representative Gattis asked for clarity regarding the "New View" of revenue. Commissioner Hoffbeck responded that the "new" was driven by the administration's discussions with the rating agencies. The administration's position was that the state was not truly running at a deficit because of its investment earnings. However, the rating agencies disagreed because the investment earnings were not included in the Revenue Sources Book. In their discussions the administration had to argue why the investment earnings were not in the book. In the current year the DOR included all of the available investment revenues, hence the "New View." It provided a fuller view of how much the state had available to spend.

Co-Chair Thompson pointed to the motor fuel tax on the chart on slide 41. In the previous year the legislature looked at how to increase state revenues. It was his understanding that the previous year's motor fuel tax was \$80 million but the DOR's chart was showing only \$42 million for 2015. He wondered about the discrepancy. He also pointed out that the mining license tax showed a substantial reduction from years 2015 to 2016 to 2017, yet some large mines were scheduled to come online. He wondered why reductions were shown for the mining license tax. Mr. Tichotsky explained that for the mining license tax that the numbers were based on the department's view of commodity prices. The Department of Revenue anticipated that the commodity price would be lower and would result in lower mining license taxes. Commissioner Hoffbeck added that it was unrestricted revenues and a share of what fell under motor fuel - aviation fuel taxes that were restricted.

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Representative Wilson wondered why the motor fuel tax increased from \$42 million to \$51 million. She also noted the decrease in the non-petroleum taxes from \$136 million to \$105 million and stabilizing in 2017 at \$105. Mr. Tichotsky responded in answer to her motor fuel tax question. He explained that although the department had a naive forecast, it tried to get the best available information possible to put together a forecast. Typically, an adjustment was done every year to the forecast to reflect what was actually happening. However, it was a moving target. Some of the analysis the department conducted included looking at the price of motor fuel. If fuel prices dropped, utilization increased. For every tax a department economist went through and completed an individual forecast. The difference of \$51 million and \$42 million had to do with margins of error when running the models.

Commissioner Hoffbeck stated that the difference in the motor fuel tax was actually a result of the increase - just short of a penny - adopted in the prior year.

Representative Wilson asked for an explanation for the decrease in the non-petroleum corporate income from \$136 million to \$105 million. Mr. Tichotsky reported it had to

do with the estimations of the global economy. He did not know the particulars about the higher take in 2015. He recalled the estimate to be between \$100 million and \$120 million. The actual number was \$136 million for 2015.

Representative Wilson wondered about the original estimate even though he was reporting actual numbers for 2015. Mr. Tichotsky stated that as the chief economist when he looked at the non-petroleum revenues he looked at them as a portfolio. Even though the individual items within the portfolio bounced around occasionally, they averaged out at around half of \$1 million. Although there were changes from year-to-year the total number was a fairly stable revenue supply.

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Co-Chair Neuman asked Mr. Tichotsky, the chief economist for several years, if it was possible to look at the forecasts from a few years prior. His point was that, as uncomfortable as it was to bring up, he thought politics were becoming part of the discussions around the forecast. He suggested that perhaps if someone who had an interest in trying to show that the deficits to the state were going to be greater, the forecast would need to look lower. He was not saying that it had occurred, but he thought it was a possibility. He wanted a comparison since the same person had been doing the revenue forecasting for many years. Commissioner Hoffbeck would provide the data and assured Co-Chair Neuman that politics were not a factor. Co-Chair Neuman replied, "Let's make sure."

Mr. Tichotsky responded that over all non-petroleum revenue was a relatively stable source of revenue from an economic point of view.

Representative Munoz referred to slide 29. In looking at the deductible lease expenditures for Spring 2015 forecast for \$6.7 billion and Fall 2015 forecast for \$5.7 billion it appeared that there was a correlation between the price of oil and the amount companies spent. Conversely, when prices were higher a few years prior, she wondered if the capital expenditures were significantly higher or similar to the forecast numbers on the slide. Mr. Tichotsky responded that they were significantly higher in a higher price environment.

Representative Munoz asked him to walk the committee through what qualified lease expenditures included and how the credits were calculated. Mr. Tichotsky conveyed that the numbers for the overall forecast equaled the aggregate across the entire industry. Using the DOR's model, the department worked with the companies to complete a detailed questionnaire. The companies were also asked to provide a forecast of their lease expenditures. The department referenced the history of what was actually done. An aggregate number was derived by taking the information the companies provided as well as the historical information and applying the department's knowledge of the responsiveness of lease expenditures to prices. The numbers were added together by company and an aggregate number was defined. The department then ran the tax calculation and based on the lease expenditures, production, and price, the overall revenue forecast was derived.

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Representative Munoz stated that the information helped with the forecasting. However, she wanted the commissioner to walk through how they were calculated and applied. Commissioner Hoffbeck would provide the information.

Representative Guttenberg reiterated that he had asked about the general fund price sensitivity and deductible lease expenditures. He wondered if the department tracked what projects were being worked on to help with forecasting into the future. He understood that in the short turn there might not be significant changes in project schedules based on price. However, he wondered if the production forecasts factored in potential project development changes due to future oil prices. Mr. Tichotsky explained that the department did the interview process with the companies in September of each year. The department looked at both the spring actuals and the data from the companies to create the following spring forecast. Depending on what the department thought was happening, there was a follow-up opportunity to have discussions with the industry. He reiterated that the near-term forecast was typically spot on. However, uncertainty crept in beyond a year due to price uncertainty and other uncertainties. The farther out the forecast, the more uncertain the numbers were.

Co-Chair Neuman asked the commissioner to move on to the next presentation on the budget overview.

Co-Chair Thompson asked members to submit any questions on the revenue forecasts to Co-Chair Neuman and he would obtain and distribute written responses.

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^FY17 BUDGET OVERVIEW: DEPT. OF REVENUE

Commissioner Hoffbeck turned the meeting over to Mr. DeBartolo.

DAN DEBARTOLO, DIRECTOR, DIVISION OF ADMINISTRATIVE SERVICES, DEPARTMENT OF REVENUE, introduced the PowerPoint presentation: "State of Alaska: Department of Revenue Budget Overview."

Mr. DeBartolo began with slide 2: "Alaska Department of Revenue":

- Core Programs
- Treasury Division - Invest
- Tax Division - Collect
- Permanent Fund Dividend Division - Distribute
- Child Support Services Division - Collect and Distribute
  - Authorities, Corporations, and Boards
- Alaska Housing Finance Corporation (AHFC) - Invest and Distribute
  
- Alaska Permanent Fund Corporation (APFC) - Invest
- Alaska Retirement Management Board (ARMB) - Invest
  
- Alaska Mental Health Trust Authority (AMHTA) - Distribute
  
- Alaska Municipal Bond Bank Authority (AMBBA) - Distribute

Mr. DeBartolo relayed the mission of the DOR was to collect, distribute, and invest funds for public purposes. He indicated the department had had questions as to why the Child Support Services Division fell within the DOR. He explained that a money stream had to be collected and distributed. He continued to read the slide.

Mr. DeBartolo explained the structure of DOR on slide 3: "Alaska Department of Revenue." He read from the organizational chart. (Copy on File). He noted that the Alaska Liquefied Natural Gas (AKLNG) fell under the DOR as well. He clarified that the component within the DOR was called Natural Gas Commercialization, a very small portion of the overall AKLNG project.

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Mr. DeBartolo read from slide 4: Alaska Department of Revenue: FY 17 Department Snapshot of Programs":

- Treasury Division
  - Mission - To Manage and Invest State Funds
  - Positions - 42 Full Time
  - Programs under the Treasury umbrella - \$83,851.8 (20.83% of DOR Budget)
    - Treasury Operations - \$10,225.6 (2.54% of DOR Budget)
    - Alaska Retirement Management Board - \$72,039.8 (17.89% of DOR Budget)
    - Alaska Municipal Bond Bank - \$1004.7 (.25% of DOR Budget)
    - Unclaimed Property - \$581.7 (.14% of DOR Budget)
- Tax Division
  - Mission - Collect Taxes, Forecast & Report Revenues, and Regulate Gaming
  - Positions - 110 Full Time, 1 Part Time
  - Tax Operations - \$15,142.8 (3.76% of DOR Budget)
- PFD Division
  - Mission - Distribute Timely Annual Dividend Payments to Eligible Alaskans
  - Positions - 72 Full Time, 9 Part Time
  - PFD - Operations - \$8,754.2 (2.17% of DOR Budget)

Mr. DeBartolo read directly from slide 5: "Alaska Department of Revenue: FY 17 Department Snapshot of Programs":

- Child Support Services Division

- Mission - To Collect and Distribute Child Support Payments to Custodial Parents
- Positions - 224 Full Time
- Child Support Operations- \$27,531.2 (6.84% of DOR Budget)
- Administration and Support
  - Positions - 24 Full Time
  - Programs under the Administration umbrella - \$4,049.9 (1.0% of DOR Budget)
    - Commissioner's Office
    - Administrative Services Division
    - Criminal Investigation Unit
    - Natural Gas Commercialization - AKLNG
- Permanent Fund Corporation
  - Mission - To Maximize the Value of The Permanent Fund Within Return Objectives
  - Positions - 48 Full Time, 2 Part Time
  - APFC Operations and Management Fees - \$160,300.8 (39.82% of DOR Budget)

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Vice-Chair Saddler asked if operational expenses for the ARM Board equaled \$72 million. He wondered if it counted money under management. He also asked about the \$160 million figure for management and operations for the Permanent Fund Corporation. Mr. DeBartolo explained that it was a combination of their operational budgets and management fees. The actual operational budget for the Alaska Permanent Fund Corporation (APFC) was between \$10 million to \$12 million. The ARM Board was managed by the investment officers within the treasury umbrella. The ARM Board's budget was comprised of mostly fees and some budgeting components for investment officer positions that were exclusively allocated to a particular job. Vice-Chair Saddler asserted the information was helpful.

Mr. DeBartolo turned to slide 6: "Alaska Department of Revenue: FY 17 Department Snapshot of Programs." He read from the slide:

- Alaska Housing Finance Corporation
  - Mission - To Provide Alaskans Access to Safe, Quality and Affordable Housing

- Positions - 313 Full Time, 37 Part Time and Non-Perm
- AHFC Operations- \$96,075.7 (23.87% of DOR Budget)
- Alaska Mental Health Trust Authority
  - Mission - To Administer the AMHTA as a Perpetual Trust and to Ensure a Comprehensive and Integrated Program to Improve the Lives of Beneficiaries
  - Positions - 16 Full Time
  - AMHTA and LTCO Operations - \$4,998.6 (1.24% of DOR Budget)

Mr. DeBartolo moved to slide 7: "Alaska Department of Revenue: Summary of UGF and Position Reductions - FY 15 Management Plan to FY 17 Governor." He provided a bit of context on the slide. He explained that it was not just a change slide from last year's management plan to the current year's governor's budget. He wanted to provide information about what the DOR was doing to reduce the size of its operations, in terms of the budget as a whole. He read directly from the slide:

- Since the start of FY15, the Department has cut \$5.9 million (-19.1%) in UGF spending. The Tax Division has felt the greatest impact as \$2.65 million (15.5%) of its total budget has been reduced during that period.
- The Treasury Division reduced \$1.75 million (35.8%) in UGF spending primarily due to management fee reductions and cost allocation changes.
- The Child Support Services Division reduced \$1.1 million (10.1%) in UGF spending via staff reductions and programmatic changes.
- During this period the Department will have eliminated 48 positions:
  - Tax - 29
  - Child Support - 6
  - AHFC - 3
  - Treasury - 3
  - PFD - 2
  - Admin Services - 2
  - Commissioner - 2
  - Criminal Investigations - 1

Mr. DeBartolo highlighted that the reduction in positions was not a net of new positions requested. They were positions that had been eliminated. Largely the reductions had come from general administrative duties such as accounting and other administrative positions. Information Technology positions had been reduced as well as some analysts positions. He offered to provide the detail to members.

Co-Chair Neuman asked for the information.

Representative Gattis queried about the term "positions" and whether that word meant human beings. She asked if 48 human beings no longer worked within the departments listed. Mr. DeBartolo responded that it did not mean that 48 people had lost their jobs. The department had made a concerted effort to hold positions open rather than bringing in new people. The department was aware of the likelihood of potential cuts and made sure to hold off on filling vacant positions. It had the same budgetary impact. The Department of Revenue's goal was not to try to put as many people out of work as possible, but rather to reduce the overall personal services operating budget. He thought the department could show that it had done that. In a few instances the department had added investment officer positions trying to bring more investments in-house. The department had found that there was definitely a cost savings in doing the investments in-house rather than paying out management fees to outside entities.

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Representative Gattis asked how many Alaskans had lost their jobs and asked how many had been put to work. Mr. DeBartolo reported that he did not know what the actual layoff number would be for FY 17 if the budget remained intact. He was aware that some of the positions were filled. It was unclear about what would happen to the positions if the employees moved on. He relayed that 9 Alaskans were laid off or put out of positions as a result of last year's budget. There were new investment officer positions that had not all been filled. The Department of Revenue had filled 3 investment officer positions recently, 2 of which were within the treasury division. He did not know how many of the 4 positions within the APFC were filled but would get the answer.

Representative Gattis wanted to be clear that eliminating positions sometimes meant that the state was just eliminating the opportunity for the state to hire a person into a position rather than letting go of an actual person.

Co-Chair Neuman thought the department needed to provide the number of positions eliminated and how many personnel were let go.

Commissioner Hoffbeck noted the only caveat he would add was that the DOR had made a concerted effort to refrain from hiring personnel. The department had had an informal hiring freeze for some time. His instructions to his directors was not to hire a position unless they thought they were more valuable than someone already on staff. People were going to have to be laid off. Typically the vacant positions would have had bodies in them but the department knew people would have to be laid off.

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Mr. DeBartolo reviewed the pie chart on slide 8: "Alaska Department of Revenue: FY 17 Governor's Budget by Program Including Unallocated Reduction (See Handout)." The chart showed the department's entire budget. He pointed out the largest slices, representing 80 percent of the overall budget, were investment areas: The Alaska Permanent Fund Corporation, The Alaska Housing Finance Corporation, and the Alaska Retirement Management Board. There had not been any substantial cuts in any of the three entities because they were investment areas. It was imperative the state was making as much money as possible. The remaining small pie pieces made up about 20 percent of the budget and was the area of focus in terms of cuts to the budget. The department was making sure its IT staff could work across division boundaries because of position reductions. Silos of work were being eliminated. The department's next course of action would be to look at centralizing some administrative positions, such as accounting and accounting support positions, that were currently doing duplicative work within different divisions. The department continued to examine how to trim excesses throughout divisions.

Co-Chair Neuman commented that, to his knowledge, the Alaska Permanent Fund Corporation had never encountered cuts to its budget. He opined that APFC's budget mattered, especially in the governor's new proposed budget where the

Permanent Fund Dividend (PFD) would be funding government. He suggested for the DOR to consult with the APFC. He thought if there were reductions to APFC there would be more money available for the PFD. He concluded that the investment areas should be reduced as well. Commissioner Hoffbeck relayed that one of the easiest ways to increase returns was to bring more management in-house rather than paying higher outside management fees. Although it would increase the employee budget, it would also substantially increase the state's net revenue.

Co-Chair Neuman made a comment about hiring 10 more people and making significantly more money. He did not want to discuss the issue further.

Representative Wilson suggesting contracting management rather than hiring full time employees. She asked if the slide reflected unrestricted revenue funds or all funds. Mr. DeBartolo responded that he would supply the information.

Representative Wilson wanted to see a pie chart reflecting only UGF. Mr. DeBartolo responded in the affirmative.

Representative Pruitt's asked if the management people were paid from the permanent fund. Commissioner Hoffbeck responded, "That is correct."

Representative Pruitt thought investing in people within the APFC was a wise idea and noted that it would ultimately pay for itself. He requested that the DOR highlight the individuals paid for by UGF versus individuals paid for by the Permanent Fund (PF). He would oppose cutting individuals within the APFC that were paying for themselves with the work they did. Mr. DeBartolo relayed that when he was reviewing the slide and pointed out the differentiation he was not looking for additional cuts but rather was highlighting where the concentration of cuts had been.

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Mr. DeBartolo moved to slide 9: "Alaska Department of Revenue: FY 17 Governor's Budget Key Changes (Including Unallocated Reduction)":

#### Key Reductions

Tax Division - (\$757.9) UGF and 8 full time positions  
Treasury Division - (\$324.1) UGF/Other and 3 full time positions  
Child Support Services Division - (\$789.9) UGF/Fed and 6 full time positions

#### Key Increment Requests

Treasury Division - \$711.5 - Add two investment officers and one support position

Treasury Division - \$857.8 - Move investment officer salaries to market level

Natural Gas Commercialization (AKLNG) - \$1,876.7

Consulting and Legal Services - \$1,700.0

Non-Permanent Project Coordination Position - \$111.7

Travel and Support Costs - \$65.0

Mr. DeBartolo mentioned the reduction of 2 positions from the unallocated reduction within the Treasury Division. The state had given \$190 thousand to the Tax Division. He also noted that the APFC had reduced \$3 million in management fees with certain changes.

Co-Chair Thompson asked if the requests were in UGF. Mr. DeBartolo indicated that the request for the Treasury Division would not be in UGF because they would be allocated to the ARM Board.

Vice-Chair Saddler thought he heard Mr. DeBartolo mention the figures included unallocated reductions. It sounded like Mr. DeBartolo had allocated them to certain positions. He noted that it was unusual to have unallocated reduction as early in the process. Mr. DeBartolo explained that he had allocated \$190 thousand to the Tax Division, \$190 to the Treasury Division, and \$134 in UGF to the Child Support Division of the state's \$518 thousand that was a part of the state's unallocated reduction. He hoped to have the unallocated reductions in the governor's amended scenario.

Mr. DeBartolo continued reading from the slide. He mentioned that the request for \$857.8 thousand for the Treasury Division would allow the state to offer more competitive salaries to investment officers. A study had

been done confirming that the state needed to be more competitive in the market.

Representative Gattis asked about salaries having to be bumped up in order to attract people to Juneau from the Lower 48. She opined that some of the work could be done from the Lower 48. She wondered whether salaries would have to be bumped up if they were working somewhere else where the work was typically done, such as on Wall Street. Commissioner Hoffbeck answered that in order to attract people from other places salaries had to be substantially higher than what the department had asked for particularly for the ARM Board. The department had attempted to bring people in and train them. Some of the funding request was to provide salary increases for people that had been with the state for several years and were now full-fledged investment officers. He admitted that the DOR offered substantially less than the APFC for some positions. The funding request was, at least in part, to avoid losing some existing state employees. He added that the department hired locally whenever possible.

Representative Gattis wondered whether the state's salaries compared to those elsewhere in the established industry, or would the department have to bump them up to attract people to Juneau. Commissioner Hoffbeck indicated that the industry standard was higher than what the state was currently offering.

Mr. DeBartolo continued reading the natural gas commercialization section on slide 9.

[3:48:07 PM](#)

Representative Wilson asked if the legislature had already paid the costs Mr. DeBartolo had just mentioned. She thought the expenses had been addressed in the most recent special session. Commissioner Hoffbeck explained that the request was for a specific DOR position and for support in order to get through FY 17 focusing on the pre-feed. Unlike, the Department of Natural Resources (DNR), the DOR had one deputy commissioner basically dedicated to the AKLNG project, 2 audit masters working on the project rather than doing audits, and two analysts already working on the project that needed to be focusing on their normal work. He admitted that the DOR could not properly do its job without additional people hired.

Representative Wilson asked if he had known about the staff shortfall during special session. She was questioning the timing. Commissioner Hoffbeck did not know the answer to her question.

Representative Wilson wanted to point out that there was already additional costs on certain projects. The legislature should have been made aware of additional costs prior to approval of moving to the next steps.

Co-Chair Neuman did not understand why the funds were not coming out of the AKLNG fund.

Representative Wilson agreed.

Commissioner Hoffbeck explained that in the past the department had had difficulty getting the money returned to the department for the work it had done for AKLNG via a reimbursable services agreement (RSA).

Co-Chair Neuman would ask the committee to look into the issue further.

Representative Pruitt added that the discussion applied to the end of the current fiscal year in special session. He felt the current discussion was for the following fiscal year. He thought he answered the current question. The state's money that was appropriated in the previous November was only for the current fiscal year.

Representative Wilson responded that she wanted the department to respond.

Mr. DeBartolo advanced to slide 10: "Alaska Department of Revenue: FY 17 Governor's Budget Key Changes - Alaska Permanent Fund Corporation Requests":

Rules based stock portfolio

Staff: 3 investment, 1 risk, 1 IT  
Annual salary cost: \$882,000  
Annual fee savings: \$3.2 million

Special opportunities

Staff: Investment analyst  
Annual salary cost: \$145,000  
Savings: \$44 M over the life of one investment

\$216,000 for staff retention adjustments

It is important that the APFC be able to retain experienced, skilled professionals that are critical to managing and growing the Permanent Fund.

Mr. DeBartolo noted the anticipated savings with both clusters of additions.

[3:52:08 PM](#)

Mr. DeBartolo scrolled to slide 11: "Alaska Department of Revenue: FY 17 Capital Budget Requests - Governor":

- Child Support Services Database Replatforming (NSTAR)
  - Capital Funding - 1,700.0 UGF Match/3,000 Fed

These funds will be used to move the case management system off the aging and expensive mainframe, and keep them compliant with the Feds for at least the next fifteen years.

- Alaska Housing Finance Corporation Multiple Projects
  - Capital Funding - 15,950.0 UGF/  
3,900.0 Other/1,500.0 DGF/16,500.0 Fed
- General Fund Detail (UGF/DGF)
  - \$6.85 million Homeless Assistance Program
  - \$3.0 million Supplemental Housing Development Program
  - \$1.85 million Federal and Other Competitive Grants
  - \$1.5 million Beneficiary and Special Needs Housing
  - \$1.5 million Rental Assistance for Victims (ECHP)
  - \$1.0 million Teacher, Health, & Public Safety Professionals Housing
  - \$1.0 million Cold Climate Housing Research Center (CCHRC)
  - \$750,000 HUD Federal HOME Grant

Co-Chair Neuman mentioned that AFHC would be coming before the committee at which time questions could be addresses.

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

#

ADJOURNMENT

3:54:01 PM

The meeting was adjourned at 3:54 p.m.