

HOUSE FINANCE COMMITTEE
February 8, 2017
1:49 p.m.

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CALL TO ORDER

Co-Chair Seaton called the House Finance Committee meeting to order at 1:49 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Les Gara, Vice-Chair
Representative Jason Grenn
Representative David Guttenberg
Representative Scott Kawasaki
Representative Dan Ortiz
Representative Lance Pruitt
Representative Steve Thompson
Representative Cathy Tilton
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Deven Mitchell, Debt Manager and Executive Director, Alaska Municipal Bond Bank Authority, Department of Revenue.

SUMMARY

PRESENTATION: STATE DEBT AFFORDABILITY ANALYSIS
DEPARTMENT OF REVENUE

Co-Chair Seaton discussed the agenda for the day.

^PRESENTATION: STATE DEBT AFFORDABILITY ANALYSIS

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DEVEN MITCHELL, DEBT MANAGER AND EXECUTIVE DIRECTOR, ALASKA MUNICIPAL BOND BANK AUTHORITY, DEPARTMENT OF REVENUE,

provided a PowerPoint presentation titled "2017 Credit Review & State Debt Summary" (copy on file). He shared that the Department of Revenue (DOR) was required to provide two publications annually: "The Alaska Public Debt Book" and "Debt Affordability Analysis." He began with the graph on slide 2 titled "State Savings Account Balances and Ratings Timeline" and explained that the state's credit was evaluated by three national credit rating agencies: Standard and Poor's, Moody's Investor's Service, and Fitch Ratings. He noted that the graph depicted how the state's credit rating fared over time. He reported that in 2014 the state received an AAA rating, which was the highest rating. The rating coincided with the state's reserves reaching their peak (denoted by the blue horizontal line) in the amount of \$24 billion comprised of the Constitutional Budget Reserve (CBR), Statutory Budget Reserve (SBR), and the Earnings Reserve Account (ERA) of the Permanent Fund.

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Representative Guttenberg appreciated the presentation. He asked about Alaska's rating as compared to other states. Mr. Mitchell answered that Alaska was "squarely in the middle" of the states with its current AA+ rating. He remarked that the credit rating had the same "negative trajectory associated with the state's reserve balances" and was worrisome. He noted that if the historical unrestricted general fund (UGF) revenue was superimposed on the graph UGF would be in decline and when compared to expenses caused a "recurring fiscal gap issue." He indicated that how the state "categorized revenues and how [the state] utilized reserves" was "creating a portrayal" that resulted in "diminished credit strength." He furthered that the state was on a "negative outlook from all three credit rating agencies", which meant that the statistical probability existed that the rating would drop if the state did not "shift how it defined revenue compared to expenditures."

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Representative Guttenberg stated that in the context of Alaska and how it counted and looked at revenue what state did Alaska compare to. He asked how other states credit rating was measured. He thought that Alaska was unique with a "single source" of revenue. Mr. Mitchell replied that there was not a comparable state. He delineated that a

single source of income for another state would likely be a broad-based tax that was more predictable and stable versus the volatility of the price of oil.

Mr. Mitchell moved to slide 3 titled "Rating Agency Views - State of Alaska:"

POSITIVES

- Large Reserves provide time to determine what fiscal future will look like
- Some combination of re-casting the treatment of various available revenue streams currently restricted, creating new revenue, or reducing expenditures can resolve funding gap
- Baseline assumption that the State will correct deficit trend before coming close to reserve depletion
- Strong management of financial operations

Negatives

- Future of Alaska's creditworthiness hinges on the ability of its political leaders to reach agreement on substantive fiscal reforms during the 2017 Legislature
- Narrow revenue sources continue to reflect economic volatility
- Alaska's share of the PERS/TRS net pension liabilities translates to a very high \$7,402 per capita

Mr. Mitchell reiterated that the state's current credit rating was AA+(Negative) [Standard and Poor's and Fitch Ratings] and Aa2 [Moody's]. He noted that the credit agencies released a report when issuing a rating. He addressed the positive and negative findings contained in the reports. He indicated that the state's pension liability was the highest in the nation.

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Representative Kawasaki referred to slide 2 that tracked the state's account balances and ratings and thought they were confusing. He wondered how quickly the ratings could change. Mr. Mitchell replied that in the summer of 2014 the price of oil was \$106/bbl. and quickly dropped by the fall, and in December 2014, Moody's placed the state on a negative outlook with S&P to follow. The downgrades had coincided with time passing and no proposed solutions. He offered that "settlement" funding deposited into the

Constitutional Budget Reserve (CBR) during the same year CBR funds were used to close a fiscal gap was perceived as reserve spending - even though the settlement was current year revenue paying for current year costs. Representative Kawasaki asked what it would take for the legislature to turn the negative outlook around. He wondered which option was most important. Mr. Mitchell replied it was a combination of actions. He specified that the elimination of risk was the most important action. Minimizing risk included minimizing volatility, creating a balanced budget and a sustainable means of paying for expenses in the future.

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Representative Ortiz referred to the last bullet point on slide 3 and offered that Mr. Mitchell described the amount as "overwhelming" and "the highest in the country." Representative Ortiz asked for further detail. Mr. Mitchell responded he had a slide later in the presentation that would answer the question. Historically, Alaska had been overly generous in its retirement system and had a small population. He exemplified the 5-year vesting benefit that cost the state \$1.5 million that was most likely underfunded. He pointed to the benefits of the retirement tier 1 as contributors to the liability that lessened with each subsequent tier until the establishment of tier 4, which moderated the problem.

Mr. Mitchell mentioned that the next three slides were designed to point out the rating agencies methodology. He turned to slide 4 titled "Overview of Moody's State GO Rating Methodology:"

Moody's outlines four broad rating factors and 10 sub-factors in its fundamental analytical framework for rating U.S. States, each with an assigned weighting

- Economy, 20% weight
- Governance, 30% weight
- Finances, 30% weight
- Debt, 20% weight

Each of these factors is evaluated using various sub-factors scored on a scale from 1 (Aaa) to 9 (Baa and Below)

Each sub-factor's value is multiplied by its assigned weight and then summed to produce a weighted average score, which is translated to the grid-indicated rating

Mr. Mitchell reviewed slide 5 titled "Overview of S&P State GO Rating Methodology:"

S&P outlines five key rating factors in its analytical framework for rating U.S. States

- Government framework
- Financial management
- Economy
- Budgetary performance
- Debt and liability profile

Each of these factors is evaluated using various metrics scored on a scale from 1 (strongest) to 4 (weakest)

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Each metric may have several indicators that are scored on the same scale and averaged

Ultimately, the scores for the five factors are averaged with equal weight to arrive at an overall score which is translated to an indicative credit level

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Representative Grenn spoke to the rating factors of Moody's and S&P. He asked for examples of actions or items that would fall under the category of government framework or governance. Mr. Mitchell replied that a statutory requirement to balance the budget, or the requirement to develop a 10-year plan, and items such as the debt book and affordability analysis, were some examples.

Mr. Mitchell addressed slide 6 titled " Overview of Fitch State GO Rating Methodology:"

Fitch outlines four key rating factors in its U.S. State Government Tax-Supported Rating Criteria

- Debt and Other Long-term Liabilities

Economy
Finances
Management and Administration

Fitch does not use a numerical scoring system; instead, for each rating factor an entity may be classified as "Above Average," "Average," or "Below Average" based on a number of different attributes

Fitch does not detail how a final rating is derived based on how an entity rates in each category

Overall, Fitch's ratings for states' GO debt falls within the two highest rating categories of AAA or AA, with a few outliers

Fitch's methodology is more of a traditional rating approach and allows the rating analysts greater discretion in assigning relative weights to each factor depending on issuer specifics

Mr. Mitchell commented that he attempted to present the state in a positive manner when meeting with rating agencies. He moved to slide 8 titled "Executive Summary" that contained excerpts from a ratings presentation given the previous fall:

The State continues to make progress in implementing a sustainable fiscal plan.

Fiscal and Budget Update

Budget passed with substantial reductions in operations and capital spending

The Governor showed strong fiscal discipline, cutting costs and exercising his veto powers to significantly reduce state spending

Unrestricted General Fund expense reductions from FY2015: \$1.2 billion

Oil and gas tax credits: \$430 million

Paused capital projects totaling \$250 million and closed down mega-projects

Permanent Fund Dividend: \$665 million

The State is continuing to drive towards long term solutions

Substantial Reserves and Resources

General Fund balance: \$3.5 billion¹

Constitutional Budget Reserve ("CBRF"): \$7.3 billion¹

Permanent Fund: \$52.8 billion, comprised of \$44.2 billion corpus and \$8.6 billion Earnings Reserve²

Oil, gas and other resource-based industries provide substantial annual revenue that is available for appropriation

Alaska has taken extraordinary steps to improve pension funding over the past ten years including \$3 billion deposit from its CBRF in FY 2015

Mr. Mitchell detailed that even though a fiscal plan was not implemented last session in response to the budget crisis significant actions had occurred. He referred to the governor's veto of a portion of the Permanent Fund Dividend (PFD) and the legislature allowing the reduction to happen. He highlighted the budget actions as recognition that everyone understood the state was in difficult financial times.

Representative Kawasaki referred to the PFD reduction and asked whether the rating agencies viewed the action as positive in the areas of governance and economy. Mr. Mitchell answered in the affirmative. He shared that historically, credit rating analysts took a skeptical position regarding the state ever choosing to use the Permanent Fund for government. He recognized that the state had "limited options when it came to supporting the large geographic area and dispersed population with services that individuals had come to expect." The governor taking the

action showed it was not the "political third rail" and was "definitely a credit strength."

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Representative Kawasaki referred to oil and gas tax credits and asked whether the reduced payment was considered a liability. Mr. Mitchell replied that the liability was acknowledged, but it had not risen to the same level of concern as the PERS/TRS issue because it was not considered state debt.

Representative Pruitt referred to slide 8 related to the \$3 billion deposit from the CBR into the retirement trust in FY 15. He asked how the rating agencies viewed the step. He noted it had been done prior to the current budget crisis. He voiced that major policy shifts happened slowly over time. He asked whether the rating agencies considered the slow movement of the political process. Mr. Mitchell replied in the affirmative. He likened the state to a ship and relayed that it was difficult to turn a ship, especially in the wind. He cited the contribution from the CBR to the retirement systems. He delineated that he stridently touted the action as a "credit positive" and the agencies agreed. He qualified that the state recently received the "credit" on its scorecards for "prudent actions" for the deposit because rating agencies relied on the Comprehensive Annual Financial Report (CAFR) from the retirement systems for purposes of analysis. Representative Pruitt asked how long it would take for Alaska to reduce its highest ranking for retirement liability when compared to other states. Mr. Mitchell responded that he was uncertain but expected improvement due to the recent recognition of the \$3 billion deposit and new accounting standards that required states to incorporate retirement benefits into their balance sheets. He indicated that the state had already been accounting for its retirement liability, which would likely place the state in a stronger position relative to other states that had to show its full liability due to the rule change.

Representative Wilson asked how the reduction in the PFD reduction and the oil tax credit liability's impact on the economy affected the state's ratings. Mr. Mitchell replied that since the state did not have a broad-based tax there was not as much analysis on the economic sector. He related that on the local level the economic responses were more

likely to have an impact on credit analysis. The oil and gas tax credits and tax structure were factors and were followed by ratings analysts. Representative Wilson surmised that relative to the "credit rating portion" the budgetary decisions the state makes was "just a numbers game." Mr. Mitchell replied in the affirmative. He explained that viewing the process "very simplistically" the agencies considered what the state spent per capita and what it received per capita from the economy. He offered that as counterintuitive, the state's credit rating improved if there were fewer residents in the state because the state's income was from a third-party source.

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Co-Chair Seaton referred to a statement about a required minimum payment the state owed for oil tax credits. He corrected that the state was not required to appropriate a certain amount out of the fund but was only required to deposit money into the "028 fund."

Representative Wilson appreciated the correction.

Representative Ortiz referred to slide 8 and asked about the General Fund (GF) balance of \$3.5 billion listing under the category "Substantial Reserves and Resources." Mr. Mitchell answered that the amount was "sitting in the general fund" and was obligated for a variety of purposes and merely demonstrated liquidity. Representative Ortiz asked for verification that the amount was obligated in the current budget cycle. Mr. Mitchell replied in the affirmative and confirmed that the money was encumbered.

Co-Chair Seaton asked if the amount included Power Cost Equalization (PCE) and other funds. Mr. Mitchell answered in the affirmative because they were sub-funds of the GF.

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Mr. Mitchell moved to slide 9 titled "Revenues & Expenses: The Status Quo and Future Flexibility" that contained a chart of the state's revenues and expenses. He noted that the figures were based on the spring forecast. He reported that the projected budget deficits through 2021 were listed as \$3.9 billion in 2016, \$3.1 billion in 2017, \$3 billion in 2018, and \$2.9 billion in 2019. He stated that "it was a difficult credit story to tell" rating agencies. He pointed

to the diminishing short-term reserves that included the CBR and the ERA. The data assumed shifting to the use of the ERA. The chart portrayed the state as "continuing down the same path" as the status quo and depicted the ERA balance at \$3.5 billion in 2021, reduced from \$8.5 billion in 2016. He felt that the scenario was negative when considering the deficit line in red. Consequently, the department included another category of funding that had the potential for use. He pointed to the columns showing "Total Revenue Subject to Appropriation." He explained that DOR considered revenue available for appropriation but was historically restricted for use by "custom" but could be designated for certain purposes and added with UGF revenue to total an amount that was roughly the amount needed to balance the budget. He exemplified the 2018 column data that listed \$4.4 billion as the Total Revenue Subject to Appropriation. The subject to appropriation revenue had "potential" for GF budgetary use but did not included items such as the dividend and other items not considered a GF expense.

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Mr. Mitchell addressed slide 10 titled "FY 17 Enacted Budget Overview." The graphs and charts depicted that spending was significantly reduced over the last five years from \$8 billion to less than \$4.4 billion while maintaining essential services. The funding by type (lower right chart) from FY 15 through FY 17 showed that DGF would remain about the same, Undesignated General Funds (UGF) decreasing, federal funds increasing, other funds remaining the same, and the ERA diminished in FY 17.

Mr. Mitchell advanced to slide 11 titled "PERS and TRS Funding Status:"

FY2016 returns are expected to impact funding levels; however, the State's longer-run trend of improving funding levels continues.

FY2015 valuations illustrate the State's improved funding status across all areas of its PERS and TRS programs (1)

FY2015 figures reflect the impact of the State's \$3 billion transfer from the CBRF

\$1 billion PERS / \$2 billion TRS

Defined Benefit OPEB funding is near or above 100% for both PERS and TRS

FY2015 final valuations were adopted by the ARM Board in June, were used for the purpose of determining the FY2018 funding amount, and will be included in the FY2016 CAFR

Preliminary FY2016 Results

Preliminary FY2016 returns were -0.36%, well below actuarial assumptions, but consistent with other national pension returns

Estimated funded ratio of approximately 76.9% (PERS) and 81.9% (TRS)

Draft FY2016 actuarial valuation incorporating FY2016 returns is expected to be available in early 2017
[The slide also contained a chart]

Mr. Mitchell relayed that in the past retirement system funding had not been nearly as important in credit ratings as it was at present. Alaska had gone from a fully funded status to a not-so-great status, but it had been improving. He pointed to the chart that showed the funding status for PERS in 2015; the funded ratio based on valuation assets was 67 percent. He detailed that the actuarial accrued liability in 2015 was \$13.337.9 billion and the valuation assets amounted to \$8.9 million. He defined that an actuarially assumed unfunded liability existed when the actuarial liability exceeded the assets. He offered that there were many assumptions that went into the actuary analysis and it was difficult to maintain consistency over the years. He listed some of the factors that affected liability from year to year: worse investment performance than assumed; increased health care costs; retirees living longer lifespans. He explained that the state determined that the \$8.9 billion in PERS assets earning 8 percent between the current time and when the funds were expended would be sufficient to satisfy the liabilities, but the picture might look differently on a yearly basis due to factors changing that affected liability. He remarked that TRS performed better in FY 15 with the pension funded ratio

based on valuation assets at 76.9 percent and the healthcare funded ratio at 100.3 percent.

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Mr. Mitchell continued that the FY 16 performance was worse than expected and he anticipated the numbers to decrease slightly.

Co-Chair Seaton worried about the 103 percent. He recalled that if the ratio reached 105 percent the state would have to pay retirees a post retirement pension adjustment assuming the pension investments earned more than 8 percent. He believed that the 103 percent valuation pertained to the GF contribution the legislature made in FY 15. He emphasized that the deposit was made with GF money related to the underfunding situation and not from the usual retirement system funding. He wondered whether the GF money could be reimbursed to the state instead of being dispersed as post retirement pension adjustments. Mr. Mitchell believed the adjustment potential based on overfunding the trust only applied to Tier 1 employees. Co-Chair Seaton asked Mr. Mitchell to investigate the issue. Mr. Mitchell agreed to follow up. He relayed that the issue was a Division of Retirement and Benefits matter under the Department of Administration (DOA). He referred to a recent presentation by the commissioner [of DOA] who acknowledged the Other Post-Employment Benefits (OPEB) overfunded level and was actively trying to manage TRS in a manner to avoid the potential adjustment payments by directing funds towards pension benefits rather than OPEB as allowed.

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Representative Ortiz asked whether it was safe to say that the PERS and TRS situation was gradually getting better. Mr. Mitchell replied in the affirmative and delineated that the situation had "substantively" improved recently due to the \$3 billion deposit. The funding ratios were "not terrible," and placed the state in the upper middle ranking when compared to other states.

Mr. Mitchell addressed slide 13 titled "State Debt Obligation Process:"

All Forms of State Debt are Authorized First by law

May be a one-time issuance amount or a not-to-exceed issuance limit in statute

General obligation bonds must then also be approved by a majority of voters

All State Debt must be structured and authorized by the State Bond Committee

Includes general obligation bonds, subject to appropriation issues, & state revenue bonds

The State Bond Committee determines method and timing of debt issues to best utilize the state's credit and debt capacity while meeting the authorized projects cash flow needs

The State has established other debt obligations

Reimbursement Programs

The School Debt Reimbursement Program or HB 528 reimbursement

Communities issues bonds and the State agrees to reimburse at a certain level

Not currently authorized for new debt and periodically partially funded

Retirement Systems

Unfunded actuarially assumed liability (UAAL) for defined benefit employees is guaranteed by the Constitution creating a state debt

Annual payments on the UAAL of other employers is reflected as State debt in the CAFR

Some flexibility in how payments are made

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Mr. Mitchell addressed slides 14 and 15 titled " Total Debt in Alaska at June 30, 2016," which was taken directly from the debt book. He listed the debt categories and amount of outstanding principal as follows:

State Debt

State of Alaska General Obligation Bond \$823.2

State Guaranteed Debt

Alaska Housing Finance Corporation State Guaranteed Bonds
(Veterans' Mortgage Program) \$11.6

State Supported Debt

Certificates of Participation \$27.5
Lease Revenue Bonds with State Credit Pledge and Payment
\$228.2
Total State Supported Debt \$255.6

State Supported Municipal Debt

State Reimbursement of Municipal School Debt Service \$901.0
State Reimbursement of capital projects \$32.8
Total State Supported Municipal Debt \$933.8

State Supported Unfunded Pension Liability

Unfunded Actuarially Assumed Liability \$5,801.0
Total State Unfunded Pension Liability \$5,801.0

State Moral Obligation Debt

Alaska Municipal Bond Bank:
2005, 2010, & 2016 General Resolution General Obligation
Bonds 1, \$90.4

Alaska Energy Authority:

Power Revenue Bonds #1 through #6 \$62.6

Alaska Student Loan Corporation

Student Loan Revenue Bonds \$26.9
Education Loan Backed Notes \$85.6
Total State Moral Obligation Debt \$1,265.5

State Revenue Debt

Sportfish Revenue Bonds \$27.9
International Airports Revenue Bonds \$487.3

University of Alaska Debt

University of Alaska Revenue Bonds \$270.3
University Lease Liability and Notes Payable \$16.2
Installment Contracts \$1.3
Total University of Alaska Debt \$287.8
Total State Revenue and University Debt \$803.0

State Agency Debt

Alaska Housing Finance Corporation:
Commercial Paper \$71.6
Alaska Municipal Bond Bank Coastal Energy Loan Bonds
\$10.3
Alaska Railroad \$147.9
Northern Tobacco Securitization Corporation
2006 Tobacco Settlement Asset-Backed Bonds (1) \$338.6
Total State Agency Debt \$568.4

State Agency Collateralized or Insured Debt
Alaska Housing Finance Corporation:
Collateralized Home Mortgage Revenue Bonds & Mortgage
Revenue Bonds:
2002 Through 2011 (First Time Homebuyer Program) \$799.4
General Mortgage Revenue Bonds II -2012 \$121.6
Government Purpose Bonds 1997 & 2001 \$122.8
State Capital Project Bonds, 2002-2011 (2) \$147.6
State Capital Project Bonds, II 2012-2015 \$818.5
Alaska Industrial Development and Export Authority:
Revolving Fund Bonds \$55.6
Power Revenue Bonds, First Series (Snettisham Hydro
Project) \$64.4
Total State Agency Collateralized or Insured Debt
\$2,129.9
Total State and State Agency Debt \$12,592.1

Municipal Debt
School G.O. Debt \$1,338.8
Other G.O. Debt \$1,047.8
Revenue Debt \$960.2
Total Municipal Debt \$3,346.8

Mr. Mitchell explained that the state via constitutional amendment guaranteed Alaska Housing Finance Corporation State Guaranteed Bonds for the Veterans' Mortgage Program through GO bonds. He noted that the debt had always been paid by the mortgages. He reported that the Unfunded Actuarially Assumed Liability was a new category required per new Governmental Accounting Standards Board (GASB) rules. He informed committee members that the State Moral Obligation Debts were credit enhancements used to acquire lower capital costs by leveraging the state's credit rating and historically no debt was owed. He clarified that State Agency Debt was accumulated by state public corporations and was not supported by the state.

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Mr. Mitchell moved to slide 16 titled "State Debt Obligations Outstanding" as of June 30, 2016 and reported that the GO debt "par amount" or current valuation was \$823.235 billion, and the final payment year was 2038.

Representative Thompson spoke to GO bond funded projects in Fairbanks that the governor vetoed in FY 17. He asked if the bonds had been sold by the 30th of June. Mr. Mitchell responded that the governor did not have the authority to veto GO bond spending although he could decide when the spending occurred. He thought that the later was the case stating that the governor wanted to slow down the projects. Representative Thompson asked whether the interest was accruing on the bonds. Ms. Mitchell answered that perhaps but, indicated that the state had not issued roughly \$110 million remaining of the 2012 Transportation Act authority. He had not yet received the updated accounting from the Department of Transportation and Public Facilities (DOT) related to the slowdown.

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Representative Pruitt referred to the 2006 Tobacco Settlement Asset-Backed Bonds on slide 15 and wanted to know more about the bonds. Ms. Mitchell referred to the tobacco lawsuit which was the impetus for the bonds. The bonds were issued through a subsidiary of Alaska Housing Finance Corporation (AHFC) [Northern Tobacco Securitization Corporation] that securitized the master settlement agreement with the tobacco companies. The bonds were considered risky therefore, the interest rates were high. Representative Pruitt noted a "substantial" amount of interest accrued on the other AHFC debt. He inquired about the reason. Ms. Mitchell did not perceive the interest rates as high. He indicated that the interest to maturity on the tobacco debt was more than the outstanding principle but the other AHFC debts were at approximately 50 percent and the interest rates were lower. He guessed that the rates were market rate or better due to AHFC's typically highly rated securities that performed well.

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Representative Guttenberg asked for clarification about the interest collected from the GO bonds. He asked when the interest began to accrue, and the payments were due. Mr. Mitchell indicated that currently GO bonds were sold as

long dated fixed rate bonds. The state shifted over to long term financing from one-year notes in the previous year, which carried an interest rate of 3.25 percent. The state had to be very conservative but had to reinvest the money by the Treasury Division in a short-term pool earning .5 percent to 1 percent. He expounded that there was a cost to money sitting in the pool that was not needed therefore, not all the bonds were sold at once; DOR attempted to match annual cash flow. He reported that the state had about \$150 million in the bank waiting for expenditure.

Co-Chair Seaton indicated that Vice-Chair Gara had joined the meeting.

Mr. Mitchell continued with slide 16. He highlighted the level of contribution the state made for the Unfunded Actuarially Assumed Liability. He defined the liability as the payment the state made for the actuarially assumed rate above the 22 percent for PERS and the 12 percent for TRS employer rate. He elaborated that the \$185 million FY 2018 UGF Payment was more than the state was paying in GO bonds and close [less] to the amount the state paid for the total of all other debt categories combined.

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Representative Wilson referred to slide 16 and asked what the Subject to Appropriation (COP/Lease Revenue) category was. Mr. Mitchell replied that subject to appropriation meant that the legislature statutorily committed to pay on an obligation. He explained that a COP was a Certificate of Participation, which was a lease fractionalized into \$5,000 participation notes; a certificate was essentially the same thing as purchasing a \$5,000 bond. There was currently one COP outstanding for the Alaska Native Tribal Health Consortium (ANTHC) residential housing facility. In addition, the state had two Lease Revenue Bonds; Goose Creek Correctional Center (GCCC) and the Atwood Building and parking garage acquisition funded through AHFC. Representative Wilson asked whether the UGF debt payment total for FY 18 was paid through the operating budget. Mr. Mitchell replied in the affirmative. Representative Wilson asked if the state had bonding authority that it had not yet utilized and if so, she wondered what the total amount was. Mr. Mitchell replied the amount was \$110 million remaining from the Transportation Act. He noted the 2015 moratorium on the School Debt Reimbursement program.

Representative Wilson wondered whether rescinding the authorization required adopting statute.

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Mr. Mitchell responded in the affirmative and delineated that it would be difficult to rescind the authority because the projects were voted for in aggregate. Representative Wilson wondered what the budgetary impacts of authorizing the \$110 million GO debt were and how to utilize it so the state was not paying more interest. Mr. Mitchell answered DOR always endeavored to issue debt wisely without paying more interest. He turned to slide 18 titled "General Obligation Bonds" that contained a graph that depicted existing GO bond outstanding debt service. He elaborated that the graph illustrated that in 2018 and 2019 the state owed \$90 million per year the debt stabilizing and gradually declined. The data dovetailed with the prior slide that illustrated a similar "glide path" for outstanding principle. The state had a mature bond program and issued bonds with level debt service. He hypothesized that the state could utilize the \$110 million in a manner that would not increase above the FY 19 debt service level into the future by the "back end load" method; larger amounts of principle would mature further into the future. However, he recommended that debt issuance was optimized when it was part of a larger strategy.

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Mr. Mitchell reverted to slide 17 titled "General Obligation Bonds Current Financings" containing a graph that depicted outstanding GO bond principal gradually declining in a stair step fashion. He determined that any slowdown in the Transportation Act debt authorization would not result in a requirement to increase debt from a prior year's budget but would result in an overall greater level of debt service. He returned to slide 18 and informed committee members that the state had a limited ability to determine debt capacity due to a volatile revenue stream and a high reliance on reserves. The state relied on a percentage of projected unrestricted revenue to determine a level of debt service. He indicated that G.O. debt service represented 5.4 percent of projected unrestricted revenue for FY 2017 but was expected to decline to 2.5% by 2026. He moved to slide 19 titled "Bonds Authorized by Law and Paid from General Fund." He described the graph that illustrated

outstanding state debt annual payments; the GO bonds were depicted in dark blue, certificates of participation were lighter blue, and the lease financing were light blue. He read the following bullet points from the slide:

Annual debt service remains well below the 1985 peak of \$182.2 million

Debt service represents 7.5% of projected unrestricted revenue for FY 2017, but declines to 3.7% by 2026

Currently exceeds Debt Affordability Policy of 5%

Mr. Mitchell furthered that the debt affordability was above 5 percent due to the decline in UGF.

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Mr. Mitchell reviewed slide 20 titled "Bonds, Bond Reimbursements & Statutory UAAL Debt" and noted that the graph layered on the PERS and TRS payments. He pointed to the PERS/TRS payments depicted in light blue and offered that the debt dwarfed other types of debt. He noted that by 2039 the debt was totally comprised of the retirement obligation at roughly \$830 million while all of debt declined and disappeared the PERS/TRS debt increased.

Representative Wilson asked what the Capital Reimbursement Program listed on slide 20 was. Mr. Mitchell replied that the program was a result of legislation in 2002 that reimbursed various projects around the state on military bases, harbors, electric utilities, schools etc. Representative Wilson followed up about PERS and TRS. She wondered what the graph would look like if the state was paying its obligated share and "if it was based on where employees were." Mr. Mitchell estimated that the state paid 55 percent of the employer makeup in PERS; the amount was smaller in TRS. He surmised that the issue was complex, and he was unsure how it could be demonstrated in the chart due to the necessity to rely on actuarial data that was multifaceted.

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Representative Wilson restated her request for data on a broad level based on the numbers on slide 20 to better understanding how much money they were talking about. Mr.

Mitchell believed he could do more investigation and follow up.

Co-Chair Seaton interjected that previous analyses had been done two years earlier on determining what percentage municipalities could absorb.

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Mr. Mitchell addressed slide 21 titled "Largest State Debt Payment Volatility." He noted that the point of the slide was that the largest liability to the state was also the most volatile. He observed that the entire retirement system construct was currently based on a rate of return of 8 percent. He remarked that at present value the total unfunded liability was \$6 billion assuming the trust made 8 percent. The actual cash flow was \$11.3 billion amortized over 23 years at a discount 8 percent. Historically, the state had been able to achieve 8 percent over a 30-year average. He voiced that some individuals were suggesting a move to a lower assumption. However, a move to a lower assumption increased what the state would owe; \$19.5 billion in 2039 and the state debt payment would be \$2.289 billion increasing from \$865 million. The one percent difference in the assumption was "astounding" and was much higher at a reduction to a 5 percent assumption creating a liability of \$33.2 billion.

[3:09:33 PM](#)

Mr. Mitchell turned to slide 22 titled "State Debt Obligations Authorized but Unissued" that contained a chart listing authorized but unissued debt. He reported that the Transportation Act GO bond balance of \$110.348 million had a potential issuance date of FY 18. In addition, there were outstanding authorizations that were subject to appropriation by the legislature for the Knik Arm Crossing up to \$300 million and the Pension Obligation Bond authorization up to \$5 billion.

Representative Wilson asked whether the state crime lab was paid for via bonding. Mr. Mitchell replied the lab had been proposed as a COP but was ultimately paid for using GF. Representative Wilson asked about GCCC. Mr. Mitchell replied that GCCC utilized lease revenue bonds. The state paid all the costs and the Matanuska Susitna Borough acted as a "conduit." The department refinanced the bonds in the

previous year. Representative Wilson stated someone had told her the state would always owe millions on GCCC. She asked whether the state would own the facility once the bonds were paid in full. Mr. Mitchell replied that unlike the Anchorage jail, the state would own GCCC when the bonds were paid off.

[3:12:41 PM](#)

Co-Chair Seaton addressed the schedule for the following day.

#

ADJOURNMENT

[3:13:24 PM](#)

The meeting was adjourned at 3:13 p.m.