

HOUSE FINANCE COMMITTEE  
April 19, 2016  
8:35 a.m.

8:35:37 AM

CALL TO ORDER

Co-Chair Thompson called the House Finance Committee meeting to order at 8:35 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 David Guttenberg  
Representative Scott Kawasaki  
Representative Cathy Munoz  
Representative Lance Pruitt  
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

David Teal, Director, Legislative Finance Division; Randall Hoffbeck, Commissioner, Department of Revenue; Craig Richards, Attorney General, Department of Law; Angela Rodell, Executive Director, Alaska Permanent Fund Corporation.

SUMMARY

HB 245 PERM. FUND:DEPOSITS;DIVIDEND;EARNINGS

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

Co-Chair Thompson discussed housekeeping.

[8:36:16 AM](#)

#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\I). There being NO OBJECTION, it was so ordered.

[8:37:24 AM](#)

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, stated that he would be focusing on the cash-flow related changes in the newly adopted bill version I. He spoke to the document, "Cash Flow under HB 245, Legislative Finance Division," which discussed cash flow by bill section:

Sec 7

Reduces royalties dedicated to the Permanent Fund from new oil fields (post 1980) from 50% to the constitutional minimum of 25%. That increases general fund revenue by about \$50m annually depending on the price of oil.

Sec 8

Deletes the definition of income available for distribution. That formula was based on earnings during the preceding 5 years.

Sec 9

(b) Replaces the earnings-based "available for distribution" formula in section 8 with a POMV calculation. The nominal payout to the general fund is 5.25%, but the effective payout will be about 4.8% (in the long-term) if the Permanent Fund corporation's projections regarding real earnings of 5% and inflation of 2.25% are realized. The effective payout is lower than the

nominal 5.25% payout because the payout is based on the average balance during the past 6 years.

Mr. Teal noted the chart under Section 9 that showed how the POMV was computed; the table computed the FY17 payout, the year-end balance looked back 6 years - FY 17 would use the FY11 through FY15 balance.

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Mr. Teal explained that the 5.25 percent payout on the 6 year lookback average would be \$2.4 billion, which when divided by the FY16 balance, resulted in a payout of 4.6 percent. That percentage would move through the years and stabilize at approximately 4.8 percent.

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Vice-Chair Saddler asked why the calculation was based on 5 of the preceding 6 years and not simply the last 5 years.

Mr. Teal replied that the provision existed so that legislators would be aware at the beginning of the legislative session how much money was available.

[8:43:53 AM](#)

Vice-Chair Saddler asked whether any unintended consequences would result from the 1 year gap.

Mr. Teal replied in the negative. He related that a higher nominal payout percentage could be used without actually paying the money out and failing to keep pace with inflation.

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Representative Gara asked why a flat percentage payout amount had not been used in the equation.

Mr. Teal acquiesced that it was clear that the computation appeared to be based on a flat percentage, but it was based on earnings, which was a volatile revenue stream. The equation could be stabilized by having a moving average. Using a method that relied on balances, rather than earnings, would stabilize cash flow immensely for both dividends, and for payout. He noted that the model

reflected flat dividends, which was the result of using a moving average of balance instead of the interest earnings.

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Representative Gara asked whether the percentage used was based on the last 5 years of the earnings on the fund.

Mr. Teal stated that it was not. He explained that the current formula used earnings, the bill would change that to the use of the balance. He said that this major difference would stabilize the payout, both to dividends and to the General Fund.

[8:48:29 AM](#)

Representative Wilson wondered whether the legislature could cap the dividend without instituting the changes proposed in the legislation.

Mr. Teal replied in the affirmative.

Representative Wilson hypothesized that rather than implementing the changes proposed in the bill the legislature could simply cap the dividend payout.

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Mr. Teal responded that the legislature could appropriate on an annual basis to do what the bill intended. The difference was that the bill laid out a plan, rather than acting on an ad hoc basis. He relayed that the legislature had not spent from the Earnings Reserve Account (ERA) in the past, and that doing so would be a significant change. He warned that a plan of action needed to be laid out before the decision was made to spend from the ERA, in order to maintain the safety of the Permanent Fund. He believed that the bill was referred to as the Permanent Fund Protection Act because, while it removed earnings from the Permanent Fund, the fund would be shielded from being overdrawn.

Representative Wilson recognized the separation of the corpus of the fund from the ERA. She asked whether leftover funds from a capped dividend could be used directly in the state budget. She expressed confusion that there were two

separate conversations occurring about the use of the Permanent Fund.

Mr. Teal indicated that the legislature could just simply reduce the PFD payout in the first year, which would reduce government expenditures by \$700 million. He thought that the concept of the bill was that the state would begin to draw money from the earnings reserve to fill the current fiscal gap. He stated that the \$700 million reduction would be insufficient; the ERA balance, and the earnings of the fund itself, could supply a payout of approximately \$2 billion annually to the General Fund. He lamented that under either scenario the state would still face a deficit. He thought that the administration's motivation behind the bill was that if the deficit was going to be filed by taking money from the ERA, then the account would decline. He warned that the decline would result in the eventuality that the reserve would no longer fund government - revenue would need to be raised or severe cuts to government would need to be implemented. He thought that the plan attempted to plan for the future sustainability of the fund by determining the amount that could be drawn from the ERA, while still maintaining the real value of the Permanent Fund. He asserted that the governor's intent was that the bill would be accompanied by raising of additional revenues and cuts to expenditures. The fiscal gap was too big to fill by any one solution.

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Representative Wilson felt that she was witnessing a "shell game." She thought that the public should understand that the bill was essentially a tax.

Co-Chair Thompson noted that Representative Paul Seaton, Randall Hoffbeck, Commissioner, Department of Revenue, Craig Richards, Attorney General, Department of Law, and Angela Rodell, Executive Director, Alaska Permanent Fund Corporation were in the gallery and available for questions.

[8:58:07 AM](#)

Representative Munoz asked what would happen to the dividend calculation when oil prices were higher and the POMV was no longer withdrawn.

Mr. Teal asked her to restate her question.

Representative Munoz asked what happened to calculation when the POMV went to zero.

Co-Chair Thompson believed that her question would be answered further in the presentation.

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Mr. Teal continued with his presentation:

(c) Ensures that 20% of the payout goes to dividends. Under the Spring forecast, that will be about \$500 to \$600 million annually. The remaining 80% of the payout is subject to a dollar for dollar reduction as oil revenue rises above \$1.2 billion (adjusted for inflation). The impact of the payout limit is:

1. Zero when oil is below about \$75/bbl. (\$75 oil generates about \$1.2 billion in production taxes and royalties (after reserving 20% of royalties for dividends).
2. The payout is reduced by a dollar for every dollar of oil revenue (less the 20% portion of royalties that goes to dividends) between \$1.2 billion and about \$3.1 billion. The reduction occurs at oil prices between about \$75/bbl and \$100/bbl as shown in the graph below.
3. When oil prices are above about \$100/bbl, the POMV payout is reduced to zero and additional oil revenue is spendable. General fund revenue available to spend will be lower (relative to revenue without a limit) by about \$2 billion.

Mr. Teal stated that payout limit scenarios were illustrated on the bar graphs on Page 2. He said that the bars at the bottom of the boxes represented non-volatile revenue, which included taxes and fees that did not depend greatly on the price of oil. He added that the revenue included corporate income tax for oil companies, so it increased with oil prices, but was considered non-volatile. He furthered that the green line on the left hand chart represented the \$2 billion payout, which was not expected to be reduced in the future; however, the chart reflected only FY17 numbers. He said that as the Permanent Fund grew

the 5.25 grew as well, which meant that in 10 years the payout could grow from \$2 billion to \$2.5 billion.

9:03:04 AM

Representative Gara proclaimed that the state budget would be unsustainable until a reliable source of revenue was established. He highlighted some of the consequences of cuts to the budget like the flat funding of schools and the meager capital budget. He contended that no member of the committee would be able to secure funds for projects that were important to their constituency (he specifically mentioned the Knik Arm Crossing) because the state had no money to spend. He spoke to the charts on Page 2, and lamented that the scenario on the right would not fund a capital budget. He preferred the chart on the left. He labeled the chart on the right a "pathway to austerity." He reminded the committee that financial patterns were cyclical, and that the legislature should be debating austerity measures and not the administration.

Co-Chair Neuman called a point of order. He argued that letters from the Department of Transportation and Public Works had indicated that completing the Knik Arm Crossing would not cost the state any additional dollars.

Co-Chair Thompson interjected that the committee was not debating specific projects.

Co-Chair Neuman agreed.

Representative Gara attempted to clarify his remarks.

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Mr. Teal agreed that some people could view the chart on the right as a pathway to austerity. He suggested that it could also be a pathway to sustainability. He explained that \$5 billion on the left chart could be reached at \$90/bbl. However, the right chart showed that oil would need to be at \$110 in order to reach \$5 billion. The entire point of the provision in the bill was to establish a revenue limit, which would then limit expenditures. He said

that the prior draft of the bill had elicited two responses from Governor Walker; one was to inflation proof the fund, and the other was to recognize the importance of a revenue limit. He thought that the revenue limit that the administration and the division had arrived at would work and was flexible. He asserted that the legislature could make the limit work however they wished, but it would not change the fact that the revenue in the Spring Forecast would still leave the state with a deficit. He thought that the question should be whether the proposed plan in the bill should be executed independently, or should it be rolled in with revenue measures and expenditure cuts. He understood that rolling everything together could be more complicated, and suggested that executing the plan alone would allow for a base to be established, and for the state to know how much revenue was available; the state would also be able to establish how much of a gap remained, and could then focus the debate on whether the remaining gap was filled with expenditure reductions or revenue enhancements. He warned that to try to do all three at the same time would result in too many levers moving at once.

[9:10:10 AM](#)

Co-Chair Thompson indicated that there had been discussions about limiting the level of government by creating funding restraints for future legislatures.

[9:10:44 AM](#)

Representative Wilson wanted to see a spending cap in the model.

Mr. Teal replied that the bill would limit volatile revenue and would flatten available revenue at \$4.1 billion. He said that the revenue limit would leave the state with deficits; even as the state was reducing the POMV payout, withdrawals from the constitutional budget reserve (CBR) would be required, which would require a supermajority vote and would exert downward pressure on the budget.

[9:12:04 AM](#)

Representative Wilson asserted Mr. Teal was incorrect. She spoke again of putting a revenue cap in the bill. She said that the Fairbanks Northstar Borough had a cap that limited

spending. She suggested adding a revenue cap into the actual operating budget.

Mr. Teal stated that there had been a great amount of debate on the issue. He rebutted that while the payout from the POMV could be capped, the ERA would still be available, which would allow for more than the cap to be spent. He explained that if rules were to be set in statute, and followed, the proposed plan would prove to be a revenue cap. He stated that there was not a cap until oil reached \$75/bbl, the cap would be in place from \$75/bbl to \$100/bbl, after that the POMV would be zero and any revenue above \$100/bbl would become spendable. He said that a spending limit could be implemented, but that the legislative legal services had advised that there was already a constitutional spending limit, and any limit imposed that was stronger than the one that already existed would be in conflict with the Constitution. He shared that the problem with the constitutional spending limit was that it had never affected spending; the limit simply did not work, and the computations had always exceeded the amount of expenditures that the legislature had made. He said that although the revenue from the payout could be limited, a future legislature could not be bound to by the limitation of expenditures.

[9:14:59 AM](#)

Representative Wilson asked what the constitutional spending limit was for the coming fiscal year.

Mr. Teal responded that the limit was based on 1981 expenditures, inflated by the cost performance index (CPI) and by population growth, and was typically several billion dollars more than any proposed budget.

Representative Wilson voiced that the Constitution needed to be changed.

Vice-Chair Saddler queried whether payout of less than 5.25 was an attempt at inflation proofing.

Mr. Teal responded that the payout could not be computed for any year except for FY17 using the numbers available in the document. He referenced the box on Page 1, the years FY11 through FY16 were the first 5 of the preceding 6 years that would be used to calculate the numbers for FY17. He

reminded the committee that the balances before FY 17 were past balances, the current balance was higher, and the payout was 4.62 percent of the current balance. He believed that there was stability in looking back 5 years.

[9:18:35 AM](#)

Representative Gattis referred to the notion that one legislature could not bind future legislatures. She asked whether the revenue limit had been modeled.

Mr. Teal responded that the revenue limit had been modeled, but that the modeling had never worked because the Spring Forecast did not have oil prices high enough to generate the revenue required to trigger the limit.

[9:19:52 AM](#)

Representative Pruitt explained that the Spring Forecast had not forecasted prices above \$75, which was why the modeling could not be done.

Mr. Teal indicated that Representative Pruitt was correct. He added that the revenue limit had been designed to hold revenue down at sustained high prices and to respond to a one-year spike. He said that the problem that the division faced in the modeling was that under the Spring Forecast, the state was nowhere near reaching the limit. He added that if the price of oil went up in a year, then the reserves would also increase because they would not be spendable.

[9:22:02 AM](#)

Representative Gattis stated that her desire to reduce spending outweighed her ability to embrace the legislation.

Mr. Teal said that even with the POMV and forecast prices the available revenue would never go up beyond \$4.1 billion. He stated that having the \$4.1 available meant that there would always be pressure to spend no more than that, to do so would use up reserves and put the state back in the position that it now faced. He relayed that the limit would not change how the money was spent, but would change where the financial burden would be felt because of the spending choices.

9:23:39 AM

Mr. Teal moved on to Section 10:

Sec 10

(e) Allows an appropriation from the earnings reserve account (ERA)—where Permanent Fund earnings accumulate—to the general fund. The allowable appropriation is reduced by the payout limit if oil prices are sufficiently high. The amount of this appropriation that is reserved for dividends is unaffected by the payout limit.

(f) Outlines an inflation proofing methodology. If the ERA balance is "comfortably high"—defined as four times the maximum allowable payout—then the excess balance may be appropriated to the Permanent Fund principal.

Mr. Teal pointed out that subsection (e) would establish the revenue limit, and made clear that 25 percent of the payout would be reserved for dividends; 20 percent reserved for dividends would not be reduced as oil revenue rose. He spoke to subsection (f) and noted that the inflation proofing methodology would differ from the current method by making it so that the state did not inflation proof until the ERA balance was high enough to make people comfortable that future payouts were not in danger. He said that when the balance was more than 4 years-worth of payouts the excess would be transferred to the principal of the fund, this would serve as inflation proofing. He added that the revenue limit was tied in because as the payout from the ERA balance was restricted at higher oil prices, the balance would grow and trigger inflation proofing transfers.

Mr. Teal discussed Section 11:

Sec 11

Provides for dividends comprised of  
1. 20% of the POMV payout described in section 8 (AS 37.13.140(b)). This amount is not reduced by the payout limit in AS 37.13.140(c)

plus

2. An amount equal to 20% of prior year royalties deposited in the general fund.

Mr. Teal explained that the projections for dividends were relatively stable at approximately \$1000.

Co-Chair Thompson understood that the way that the bill presently read, Alaska residents would receive dividends of \$1000, over the next three years, but that number could fluctuate.

Mr. Teal answered that the dividends would increase as oil prices increased. He shared that production decline had been built into the model and that royalties would nominally affect the amount of the dividend. He said that the real impact on dividends came from the POMV payout. The reserve balance would rise with oil prices, increasing the Permanent Fund balance; as interest rates increased and earnings rose, the Permanent Fund balance would go up. Therefore, 5.25 percent payout would go up, and the 20 percent of that that went to dividends would increase. He communicated that the model was responsive to oil prices and to earnings rates.

Vice-Chair Saddler asked how adjustments to the states take of oil production taxes affected the model.

Mr. Teal answered that as taxes on oil increased, the volatile revenue would increase, resulting in more money at any given oil price, which meant that the limit would kick in earlier. Dividends would also increase.

Representative Gara did not believe that the current bill version would result in a balanced state budget.

[9:32:08 AM](#)

Representative Wilson wondered how the legislation would financially impact Alaskan residents.

Mr. Teal responded that the economic impact could not be projected by the model or any of the cash flow charts. He believed that the intent of the legislation was to protect dividends. He warned that without the legislation, or something similar, deficits would increase by \$2 billion. He asserted that the real concern should be the financial impact of not passing the bill. He said that not passing the bill would result in a \$3 billion shortfall, rather than a \$1 billion shortfall, which would have greater economic impact. He relayed that a \$3 billion shortfall

would drain reserves quickly, and having no reserves would make maintaining current spending levels impossible.

9:34:19 AM

Representative Wilson felt that it was the responsibility of the legislature to understand the fiscal impact of the bill.

Mr. Teal responded that there were three major levers available to address the deficit and he believed that it would take a combination of all three in order to fill the deficit.

Co-Chair Thompson invited the administration to the table. He asserted that it was not Mr. Teal's responsibility to speak on behalf of the governor.

Mr. Teal relayed that the projected economic impacts of various actions on families of various sizes could be found at <http://www.legfin.akleg.gov/>. He contended that the bill did not address expenditure reductions or revenue enhancement, which were the other two levers in the overall fiscal plan. He said that implementing the bill would reveal how much of the financial problem remained, which could help determine whether the remaining problem should be addressed by expenditure or by revenue.

Co-Chair Thompson reinforced that if the legislature did nothing, and things continued at the status quo, the reserves would run out in four years and there would be no dividend.

Mr. Teal responded affirmatively. He warned that there would be no reserves available in 3 to 4 years which would force the state to revisit the idea of cutting expenditures and/or raising taxes by a combination of \$4 billion. He said that the bill would lower the deficit that would need to be filled, to \$1 billion.

9:39:40 AM

RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, stated that Gunnar Knapp had made it very clear that that state should use the earnings of the Permanent Fund to help fund government.

Representative Wilson argued that the legislature was not going to be inactive on the budget. She felt that the ideas that had been presented to fill the gap had not been presented clearly so that the economic impacts could be studied by the legislature. She felt that levers in the governor's overall plan existed in "silos."

Commissioner Hoffbeck responded that specific modeling on how each lever would economically affect Alaskan families was not yet available. He contended that the various levers put forth by the governor were being considered as a total, overall package. He said that one problem that the administration faced was people holding on to the hope that government spending would rise back to past spending levels, and that the financial crisis would be short-term. He stated that DOR's Spring Forecast was consistent with what other oil price forecasting agencies had forecasted. He stated that the only way that the state would fill the budget gap was by making reductions in government spending, using funds from the ERA, and exploring additional revenue sources.

[9:43:55 AM](#)

Mr. Teal clarified that the model was designed to run the results of any combination of levers, and was capable of merging results. He stressed that the bill only spoke to one of the levers. He hoped that the committee would consider that the bill could not contain revenue measures or appropriation changes; the single subject rule and the inability to combine appropriation bills with bills of substance allowed for only one topic to be addressed at a time. He explained that the bill attempted to maximize use of Permanent Fund earnings in a sustainable way.

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Representative Kawasaki understood that the bill was the largest part of the overall fiscal plan proposed by the administration. He shamed previous legislatures for not reigning in spending. He spoke to the great things that had been done when oil was at \$100/bbl. He asked whether the revenue payout limit would hamper the ability of the administration to positively impact the state.

Commissioner Hoffbeck thought it was important to look at the trigger points within the model. He said that the limit

would not kick in until oil hit \$70/bbl, and at that point there would be a reduction in the draw from the earnings reserve. He said that as a commitment to the people of Alaska, when oil prices became more robust the draw on the earnings reserve would be reduced.

[9:49:00 AM](#)

CRAIG RICHARDS, ATTORNEY GENERAL, DEPARTMENT OF LAW, added that when oil prices returned to the level where the state had a sustainable budget, money would not be drawn for expenditures that were above a sustainable level.

[9:50:03 AM](#)

Representative Edgmon understood that draws from the Permanent Fund would cease when oil reached \$70/bbl, but that that was predicated on \$4.1 billion spending.

Commissioner Hoffbeck replied in the affirmative.

[9:51:02 AM](#)

Representative Edgmon understood that the bill was a component of a multi-year plan. He asserted that there were political components in terms of revenue enhancements. He contended that the "reordering of Alaska's fiscal reality" could not happen in one legislative session. He asked Mr. Teal to respond to his comments.

Mr. Teal retorted that he could not speak to the political elements of the comments. He referred to the document "LFD Fiscal Model"(copy on file) He said that there were expenditure reductions built into the model that the state had already reached, and that the model reflected a decent representation of the FY17 budget, without taxes. He said that if further expenditure cuts were not made, or if additional revenue was not added, the state would continue to have deficits. He said that to some, the deficit problems needed to be immediately addressed - while others point out that reserves continue to grow, and the interest earnings on those reserves was sufficient to fill the gap without reducing the reserves. He asserted that holding expenditures flat was unrealistic. He stated that as fiscal gaps went up, reserves would go down, the CBR combined with the earnings reserve had a lifespan of approximately 7 years before they were exhausted. He said that there were

many arguments at play; the future was uncertain. He opined that all that could be shown was what was considered to be a reasonable projection of the future. He said that each legislator had to judge how essential it was to do everything this year, or whether the problem could wait a year or longer.

[9:55:02 AM](#)

Representative Edgmon felt that an interactive model that revealed the impacts of the governor's proposed revenue enhancements would be helpful to the committee. He spoke to possible changes in oil tax credits that could also alter the model numbers. He wondered whether interactive modeling could be made available in order to help with decision making.

Co-Chair Thompson remarked that when the model was live in Excel, revenue variables from sales tax, income tax, and motor fuel tax could be modeled. He shared that as each of the taxes were increased the amount of draw on the CBR would be reduced.

Mr. Teal responded in the affirmative.

[9:57:19 AM](#)

Representative Gara felt that the revenue cap discussion was coming late in the game. He offered his interpretation of what would happen if the bill passed. He pontificated on oil tax legislation.

Co-Chair Thompson interjected that the committee had discussed the issue and had agreed on the revenue cap in order to limit the growth of government.

[10:00:02 AM](#)

Mr. Teal agreed that it was late in the session to have the discussion. He said that the revenue limit had been a primary part of the governor's original bill, and that he had objected to the rewrite because both the volatility limit and the revenue limit, had been left out of the bill.

[10:00:46 AM](#)

Representative Gara felt that more cuts were going to be necessary, which would result in further loss of jobs. He wondered why version I of the bill was better than the previous version.

Commissioner Hoffbeck noted that the current version of the bill was not much different than the previous version. He said that the current version would give the state more flexibility, and included \$400 million in oil and gas tax cuts and credits, and \$450 million in new revenues. He contended that taxes and expenditure cuts would be addressed in other legislation.

[10:03:21 AM](#)

Vice-Chair Saddler asked whether the state would gain from building up the corpus of the Permanent Fund, or suffer a net loss of 1 to 1, if the state did not inflation proof at the 100 percent level of the CPI for several years.

Mr. Teal responded that inflation proofing was more of a philosophical idea than financial or technical. He communicated that from a modeling and earnings perspective it made no difference whether the money was in the ERA or the Permanent Fund. He qualified that money sitting in the ERA could be spent, and once the inflation proofing transfer was made, that money went into the corpus and could never be spent. He urged that in a time of downturn, the ERA balance should be comfortably high, able to weather several years of poor returns and low oil prices, while still providing a payout. He stressed that from a modeling perspective it made no difference whether the state inflation proofed or not.

Vice-Chair Saddler countered that if there was a difference in the management of the different funds, having money in the corpus invested more aggressively for the long-term, could be a benefit. He thought that it could be beneficial for the state to invest at a higher return.

[10:06:31 AM](#)

Mr. Teal responded that the two accounts comingled for investment purposes. He pointed out to the committee the provision in the bill that called for moving management of the CBR to the Permanent Fund. He explained that it would operate similar to the Mental Health Trust Fund, and be

managed by the Permanent Fund. He furthered that dividends and the payout would not be effected. The Permanent Fund would be allowed to take the CBR, which was currently invested at approximately 2 percent, and invest it as the Permanent Funds was invested, earning 7 percent. The result would be several \$100 million per year in potential earnings, while also allowing for the co-management of liquidity.

[10:08:09 AM](#)

Vice-Chair Saddler asked whether the chart on page two of the document, "Cash Flow under HB 245 version I", presumed the effectiveness of 400 percent rollover.

Mr. Teal replied that as the limit kicked in, the state would spend less from the ERA. He acknowledged that the 400 percent and inflation proofing were related. He imparted that the chart wasn't meant to offer projections after FY 17.

[10:09:22 AM](#)

Representative Guttenberg remarked on Mr. Teal's extensive exposure to, and knowledge of, policy debates. He felt that without a constitutional amendment not much could be "taken off the table." He admitted to being supportive of past POMV efforts. He verbalized that there were a variety of ways to view the issue. He wondered whether Mr. Teal could ruminate on the actions of past legislators and whether they had exercised discipline in their decision making.

Mr. Teal replied that the situations had varied. He offered that in many cases the legislature followed the rules that were set down in statute. He furthered that legislators were very powerful people in the sense that they did not have to follow rules. He used the Public Education Fund as an example, which until recently had never been used for anything other than education. He added that the PCE fund had been left alone in the past and was now being eyed for excess earnings. He relayed that legislators had the power to take PCE funds and pay for a new ferry if they wanted to. He said that the Constitution prevented the legislature from dedicating revenue, which gave the legislatures of Alaska a lot more power than in other states. He noted that the legislature had saved a lot of money over time, and the money had been designated and had followed its designation.

He countered that the legislature had taken endowments for science and technology and had done away with them. He concluded that actions had varied over the years but that the legislature had been good about following the rules, given the fact that it was not bound to them.

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AT EASE

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RECONVENED

Co-Chair Thompson invited Angela Rodell to testify before the committee.

[10:31:02 AM](#)

Representative Kawasaki spoke to Section 7 of the bill. He asked whether every field would eventually be called a "new oil" field, as there would no longer be pre-1980, old oil fields. He wondered whether the evolution worried the corporation.

[10:31:48 AM](#)

ANGELA RODELL, EXECUTIVE DIRECTOR, ALASKA PERMANENT FUND CORPORATION, explained that the bill restored the constitutional requirement of 25 percent limit. She said that the legislature had always chosen to save more than the 25 percent; the bill restored the constitutional limit.

Attorney General Richards interjected that with 50 percent for the new, post 1980 oil the relative contribution had been 30 percent. He stated that the vast amount of current production on the North Slope occurred from Prudhoe Bay, Kaparuk, and Alpine, which would likely remain the case through the life of the North Slope.

[10:32:56 AM](#)

Representative Kawasaki he asked whether the drop in percentage would allow the Permanent Fund to continue to grow as it had been under 50 percent.

Ms. Rodell informed the committee that the fund's royalty income under current statutes was approximately \$25 million

per month. She said that the change outlined in Section 7 would not significantly affect the fund.

[10:34:11 AM](#)

Co-Chair Thompson queried a gradual reduction in the dividend over the next few years from \$2000 to \$1000. He thought that a model of the drop could be helpful.

Commissioner Hoffbeck wanted to see whether such modeling affected the fund. He said that a \$1000 dividend, versus a \$1500 dividend, would be equal to \$350 million in savings.

Vice-Chair Saddler understood that one intent of the legislation was to reevaluate the use of earnings. He asked how the intent should be interpreted by the average Alaskans.

Attorney General Richards replied that he read the intent it both ways; that in three years the legislature should revisit the question of using earnings, and that the plan should be evaluated for performance after 3 years of operation.

[10:36:36 AM](#)

Vice-Chair Saddler probed the return percentages on the ERA, the corpus, and on the CBR.

Commissioner Hoffbeck responded that the corpus of the fund and the ERA had the same investment portfolio. He said that the CBR was currently invested more conservatively, and had always been invested for safety and liquidity. He shared that the current years returns had been comparable because neither fund had made much money. He stated that the way the CBR was currently invested, long-term investment returns going forward would be substantially lower.

Vice-Chair Saddler requested the actual numbers for each fund.

Commissioner Hoffbeck would have to go back to his report for the information.

Ms. Rodell said that the 10 year forecast for both the ERA and the Permanent Fund was 6.9 percent.

Vice-Chair Saddler queried the return expected on the CBR.

Commissioner Hoffbeck replied that as it was currently invested, long-term would be roughly 2 percent.

Representative Kawasaki asked how the CBR would be managed if it were swept into the Permanent Fund.

Ms. Rodell answered that it would be invested like the ERA and the mental health trust account; however, the management of liquidity requirements would necessitate the corporation, the board of trustees, and DOR to establish a plan.

[10:40:00 AM](#)

Representative Kawasaki asked whether all funds would be overseen by the same managers.

Ms. Rodell replied that part of it would depend on what made sense considering how the CBR was invested. She said that she did not wish to inadvertently cause losses by getting out of investments through the transfer mechanism. She said that all involved parties were looking to maximize returns and minimize the costs.

[10:40:49 AM](#)

Representative Gara spoke to different payout level that had been discussed over the years. He asked whether there was much of a difference between a 5.25 percent and a 4.8 percent payout, given that the royalties were going into the Permanent Fund.

Ms. Rodell responded that the royalties were becoming a smaller and smaller portion of the fund each year, and did not provide the cushioned income that they once did. She said that the bulk value of the fund was from investment earnings. She relayed that she was not sure how much of a cushion mineral royalty deposits would provide to the fund. She said that the deposits were important to the fund, and were required under the constitution, but were a relatively small portion of the fund.

[10:43:17 AM](#)

Representative Gara asked whether having a 4.8 percent payout, rather than a 5.25 percent payout, would make a difference in the safety of the fund.

Ms. Rodell responded that every time that the payout percentage was lowered it extended the life of the fund.

Representative Gara asked whether the 5.25 payout was a safe level of payout given the returns on the fund.

Ms. Rodell took comfort in the fact that the percentage would be reviewed and could be adjusted in the future.

[10:43:49 AM](#)

Co-Chair Thompson wanted to know whether the governor supported the current version of the bill.

Attorney General Richards stated that the administration supported the bill. He added that including a mechanism for inflation proofing and the revenue limit had been viewed as favorable. He mentioned that there were some technical issues with how the revenue limit was currently drafted in the bill, but nothing substantive. He said that the bill accomplished the goal of maintaining the real value of the Permanent Fund; the 5.2 percent was right on the line, but had been shown in the modeling as sustainable. He furthered that the POMV approach to the payout was reasonable and that the amount of money that would come out of fund for dividend and the General Fund was within the range of the governor's expectations.

Co-Chair Thompson pondered the other pieces of the governor's fiscal plan.

Attorney General Richards deferred to Commissioner Hoffbeck.

Commissioner Hoffbeck felt strongly that revenue measures would be necessary in order to stabilize Alaska's economy.

[10:47:11 AM](#)

Co-Chair Thompson asked whether the plan assured stability.

Ms. Rodell noted that nothing in the bill would affect the core mission or purpose of the corporation. She said that

the corporation had been set up to manage the Permanent Fund and nothing in the bill affected the corpus of the fund. She stated that there were added responsibilities with the management of the CBR, but that the corporation already managed the mental health trust and was familiar with the management of money. She asserted that nothing in the bill affected how the corporation did the business of maximizing the value of the fund.

[10:48:23 AM](#)

Co-Chair Thompson asked whether additional personnel would be needed to make the management shift.

Ms. Rodell responded that DOR would still be responsible for managing the assets of the Retirement Management Board, which took up a considerable amount of effort on the part of Treasury Division staff. She stated that the CBR was a much smaller fund to manage and it did not appear that additional personnel would be necessary to make the shift.

Commissioner Hoffbeck concurred with Ms. Rodell. He felt that the cash management aspect of the shift would take additional work, but may not require additional staff.

[10:50:08 AM](#)

Representative Wilson spoke to confusing between utilizing the ERA, versus HB 245. She relayed to the committee that her constituency did not want the Permanent Fund dividend to be touched. She asked whether the administration planned to better explain to the general public how the legislation would affect the dividend, and the effects of the other parts of the overall fiscal plan.

Commissioner Hoffbeck replied that the administration had been having the conversation with the public since June of 2015. He stressed that communication would continue for as long as it was necessary to get the legislation passed.

Representative Wilson argued that the governor's message was not reaching her constituency. She worried that the other parts of the governor's plan could have negative effects on various industries in the state. She felt that industry had already suffered more under the fiscal climate than the state. She contended that the governor's original

budget had not reflected any savings, and that there was a big difference between a revenue cap and a spending cap.

Commissioner Hoffbeck responded that the governor's goal was to establish a long-term, sustainable budget. He said that the governor was committed to continuing to look at areas where government could deliver services more efficiently, and more cheaply. He insisted that reducing the size of government alone would not solve the problem, additional revenue sources outside of the oil and gas industry, and the Permanent Fund were necessary to solve the problem.

[10:54:01 AM](#)

Representative Wilson asked why the surplus 400 percent funds from the ERA would go back into the corpus, rather than be distributed to Alaskan residents.

Commissioner Hoffbeck stated that as the money was moved back into the corpus it would grow the corpus of the fund, and the returns associated with that larger fund would grow the size of the dividend.

[10:54:54 AM](#)

Attorney General Richards stated that the value of the Permanent Fund would be preserved for future generations. He added that inflation proofing was critical to the plan because otherwise the corpus would not grow over time and there would be no guarantee that the Permanent Fund would be available for the next generation.

Representative Wilson stated that she philosophically disagreed with the bill. She believed that the bill would take a lot from Alaskan residents while providing little in return.

Co-Chair Thompson countered that taking no action would heighten the risk of the dividend disappearing completely within the next four years.

[10:55:53 AM](#)

Representative Gara expressed concern that cutting the dividend would disproportionately affect low income Alaskans. He asked whether the plan would fit within the

core mission of the corporation if the draw were 5.25 percent.

Ms. Rodell responded affirmatively.

Representative Gara opined that explaining the budget to the general public required a multifaceted approach. He argued that the small, established policy groups that the administration had communicated its budget plan with represented a very small section of the general public. He lamented that Governor Walker had not held town hall meetings for people unaffiliated with policy groups to get information about the state budget.

Commissioner Hoffbeck responded that the administration had held a substantial number of meetings; typically, town halls were hosted by legislators. He said that representatives from DOR had accepted every invitation to speak on the issue. He pointed out that there was a significant television campaign. He shared that the most recent Rasmuson Foundation poll indicated that over 90 people in the state recognized that there was a fiscal problem.

[10:58:57 AM](#)

Representative Gara appreciated the commissioner's response. He indicated that very few constituents attended the town hall meeting in his district. He maintained that the governor needed to connect with residents who were unaffiliated with any policy group.

[11:00:23 AM](#)

Co-Chair Thompson asked what the Alaska Permanent Fund Board thought of the POMV method.

Ms. Rodell stated that the board had drafted a resolution for a constitutional amendment supporting utilizing the POMV payout of the fund. She said that the board would not take a formal position because the bill would not affect the management of the fund.

[11:01:17 AM](#)

Vice-Chair Saddler mentioned the exemption of the corporation from the state's procurement code in Section 3.

He queried why some groups would be exempt and some would not.

Ms. Rodell responded that the language had been designed after the exemptions been created for the Alaska Retirement Management Board. She stated that the request by the board of trustees was to be able to react quickly to investment opportunities. She explained that there was sometimes due diligence around investment opportunities that required the hiring of experts that were not fiduciaries to the fund. The language would allow for the professionals to get to work immediately on investment decisions. She noted that the section would require the corporation to adopt regulations similar to state regulations, and that the corporation continued to work under the preview of Legislative Budget and Audit, which meant that it could answer any questions before that committee.

[11:03:34 AM](#)

Vice-Chair Saddler understood that the corporation wanted to be exempt from the procurement code and planned to adopt regulations similar to the code. He asked whether the goal of rapid response to investment could be met by including the exemptions in d, e, and f of AS 36.30.

Ms. Rodell thought that the biggest issue with the current state procurement code was the timing. Substantial time was built into procurement for protest, notice, and application periods. She offered a personal example of the 8 weeks it took her to procure an executive recruiter to help look for a new Chief Investment Officer.

Vice-Chair Saddler expressed continued discomfort with the language in the section.

Ms. Rodell replied that the language was intended to make room to speed up the procurement timeframe.

Co-Chair Thompson surmised that 8 weeks to hire a Chief Financial Officer was excessive and costly.

Ms. Rodell answered in the affirmative.

Vice-Chair Saddler asked why the exemption in subsection (a) had not been excluded.

Ms. Rodell asked where Vice-Chair Saddler was reading the information.

Vice-Chair Saddler pointed to Page 3, line 7:

Notwithstanding any other provisions of this subsection, the Alaska Permanent Fund Corporation shall comply with the five percent preference under AS 36.30.321(a) and the requirement that contracts for legal services be approved by the attorney general under (d) of this section.

He added that there were also 5 percent preferences for other Alaskan groups in paragraphs (d), (e), and (f).

Ms. Rodell replied that she could not speak to how the bill was drafted. She thought that the language was meant to recognize the corporation in the same way as the Alaska Retirement Management Board and Alaska Housing Finance Corporation (AHFC).

Co-Chair Thompson recommended Vice-Chair Saddler direct the question to the Division of Legislative Legal.

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

Co-Chair Thompson discussed housekeeping. He recessed the meeting to the Call of the Chair [Note: the meeting never reconvened].

#  
ADJOURNMENT

11:07:18 AM

The meeting was adjourned at 11:08 a.m.