

SENATE FINANCE COMMITTEE

April 25, 2015

1:38 p.m.

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CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 1:38 p.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair
Senator Pete Kelly, Co-Chair
Senator Peter Micciche, Vice-Chair
Senator Click Bishop
Senator Mike Dunleavy
Senator Lyman Hoffman
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Jerry Burnett, Deputy Commissioner, Treasury Division, Department of Revenue; Representative Cathy Giessel; Senator Gary Stevens; Pat Pitney, Director, Office of Management and Budget, Office of the Governor.

SUMMARY

PRESENTATION: ALASKA'S FISCAL CRISIS - DEPARTMENT OF REVENUE - FISCAL REPORT

Co-Chair MacKinnon discussed the agenda for the day and went over the handouts. She remarked that the state was facing a \$3.9 billion deficit for FY 15, which signified a draw on reserves. She furthered that there was a prospective \$3.5 billion to \$4 billion deficit for FY 16, contingent upon oil production and price. She reported that the Senate had cut \$374,971,000 from the operating budget. Based on the previous year, and considering the \$3 billion Teacher's Retirement System and Public Employees Retirement System (TRS/PERS) investment, the number could be

calculated with an additional \$500 million. She added that \$487 million of capital expenditures had been reduced from the previous year. She indicated that the Senate was doing everything it could to set the state's operating budget to the right size while investing in items that benefitted Alaskans.

^PRESENTATION: ALASKA'S FISCAL CRISIS - DEPARTMENT OF REVENUE FISCAL REPORT

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JERRY BURNETT, DEPUTY COMMISSIONER, TREASURY DIVISION, DEPARTMENT OF REVENUE (DOR), introduced the PowerPoint presentation "Department of Revenue - Fiscal Report" (copy on file), stating that the presentation would look at expectations from the FY 15 revenue forecast while examining projected deficits for subsequent years.

Mr. Burnett began with slide 2: "Department Of Revenue Fiscal Summary":

- Spring 2015 Revenue Forecast
- Reserve Outlook
- Cash Flow & Burn Rate
- Division of Finance -Management of Cash
- Reserves as of March 31, 2015
- Other Fund Balances

Mr. Burnett stated that some of the numbers presented would be different than what the committee had, as the department was unaware of the final budget numbers for the year. He clarified that the forecast numbers were for the future. He intended to discuss cash flow, immediate reserves, and some other fund balances.

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Mr. Burnett turned to slide 3: "Spring 2015 Revenue Forecast FY 15-FY 24," sourced from the DOR Revenue Sources Book Spring 2015. He shared that the expenditures were from an internal fiscal model, and were reflective of a budget estimate based on a budget presented by the governor. He drew attention to the deficit of \$3.932 billion unrestricted general fund (UGF) revenues from 2015, and compared it to the \$1.9 billion deficit for FY 14. He remarked on the significant change in expected revenues,

based on previous forecasts using oil priced at \$100-plus per barrel (bbl). He noted that year to date, actual Alaska North Slope West Coast (ANS WC) oil prices were above the \$67.49 bbl indicated on the slide, but the revenues would be close to what was reflected on the slide for 2015.

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Co-Chair MacKinnon asked about the \$67.49 ANS WC oil price for 2015, and wondered if Mr. Burnett could share an updated figure. Mr. Burnett responded that the ANS WC price was over \$70 bbl as of the current week. He discussed changing prices and explained that there would be a high-lagged average price until the end of the fiscal year.

Co-Chair MacKinnon asked about the average daily price of \$70 for three-quarters of the year, and wanted to assess the certainty of the \$67 figure considering the drag. Mr. Burnett stated he thought it would be close to \$67.

Co-Chair MacKinnon asked to what degree of certainty Mr. Burnett believed the ANS WC price of \$67 bbl would be set. Mr. Burnett believed with a fairly high degree of certainty that the price would be \$67 or higher for the FY 15 average. He did not think it likely to be lower due to almost 10 months of prices that were much higher.

Co-Chair MacKinnon asked if the price fluctuated from the second quarter to the third quarter, or if Mr. Burnett could speak to the degree of change between quarters. Mr. Burnett reported the ANS WC price in much of the first quarter was much higher (almost \$111 bbl) and then it had dropped dramatically to prices in the \$50 bbl range. The price had moved up to the \$60 bbl range currently, but was very volatile in a narrow range.

Co-Chair MacKinnon asked if Mr. Burnett could supply the committee with accurate second quarter data. Mr. Burnett stated that he would get the figures to the committee.

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Mr. Burnett discussed the 2016 forecasted ANS WC oil price of \$66.03, looking at other markets in comparison. He commented that there was a lot of volatility and prices changed very rapidly. The state had two years (2013 and

2014) of the exact same average price, with every other year seeing significant changes up and down.

Vice-Chair Micciche thought it would have been helpful to observe unrestricted revenues for one of the years represented. He discussed oil taxes, royalties, and corporate taxes; and wondered if they would remain fairly consistent in a set price range until ANS WC came up to about \$80 bbl. He wondered if Mr. Burnett had a breakdown for FY 15.

Mr. Burnett referred to the FY 15 spring forecast, and reported that the petroleum property tax was stable at about \$128 million. He furthered that the petroleum corporate income tax was about \$204 million, oil and gas production tax was at \$362 million, and royalties were at \$947 million. The royalties for FY 16 went up to \$1.22 billion, the production tax was lower at \$320 million, and the corporate income tax was lower at \$148 million. He added that the petroleum property tax for FY 16 was stable at \$125 million.

Vice-Chair Micciche asked if the vast majority of the income was still from oil. Mr. Burnett clarified that the biggest part of the revenues for 2015 and 2016 was royalties, at nearly half of the total of UGF revenues.

Vice-Chair Micciche asked if there was a net-to-the-good on production taxes for FY 15 and FY 16. Mr. Burnett stated that the state had a net-to-the-good on production taxes every year in the forecast.

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Co-Chair MacKinnon asked about the deductible lease expenditures and referred to proprietary information. She suggested that the Point Thomson project was a large asset to come online, and wondered if there was a way to give an indication of what portion of the lease expenditures was coming from Point Thomson and "riding on the back of oil."

Mr. Burnett shared that he could not provide the information if he had it (for proprietary reasons), and specified that expenditures were nearly all to one company. He stated that Co-Chair MacKinnon was correct in that there was a very large expenditure which was deductible from the state's tax base, which accrued through the companies

involved at Pt. Thomson and reduced the companies' petroleum production tax. He surmised that some of the expenditures would be going down in the forthcoming years as the project was developed.

Co-Chair MacKinnon discussed the Pt. Thomson project timeline and thought the general public may not be able to see the investment as no revenues had been generated yet.

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Senator Hoffman referred to the original forecast in the DOR Revenue Source Book, and the revenues expected for FY 17 based on ANS WC at \$110 bbl, compared to the \$86.66 bbl listed in the presentation. He asked for confirmation of the total drop in revenue between the two figures and wondered if it was \$400 million. Mr. Burnett did not have the number at hand but estimated the total drop to be larger than \$400 million.

Senator Hoffman asked about the ANS WC price of \$130 bbl forecast in the DOR Revenue Source Book for FY 21, which was listed as \$112 in the presentation. He asked Mr. Burnett to provide the dollar drop for the comparison, along with the FY 17 comparison, to illustrate the volatility of oil prices over a short time period.

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RECONVENED

Mr. Burnett estimated that the difference in the forecasted prices was a very large number close to \$1 billion, and stated that there was a lot of sensitivity to price above the \$80 bbl range.

Senator Hoffman thought the number was substantial as well.

Vice-Chair Micciche commented that if total ANS production through 2024 stayed at 535 thousand barrels per day (THSbbls/day), which he considered a fairly conservative number, the difference would be that the state would starting "going to the good" in 2019. Under that scenario, the state would expect future revenues to be: minus \$295 million in 2018, plus \$167 million by 2019, plus \$725

million by 2020, plus \$811 million in 2021, plus \$795 million in 2022, plus \$969 in 2023, and plus \$1.1 billion in 2024. He calculated the difference of production staying flat at 535 THSbbls/day to be \$12.5 billion.

Mr. Burnett could not verify the numbers calculated by Vice-Chair Micciche but thought that despite other factors in the production tax calculation, the difference was probably in the neighborhood of \$12.5 billion. He asked the committee to bear in mind that the forecasts were risk-based and therefore showed production decreasing. He thought production was likely to be higher than what was reflected in the presentation, but not as high as what Vice-Chair Micciche was suggesting.

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Vice-Chair Micciche discussed the difference in the production tax values in FY 15 and FY 16, and Alaska's Clear and Equitable Share Act (ACES); and asserted that if the production tax worked on additional projects and oil production flattened out, there would be a substantial difference in income. He qualified that he was thankful for the conservative forecast by DOR.

Co-Chair MacKinnon referred to SB 21 and thought there had been a flattening and a slight increase in production which she believed to be about 1 percent. Mr. Burnett concurred that there had been a flattening and slight increase in production.

Co-Chair MacKinnon thought it appeared as though there was a greater confidence level in production in the years 2015 through 2017, and less confident as the dates moved farther out. Mr. Burnett concurred.

Senator Hoffman hoped that the oil production was flat or moving in a positive direction, and pointed out that the bottom of the slide reflected the reverse scenario, with budget deficits totaling \$17 billion plus. He remarked that the state did not have that in reserves, which necessitated further reductions to the budget, and he hoped the state would eventually have a \$1 billion cushion in the constitutional budget reserve (CBR).

Co-Chair MacKinnon thought that that what Senator Hoffman stated was fair. Production and prices were variable, and

the state's expenses were somewhat within its control. She suggested the state could not control the world oil market, but could control its spending and incentivize to affect for greater production. She stated that the senate had made a first step in trying to right-size the budget and take a "bite" out of the budget.

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Mr. Burnett turned to slide 4: "Reserve Outlook - Spring 2015 Forecast." He highlighted the \$12,780 million CBR balance at the end of FY 14. He continued that the state would have \$8,875 million in the CBR and \$0 in the statutory budget reserve (SBR) at the end of FY 15, assuming the balance of the deficit was taken out of the CBR.

Co-Chair MacKinnon recalled that as of March 2015 the CBR had approximately \$10,130 million, and the SBR had approximately \$1,660 million. She shared that she had received the numbers from the Treasury Division and asked if her figures were correct.

Mr. Burnett stated that there was a cash balance in the SBR was approximately \$1.6 billion as of the end of April 2015, and did not think any transfers had been made from the fund since. He explained that the funds were obligated to be spent in FY 15, in addition to another \$1.2 billion beyond that amount.

Co-Chair MacKinnon commented that it would be interesting to see what it would mean to the administration if a three-quarters vote [necessary to access CBR funds] was not achieved. Mr. Burnett agreed.

Mr. Burnett pointed out that under the spring forecast numbers, as of 2020 the state would have no reserves and a bit of a deficit beyond that point.

Co-Chair MacKinnon asked how the figures were different from those of the Legislative Finance Division (LFD). She recalled that previous figures indicated the state would have exhausted reserves by 2018.

Mr. Burnett believed that the difference was due to setting oil prices or state expenditures at a different level when completing calculations. He clarified that it would not

take much sensitivity between the two variables to exhaust the reserves by 2018. He considered the DOR forecast to be reasonable and thought that another forecast that was also considered reasonable could produce a different result.

Co-Chair MacKinnon remarked that there was a great deal of public interest in the deficit and drawing on savings. She thought that Mr. Burnett was projecting the use of reserves somewhat more optimistically than the committee had heard earlier in the week.

Mr. Burnett stated that both sets of numbers were reasonable. He did not think it would take much difference [from the other forecast] in revenues to come up with a diminished reserve in 2018. He did not see a scenario in which the state would run out of reserves before the end of 2017; however he did not know of scenarios in which the state did not run out of funds in the early part of 2020.

Co-Chair MacKinnon clarified that the committee understood the variables being used in the forecasts, however the public may not. She pointed out that FY 17 actually started in the year 2016.

Mr. Burnett concurred, and furthered that FY 18 started in the year 2017. He stated that in LFD's revenue forecast model, reserve funds would run out in July of 2017, with a significant deficit that was uncovered in 2019.

Co-Chair MacKinnon clarified for the public that fiscal and calendar years used different dates. When discussing FY 17, the committee was in reality discussing a beginning date of July 1, 2016. She explained that FY 17 projected out further in some people's minds, when in reality budget change required action in the current or subsequent year.

Mr. Burnett agreed and stated he would be careful to use both types of date reference.

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Vice-Chair Micciche elucidated that FY 16 would start in two months and FY 17 would start in 14 months.

Mr. Burnett referred back to slide 4 and pointed out that from 2021 to 2025 there were deficits reflected with no reserves to cover them. He pointed out that significantly

lowered spending or an additional revenue source was needed to cover the budget. He commented that prices fluctuated, but the legislature should plan to have something in place.

Co-Chair MacKinnon asked if Mr. Burnett had a plan to share with the committee. Mr. Burnett responded in the negative.

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Mr. Burnett advanced to slide 5: "Spring 2015 Revenue Forecast Discussion":

- If only the CBRF is tapped each Fiscal Year to Balance the State's Budget, current anticipated run-out date occurs in June of FY 2020
- CBRF Subaccount transfer into the Main account incorporated into Spring projections
- SBRF is anticipated to be fully expended during FY 2015
- After SBRF is fully expended, approximately \$1.2 billion is needed to balance anticipated General Fund spending for FY 2015

Mr. Burnett pointed out that much of 2015 had passed, and many of the state spending obligations had already occurred.

Co-Chair MacKinnon asked Mr. Burnett to comment on the Senate's budget proposal to expend the school fund in order to close the budget gap for FY 15. She clarified the proposal was due to not being able to get a three-quarters vote from the Minority necessary to access the CBR.

Mr. Burnett stated that the proposal would create cash flow differences for FY 16. He did not have a comment on the spending, but remarked that the proposal was legal and do-able.

Co-Chair MacKinnon was unaware of another alternative to fund FY 15, and wondered whether Mr. Burnett was aware of another fund that could serve the same purpose. Mr. Burnett stated that other funds with available cash were the Power Cost Equalization (PCE) Fund and Higher Education (governor's scholarship) Fund.

Co-Chair MacKinnon reiterated that the committee was looking for a three-quarter vote.

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Mr. Burnett referred to slide 6: "CBRF STATISTICS AS OF MARCH 31, 2015". He stated that it showed the investments, the total asset value, and how much the fund had earned for the year. He pointed out that the state had earned a bit more in the subaccount than the spring forecast had projected prior to the transfer from the subaccount to the main account. He stated that in the month of February there had been earnings of about \$200 million in the subaccount, with negative earnings for most of the rest of the year, for a total of \$179 million in investment income prior to being moved over to the main account.

Co-Chair MacKinnon expressed that she had concerns with the current management of funds. She had no challenge with the authority of the commissioner of DOR to move funds how he deemed appropriate to benefit the state, and thought that everything had been done legally and under the right conditions. She felt that there was lost opportunity when the earnings from the subaccount were placed in the main account, which drew substantially less interest.

Mr. Burnett reported that in 2008 he was the deputy commissioner of DOR. At that time there was a transfer of \$4.1 billion to the subaccount from the main account of the CBR; in September of the same year the balance in the subaccount was \$5 billion. He continued that in February of 2009, there was \$3.1 billion in the subaccount. He explained that when the spending horizon was shorter, the opportunity to lose money was a greater risk than the possible gain of earnings. He referred to the 5-year horizon in statute as an example of using the same logic. He stated that there had been a lot of discussion at the time, and the decision to have the funds in the subaccount was correct in the long run, as the money was not used and became close to \$7 billion over a period of the next a few years. He stated that Alaska had an unprecedented 6-year run-up in the equity markets, with a maximum correction of 20 percent in a day.

Mr. Burnett continued that there had been a 40-plus percent correction in a period of a year, and the state could not

recover from that in a 5-year time horizon. He explained that the decision to move the funds was based on protection from loss rather than seeking earnings. He emphasized that he did not make the choice; rather, he was explaining what the basis for the choice was. He referred to committee members that were in office at the time of the earlier funding scenario, and suggested that some had been "somewhat upset" with the commissioner of DOR.

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Co-Chair MacKinnon stated that her concern had to do with forgoing a \$100 million opportunity, and thought that Mr. Burnett had been absolutely right (from a conservative perspective) that the state could stand to lose the money in the case of a negative market. She asserted that the state would not know for a year if the decision was right or if there was an opportunity lost. She thought that in its current location, the money would be lucky to earn 2 percent interest.

Mr. Burnett stated that the ten-year expected capital market averaged somewhere in the two percent range, which was not a high number but was unlikely to lose a large amount. He clarified that the funds were in fairly short-duration investments.

Co-Chair MacKinnon wondered if the reasoning behind the choice (of moving the funds from the subaccount) had to do with liquidity because the assets could be called upon for use within the next five years. Mr. Burnett responded in the affirmative.

Co-Chair MacKinnon asked about the investment strategy on the main account, and wondered if there was any way to safely increase the return to greater than 2 percent rather than holding the funds in treasuries. She wondered if there were long-term equity mutual funds or other options that might draw more income for the state.

Mr. Burnett indicated that the DOR commissioner and the investment staff in the Treasury Division were looking at the asset allocation of the fund, and all other funds. He explained that the fund evaluation was an annual process after which the funds were reset in July. He stated that he would not be surprised if there were changes made to the asset allocation of the fund, he had participated in

discussions about it, and it was ultimately the commissioner's decision.

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Co-Chair MacKinnon asked if the committee members were interested in receiving an update from the department on subsequent changes or distinctions in the allocation of the fund. She indicated that members nodded in agreement. She asked Mr. Burnett to keep the committee updated on any decisions with regard to the asset allocation. Mr. Burnett agreed.

Senator Olson asked about the aforementioned subaccount earnings from 2008, and wondered if there were indications there at the time that may have suggested it was fine to leave the funds rather than move them to a safer location. He referenced a recent \$4 billion transfer, and wondered if there had been indicators that suggested the state would be losing a large amount of money if it was not moved.

Mr. Burnett reported that the equity markets had one of the longest term run-ups that they had ever had. There had never been a longer time period in which there had been no major market correction, and that was considered an indicator. He recounted that the biggest change was when the spring forecast came out and there was a less than five-year time horizon; that was the statutory trigger, and was what the commissioner had recognized as a condition for the funds not to be in the subaccount. He stated that DOR was in the process of addressing whether the funds should be in a different asset allocation in the main account than it currently was.

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Senator Olson wondered if there should be something put into statute to protect state funds from current market volatility. Mr. Burnett did not think any changes to statutes were necessary, and furthered that the commissioner invested under "the prudent investor rule" with a look at the life of the asset and when it would be needed. He furthered that the approach was consistent for the various funds the state had, and asset allocations were used to protect the state from volatility.

Senator Bishop asked if there was a difference in penalties between draws from the main account and draws from the subaccount.

Mr. Burnett responded in the negative, and explained that the subaccount was set up around 2000 to gain additional earnings because there were more funds in the CBR than were originally predicted to be spent. He furthered that the subaccount started with a deposit of \$400 million, an amount specifically chosen in order to be a match and a "natural arbitrage" between financing that was being contemplated in the CBR earnings for capital projects.

Co-Chair MacKinnon asked Mr. Burnett if the state had been willing to take a little more risk because it felt the money would be held for a longer period of time, thereby diminishing the risk; whereas the recent transfer to the main account was to guard the funds a little closer. Mr. Burnett concurred and added that prior to 2015, the state had not planned to spend the funds for a long period of time.

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Mr. Burnett turned to slide 7: "APFC Fund Financial History and Projections As Of February 28, 2015." He explained that the slide showed permanent fund projections on earnings, and the fiscal year end assigned balance, which constituted the earnings reserve account. He furthered that the account would theoretically have funds available for appropriation.

Co-Chair MacKinnon referred to the slide and wondered if the fund should be rebalancing to a more conservative nature after hitting the longest run of good return. She asked if there would be conversations with the managers of the fund accounts regarding switching to more conservative areas.

Mr. Burnett believed that the fund managers had rebalanced to be more conservative, and specified that the fund's projected earnings (after fees) was around 6 percent. He added that there were liquid assets and private equity within the fund, which had higher returns over the long period. He reminded the committee that the principal of the permanent fund could not be spent, only a portion of the realized earnings.

Co-Chair MacKinnon asked about the projected rate of return for the CBR account. She observed that in past years, at times the CBR had managed a higher rate of return than the permanent fund, and other times the opposite was true. She asked Mr. Burnett to reflect on the previous year, and compare DOR's management and returns to those of the permanent fund. She wondered how the returns would be forecast for the future considering the decisions of the administration.

Mr. Burnett did not have the actual numbers with him, but shared that the PCE Fund, the retirement funds, and the subaccount of the permanent fund earned a higher rate in FY 14 than the permanent fund. He was unable to recall the earnings of the current year.

Co-Chair MacKinnon asked for Mr. Burnett's perspective as well as to provide anticipated amounts for earned income for the year. Mr. Burnett was unable to provide the exact number for the main account of the CBR, but shared that it was low. He commented that the information was available on the department website.

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Senator Hoffman commented that the permanent fund earnings reserve account continued to grow, and opined that the legislature should be examining related policy questions and where the money should be spent. He asked about the current balance of the earnings reserve account. Mr. Burnett responded that the account was projected to be over \$6 billion dollars at the end of FY 15.

Senator Hoffman observed that it would grow to \$12 billion by 2025. He asked if Mr. Burnett included the earnings when he had mentioned "available funds." Mr. Burnett responded in the affirmative; stating that the earnings of the permanent fund were deposited in the general fund as provided by law, and the legislature could appropriate them for any purpose.

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Mr. Burnett advanced to Slide 8: "GeFONSI Market Value \$5.07 billion at 3/31/2015." He explained that the slide was an illustration of the market value of the general fund and other non-segregated investments (GeFONSI). He pointed

out that the account grew very rapidly up to 2013; and explained that from 2008 to 2013, the total had included the SBR. He recounted that in 2013, the SBR (which contained about \$4.7 billion) had been moved into a separate fund for investment purposes, which explained the significant drop from 2013 to 2014. He continued that the fund had a variety of monies from over 100 different funds and accounts in it, including UGF, the education forward-funding account, and money that the legislature had appropriated to the Alaska Housing Finance Corporation (AHFC). He specified that the fund had just over \$5 billion, and of that, less than \$1 billion was currently UGF. He discussed short-term fixed-income returns, and commented that they had been very low for the last several years.

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Vice-Chair Micciche asked if there were any results from the returns trend for FY 15. Mr. Burnett responded that the returns were very low, and were under one percent.

Vice-Chair Micciche asked if the department had a spreadsheet available listing the various funds. Mr. Burnett responded that the department had the information, and on the DOR website there was a list of the funds that received their own interest. He remarked that the department had monies that may not belong to the state, such as student loan corporation monies or reserves of AHFC, which were invested in GeFONSI to garner higher returns than they might gain otherwise.

Co-Chair MacKinnon noted that after Mr. Burnett's slide presentation, the committee would start a conversation about the cash deficiency plan, and available sources of funds without the three-quarter vote needed to access the CBR.

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Mr. Burnett pointed to Slide 9: "Other Fund Balances As Of March 31, 2015":

- Alaska Higher Education Investment Fund
-\$459.9 million, total investment income \$14.7 million

- Public School Trust Fund (P&I Account)
-\$601.2 million, total investment income \$19.2 million
- Power Cost Equalization
-\$980.1 million, total investment income \$33.5 million

Mr. Burnett noted that the Public School Trust Fund was not available. It was a constitutionally-dedicated fund whose income could only be spent on schools, and the investment income was portioned into the foundation formula every year. He discussed the PCE Fund, noting that the previous year it had earned an approximately 20 percent return, and the current year it was earning somewhat less.

Co-Chair MacKinnon mentioned that the governor had proposed different management of the PCE Fund, and wondered about the status of the related legislation. Mr. Burnett specified that the legislation (SB 34), had passed the Senate as amended in the Senate Finance Committee, and had passed the House. He continued that now the fund had a 4 percent investment policy floor, which may or may not change how it was invested, but the department would not be seeking the higher-risk targets.

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Mr. Burnett clarified that the funds listed on slide 9 were invested outside of the GeFONSI pool. He thought the Public School Trust Fund had a very interesting investment policy which might be a topic for further discussion for the committee.

Co-Chair MacKinnon asked if Mr. Burnett wanted to go into detail about the public school trust fund investment policy. Mr. Burnett shared that the earnings of the fund were limited to the realized earnings and did not include capital gains. He found that investing the earnings in the modern world was interesting because the gains on equities were not included in the income, so fixed income and dividend-paying stocks were used to provide income. Equities were used to increase the value of the fund, but capital gains were not spendable. He reiterated that the policy was something the committee might want to examine.

Co-Chair MacKinnon clarified that the fund was constitutionally dedicated, but there were statutory ways for the fund to grow over time. She thought Mr. Burnett was inferring that the state was not optimizing the growth and able to provide it for school education due to statutory restrictions. Mr. Burnett believed it was likely the case, and thought it was something to look at.

Co-Chair MacKinnon avowed to make a note of the policy in order to bring it to the Senate's attention, possibly during the upcoming interim, to see if the legislature could work with the administration to better utilize the revenue stream for public education.

Co-Chair Kelly wanted to be caught up on the conversation. He was wondered if GeFONSI was the account in which the CBR was managed. Mr. Burnett relayed that GeFONSI was a pool of funds including the GF, the forward funding of education monies, the funds put aside for the natural gas pipeline, AHFC funds, the rail belt energy fund money, and other similar types of funds. He stated that it was an investment pool and each of the funds owned a portion.

Co-Chair Kelly asked if the fund was fairly liquid. Mr. Burnett stated that it was fairly liquid and spendable, and many of the funds were spent on a regular basis. He added that the CBR and SBR were managed separately, as well as the higher education fund.

Co-Chair MacKinnon mentioned funds that were not accessible by the legislature, such as funds from AHFC or the Alaska Commission on Postsecondary Education (ACPE). Mr. Burnett noted that there was a portion of the fund made of monies that had been appropriated for a purpose and had not yet been spent.

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Senator Dunleavy mentioned the AHFC and student loan corporation and thought that both had dividends that went to the state. Mr. Burnett clarified that both were set up to spin off a dividend, and assuming that they earned income, would pay a dividend. He added that the ACPE board determined whether a dividend was paid every year.

Senator Dunleavy asked if Co-Chair MacKinnon had been referring to something beyond dividends.

Co-Chair MacKinnon responded in the affirmative, and reiterated that the board of directors made the dividend policy decision on behalf of the state, and used AHFC as an example of investing dividends based on board's mission. She thought the committee might want to examine the corporation's mission in the state statutes if they expected the corporation to pay dividends to the state. She reiterated that the board was determining investment of the dividends, and thought that most of the dividends were spent on clientele and other housing opportunities. She thought the state had not received a dividend from ACPE for the past several years; they had reinvested the dividends in additional loan programs or discounts to current students in repayment. She considered that the board had looked at the postsecondary debt load and repositioned the dividends.

Mr. Burnett responded that Co-Chair MacKinnon was correct. He referenced three corporations: the Alaska Industrial Development and Export Authority (AIDEA), AHFC, and ACPE. As with ACPE and AHFC, AIDEA dividends were at the discretion of the board to make recommendations as to how they would be spent.

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Senator Dunleavy asked if it was safe to say that any dividends would be a fraction of the money the state had invested for the principal.

Co-Chair MacKinnon responded that she thought it was fair to say.

Senator Dunleavy asked about an item requested by ACPE and taken out of the current year's budget; funding for an Alaska Navigator: Statewide Workforce and Education-Related Statistics (ANSWERS) grant longitudinal study. He wondered if the item could then in turn be funded through the process of declaration-of-dividend by the board.

Co-Chair MacKinnon stated that ACPE would be required to come back to the legislature to request the appropriation for the direct line of funding. She related that the commission had made the recommendation, which the legislature had turned down. Mr. Burnett did not have any

further information, and related that he sat as a member of the board of directors of all three corporations.

Co-Chair MacKinnon related that the board had very passionately requested the appropriation, and that the administration had followed up with herself and Co-Chair Kelly in its request to fund the particular study. It was her belief that the corporation did not have the authority to fund the study without the language in the budget.

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Vice-Chair Micciche asked for a quick review of the cash deficiency contingency plan.

Co-Chair MacKinnon asked Mr. Burnett to address the department's cash deficiency plan. She reiterated that the legislature had not completed a three-quarter vote to access the CBR, and wondered how the department would go through its cash deficiency operation plan and pay for state government.

[2:43:07 PM](#)

Vice-Chair Micciche expected that the current administration was working on a comprehensive and fully executable cash deficiency plan. He wondered if such a plan was underway considering present conditions.

Mr. Burnett stated that the plan was reviewed and updated each year, and the current plan had been executed by the previous administration. He told the committee that it could expect a new plan that would be changed somewhat, and it would be a collaborative project with the Department of Law (DOL), the Department of Administration (DOA), the Office of Management and Budget (OMB), and DOR.

Co-Chair MacKinnon recognized that it was a collaborative effort and thought it was a framework in which to start policy discussions internally with the administration. She furthered that the Senate Finance Committee would like to know how the department would start implementing the cash deficiency plan, because that appeared to be the direction in which the state was going. Mr. Burnett stated that at the current time the SBR had \$1.6 billion, and the GF still contained cash; and from a cash stand point the State of Alaska could continue to operate and pay its bills. He

pointed out that at the end of the fiscal year, the state would have a deficit and would be unable to close out the fiscal year. The state could continue to operate, as long as it believed the deficit would be funded in some manner.

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Co-Chair MacKinnon asked if the state had the reserves in a variety of accounts to keep the state cash flow current and keep paying bills. She asserted that it was a policy decision as to where the state accessed the funds, and wondered how DOR would pay the state's bills without the three-quarters vote needed to access the CBR. She asked about Mr. Burnett's mention of "closeout" and wondered whether he was referring to an accounting closeout, where the state would be unable to meet the single audit requirements to close out the year.

Mr. Burnett explained that the state had sufficient cash to pay its bills; it had an appropriation from the current year's revenues and the SBR. The state would not have exhausted the cash prior to after the end of the fiscal year. He emphasized that from a cash basis, the state could continue to operate; qualifying that with the shortage, the state would not have the authorization to spend beyond that. Thereby the state would have an unfunded budget, would not be able to close out the fiscal year, would not be able to meet the single audit requirements, and would have gone in to deficit spending. He stated that he was not the attorney that would be advising the state on the matter, so he was unable to tell the committee how to proceed.

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Co-Chair MacKinnon shared that the Senate had proposed an idea to fund the deficit, had passed the motion with a three-quarter vote, and was not the legislative body that was creating the cash deficiency conversation. She relayed a hypothetical situation that the Senate passed a budget, enabling the department to do the single audit and close out FY 15 by utilizing non-forward funding (because of being unable to get the three-quarters vote from specific members of the other body). She anticipated revenue of \$2.2 billion to start FY 16, and wondered how the state would fund FY 16 without the three-quarter vote.

Mr. Burnett stated that at the beginning of FY 16, assuming the budget passed and use of the CBR was not authorized, under the cash deficiency plan the state would have the ability to inter-fund borrow or borrow externally within the fiscal year. He furthered that if the legislature reasonably believed that there would be some way to close the gap later on, it could borrow against expected tax revenues. He believed the state would bring \$100 million per month in production tax and royalties. He thought that dependent upon cash flow, the money could be borrowed early in the year and pay the state's bills until it was no longer possible. He added that it was not a long-term solution.

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Co-Chair Kelly asked how much of the funds being discussed were automatically available to the administration. He wondered if legislative approval (other than the CBR vote) was required for the department to employ the cash deficiency plan. Mr. Burnett responded that with the memorandum of understanding between DOL, DOA and OMB; the state could utilize inter-fund borrowing without additional legislative approval if it was expecting the revenue later in the year.

Co-Chair Kelly asked for clarification that inter-fund borrowing was exclusive of the CBR. Mr. Burnett answered in the affirmative, and relayed that the state had previously borrowed against the CBR and paid it back. Additionally, the state could borrow in the market against future revenues. He summarized that there was potential to move cash flow from one end of the year to the earlier part of the year to pay bills.

Co-Chair Kelly asked how the state could adequately demonstrate the ability to pay back the funds if there was not a vote to authorize use of the CBR.

Mr. Burnett stated that there must be knowledge of funds forthcoming in the future in order to borrow against it. He qualified that the state could only borrow in the same fiscal year as the funds for repayment were expected.

Co-Chair Kelly wondered if the collateral for borrowing also had to be within the same fiscal year. Mr. Burnett said not necessarily.

[2:51:51 PM](#)

Senator Hoffman read aloud section 10, "Interim Borrowing" in Article IX of the Constitution of the State of Alaska.

§ 10. Interim Borrowing

The State and its political subdivisions may borrow money to meet appropriations for any fiscal year in anticipation of the collection of the revenues for that year, but all debt so contracted shall be paid before the end of the next fiscal year.

Senator Dunleavy referred to the scenario of the legislature sending the department a spending plan and funding plan, and wondered if Mr. Burnett was describing a scenario in which that the state would be writing an IOU on behalf of the legislature. Mr. Burnett did not believe that the department had the authorization to borrow funds. He reminded the committee that he was not the attorney tasked with analyzing the legality. He believed that if the legislature were not to have provided any type of funding for state government, there would be a problem moving forward. He reiterated that it was possible to borrow against anticipated revenues within the fiscal year to move cash flow to the beginning of the fiscal year.

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Senator Dunleavy asked for clarification as to whom Mr. Burnett was referring to when he used the word "we." Mr. Burnett clarified that he was referring to the administration.

Senator Dunleavy referred to the word "state" in the aforementioned section in Article IX of the constitution, and wondered if it was referring to the legislature, or the administration. He thought it was an important distinction, and wondered if the administration could act on behalf of the state in the context of the passage.

Co-Chair MacKinnon suggested that the DOL would be a resource for interpretation of the constitution rather than Mr. Burnett.

Co-Chair MacKinnon referred back to Section 10 of Article IX of the constitution.

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Vice-Chair Micciche referred to the "Cash Deficiency Contingency Plan" (copy on file), and the \$400 million minimum balance which appeared to be a trigger for many of the procedures listed in the plan. He wanted to better understand the logic for doubling the required minimum balance of the GF. Mr. Burnett stated that there had been times in which the state had paid out \$200 million in one day, due to fund transfers and other items, so the minimum was then set at a high enough level to ensure there was sufficient cash to meet an obligation. He stated that he was not involved in the creation of the document.

Vice-Chair Micciche thought that the number could be lower, and expected that the department would be looking at the minimum level in the future.

Co-Chair MacKinnon stated that the plan was an internal document where the involved departments had made their best policy judgements, and restated that it was the work of the past administration. She commented that the legislature was interested in what the current administration would do for cash deficiencies, and wondered when it could expect a new cash deficiency operation plan.

Mr. Burnett responded that he was not aware of a date for a new plan, but the department would be discussing it soon.

Co-Chair MacKinnon asserted that the committee would like a copy of the new plan as soon as possible, and requested that Mr. Burnett ask the commissioner for a timeline as to when the plan might be developed. She thought that considering the current fiscal situation, the plan may be a priority.

Mr. Burnett thought that regardless of the votes on the budget, it was likely that the state would be utilizing a cash deficiency plan as a result of not having a monthly cash flow large enough to cover bills in some months. The plan was something that would be utilized under any circumstances when the state was spending down reserves.

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Senator Bishop was curious about the aforementioned constitutional question of the word "state" in Section 10 in Article IX.

Co-Chair MacKinnon stated that she had been in contact with DOA Commissioner Sheldon Fischer to examine some of the administration's actions in managing government. She noted that Commissioner Fisher and Commissioner Hoffbeck would both be available the following Tuesday for consultation.

Co-Chair MacKinnon pointed out that the PCE Fund and the higher education fund were not listed in the cash deficiency plan, and wondered if the administration believed they could access the funds to help with deficit spending when it did not have authorization.

Mr. Burnett stated that the department had not given the idea full consideration yet, and a plan from the previous year had been looking at a much different level of cash deficiency needs and timing. He stated that the issue of using the PCE or higher education funds was that they were both invested long-term, and thereby any draws would provide risk to the funds' long-term viability and result in greater debt.

Senator Dunleavy wondered if Legislative Legal Services could shed some light on the question of the definition of "state" in Article IV.

Co-Chair MacKinnon thought that if the legislature was still in session the following week, the question might bring Department of Law to committee to discuss its constitutional responsibilities in the case of not being able to obtain the three-quarters vote to access the CBR.

Co-Chair MacKinnon commented that in the earlier cash flow conversation she had understood that the state made different amounts of payments at different times of the year. She discussed a cash-flow model and wondered if education was funded on a six-month cycle or monthly. She asked how the money was distributed to local school districts. Mr. Burnett thought that the Department of Education and Early Development could provide a better answer, but stated that the funding for education was not done all at once. Rather, the funding was done over time, with a larger draw at the beginning of the year and smaller draws throughout the remaining time. He added that local

governments were funded similarly; except for shared taxes, which were paid after they were collected.

Co-Chair MacKinnon pointed out that most school districts did not have taxing authority, and thought that districts understood the fiscal situation. She asked that if the larger draw in the beginning of the year that meant that the FY 15 draw would help the districts go past July 1st and start the next fiscal year, or would there be another draw later in the summer.

Mr. Burnett stated that for the past several years the draws had come from the education forward-funding account, so it was not a GF draw. He looked at the funding differently than the cash plan for the GF; and so long as education was forward-funded, it was not included in the cash deficiency model. He stated that certainly it was necessary to fund early in the year, and also through the year. He had looked at the historic balances through the year but did not recall exact numbers.

Co-Chair MacKinnon asked if Mr. Burnett could provide the committee with information on the second draw from the education fund. She discussed the timing of the school year and the fiscal year, and recognized that there were operating expenses before the beginning of the school year. She wondered when the next large payment would go to school districts in Alaska. Mr. Burnett agreed to provide the information.

Co-Chair MacKinnon expressed appreciation for Mr. Burnett testifying on a Saturday. She related that the committee was trying to understand what the administration was facing in regards to the budget. She was concerned about what the administration might do if the three-quarters vote was hampered by a small group of people. She did not support a draw from the PCE account, and considered that it would be detrimental to the account. She thought that selling conservatively-invested assets would cause an even greater need for cash in the future. She relayed that there were several committee members who concurred with the sentiment.

Mr. Burnett mentioned Alaska's credit rating, and wondered if the committee wanted to discuss it.

Co-Chair MacKinnon expressed that the current administration did a good job and went to the markets to

make a case for the state as to why it should maintain a strong credit rating. She mentioned the sizable reserves and the contentious relations over how they would be accessed. She asserted that the state was currently cash rich, and acknowledged that accessibility and the projected use of the savings would be a cause for pause to credit agencies. She asked Mr. Burnett to do a high-level overview of key factors included in the state's credit rating, so the committee could understand what was being examined on a national level.

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Mr. Burnett discussed key rating considerations of the state including its large undedicated and unrestricted reserves, and possession of a volatile single-resource income stream. He described that the state had conservative financial planning over the years, which was positive and attributable to the legislative body. He discussed the CBR and the SBR, and past stability of the budget. He reminded the committee that Alaska's economy was very dependent upon natural resources, and a manageable liability position with little debt relative to income. He discussed the state debt level remaining stable over time and specified that it was currently about 8 percent (including school debt reimbursement). He thought that credit agencies were sensitive to a long-term downward trend with no plan to access reserves in a systematic way. He thought most of the rating analysts he had spoken with over preceding years did not believe the legislature would ever spend permanent fund earnings on government. Rating agencies would consider whether the state would access other sources of revenues; they were used to other states employing broad-based taxes. The agencies were very conservative and viewed Alaska as being different than other states.

Mr. Burnett remarked that the credit agencies would be looking at how the state handled the current fiscal situation. He discussed reducing expenses over time and having a systematic plan for using the reserves so they did not run out.

[3:10:01 PM](#)

Co-Chair MacKinnon remarked that the state had a plan with engaging a natural gas pipeline. She said the state had laid the framework, and though it might not be apparent to

the general public, policy makers had been advancing a plan.

Mr. Burnett stated that the rating agencies were well aware of the natural gas pipeline plan, and they were rating twenty-year debt. The agencies were expecting additional revenue sources in the future, which would include a gas pipeline within that period.

Co-Chair MacKinnon commented that DOR's projected revenue streams reflected the gas pipeline, as far as expending to meet the goal.

Senator Dunleavy felt as if the Senate was on its own, separate from the House of Representatives in trying to navigate the fiscal situation. He stated that he was very interested in hearing from the administration about its plan to get through the subsequent two to three years. He remarked that the state was the size of a subcontinent, with 700,000 people, and was not the same as a city or county down south.

Vice-Chair Micciche thought that the state should have a fiscal plan independent of the natural gas pipeline, and suggested that the success of the project would benefit how the state's finances were viewed in the future. He thought the state should manage spending and revenue independent from the project.

[3:13:01 PM](#)

Senator Dunleavy indicated that there were plans being put forward, and mentioned a plan put forth by retired UAA economist Dr. Scott Goldsmith that he considered of merit. He restated his interest in hearing a plan from the administration. He agreed with Vice-Chair Micciche on using caution when considering a future gas pipeline as a large revenue component of a fiscal plan.

Co-Chair MacKinnon discussed the schedule.

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ADJOURNMENT

[3:14:52 PM](#)

The meeting was adjourned at 3:14 p.m.