

HOUSE FINANCE COMMITTEE
April 17, 2016
9:41 a.m.

9:41:12 AM

CALL TO ORDER

Co-Chair Thompson called the House Finance Committee meeting to order at 9:41 a.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 Scott Kawasaki
Representative Cathy Munoz
Representative Tammie Wilson

MEMBERS ABSENT

Representative David Guttenberg
Representative Lance Pruitt

ALSO PRESENT

Kristen Pratt, Staff, Senator Anna MacKinnon; Diane Barrans, Executive Director, Alaska Commission on Postsecondary Education and Executive Officer, Alaska Student Loan Corporation, Department of Education and Early Development; Jane Pierson, Staff, Representative Steve Thompson.

PRESENT VIA TELECONFERENCE

Sterling Gallagher, Self, Anchorage; Charlene Morrison, Chief Financial Officer, Alaska Commission on Postsecondary Education and Alaska Student Loan Corporation, Department of Education and Early Development.

SUMMARY

HB 245 PERM. FUND:DEPOSITS;DIVIDEND;EARNINGS

HB 245 was HEARD and HELD in committee for further consideration.

HB 250 INDIV. INCOME TAX: CREDITS; RETURNS

HB 250 was SCHEDULED but not HEARD.

SJR 2 CONST. AM: G.O. BONDS FOR STUDENT LOANS

SJR 2 was REPORTED out of committee with a "do pass" recommendation and with a previously published zero fiscal note: FN1 (GOV).

Co-Chair Thompson reviewed the agenda.

[9:42:09 AM](#)

#sjr2

SENATE JOINT RESOLUTION NO. 2

Proposing an amendment to the Constitution of the State of Alaska relating to contracting state debt for postsecondary student loans.

KRISTEN PRATT, STAFF, SENATOR ANNA MACKINNON, conveyed Senator MacKinnon's gratitude for the bill hearing. She explained the resolution was a constitutional amendment that would permit the issuance of general obligation bonds for the purpose of funding postsecondary student loans. The bill would amend Article IX, sec. 8, of the Alaska Constitution, which currently allowed state debt to be contracted for capital improvements and housing loans for veterans. The intent of the legislation was to access lower cost loans to have lower interest rates for borrowers as well as to give the Alaska Student Loan Corporation (ASLC) more flexibility with its underwriting criteria.

Vice-Chair Saddler asked what it meant that the bill would allow increased criteria flexibility.

Ms. Pratt deferred the question to the Department of Education and Early Development.

DIANE BARRANS, EXECUTIVE DIRECTOR, ALASKA COMMISSION ON POSTSECONDARY EDUCATION (ACPE) and EXECUTIVE OFFICER,

ALASKA STUDENT LOAN CORPORATION, DEPARTMENT OF EDUCATION AND EARLY DEVELOPMENT, responded that currently a minimum credit criteria was required in order for the underlying assets (the student loans themselves) to be of sufficient quality to use in the issuance of bonds or revenue bonds. The credit criteria was currently a 680 FICO credit score. She detailed that if the state's credit backed the bonds in the terms of a general obligation bond, the existing credit criteria could be somewhat modified, which would allow a larger group of students to qualify.

[9:44:57 AM](#)

Vice-Chair Saddler asked for verification the corporation could offer loans to students with lower credit scores. Ms. Barrans responded in the affirmative.

Vice-Chair Saddler asked for background information about the number of loans the commission issued for postsecondary tuition per year. Additionally, he wondered how many loan applications were approved and rejected.

Ms. Barrans responded on an annual basis the student loans had been issued to as many as 12,000 students in a year. Currently, the numbers had dropped substantially to several hundred loans per year. The decrease was due in part to the interest rates, which consumers were concerned were excessive. Additionally, approximately 40 percent of the applicants did not qualify for the credit criteria and were unable to obtain a cosigner who met the criteria.

[9:46:08 AM](#)

Vice-Chair Saddler asked about the commission's current interest rate compared to other financial loans available elsewhere.

Ms. Barrans responded that the interest rate charged in the past two to three years was 6.25 percent, which was a fairly good rate for unsecured credit. Other non-federal student loan programs throughout the country had similar rates, although some had higher credit criteria. The commission expected it could decrease the interest on its loans by a full percent (i.e. to a 5 percent rate) if the state was able to maintain its AAA credit rating. She detailed the decreased rate would be very attractive and amongst the best in the nation.

Representative Gara relayed his support for the bill, given interest rates charged by the state. He recalled that during the country's financial crisis in 2008 the criteria had changed to require applicants to have a cosigner. He wondered if the criteria was still necessary. He spoke specifically about a situation where a student did not have a parent with money.

Ms. Barrans answered that a creditworthy cosigner was required if a student did not have sufficiently high credit. She elaborated it was not something she expected to change. She detailed that even with a general obligation bond there was an expectation the assets of the corporation would be sufficient to ensure cash flow on the loans and repay the debt. There was no expectation the corporation would look to the state to have general funds paying down the bonds. The corporation believed lowering the credit score requirement would be very helpful in allowing students to qualify on their own credit; however, a creditworthy cosigner would still be required if a student did not have sufficiently high credit.

Representative Gara remarked the issue was obviously a problem, but it was not a problem that could be solved in the current bill. He noted intent to work on the issue separately.

[9:48:49 AM](#)

Representative Kawasaki spoke in support of the bill. He noted that when the bill had first been introduced the state had a great credit rating. He wondered about the impact if the state's credit rating was downgraded in the near future. He questioned whether it would be worth opening up the state's constitution to change the particular article.

Ms. Barrans responded that the corporation had asked its financial advisor to analyze the impact if the state were to experience an entire step downgrade. She relayed it would still allow the corporation to reduce the interest cost by about 95 basis points, which would still offer a substantial benefit.

Co-Chair Thompson thanked Ms. Barrans for her testimony. He OPENED public testimony.

[9:50:24 AM](#)

STERLING GALLAGHER, SELF, ANCHORAGE (via teleconference), shared that he was a former commissioner of the Department of Revenue (DOR) who had worked to put together the Permanent Fund. He had also worked as a bond underwriter for the state for Alaska Housing Finance Corporation (AHFC) and Alaska Industrial Development and Export Authority (AIDEA). Additionally, he had been the underwriter on the bond issue addressed by the bill. He shared that he had put together the original loan for the student loan authority. He elaborated that the program had worked for 25 years as intended. He explained the agency was designed around cash flow, which was a problem. Currently the agency had an overall loan default rate of 28 percent. He stated the agency had a total expenditure of \$15 million to administrate \$350 million in loans the previous year (4 percent). He specified the loans from the past year only originated \$3.2 million. He calculated that the cost of administration was four times every loan the program made. He believed the agency's performance needed a serious review before general obligation bonds were considered.

Mr. Gallagher continued that general obligation bonds should be preserved for the state's first line of defense for major areas of finance. He provided the occurrence of another major earthquake as an example. He believed the agency wanted to start cutting away at the numbers and the state's flexibility on general obligation by urging "these sorts of debts" that had a 28 percent default rate. He reiterated the cost of the administration of the program. He remarked that the current structure could also accommodate a lowering of interest rates. He noted the state had a AA rating and because of the moral obligation attached the agency would trail 10 or 15 basis points behind it. He believed it was a small price to pay for maintaining the state's flexibility on general obligation debt. He opined the agency could work out its problems. He stated the agency needed more collateral and did not necessarily need more cash. He suggested taking loans from AHFC or any other program. He emphasized the program needed quality cash flow. He restated the 28 percent default rate and noted the national default rate was 40 percent. He referred to a recent case where the State of New York had

allowed the debts to be charged off bankruptcy. He concluded the entire area was influx nationally. He restated the program's accomplishments needed a review. He believed it was dangerous to attach the loans to the state's general obligation debt, which would result in a loss of flexibility.

[9:55:22 AM](#)

Co-Chair Thompson CLOSED public testimony.

Representative Wilson referred to Mr. Gallagher's statement that it cost \$15 million to administrate the program. She asked how much the cost influenced the interest rates offered to students.

Ms. Barrans relayed that the corporation did a calculation on the interest rate. She deferred to the commission's chief financial officer who had recently done the calculation to set the 2016-2017 interest rates.

CHARLENE MORRISON, CHIEF FINANCIAL OFFICER, ALASKA COMMISSION ON POSTSECONDARY EDUCATION and ALASKA STUDENT LOAN CORPORATION, DEPARTMENT OF EDUCATION AND EARLY DEVELOPMENT (via teleconference), replied that the calculation referred to by Ms. Barrans included the cost of administration of approximately 2.5 percent of the interest rate.

Representative Wilson asked for detail on the new calculation Ms. Morrison had recently completed [for 2016-2017]. She wondered what the interest would be on a new loan at present. Ms. Morrison replied the interest rate was 6.25 percent for the coming academic year.

[9:57:57 AM](#)

Representative Wilson asked for verification the 6.25 percent included the 2.5 percent administration cost. Ms. Morrison answered in the affirmative.

Representative Wilson surmised that if bonds enabled the rate to drop to 5.25 percent it would not include the 2.5 percent administration cost. Ms. Morrison responded in the negative. She detailed that if the state maintained its AAA credit rating and if the market remained steady at its

recent level, the interest rate could drop as low as 5.25 percent.

Representative Wilson was trying to understand the administrative cost percentage of 2.5. She reasoned the 2.5 percent was almost as much as the amount charged to students. She wondered if there would be a limit on how much money could be put into the bonds if the bill passed and was approved by voters.

Ms. Barrans replied that if voters approved the modification of the state's constitution, the legislature would then be required to authorize the operating rules allowing the corporation to proceed, which would include a cap similar to the caps AHFC had in place on the issuance of debt for the veterans' home loan program.

Representative Wilson remarked that 28 percent [default rate] was pretty scary. She surmised the corporation would have to show it could cover the bond with receipts (and not state general funds).

Ms. Barrans responded in the affirmative. It would be similar to the corporation's current process, when it went into the market, of providing cash flows to the ratings agencies in order for the agencies to verify and rate the issuance of the bonds. She noted the corporation had successfully issued \$1.6 billion in debt since 1988. Additionally, the corporation had always had the support of the state's moral obligation and had never needed to ask the state for any cash support. Several years back the legislature had authorized a bridge loan to assist the corporation for a short period of time. She specified the corporation had used the loan and had fully repaid it to the state. The corporation had never needed to place a call on the legislature for support and did not anticipate that changing in the future.

[10:01:10 AM](#)

Representative Gara stated that the cost of administration would go down because the conference committee had cut a couple of positions within the corporation. He reasoned the corporation needed to do outreach to make students aware of the student loan program. He noted that banks did outreach for their businesses. He asked about the corporation's

administration cost compared to other state student loan agencies or financial institutions.

Ms. Barrans answered she could not speak to the costs of other organizations. The scale of operation was an issue. The decline of the corporation's loan volume over the last several years impacted the scale. She responded to Mr. Gallagher's public comment and relayed that the loan default rate was not 28 percent. She detailed the rate was calculated on an annual basis and the most recent rates were around 7.8 percent. She stated it was a factor in the cost of administering the loans, which also impacted servicing costs.

Co-Chair Thompson commented that the 28 percent to 7.8 percent default rates were quite a variation. He asked about the differential.

Ms. Barrans responded she had testified in the past that default rates had been very high (in the 20 percent range) in the late 1980s and early 1990s. She could not speak to Mr. Gallagher's source of information. She explained the rate had been substantially reduced over years, in part due to putting collection levers in place (authorized by the legislature) and implementing credit criteria. She explained there had been no credit criteria or cosigner requirements when the rates had been that high.

[10:03:39 AM](#)

Co-Chair Neuman provided a scenario where the legislature came back in the following year and determined a change needed to be made to the corporation after determining its administrative costs. He wondered if passage and voter approval of the bill would lock the legislature into any future commitments around how the fund was managed.

Ms. Barrans responded not that she was aware of.

Co-Chair Neuman believed the costs needed to be looked into further. He thought the program operation costs were between \$1.2 million and \$1.4 million.

Ms. Barrans answered that the program's administrative costs had reduced over the past two years. There were some increased costs, but they were relative to pass through funds. The WWAMI (Washington, Wyoming, Alaska, Montana, and

Idaho) program budget was included in the corporation's organizational budget. She elaborated there had been some increases until the past year or so, which had flattened out. The other new money was pass through funds for scholarships and grants.

Vice-Chair Saddler asked if it could be assumed ACPE and ASLC were on the same side (different entities with the same mission).

Ms. Barrans answered in the affirmative. The entities shared a mission - the corporation was the fiduciary of the funds, which directed investments and determined terms and conditions on loans, whereas, ACPE represented the policy-setting side responsible for controlling student aid programs or outreach activities. The agencies worked essentially as an integrated organization.

Vice-Chair Saddler surmised the current consumer rate of 6.25 percent included a cost of 3.75 percent on the open market and the 2.5 percent administrative cost. He asked for verification if the corporation was able to obtain a 2.75 percent market rate as envisioned by the legislation, the rate [offered to students] would reduce to 5.25 percent.

Ms. Barrans responded in the affirmative.

[10:07:00 AM](#)

Vice-Chair Saddler referred to Ms. Barrans' testimony the commission had never needed to ask for cash assistance from the state. He noted Ms. Barrans had also referred to a bridge loan the commission had received. He thought she had testified the loan had been to pay back the state. He asked for detail.

Ms. Barrans answered that after the bond market collapsed in 2007 the student loan backed bonds had been tainted by the mortgage industry [crisis]. Investors had become very wary of certain asset backed bonds, which included student loans. She detailed that the cost on the bonds had become exorbitant for anyone in the market at the time. Therefore, ACPE had not been able to go into the market to issue debt for a period of time. In order for the commission to continue to meet loan demand during the two or three years after the collapse, the legislature had authorized DOR to

enter into a loan agreement with ACPE. She furthered that DOR had to structure it as an investment of the state, which required DOR to charge an interest rate similar to what the department would have otherwise received on other investments. The corporation had used about \$68 million of a \$100 million line of credit and had subsequently paid it back. She believed the interest ACPE paid on the debt to the state was around 3.8 or 4 percent.

Vice-Chair Saddler referred to the bond market collapse in 2007. He wondered if the circumstances had been considered an extraordinary condition that may happen every 50 to 100 years.

Ms. Barrans responded the situation had been considered a once-in-a-generation collapse. She elaborated it had occurred due to the result of extended subprime mortgage lending activity.

Vice-Chair Saddler asked for clarification on what Ms. Barrans meant by once-in-a-generation. He wondered if the legislature should expect that kind of thing to happen every 20 years.

Co-Chair Thompson interjected "next time we have a recession."

Vice-Chair Saddler wondered how often Ms. Barrans thought a situation may call into question the corporation's ability to carry its loan debt on its own.

Ms. Barrans replied she would not expect to see the circumstance happen again. She detailed the situation had led to a series of changes in the market's structure by rating agencies and bond insurers. The collapse had been catastrophic and had led to a changing of the "rules of play" in the market.

Co-Chair Thompson asked Vice-Chair Saddler to address the fiscal note.

10:10:40 AM
AT EASE

10:11:16 AM
RECONVENED

Vice-Chair Saddler reviewed the bill's zero fiscal note from the Office of the Governor for the Division of Elections. He remarked there were no position changes included in the note.

Co-Chair Neuman MOVED to report SJR 2 out of Committee with individual recommendations and the accompanying fiscal note. There being NO OBJECTION, it was so ordered.

SJR 2 was REPORTED out of committee with a "do pass" recommendation and with a previously published zero fiscal note: FN1 (GOV).

[10:12:06 AM](#)

AT EASE

[10:51:01 AM](#)

RECONVENED

#hb245

HOUSE BILL NO. 245

"An Act relating to the Alaska permanent fund; relating to appropriations to the dividend fund; relating to income of the Alaska permanent fund; relating to the earnings reserve account; relating to the Alaska permanent fund dividend; making conforming amendments; and providing for an effective date."

Co-Chair Neuman MOVED to ADOPT the proposed committee substitute for HB 245, Work Draft 29-GH2859\N (Wallace/Martin, 4/16/16). There being NO OBJECTION, it was so ordered.

[10:51:46 AM](#)

JANE PIERSON, STAFF, REPRESENTATIVE STEVE THOMPSON, reviewed the changes in the work draft from the previous version. She read the prepared sectional analysis:

Sec. 1:
3 year Reevaluation

Sec. 2: AS 36.30.015:
Alaska Permanent Fund Corporation procurement. Alaska Permanent Fund Corporation can adopt its own

procurement procedures, as long as they are similar to State procurement codes

Sec. 3: AS 36.30.990(1):

Adds Alaska Permanent Fund Corporation to the list of those exempt from State of Alaska procurement requirements.

Sec. 4: AS 37.05.540(d):

Tells the Alaska Permanent Fund Corporation to manage and invest assets of the Constitutional Budget Reserve

Sec. 5: AS 37.05.565(a):

Amerada Hess money no longer flows into the Capital Income Fund

Sec. 6: AS 37.10.430(a):

Alaska Permanent Fund Corporation shall manage Constitutional Budget Reserve funds by the effective date 7/1/17

Sec. 7: AS 37.10.430(b):

Report by Alaska Permanent Fund Corporation to legislature re: Constitutional Budget Reserve

Sec. 8: AS 37.13.010:

Dedicated deposits of royalties to the Permanent Fund are reduced from the current 25/50 split in old/ new leases to the constitutional minimum of 25 percent

Sec. 9: AS 37.13.140(a):

Requires the Alaska Permanent Fund Corporation to determine the net income of the Earnings Reserve Account and excludes unrealized gains or losses

Sec. 10: AS 37.13.140:

Defines Percent of Market Value payout at 5.25 percent of the average year-end market value of the ERA for the first 5 of the most recent 6 years of the payout may not exceed the year-end balance of the Earnings Reserve Account

(c) Volatility provision

Sec. 11:

Inflation Proofing

Sec. 12: AS 37.13.446:

Dividends are comprised of 20 percent of the 5.25 percent Percent of Market Value , and 20 percent of the prior year's royalties, excludes those dedicated to the Permanent Fund or School Fund (25.5 percent are dedicated)

Sec. 13: AS 37.13.206(a):
Conforming to new procurement

Sec. 14: AS 37.13.300(c):
Mental Health Trust Fund may not be included in the computation of the available income available for distribution under the Percent of Market Value

Sec. 15: AS 37.14.031 (c):
Makes computation of the AK Mental Health Trust Fund income consistent with computation of other PF income

Sec. 16: AS 43.23.025 (a):
Transfer of money to the Dividend Fund requires an appropriation

Sec. 17: AS 43.23.025 (a):
The amount of each Permanent Fund Dividend for fiscal years 2017, 2018, and 2019 shall be \$1,000

Sec. 18: AS 43.23.045 (a):
Conforms to Sec. 12 which moves dollars to dividend by appropriation.

Sec. 19:
Once the money is in the Dividend Fund, the Department of Revenue shall annually pay dividends without further appropriation.

Sec. 20:
Repealers:
AS 37.10.430 (c) Subaccount of CBR,
AS 37.13.145 (b) Dividend based on statutory net income,
AS 37.13.145 (c) Inflation proofing,
AS 37.13.145 (d) Amerada Hess

Sec. 21:
Repeals corresponding Session Law

Sec. 22:

Repeals \$1000 dividend; Dividend goes to formula

Sec. 23:

Transition language RE: Regulations and policies adopted by Commissioner of the Dept. of Revenue and Permanent Fund Corporation

Sec. 24:

Retroactivity clause

Sec. 25:

Immediate effective date

Sec. 26:

Effective date July 1, 2017

Sec. 27:

Effective date of July 1 2016

HB 245 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson recessed the meeting to a call of the chair [Note: the meeting never reconvened].

#

ADJOURNMENT

[10:57:27 AM](#)

The meeting was adjourned at 10:57 a.m.