

HOUSE FINANCE COMMITTEE
February 23, 2017
1:33 p.m.

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CALL TO ORDER

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

Steven Center, Senior Vice President, Callan Associates, Inc.; Gregory Allen, President and Director of Research, Callan Associates, Inc.; Angela Rodell, Executive Director, Alaska Permanent Fund Corporation; Dan DeBartolo, Director, Division of Administrative Services, Department of Revenue; Jeff Jesse, Legislative Liaison, Alaska Mental Health Trust Authority; Representative Lora Reinbold.

PRESENT VIA TELECONFERENCE

Brandon S. Spanos, Deputy Director, Tax Division, Department of Revenue.

SUMMARY

HB 57 APPROP: OPERATING BUDGET/LOANS/FUNDS

HB 57 was HEARD and HELD in committee for further consideration.

HB 59 APPROP: MENTAL HEALTH BUDGET

HB 59 was HEARD and HELD in committee for further consideration.

PRESENTATION: PERMANENT FUND FORECASTING METHODOLOGY,
VARIABILITY and VOLATILITY DISCUSSION and REALIZED and
UNREALIZED EARNINGS PRESENTATION: CALLAN ASSOCIATES, INC.

Co-Chair Seaton reviewed the agenda for the day. He asked members to hold their questions until the presentation end.

^PRESENTATION: PERMANENT FUND FORECASTING METHODOLOGY,
VARIABILITY and VOLATILITY DISCUSSION and REALIZED and
UNREALIZED EARNINGS PRESENTATION: CALLAN ASSOCIATES, INC.

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GREGORY ALLEN, PRESIDENT AND DIRECTOR OF RESEARCH, CALLAN ASSOCIATES, INC., introduced himself and provided some background information on Callan Associates, Inc. He had been with the company for 28 or 29 years, since 1988. His firm worked with large institutional investors like the Alaska Permanent Fund Corporation (APFC). The company's clients represented about \$2 trillion in assets. The company worked with several large public entities including public pension funds, foundations, endowments, corporate pension funds, and corporate defined contribution funds. The company provided three services. It helped clients with strategic planning which entailed deciding on a plan for an entity's portfolio, determining which asset classes to include, estimating the expected return over time, and establishing how to implement the asset classes. The firm also helped companies monitor their portfolios by conducting performance measurements and reviewing the investment managers who handle funding. Callan and Associates, Inc. had a team that specialized in understanding investment managers and investment strategies. The company had assisted APFC for over 30 years. He had personally been involved with the Permanent Fund (PF) for the previously 20 years. He had been involved with doing a modeling exercise to look at the expected returns and the interaction of the capital markets with the earnings reserve account (ERA), the market value, and

inflation proofing. He felt he had a good handle on all the moving pieces that went into understanding the finances of the PF.

Co-Chair Seaton recognized Vice-Chair Gara in the room.

Mr. Allen introduced the PowerPoint Presentation: "Callan's Return Projection Methodology for the Alaska Permanent Fund: Capital Market Expectations, Total Return, and Statutory Return"(copy on file). He turned to slide 2: "Projected Returns." He reported the numbers to be nominal. for the Alaska Permanent Fund":

Background:

- Callan has maintained a financial model of the Alaska Permanent Fund for the past 15 years, and provides projections to assist the Board and Staff in the management of the Fund.
- The model employs capital market projections maintained by Callan, Fund specific information provided by APFC Staff, and a sophisticated and flexible model of the accounting framework to allow us to test various spending and asset allocation proposals.
- The model uses Monte Carlo simulation to generate a full range of potential outcomes from best-case to worst-case, with associated probabilities.
- The model provides projections for many key financial variables including
 - o Total Return
 - o Statutory Return
 - o Market Value
 - o Earnings Reserve Balance
 - o Distributions
- The model has been used many times over the years to analyze various proposals related to the Permanent Fund, including three legislative proposals in February of 2016.

Mr. Allen explained that Callan had maintained a financial model of the PF, the Monte Carlo simulation model, for the prior 20 years. The model employed capital market projections which he would be discussing. They were Callan's expectations for return, risk, and correlation for the various capital markets that were used in the investment portfolio. The firm was able to generate a wide

range of outcomes from best-case to worst-case. He stressed that typically when discussing returns, people focused on the midpoint of the distribution of returns. However, it was unknown what the return would be in any one year. The Monte Carlo simulation allowed his company to look at the full range of returns and to assign probabilities around them. The model allowed Callan to do projections not only for return but for statutory return (the realized return), the market value, the ERA balance, and distributions under various formulas. For example, the company used the model in the previous February to evaluate three legislative proposals that had been brought forward for different ways to tap the PF going forward.

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Mr. Allen advanced to slide 3: "Return Projections FY 2017":

Latest Projections for Total and Statutory Return:

- Return projection period was assumed to begin July 1, 2016.
- Market values and cost-basis inputs were as of June 30, 2016.
- 1-year returns for FY 2017 do not take into account performance in the first half of the fiscal year.
- Median 10-year total real return expectation is 4.70%, below the 5% real return expectation that has been employed as a target by the APFC.
- The mid-point of these distributions is just one potential outcome. It is important to recognized that the Fund takes on risk therefore there can be significant variance relative to the mid-point projections.

Mr. Allen explained that the slide showed the latest return projections. They were calculated in the previous summer and fall of 2016. They reflected statutory and total return projections. The 10-year projections were reflected at the top of the slide. He pointed to the highlighted section which showed the midpoint. He reported that 6.95 percent was the total return projection and 6.24 percent was the total statutory return. He indicated that they were nominal and that the inflation projection over the same period was about 2.25 percent. He relayed that by subtracting 2.25

percent the result would equal the real return projections. He re-emphasized that he was highlighting the midpoints. It was important to note that in Callan's way of thinking there was about a 50 percent chance that the return could be higher than 6.95 and about a 50 percent chance that it could be lower. He directed members not to focus too much on the midpoint. He did not want anyone to walk away from his presentation thinking that the PF would earn 6.95 percent every single year. There was a reasonable amount of risk built into the PF portfolio. However, he could almost guarantee there would not be a year in which the PF would earn exactly 6.95 percent. Again, there was a 50 percent chance that the return would be higher and a 50 percent chance that it would be lower.

Co-Chair Seaton asked Mr. Allen to clarify the total return and the statutory return and the difference between the two columns on the slide. Mr. Allen explained that the total return was a measure of the market value at the end of the year relative to the market value at the beginning of the year. It had nothing to do with whether anything had been realized, or whether it was income or capital appreciation. A large portion had to do with changing the prices, the valuation. The statutory return was sort of a PF concept. It was the realized return. A statutory return worked such that if the corporation received a coupon or a dividend from a bond, it would be considered income counting towards the statutory. If the corporation sold a stock or a bond and it realized a gain or a loss, it would count towards a statutory return. He suggested thinking of a statutory return as being the realized return in any given year.

Mr. Allen continued that, typically, the statutory return was lower than the total return because the corporation did not realize all its gains every year. The Permanent Fund was invested in several different things such as real estate and private equity. He suggested that even the typical turnover (the percentage of the portfolio sold between the beginning of the year and the end of the year) of the stock market was about 25 percent. In any given year, APFC would only realize about 25 percent of its total capital appreciation. He continued that in a private equity portfolio none might be realized. Statutory return was important because it was what drove the size of the ERA. The corporation had to realize a return before the money could get moved into the earning reserve. He would provide

more detail later in his presentation in a section on statutory return.

Mr. Allen continued to slide 4: "Capital Market Assumptions":

Projected Return and Standard Deviation:

- Employed Callan's 2016 10-year capital market expectations for all models.
- Expectations are developed annually and used for strategic planning work for all client types.
- Represent long-term consensus expectations.
- Designed to work as a set-in optimization and simulation analysis.
- Generally, these expectations evolve slowly with only modest year-to-year changes.

Mr. Allen indicated that the table on the slide provided Callan's outlook for the following 10 years for all the different asset classes employed by APFC. The asset classes included everything from equities with an arithmetic return of 9 percent down to several other asset categories. He commented that the APFC had a very diversified portfolio. Callan had to come up with a projection for each category. He relayed that he had been hired at Callan in 1988 to work on the process, which he had been involved with every year since then. The projection return was a long-term 10-year outlook. He considered what was going on in the economy, what was going on with interest rates and inflation, the previous year projections, and what other participants in the industry were saying. He suggested that the numbers could be viewed as "consensus" numbers. He thought competitors would have similar numbers.

Mr. Allen Scrolled to slide 5: "Capital Market Assumptions: Projected Correlation Matrix." He explained that correlations act as a measure of the way assets interact with each other. He suggested that it was important to know when assets had low correlation (when one item goes up, the other item goes down at the same time). He provided the example of an ice factory and a coal factory: coal was used in the winter and ice was used in the summer - they had low correlation with each other. He relayed that low correlation was good because when putting two things together it reduced risk. It was important to know the

correlations between asset categories to understand the returns and the variability of returns when they were combined.

Mr. Allen moved to slide 6: "Assumed Asset Allocation." He suggested that the last thing he needed to know to get a return projection and a risk projection was the asset allocation of the PF. He pointed to the slide showing the target asset allocation adopted by the board in 2016. The board went through an exercise of looking at this once a year. He noted there was a strategic asset allocation and the assumptions. There was an expected return of 6.95 percent with a standard deviation of about 12.5 percent. It meant that there was a two-thirds chance that the return over 10 years would be between 6.95 percent plus 12.38 percent and 6.95 percent minus 12.38 percent.

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Co-Chair Seaton acknowledged Representative Pruitt had joined the meeting.

Mr. Allen proceeded to slide 7: "Statutory Net Income and Permanent Fund Mechanics":

- Understanding the mechanics of the Permanent Fund can lend some insight into the expectations for Statutory Net Income which determines Statutory Net Return.
- Statutory Net Return is the total of realized income and realized capital gains in each fiscal year.
- The asset allocation determines the Fund's exposure to a number of factors which, in turn, will influence the Statutory Net Return over time.
 - Ratio of income producing assets to capital gains oriented assets
 - Turnover
 - Active versus passive management
 - The use of illiquid asset classes such as real estate, private equity, infrastructure
- We review the mechanics of the Fund, and look at the history of a number of important variables to help put Statutory Net Income into context.
 - Fund Market Value
 - Oil revenue

- Statutory Net Income (realized income)
- Earnings reserve balance

Mr. Allen wanted to delve into the topic of statutory net income, which resulted in statutory return, and the mechanics of the PF. He relayed that statutory return was a measure of the return generated by realized income and realized capital gains in each fiscal year which was the amount that counted towards the earnings reserve and the amount that could be spent. If gains were not realized money could not be spent. He continued that statutory return was more complicated than the total return because it was dependent on some accounting variables. For example, if returns were positive for a number of years on the fund, the market value would rise well above the cost basis due to prices going up. However, not all the gains would have been realized and the cost basis would have stayed low. He furthered that when there was a large spread between market and cost and turnover was done it supercharged the return. Conversely, if there were several bad years in a row, there might be unrealized losses and when there was turnover, the losses would be realized and reduce the size of the earnings reserve. One of the metrics to be aware of when thinking about statutory return was looking at the activity for the previous 5 years. It was important to know whether the market was an up market or a down market. A company would generally realize about 25 percent of the capital gains or capital losses in any given year in the normal operation of the PF. Although his point was subtle, he thought it was important in terms of forecasting the statutory return.

Mr. Allen continued to review slide 7. He explained that turnover was another factor influencing the statutory net return. There were many things that caused turnover including managers buying and selling stocks. Other things also caused turnover, such as when the APFC had to raise cash to make a distribution to the government or the dividend. The corporation had to sell securities which would realize gains and cause the statutory return to change.

Mr. Allen noted that when companies rebalanced, which entailed taking money out of equities that had gone up and putting them into bonds that had stayed flat, they were selling equities. He mentioned changing asset allocations. If the board came in deciding to do something completely

different, such as having a separate asset allocation for the earnings reserve that was all in cash, it would have to sell a bunch of stocks and bonds and realize a bunch of gains to get from point A to point B. Realizing a bunch of gains would create turnover and raise the statutory return.

Mr. Allen discussed active versus passive management. Active management had more turnover and passive management had less turnover. He also brought up illiquid asset classes such as real estate, private equity, and infrastructure that had very low turnover. He concluded that the more that APFC invested in illiquid asset classes, the less turnover and the less gains realization as a percent of the total. He thought the points he discussed were important to understand because statutory return was, in some ways, more important than total return as it related to the Permanent Fund.

Mr. Allen continued to the chart on slide 8: "Mechanics of the Permanent Fund." He wanted to provide a picture of the relationship between statutory return and the PF. Slide 8 showed a historical market value of the PF over time. He reported that at the end of FY 16 there was a balance of about \$53 billion. There had been a steady rise. There had been a couple of dips in 2002 and 2008 periods, but a relatively stable path that sloped upwards.

Mr. Allen reviewed slide 9: "Statutory Net Income." He conveyed that in looking at the statutory return a much more volatile pattern could be seen. The statutory net income had varied much more with respect to market crisis' than the fund itself. He highlighted that in 2009 the statutory net income was significantly negative. He recalled that in 2009 it was a positive return year. He explained that the reason statutory net income was low, and negative was because it was at a time when the fund was realizing the losses that had been incurred in 2008. He conveyed that the statutory return lagged total return because things had to be realized and usually they were not realized until the next year or the following year. He thought it was possible that APFC could announce that the total return for the year was 6 percent. However, the statutory return could be -2 percent depending on the events of the previous year. He wanted to point out the potential disconnect between the two measures.

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Mr. Allen detailed slide 10: "Statutory Net Income Projection: Conclusions":

- Statutory Net Income is influenced by a number of different dynamic factors besides the total return on the portfolio.
- The ratio of income producing investments to capital appreciation focused investments will have a significant impact.
- The amount of turnover in the capital appreciation focused investments will also have an impact.
- Rebalancing frequency between asset classes will also have a meaningful impact.
- Cash raised for distributions can accelerate the realization of gains or losses in the portfolio and will have an impact.
- Callan's projections for statutory net income are probably on the high side due to the assumption of quarterly rebalancing. APFC Investment Staff employs a much more efficient and sensible rebalancing approach in practice.

Mr. Allen was at the end of his presentation and believed he had covered the points listed on the slide. He thought Callan and Associates, Inc.'s projections and expectations were reasonable. The company had reviewed its performance in terms of projections. The company had never been exactly correct, but was reasonably close in terms of a total portfolio. He encouraged questions from members.

Co-Chair Seaton referred to slide 3 regarding statutory returns. He pointed to the 1-year and 10-year projections. He asked about the period. Mr. Allen responded that the period began July 1, 2016 through June 30, 2025, a 10-year period. Co-Chair Seaton asked if the 1-year statutory return would extend through June 30th of the current year. Mr. Allen responded, "correct." Co-Chair Seaton wondered if the 50 percent probability had a statutory return of 5.43 percent total. Mr. Allen responded positively.

Co-Chair Seaton asked if 2.25 was subtracted from the amount to determine the real return. He wanted to bring up 2 different points regarding the 1-year projection. Mr. Allen suggested that the year was already half way over presently. The figures were done as part of the revenue

sources projection book for the fall. Callan only had data through June. Prior to the election the performance of the fund was not looking good. He would have suggested that the 5.43 percent might not be reached. He furthered that since the election, there had been a rally in equity markets and high yield markets. Anything that had risks had performed well, even emerging markets. He thought that presently the state was running ahead. He opined that many things could happen in any given year that could make the number off. He mentioned that inflation was running a little less than 2.25 percent. He thought it would be about 1.5 percent at the end of the fiscal year. He conveyed that 2.25 was the long-term projection. The short-run was affected by just the 6 months that had already occurred.

Co-Chair Seaton mentioned having talked about 90 percent realized earnings. He wondered if it meant, compared to total return, looking at a 90 percent asset turnover. He thought Mr. Allen had reported the stock turnover was generally 25 percent. Mr. Allen indicated that historically the statutory return had averaged about 90 percent of the total return. He had heard the number referenced before. He added that in any given year they could vary wildly from each other depending on what happened leading into that year. He recommended thinking about the statutory return as 80 to 90 percent of the total return in up years - it was a reasonable way of thinking about it. Interestingly, though, in a really negative year, not as many losses were realized in the statutory return in up years. However, in a negative year the statutory return was substantially better than the total return. They were related but were lagged relative to one another.

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Co-Chair Seaton asked if it had something to do with having a loss in an asset in which case a company might be inclined to hold onto it to let it recover. Mr. Allen responded that the fund generally held onto assets. Many of them had paper losses, but the fund did not sell them as a matter of course. A person could not sell their private equity portfolio. Just because a stock portfolio went down was not a reason to sell it. In fact, it might be a reason to buy more of it. He continued that in the day-to-day operation of the fund a certain amount of gains and losses would be realized every year.

Mr. Allen informed the committee that when the fund started it was invested entirely in bonds. He thought that was where the statutory return concept was born. The primary source of bonds was income. They paid a coupon. When someone received a coupon, it counted towards statutory return. Over the years, the fund has moved away from bonds and into stocks, private equity, real estate, and everything else. Income was a much smaller component of the return. Capital appreciation had become a larger component of the return. He reemphasized that the only way to get capital appreciation to go into the return was by selling the stock and realizing the gain.

Vice-Chair Gara referred to the bottom chart on slide 3. He commented that the difference between the statutory and the total return at the 50 percent likelihood level was pretty close. At the 90 percent likelihood level, the 1-year total return was 22.26 percent, but the statutory return was only 8.15 percent. He asked if the numbers reflected not cashing in much in realized earnings, but keep the stocks.

Mr. Allen indicated Vice-Chair Gara was exactly right. The stock market could go up 20 percent in a year. However, in a normal year an entity would not sell its entire stock portfolio at the end of the year. It would be more likely to sell about 20 to 25 percent of it. He suggested that if the return all happened at the end of the year, for example, none of the return would be captured. It was a matter of when a return took place and when purchases and sales occurred. In the stock portfolio there was a natural level of turn over which ran at about 20 percent to 25 percent per year. If a person looked at it back 10 to 15 years, it was very stable. He projected that if a company had a 22 percent year, going into the following year there would be a large difference between the paper value of a portfolio and what was actually realized. He suggested that even if the next year was negative, because the portfolio was being turned over and realizing the embedded gains, it would be higher. He asked if members understood what he was trying to explain.

Vice-Chair Gara was not following Mr. Allen, but did not need him to repeat himself. He noted that many legislators were trying to eke out as much for dividends in the current year and for public services. In looking at the 50 percent level, the statutory return was predicted to be 5.43 percent. He wondered what Mr. Allen's projection was

presently, and what the projected change would mean in terms of money in the ERA by the end of the fiscal year.

Mr. Allen speculated that if the market stayed where it was between the present day and the end of the fiscal year, it would not be unreasonable to expect about a 6 percent statutory return in the current year (as opposed to 5.4 percent). He reviewed the formula. He took 6 percent and multiplied it by about \$53 billion. The total equaled approximately \$3 billion which would be added to the earnings reserve relative to the prior year's figures.

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Vice-Chair Gara asked Mr. Allen to do the other calculation having to do with another half of a percent. He wanted to know the amount of additional funding into the earnings reserve. Mr. Allen thought it would be close to \$250 million.

Representative Pruitt asked for an estimate of the returns rather than the statutory returns. Mr. Allen responded that it depended on what happened in the remainder of the year. He had just done the performance through December 31st. He thought the funds went up about 8.3 percent. He thought the amount was somewhere in the 4's. He suggested that if the APFC went along at the exact same pace and the amount was up 4.5 percent through December the state would be closer to 5.5 percent. He thought it was possible that with normal type returns he could expect the percentage to be higher than 6.7 percent. He did not believe 6.7, 7.5, or 8 percent was out of the question. He commented that if the markets reacted badly, the percentage could drop by 10 percent. He remarked that having been in the business for 28 years, the money managers were the people who were paid a significant amount of money. Consultants were paid much less. He thought it was much easier to do a 10-year return rather than a 1-year return. He remarked that 1-year returns were crazy and were impossible to get right. He preferred doing 10-year forecasts.

Representative Wilson asked if Mr. Allen would recommend doing a Percent of Market Value (POMV) for the state's operating budget each year rather than putting it in statute and binding the state.

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Mr. Allen responded that from the standpoint of the health of the fund, Callan and Associates, Inc. favored knowing in advance about what would come out of the fund and the time of the withdraws. Having clarity about those items would make it much easier to operate the fund. He thought it was an important point for members to take away. He noted that the POMV formulas under consideration and as he understood them, had one very important component which was that they were a percent of the average market value over 5 of the prior 6 years. They excluded the most recent year. He thought a POMV applied to 5 out of the previous 6 years could be applied, it would be much better for the operations of the PF. It would allow Callan and the government to know a year in advance how much could be pulled from the fund. His company liked the certainty around a POMV approach rather than an ad hoc method. Planning could be done; investment policies could be implemented; and long-term decisions could be made. In choosing the right percentage it could be very sustainable over the long run and could affectively inflation proof the corpus. He thought one of the hallmarks of the fund had been to protect the corpus against inflation. He highlighted the importance of inflation proofing the corpus, otherwise, it would mean there would be less to spend for future generations. He reiterated that with a correct percentage, a POMV formula would naturally inflation proof. He suggested a percentage between 4.5 percent to 5 percent was sustainable. It would automatically inflation proof because the state would not be spending too much. A percentage of 5.5 or 6.0 would eat into inflation proofing making it unsustainable.

Representative Wilson was talking about a formula. She agreed with Mr. Allen that the state should not just choose a formula that looked good for the state. She thought everyone recognized the need for containment. She was concerned about putting something into law without having any experience with it. She was wondering how to choose a number. She thought Mr. Allen was saying that even if the state chose a formula, it also needed to choose a number even if it turned out to be a wrong number. Knowing the number was better than not knowing it every year. Mr. Allen agreed that it was important to choose a number. He suggested that the state could always correct its course. If the number was wrong for long there would be pressure to change it.

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Representative Grenn thanked Mr. Allen for his explanation and Representative Wilson for her question. He thought it was clear the importance of the issue.

Representative Guttenberg referred to the history of the fund and remarked that the legislature had indicated its expectations of the fund and provided some directions. If the state moved to a POMV or something else, he wondered about setting up a process for shifting the state's asset allocations and investment style to fit the direction the state would be headed in. He wondered if the state would increase risk or provide more stability.

Mr. Allen responded that if the right percentage was chosen, the asset allocation would not have to be changed at all. He elaborated that Callan worked with several large pension funds. Pension funds 10-15 years previously the expected returns and the actual returns ran at about 8.5 percent. In the 2000s there had been 2 large financial crisis' and the returns were disappointing. Many of the pensions had fallen behind in terms of the assets that they had to cover their liabilities. There was a significant amount of pressure on decision makers to make up the gap. However, they did not want to go after the tax payers to stop fixing the roads to make up the gap. A large amount of pressure had been placed on the investment staffs to take on more risk. Another important take-a-way was that if a high percentage was chosen, it would put pressure on the PF to take additional risk. He reported that when more risk was taken there was greater volatility, for loss and for not being able to protect persons in power of the fund. It would introduce volatility to the payout as well. His sense was that, from the legislature's standpoint, having some consistency in the payout from year-to-year made budgeting much easier. He added that by forcing the PF to take more risk, by asking for a lot of money, it would naturally introduce more volatility into the payment stream. He thought it would be aggravated tremendously and advised against it. He had not previously discussed the earnings reserve. A three-fourths vote was required to change the concept of the earnings reserve in the constitution. He asked Ms. Rodell to correct him. He had always been under the impression that the corpus was protected constitutionally.

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ANGELA RODELL, EXECUTIVE DIRECTOR, ALASKA PERMANENT FUND CORPORATION, clarified that the ERA was created in statute and not in the constitution. A majority vote of the body was required to appropriate money. It was available for appropriation at any time in its entirety. While all the things Mr. Allen spoke to about percent and asset allocation were 100 percent correct and which she agreed with, she reminded members that because of the ability and right to appropriate and not knowing how much might be taken out in the first year if it was different than the percent, it would influence how the APFC thought about it going forward. Inflation proofing of the corpus only came with appropriations from the earnings reserve back to the corpus. The corpus did not grow its value inherently and would get to keep that value. It turned all its gains to the ERA.

Mr. Allen thanked Ms. Rodell for the correction. He thought of the ERA as being the difference between the corpus (the protected piece that could not be touched without a constitutional change) and the rest of the fund. He reported that there had been times since his involvement that the ERA had a zero balance at the start. There was a time where if there was a balance in the ERA after the dividends were paid out it would be appropriated back to the corpus to protect and grow the corpus. The danger in doing that was that the year would begin with nothing in the ERA. He reemphasized that if a percentage was chosen that was too high, it would drain down the earnings reserve over time, making it smaller and smaller relative to the corpus. If there was a big negative year the ERA could potentially go to zero and nothing could be spent. He was providing the information to encourage members to be prudent in choosing the percentage to maintain the fund's purchasing power at a sustainable level and to maintain the corpus. Currently, the state had a very healthy earnings reserve. It was as large as he had ever seen it. The state's ability to spend in the future would be inhibited if the state were to eat through its cushion in conjunction with experiencing a number of negative years in a row.

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Representative Ortiz asked about the variability in the 2.2 percent inflation rate. If it was highly volatile, he wondered how it would impact the rest of the picture. Mr. Allen thought inflation was an interesting variable. Inflation from one year to the next did not tend to move around very much. Inflation would not increase from 1 percent inflation to 9 percent inflation in a single year. It had never happened before. In terms of inflation's standard deviation volatility was low, 2.25 with a standard deviation of about 1.5 percent. It had another feature referred to as autocorrelation, which meant that it trended. The episodes of trending inflation, like in the 1970s, wiped out purchasing power and wealth. The one thing that had changed since the 1970s was the central banking focus on keeping inflation under control. There were much fewer checks and balances on inflation when the last large inflation episode occurred than there were presently. There were things happening in the economy that made it look like inflation would start picking up. He did not want to state that it would get out of control. However, the labor markets in the US had never been as tight for 20 years. Alaska was a service-based economy and labor was a large part of the inflation equation.

Mr. Allen reported that inflation had been kept artificially low in the US because of 2 things: there was a huge decline in energy prices and the rising dollar. There had been a tremendous run where the dollar had increased relative to other currencies, which had made importing goods cheap. There had been a perfect storm to keep inflation low. He believed some of those factors were coming to an end. Although 2.25 percent was low relative to what he thought he would see in the current year, it was a reasonable estimate for the following 10 years. He suggested that it could be higher as well. He suggested that if inflation was 2.25 and the fund was not inflation proofed the corpus would be 2.25 percent less than it was before.

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Co-Chair Seaton asked about slide 10 and the statement on the bottom having to do with quarterly rebalancing. He wondered about the importance of the caveat Mr. Allen included. He wondered by how much he was estimating on the high side. Mr. Allen did not think it would be more than three-tenths of a percent. He added that APFC was careful

in the way it managed money to reduce unnecessary turnover. He continued that when stocks were sold commissions were paid which costed money. One way to minimize the amount of transaction costs over the course of a year was to reduce turnover. In his model he had to assume that when stocks went up and bonds went down he had to sell the stocks to stay at the target asset allocation. In the case of the PF, the corporation might sell its stock to pay the distribution, rather than to buy bonds. The corporation was crafty at how it managed the turnover issue. It ended up being a little bit lower than what he had projected. It meant that the realized return would be slightly lower than what he projected.

Co-Chair Seaton provided his understanding which was that the state had not been structuring the draw such that they would drive his asset selling to put money in the ERA. He offered Ms. Rodell an opportunity to clarify that point one way or the other. He asked Ms. Rodell if she was selling assets to put money in the ERA for allocations, or if her investment strategy was independent of the state's potential cash needs. Ms. Rodell confirmed that the investments were not being driven by a particular outcome. She spoke to Mr. Allen's point. For example, the corporation knew what the amount of the transfer for the dividend would be because it had the 4.5 years of performance. The corporation made an estimate about the final 6 months to know what the cash transfer would be. She thought Mr. Allen was illustrating the APFC, in planning for a cash transfer, might decide to start selling stocks to generate the cash presently or perhaps a month from the current day to reduce the transaction costs rather than doing it automatically to have a forced rebalancing. His computer model required a forced rebalancing to hit the number. She appreciated the opportunity to clarify on the record what the corporation did on that front.

Co-Chair Seaton asked if the corporation's basic investment strategy would change based on the modeling with a POMV statutory requirement going forward at a range of 4.75 percent to 5.25 percent. Ms. Rodell did not believe so because, as Mr. Allen testified earlier, it provided the corporation much more certainty as to what the number would be. It meant that the corporation would be able to take longer-term positions and to make better investment decisions about the balance. There would not be an expectation or an unforeseen transfer in which the

corporation would need to pull more cash than necessary due to unpredictability.

[2:22:56 PM](#)

Co-Chair Seaton asked about the mechanism in several bills that talked about 4 to 1 after the draw and anything above the amount being transferred internally for inflation proofing. He asked if it would drive or change any of the corporation's investment strategies either way. Ms. Rodell responded, "No, I don't believe it would change any investment strategies."

Representative Guttenberg mentioned using the term "investment strategies." He noted the term "Mechanics of the Permanent Fund" used on slide 7. He asked if the terms were interchangeable. He asked if she would describe it differently - between what the state was currently doing and what it would do if the state had a POMV model. Mr. Allen replied that when he was talking about the mechanics of the PF in this context he was talking about the current spending policy: the interaction of the corpus and the earnings reserve and the way the distributions were determined. He looked at the POMV model as being a different set of mechanics. Under the current spending rule the corporation was not spending 5.25 percent or 4.75 percent. It had been 1.5 percent to 2.0 percent. The largest change that was being contemplated was the amount - as long as the rules were clear and well known in advance. In looking at the way the current distribution was determined, it was based on 5 years of realized earnings. It was as if it had a 5-year average built into it already. A five-year POMV was not a huge shift and the corpus was protected under both paradigms. The substantive difference was the percentage.

Representative Guttenberg asked if the rules needed to be recalibrated. The committee had heard that when the legislature changed something significant very strong structural rules were needed to know the effects of the change and whether the change was durable from one year to the next. He asked Mr. Allen what rules needed to be recalibrated based on his looking at what had been proposed in the previous year and what had been proposed in the current year.

Mr. Allen commented that there had been a spirit of cooperation between the three bills offered in the previous year. He noted that the legislation put forth by the governor was the most different of the three bills. He liked that all three pieces of legislation had an averaging formula based on the average of the first 5 out of 6 prior years. The Percent of Market Value was then applied to the average. He did not believe any of the previous POMV concepts had contained that formula. It provided 1 year where everyone was aware of how much would come out of the fund. Another important piece was whether the fund would be explicitly inflation proofed. He thought the issue was controversial. He did not want to take sides but offered the committee some information. He indicated that if the fund was inflation proofed it would require the legislature to appropriate a certain percentage back to the corpus every year. It had the benefit of ensuring that the corpus grew with inflation which would make the earnings larger for future generations or at least the same on an inflation adjusted basis - a noble goal. The risk with inflation proofing was that it reduced the size of the earnings reserve and reducing the size of spending. He continued that a combination of high spending, high inflation, negative returns, and doing inflation proofing, would reduce the size of the earnings reserve. The buffer, in some sense, would be eroded. The nice thing would be that the corpus would be larger and would generate future earnings. He thought it was important to know in advance whether inflation proofing was going to happen every year or every so often. He suggested that an ad hoc policy around inflation proofing would muddy up the rules and would create greater uncertainty. Uncertainty was the worst circumstance for investment people.

[2:29:01 PM](#)

Vice-Chair Gara mentioned that every time Ms. Rodell came before the committee, members asked her if 5.25 percent was okay. He was glad it was still okay because he thought that to get out of the fiscal crisis, at least for a few years, it would probably be what the legislature would have to do to possibly increase the dividends and to have as much of a government payout for services as possible. He asked about her caveats. He wondered about the idea of revisiting whether the market was responding as predicted. He understood her to want a 3 or 4-year revisit.

Ms. Rodell responded that it went back to the question about whether the corporation got the percentage correct. It gave the corporation an opportunity to look at what was happening to the ERA in light of the size of the draw that occurred, what was happening in the state, and whether there was pressure about taking additional monies out of the ERA over and above the POMV because of revenues not being replaced or generated. It gave everyone an opportunity to push the reset button if the legislature wanted to.

Vice-Chair Gara was aware Director Rodell would like to have as much inflation proofing as possible. He thought she had been clear about that point. He asked her opinion about any excess over the amount of 4 times the draw going straight into the principle. It would be a way to deal with inflation proofing, maybe not in the current year, but a significant amount of inflation proofing later.

Ms. Rodell thought it was good to recognize the importance of inflation proofing. She was concerned if it was repealed altogether that the narrative would become that inflation proofing did not have a role or was not important to the corpus or to future generations. She confirmed that it was acceptable.

Vice-Chair Gara thanked Ms. Rodell. He could work around her response.

Co-Chair Seaton drew everyone's attention to slide 6. He noted that one of the things the committee had been looking at was volatility. He pointed to the standard deviation of plus or minus 12.38 percent around an expected return of 6.95 percent. He noted having requested LFD to calculate the 9-year actuals and applying the numbers to the returns and applying them in reverse as well. He appreciated LFD's work. He thought the slide emphasized the importance of thinking of a single number and a smooth curve. He thought it was important to do what was possible to smooth out things through mechanics. He wanted to always remember this particular slide and the slides provided by LFD about volatility.

Co-Chair Seaton indicated the committee would be taking up subcommittee reports for the Office of the Governor, the Department of Revenue (DOR), and the Department of Military and Veterans Affairs (DMVA). He noted that all subcommittee

actions were to Section 1, the numbers section. The reported subcommittee recommended amounts might be an incomplete picture of a department's budget.

[2:34:00 PM](#)

AT EASE

[2:35:36 PM](#)

RECONVENED

#hb57

#hb59

HOUSE BILL NO. 57

"An Act making appropriations for the operating and loan program expenses of state government and for certain programs; capitalizing funds; amending appropriations; repealing appropriations; making supplemental appropriations and reappropriations, and making appropriations under art. IX, sec. 17(c), Constitution of the State of Alaska, from the constitutional budget reserve fund; and providing for an effective date."

HOUSE BILL NO. 59

"An Act making appropriations for the operating and capital expenses of the state's integrated comprehensive mental health program; and providing for an effective date."

[2:35:36 PM](#)

Co-Chair Seaton noted that all subcommittee actions were to Section 1, the numbers section of the budget. The reported subcommittee recommended budget amounts might be an incomplete picture of the department's budget. He relayed that after the committee completed the subcommittee amendment process including the language amendments that he would propose, a new committee substitute work draft of the bill along with the reports that would include both the numbers and the language appropriations providing a more complete picture of each agency's budget totals. The subcommittee reports were distributed to members the previous day and were posted on the Legislative Finance Division's website. Since he was the subcommittee chair for

the Office of the Governor and the Department of Revenue he would begin with his reports.

Co-Chair Seaton reported that the finance subcommittee for the Office of the Governor had no amendments to consider, nor did the governor. As the subcommittee chair he recommended no changes to the Office of the Governor's FY 18 budget. He read the budget totals by fund source:

The budget totals:

Fund Source: (dollars are in thousands)
Unrestricted General Funds (UGF) \$23,135.8
Designated General Funds (DGF) -0-
Other Funds 838.3
Federal Funds 205.0
Total \$24,179.1

The Unrestricted General Fund difference from FY15 Management Plan to the FYI 18 Governor budget is a reduction of \$8.9 million, a decrease of 27.7 percent. From FY17 Management Plan, the FYI 18 Governor budget reflects an unrestricted general fund increase of \$279.7, an increase of 1 .2 percent.

[2:38:06 PM](#)

AT EASE

[2:38:26 PM](#)

RECONVENED

Co-Chair Foster asked Co-Chair Seaton to provide his next subcommittee report.

Co-Chair Seaton recommended two budget amendments for consideration by the House Finance Committee and several recommendations to various policy committees for statutory changes. He read from the subcommittee report:

The budget if theses amendments are adopted totals:

Fund Source: (dollars are in thousands)
Unrestricted General Funds (UGF) \$25,646.4
Designated General Funds (DGF) \$2,587.5
Other Funds \$269,013.3
Federal Funds \$78,665.5
Total \$375,958.7

Positions:

Permanent Full-time 812
Permanent Part-time 33
Temporary 16
Total 861

If these amendments are adopted, the Unrestricted General Fund difference from FY 15 Management Plan to the FY 18 House Subcommittee Recommended Budget is a reduction of \$8.185 million, a decrease of 24.2 percent.

The Unrestricted General Fund difference from FY 17 management plan to FY 18 House Subcommittee Recommended Budget is a reduction of \$455.2 thousand, a decrease of 1.7%.

[2:40:35 PM](#)

AT EASE

[2:40:52 PM](#)

RECONVENED

Co-Chair Seaton read the recommendations for DOR:

The following statutory recommendations are also submitted to the House Finance Committee

1. A recommendation to the House State Affairs Committee: Amend AS 43.23.008 to consider repealing allowable absences for the Permanent Fund Dividend. In 2016, 26,524 dividends were paid to people with an allowable absence from the state. According to a study, many of those who claim allowable absences do not return to the state. 64% of students did not return, and 81% of those accompanying someone else with an allowable absence did not return to the state. 17% of all appeals through the Permanent Fund Division relate directly to allowable absence claims. Repealing allowable absences would increase the value of the Permanent Fund Dividend for those residents that remain in the state.

2. A recommendation for the House State Affairs Committee: Consider amending AS 43.23 to include directives or incentives to transition to a completely paperless environment for Permanent Fund Dividend Applications. Incentivizing paperless applications would reduce the current printing and postage costs of

\$120,705.57. It would also reduce the number of seasonal employees necessary to process paper applications, with a corresponding decrease in \$239,000 in seasonal personal costs.

3. A recommendation for the House Fisheries Committee: Amend AS 43.75 to change the amount of fisheries taxes distributed to local communities and direct that revenue to fund direct management of fisheries. Currently 50% of fisheries taxes collected by the state are distributed to municipalities.

4. A recommendation for the House Fisheries Committee: Reconsider AS 43.75.015(b)-(d) and AS 43.77.010(1) to determine if the reduced tax rate for small fish processors and the reduced tax rate for developing fisheries are effective or if the reduced rates should be repealed or more narrowly defined. These three indirect expenditures currently cost the state an estimated \$525,852 in foregone revenue.

5. A recommendation for the House Education Committee: Amend AS 43.20.014, AS 43.55.019, AS 43.56.018, and AS 43.77.045 to remove the 100% level of the education tax credit. Currently the first \$100,000 of an eligible contribution receives a credit of 50%, the next \$200,000 is credited at 100%, and contributions above \$300,000 is credited at 50%. This credit can be taken across multiple tax types. Reducing the 100% level of the credit would reduce the more than \$7.4 million in foregone revenue.

6. A recommendation for the House State Affairs Committee: Amend AS 43.52.255 to remove the deduction of local levies against the Commercial Passenger Vessel Tax. This deduction results in an estimated \$13,559,5558 (\$13.56 million) in forgone state revenue.

7. A recommendation for the House Transportation Committee: Amend AS 43.40.010(c) and AS 43.98.025(d) to repeal or amend the motor fuel tax timely filing discount and the tire fee timely filing credit, which result in forgone revenue of approximately \$66 thousand each. Further, reconsider the commercial passenger vessel tax 72-hour voyage exemption under AS 43.52.295(4), which has likely modified cruise ship voyage plans in order to avoid the tax.

8. A recommendation for the House Labor and Commerce Committee: Amend or repeal AS 43.60.010(c), which reduces the beer and malt beverages tax from \$1.07 a

gallon to 35 a gallon for the first 60,000 barrels of beer sold in the state from a brewery who meets the U.S. definition of a small brewery. 35% of this reduced rate is claimed by out of state breweries. The estimated forgone revenue is \$2.6 million.

9. A recommendation for the House Resources Committee: AS 27.30.030, AS 43.20.044, and AS 43.62.010, relating to mining license tax exemptions, credits, and deductions, should be re-examined by an interim taskforce. Some of these deductions and credits were established pre-statehood and may no longer meet intent. Estimated known foregone revenue exceeds \$6 million, with more foregone revenue that is not tracked.

10. A recommendation for the House Resources Committee: Sunset AS 43.20.053, the in-state refinery tax credit, on December 31, 2017. The current sunset date is December 31, 2019. If all three in-state refineries were to claim this credit each year it is available, changing the sunset by two years could result in savings of \$60 million. However, because of the number of tax payers involved it is impossible for Revenue to report how much has been claimed under this credit.

11. A recommendation for the House Finance Committee: Amend or repeal various corporate income tax exemptions found under AS 43.19 and AS 43.20, several of which were adopted to conform with federal tax code but are no longer necessary or no longer meet intent. The fiscal impact of these exemptions is unknown at this time because the potential tax revenue is not reported.

Other Information:

The Subcommittee discussed a variety of issues during the meetings.

Several members expressed interest in increasing state investment officers or improving investment officer recruitment and retention tools. More in-house investment officers could result in a decrease in external investment management tools. Ultimately no amendment was put forward during subcommittee; however, this remains a point of interest if the Department can demonstrate a plan to recruit and maintain these positions.

The subcommittee also discussed a requested remodel of the Alaska Permanent Fund Corporation office building, which is also related to investment officer retention. This request was not offered as an amendment, as it was more properly viewed as a capital request.

Governor's Amendments:

The Governor did not submit any amendments for this agency.

[2:48:38 PM](#)

Co-Chair Seaton MOVED to ADOPT Amendment H DOR 1 (copy on file):

Taxation and Treasury
Tax Division
H DOR 1 - Add Corporate Income Tax Auditors

Offered by Representative Seaton
Increase the corporate income tax auditing staff to capture additional revenue that is currently foregone due to lack of staff resources. Currently the tax system is identifying audit leads that the division lacks the staff time to investigate. Estimated additional revenue of \$500,000 per auditor.
1004 Gen Fund (UGF) 246.0

Representative Wilson OBJECTED for discussion purposes.

Co-Chair Seaton read from a prepared statement (see above).

Representative Wilson asked why the money would not be program receipts. She suggested that the money that could be found could be used to pay the amount. She wondered if the state would be pursuing people that owed more corporate tax than what they were paying now. She wondered how the state would be losing approximately \$1 million on corporate income tax. Co-Chair Seaton relayed that the new accounting system identified leads. There were multiple leads but no auditors available to work on those leads. The revenues were foregone which the department anticipated. He noted that two other states had hired additional auditors for corporate income taxes. Those states recovered money and encountered increased compliance by corporations. The taxes

came in as general funds and were not program receipts. The funds came in as general taxes from the auditing of the tax division. It was appropriate for the monies that came in to the unrestricted general fund to provide the monies for auditors. He had no problem looking at it a few years down the road to see about recovery efforts. The estimate was that the auditors would pay for themselves in the first year and bringing in \$500,000 annually per each additional auditor.

Co-Chair Foster let committee members know Mr. Spanos was available for questions.

Representative Wilson indicated that even if the program receipts were not used currently the legislature would be adding two additional positions in anticipation that the state would receive more money. She thought it was great if the state received additional funds. She wanted to be able to find out whether the auditors were able to bring in the anticipated revenue after the first year. She wanted to follow the money similar to the Alaska Gasline Development Corporation (AGDC). She did not have a problem with the amendment if it was successful in bringing in the money. She would have a problem if she could not follow whether the state received what the state thought it would She asked if the committee could make its program receipts.

Vice-Chair Gara relayed that in speaking with DOR. The department was very clear that they did not have enough auditors. They were also clear that if they had enough auditors they would be able to raise more money than the auditors would cost. The question concerning whether it would come in in the current year depended on whether the state caught someone who was underpaid whether they would take it to court and whether there was litigation. The state could not be guaranteed that someone was not going to stall on payments. He thought it had been clear from the department that the state was very short on auditors. If it had the auditors, the state would make more money than the cost of the auditors.

[2:53:47 PM](#)

Co-Chair Foster also informed members that Mr. Dan DeBartolo, Director, Division of Administrative Services, Department of Revenue, was in the audience available for questions.

Co-Chair Seaton mentioned the ease of requesting a report on general tax receipts recovered through corporate income tax. He thought it would be more difficult to set up a different account from UGF. He suggested it would be easy to find out whether the auditors that were hired brought in the anticipated receipts.

DAN DEBARTOLO, DIRECTOR, DIVISION OF ADMINISTRATIVE SERVICES, DEPARTMENT OF REVENUE, spoke to the question. He had discussed, within the department, the issue following the subcommittee process. It was agreed that one thing the department should be doing right away was to create a more robust reporting mechanism so that it could report back in the following year during the subcommittee process what the auditors accomplished, and the amount collected in corporate income taxes. He anticipated having the discussion about the effectiveness not only in the first year but in years 2-5. To claim that the mechanism worked, he suggested it might be worthwhile to look beyond 5 years. He would defer further questions on the tax side to Mr. Spanos on line.

[2:56:19 PM](#)

BRANDON S. SPANOS, DEPUTY DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE (via teleconference), clarified the question.

Representative Wilson wondered, if the state were to hire the auditors, why they could not be program receipts. She understood that it would entail a code. It would make it easier to find out whether the two additional hires brought in enough to pay for their wages or more. The same idea could be applied in other places as well. Mr. Spanos stated that it would be very difficult to track the payments from audits of just two auditors. He suggested it might make more sense to put all the corporate receipts into a special fund. It was a policy call. It would be difficult to track payment receipts from audits done by specific auditors. While the department's system was robust, it did not record payments attached to audits done by individuals. The department could do it manually. The department would be tracking the new auditors' revenues manually and could report that information back to the legislature. He provided the caveat that the information could be provided assuming it was aggregated. If one auditor did one audit

and a payment came in for that one audit it would be questionable that the specific number could be provided. He anticipated within one year several audits would be completed. Assessments could be provided in a total dollar figure. The department could also provide a report on payments, assuming they were paid.

Representative Pruitt asked what the state was looking for. He wondered if the state was looking for people that did not pay their taxes or people that had errors in their calculations. Mr. Spanos responded the tax payers were sophisticated corporations that were doing their best to pay Alaska as little tax as possible. The corporations studied Alaska's statutes and interpret them in their best interest. Often when the division looked at the corporations it disagreed with the stance they were taking. Many of the audits were not what would be called "slam-dunk" audits. An audit was not an open and shut case, but a resource intensive audit. An auditor might have to be sent to a company's corporate headquarters to review large amounts of paperwork or to communicate frequently back and forth to get the needed level of substantiation to make a determination. Some of the issues involved a unitary filing for corporations. For example, a company doing business in Alaska might be a member of a much larger corporation. They might claim that they were not unitary with their parent - the business they do in Alaska should be looked at as a separate entity. It was hardly ever the case in the modern world. Giant corporations controlled their subsidiaries and, generally, the income from the parent company should be part of the tax pie. Alaska should be receiving a slice of the pie. If the income from the parent company was not in that pie, the pie was much smaller as well as the revenue Alaska received. There were several other tax issues that the department would consider assigning to the new auditors.

Co-Chair Foster recognized Representative Lora Reinbold.

[3:01:23 PM](#)

Representative Pruitt thought Mr. Spanos was indicating that the entities the state was pursuing were typically multinational or multistate entities rather than the small business corporations within the state. They were entities that created different limited liability corporations to

create different tax shields. He asked if his assessment was fair. Mr. Spanos agreed.

Representative Wilson MAINTAINED her OBJECTION. She thought the information should be tracked.

A roll call vote was taken on the motion.

IN FAVOR: Grenn, Guttenberg, Kawasaki, Ortiz, Pruitt, Thompson, Seaton, Foster.

OPPOSED: Tilton, Wilson.

Representative Gara was absent from the vote.

The MOTION PASSED (8/2). There being NO further OBJECTION, Amendment H DOR 1 was ADOPTED.

[3:03:54 PM](#)

AT EASE

[3:04:36 PM](#)

RECONVENED

Co-Chair Foster repeated that Amendment H DOR 1 passed on a vote of 8/2.

Co-Chair Seaton relayed that he was in charge of the language sections of the operating budget bills. He had two other amendments to the Department of Revenue's budget that were linked together.

Co-Chair Seaton MOVED to ADOPT Amendment H DOR 2 (copy on file):

Child Support Services
Child Support Services Division
H DOR 2 - Move Cost Recovery for Paternity Testing
from Language to Section 1 (Numbers)

Offered by Representative Seaton
This amendment adds the funding from the language section (formerly sec. 15 in HB 57, version J) to the numbers section and increases the amount of program receipt authority from an estimated \$46.0 to \$50.0. The language section is deleted in another amendment.

H DOR 2 and H DOR 3 were being offered to clean up and reduce the language sections of the bill where possible and to put the information in the numbers section.

Representative Wilson OBJECTED for discussion.

Co-Chair Seaton read from a prepared statement (see above). He noted that the item was being moved from the language section (subcommittees could not address or act on this section) of the bill to the numbers section. Subcommittee members would be able to address and amend the numbers section once the information was moved over.

Representative Wilson asked who was paying for the program. Co-Chair Seaton responded that the money was from the general fund and that currently the numbers were in the language section. Items in the language section could not be addressed or amended at the subcommittee level. The idea was to take items out of the language sections, where possible, and place them into the numbers section to be available for subcommittee action in the future.

Representative Wilson understood the change Co-Chair Seaton was suggesting. She was unclear where the full \$50,000 was coming from. Co-Chair Seaton deferred to Mr. DeBartolo.

Mr. DeBartolo did not have the amendment in front of him. Paternity testing for Child Support Services was a budget item that was added in every year and adjusted back out at the end of the year. The source of the funds was a general fund match. He apologized for not having the documentation in front of him.

Representative Wilson referred to page 1 of the backup. It appeared there was an increment of \$50,000 and a decrement of \$46,000 that was not used, leaving a balance of \$4,000. She was trying to determine if the legislature was putting in \$50,000 from program receipts. She indicated that typically when money came from program receipts someone was paying for it. She assumed, because the test was paternal in nature, it would be paid for by a man. She was trying to understand who would be paying for the increase of \$4,000. She requested an "at ease."

3:10:01 PM
AT EASE

3:11:31 PM

RECONVENED

Mr. DeBartolo addressed Representative Wilson's question. He explained that every year the Child Support Services Division had to estimate what would be paid for by the custodial fathers for paternity testing. Representative Wilson was correct that the parent paid for the testing rather than the state. Last year the division underestimated the collection amount by about \$4,000 which was the reason for the change.

Representative Wilson understood the language portion being moved. She wanted to clarify that money was not being added to the budget. Rather, it was money the state was recouping from users of the program. Mr. DeBartolo responded, "That is correct."

Representative Wilson WITHDREW her OBJECTION.

There being NO further OBJECTION, Amendment H DOR 2 was ADOPTED.

Co-Chair Seaton MOVED to ADOPT Amendment H DOR 3 (copy on file):

Child Support Services
Child Support Services Division
H DOR 3 - Move Cost Recovery for Paternity Testing
from Language to Section 1 (Numbers)

Offered by Representative Seaton
See 30-GH1855J.7, Wallace, 1/31/17
This amendment deletes section 15 in HB 57, version J.
The funding is added to the numbers section and
increased to \$50.0 in another amendment.

Representative Wilson OBJECTED for discussion.

Co-Chair Seaton explained that the amendment reflected the other half of the change to the language section. It removed an estimated amount in the language section to a specific dollar amount receipt authority in the numbers section.

Representative Wilson asked Co-Chair Seaton to restate his position. Co-Chair Seaton repeated his explanation.

Representative Wilson WITHDREW her OBJECTION.

There being NO further OBJECTION, H DOR 3 was ADPOTED.

Co-Chair Seaton MOVED to ADOPT Amendment H DOR 4 (copy on file):

Alaska Mental Health Trust Authority
Mental Health Trust Operations
H DOR 4 - Restore Funding Level to Trust Requested
Amount or FASD Campaign

Offered by Representative Seaton
This amendment in the amount of \$150,000 is to fully fund and maintain the capacity of the Institute for Circumpolar Health Studies to continue to develop, implement and evaluate Fetal Alcohol Spectrum Disorder (FASD) prevention strategies and to continue the FASD media campaign, which has been instrumental in the dissemination of FASD prevention messaging. Each child diagnosed with FASD will cost the State of Alaska \$850,000 to \$4.2 million from age 0-18.

Representative Wilson OBJECTED for discussion.

Co-Chair Seaton read from a prepared statement (see above).

[3:16:14 PM](#)

Representative Wilson assumed that the state already funded the program in the amount of \$250,000. The amendment would add \$150,000 to program funding. Co-Chair Seaton responded that the current funding level was \$500,000. There was a decrement of \$150,000 in the governor's budget relating to the media campaign which disseminated the message that no amount of alcohol was appropriate during pregnancy. The other portion of funding would be applied to pregnancy test kits. He reported 2000 responses to surveys by women. The funding would provide money for survey follow-ups regarding those women that stopped drinking upon finding out about their pregnancies. The purpose of the project was to lower FASD in Alaska.

Representative Wilson argued that although the amount being requested was minimal, she opposed providing additional funding. She thought the tests were provided at bars to

determine whether an individual was pregnant or eligible to drink. She was unclear where the survey data would come from. She did not feel it was the job of state government to provide the funding. She would be opposing the amendment.

Representative Kawasaki agreed with some of the comments made by Representative Wilson. He reported that the program was being funded for the second year. Although the survey provided some results, it was difficult to tell from the sample whether the information that was gleaned was voluntary. He was trying to understand the efficacy of the specific program of putting pregnancy tests in bars. If the program was not working the state should cease paying for it. Conversely, if the program was working, he thought it deserved further discussion. If there were results, he wanted to hear about them. Co-Chair Seaton relayed that Mr. Jesse was available for questions. He reminded members that the amount would restore the media campaign to adults across the state.

[3:19:41 PM](#)

JEFF JESSE, LEGISLATIVE LIAISON, ALASKA MENTAL HEALTH TRUST AUTHORITY, introduced himself. He responded to Representative Kawasaki that the surveys were voluntary. He explained that there was a que code on a poster with the pregnancy dispensers. He believed there was a small gift certificate that was provided to women who completed the survey. It was a remarkable return of the survey for the type of an analysis. He emphasized that the survey was completely voluntary.

Representative Wilson noted that the \$150,000 was designated general funds. She wondered if the amount could be utilized in another part of the budget for another program. She asked if she was accurate. Co-Chair Seaton answered that the amount was for alcohol and drug treatment prevention funds, 20 percent of which was to go towards alcohol and prevention programs. He thought FASD was an appropriate target for reducing the effects of alcohol on the Alaska population. The state had a high rate of FASD. He invited Mr. Jesse to talk about the distribution of funds.

Mr. Jesse thought Representative Wilson was correct that the state did not have dedicated funds. The amount was a

designated fund which meant the money could be used for any purpose.

Representative Wilson suggested that the money could be used for more services in behavioral health to get more services to people with drinking problems. She pointed out that the money could be spent towards more services rather than a campaign. She thought the gift cards given to survey participants were likely another cost to the state. She thought the money should be utilized for a behavioral service having to do with alcohol or drug addiction. She wanted the committee members to understand that it was not money the state would be giving up, it was money that could go directly towards services. She did not need a response. She knew her statement to be true.

Representative Wilson MAINTAINED her OBJECTION.

A roll call vote was taken on the motion.

IN FAVOR: Guttenberg, Ortiz, Gara, Grenn, Foster, Seaton.
OPPOSED: Kawasaki, Pruitt, Thompson, Tilton, Wilson.

The MOTION PASSED (6/5). There being NO further OBJECTION, Amendment H DOR 4 was ADOPTED.

[3:23:28 PM](#)
AT EASE

[3:24:14 PM](#)
RECONVENED

Co-Chair Seaton asked Representative Kawasaki to present the subcommittee report for DMVA.

Representative Kawasaki read from his report:

The Chair of the House Finance Budget Subcommittee for the Department of Military and Veterans' Affairs recommends that the House Finance Committee accept the Governor's FY18 Amended Budget with further amendments:

The FY18 budget with recommended subcommittee amendment totals:

Fund Source: (dollars are in thousands)

Unrestricted General Funds (UGF) \$16,349.4
Designated General Funds (DGF) 28.4
Other Funds 10,180.6
Federal Funds 30,995.1
Total \$57,553.5

Representative Kawasaki indicated that there was an increase of roughly \$100,700 from the FY 17 Management Plan with an unrestricted general fund (UGF) of \$16,248.7 representing a .6 percent increase. He continued that the subcommittee met several times over the month and was forwarding two budget amendments which he would speak to shortly.

Representative Kawasaki read the statutory recommendations by the finance subcommittee:

The following statutory recommendations are submitted to the House Finance Committee:

1. Amend AS 26.27 to provide statutory authority to the Alaska Aerospace Corporation to issue dividends to the State of Alaska. This change is necessary because the corporation stated intentions to provide dividends to the State in the future, but does not currently have the statutory authority to do so.

2. Move Alaska Aerospace Corporation from Title 26, the Department of Military and Veterans' Affairs, to Title 14, the Department of Commerce, Community and Economic Development. This change is important because several public corporations are housed in DCCED, including Alaska Energy Authority, Alaska Railroad, Alaska Gasline Development Corporation and the Alaska Industrial Development & Export Authority, several of which have bonding authority, issue dividends, can purchase land and have tangible assets. AAC was originally housed in DCCED until 2011 when moved by Executive Order 115.

Representative Kawasaki reviewed other information from his report:

Other Information:

1. An amendment proposal was offered that would have reduced \$388.0 UGF from personal services in the

Office of the Commissioner, an approximate 20 percent reduction from post-vacancy amount. The sponsor offered the proposal as flexibility to reduce UGF spending in the Office of the Commissioner.

Subcommittee Discussion:

The Department said the \$388.0 deletion would impact 46 PCNs that specialize in human resources, budget submissions, equipment procurement, internet technology and others that support 270 personnel across the state, including those who oversee the development and submission of its operating, capital and federal budget requests.

2. An amendment proposal was offered that would have reduced \$273.0 UGF from services in the Office of the Commissioner, a 15 percent reduction of services from the Governor's FY18 Amended Budget. The sponsor offered the amendment to scale back on recent years increases.

[3:27:38 PM](#)

Representative Kawasaki MOVED to ADOPT Amendment H MVA 1 (copy on file):

Military and Veterans' Affairs
Office of the Commissioner
H MVA 1 - Eliminate Expansion of Alaska State Defense Force for Rural Engagement

Offered by Representative Kawasaki
Due to current budget deficit, the subcommittee does not wish to expand or create new programs at this time.

1004 Gen Fund (UGF) -210.9

Co-Chair Foster OBJECTED for discussion.

Representative Kawasaki read the amendment (see above). He noted that while the committee agreed that the rural engagement component and the Alaska State Defense Force were very important, due to budget restraints the committee denied the increment. He furthered that the department came to the legislature in FY 17 for a \$1.3 million UGF request

and a \$1 million capital request which were denied at the time for similar reasons.

Co-Chair Foster WITHDREW his OBJECTION.

There being NO further OBJECTION, Amendment H DMV 1 was ADOPTED.

Representative Kawasaki MOVED to ADOPT Amendment H MVA 2 (copy on file):

Alaska Military Youth Academy
H MVA 2 - Report on Alaska Military Youth Academy UGF Structure

Offered by Representative Kawasaki
It is the intent of the Legislature that the Department of Military and Veteran's Affairs (DMVA) develops a report to the Co-Chairs of the Finance committees and Legislative Finance Division by December 1, 2017, identifying funding options available to the Alaska Military Youth Academy to generate revenue. The report shall include recommendations and limitations for tuition and fee structures based on income levels of applicants' households, and how to incorporate those recommendations into Fiscal Year 2019 budget for the Department. The report shall also include the impact of those recommendations on federal matching dollars and the UGF budget.

Co-Chair Foster OBJECTED for discussion.

Representative Kawasaki read the amendment (see above). He indicated that, according to the department, any dollar recuperated from tuition or voluntary contributions might reduce the federal pay-in to a ratio of 75 cents per dollar.

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Representative Wilson commented that the Military Youth Academy had taken less money for BSA [Base Student Allocation] than any academy. The academy set a fee structure a few years prior. She was concerned with the intent language and whether it would apply to Mount Edgecombe or other public schools. She thought the academy

had made great efforts. She noted the entity had accepted Alaska dropouts and helped them get back into school. She did not believe there would be very few parents of the academy that would be able to provide funding for their children. She suggested the intent language be adjusted. She also suggested some of the schools giving up their BSA. She wanted additional information prior to including intent language that could result in the loss of federal funding. She was concerned with entities being treated equitably.

Co-Chair Seaton clarified that the DMVA budget was the only one before the committee presently. He also noted that during round two of the amendment process individual finance members could offer further intent or other amendments.

Representative Pruitt mentioned the 75/25 ratio. He suggested that the state received \$25 for every dollar the state brought in. He wondered if it would make sense to seek the funds from a few available people. His friends that attended the academy would not have had the means to pay for it on their own. He noted that in the narrative a non-profit was mentioned. He wondered if there was an opportunity to utilize monies from non-profits or money from outside state government to cover the 25 cents to avoid losing federal funding.

Representative Thompson was concerned with the amendment. He reported that over the last 3 years the legislature had reduced the Youth Academy funding. The entity had laid off several people and was operating on a shoestring budget. He thought demanding an additional report that would require research was unreasonable because of the reduction in personnel. He thought the committee would be asking the academy to do more with less people. He opposed the amendment.

Representative Kawasaki believed at the time the department had no objection to the amendment. Subcommittee members also had no objection. The committee did not want to deny someone the ability to attend or to create a chilling effect with a tuition. There were cases in which there were kids whose families could pay that had no avenue to capture the funds. He relayed that there was a 501(c)3 non-profit that was being lined up, but the paperwork was in process. The recommendation, if passed by the committee, would come before the body again in the following year at which time

options would be presented. He reiterated that there were no objections in the subcommittee to the amendment proposal.

[3:35:13 PM](#)

Co-Chair Seaton asked if it meant the 501(c)3 being set up to receive funds was providing a mechanism for receipt authority. He wondered if the state of Alaska would be able to accept donations from the 501(c)3 for augmentations to the program. Representative Kawasaki responded that it was envisioned that the 501(c)3 would allow offsetting of general funds. Research was still needed to determine whether the offsetting of funds would cause a problem with federal receipts - the reason the intent language was being offered.

Co-Chair Seaton clarified that it was intent language to allow it. However, nothing had been done to-date. Representative Kawasaki responded affirmatively.

Co-Chair Foster WITHDREW his OBJECTION.

Representative Wilson OBJECTED. She commented that the military academy had done what she wished all schools did. They dwindled their budget and only charged the state what it needed. She wished all the districts would do the same. The academy had a very successful program and attained federal dollars. She thought it was terrible to tell the academy it needed to find additional funds somewhere else when they had been a model. She believed it would be sending the wrong message to a successful program. She invited members to imagine what would happen if the academy got caught up, causing anguish and a lack of desire to participate. The academy accepted mostly dropouts. She concluded that instead of rewarding the academy for its performance, the amendment sent the wrong message. She could not support it.

Representative Kawasaki addressed one of the concerns that was mentioned. He thought the Alaska Military Youth Academy had done a great job. However, the academy was capacity driven and was up such that they needed to match every federal dollar available. If the state was able to contribute more into the GF function, it could potentially expand and grow with another unit. He pointed out that the problem was that the state was looking for nickels and

dollars everywhere. If the state wanted a successful program within the Alaska Military Youth Academy to increase, utilizing a 501(c)3 or some sort of tuition system provided an avenue to do so.

Representative Wilson MAINTAINED her OBJECTION.

A roll call vote was taken on the motion.

IN FAVOR: Guttenberg, Kawasaki, Ortiz, Seaton, Foster

OPPOSED: Pruitt, Thompson, Wilson, Grenn

Vice-Chair Gara and Representative Tilton were absent from the vote.

The MOTION PASSED (5/4). There being NO further OBJECTION, Amendment H MDV 2 was ADOPTED.

Co-Chair Seaton asked Representative Kawasaki if there were any other amendments for DMVA. Representative Kawasaki responded in the negative.

Representative Pruitt asked if the statutory recommendations would be discussed further. He asked if it was currently the time to discuss the recommendations. Co-Chair Seaton relayed that the statutory recommendations were developed by the subcommittees and forwarded to the policy committee by the subcommittees. House finance was not taking any action. Every member had the ability to forward statutory amendments on their own. The recommendations were for the policy committees to consider. The legislature was not voting on the statutory recommendations developed by the policy committee.

Representative Pruitt wondered if it was an appropriate time to discuss the subcommittee recommendations prior to the bill moving out of the House Finance Committee. He restated his question about discussing the items prior to them moving out of committee. Co-Chair Seaton explained that one of the ideas of having the policy committees serve as the budget subcommittees was for the recommendations to be discussed within the subcommittee except for those from the Department of Revenue. He explained that DOR was considering tax items. In most cases, the subcommittees were policy committees reviewing proposed actions. It was not the finance committee telling the policy committee but rather the policy committee's functioning as budget

subcommittees. The budget subcommittees were responsible for identifying statutory actions for consideration. The recommendations would come through the House Finance Committee in the form of a piece of legislation because they would most likely be related to finance. He anticipated that the statutory recommendations based on change in the budget would come to the committee. If recommendations did not evolve into bills they could be offered by any individual member of the subcommittee or anyone in the House. The committee would not get into a discussion about the subcommittee recommendations. They were subcommittee recommendations to the policy committees.

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Representative Pruitt express confusion about the policy committee versus the subcommittee. He indicated that the subcommittees were chaired by House Finance members. He thought there would be some statutory recommendations that would come from the finance subcommittee that he might have concerns with. He felt there was confusion about why statutory recommendations would be generated from a finance subcommittee. He thought they should have been left with the policy committee and left out of the finance reports. Co-Chair Seaton added that he wanted the full committee to have the information about the findings of the subcommittees. However, changes could not be accomplished through the finance committee. They had to be accomplished through statutory change.

Representative Wilson noted the Alaska Aero Space Corporation and wondered if it would take a statute change to move the division into commerce rather than to change it in the budget. Co-Chair Seaton responded affirmatively. Representative Wilson wanted clarification. She thanked Co-Chair Seaton.

HB 57 was HEARD and HELD in committee for further consideration.

HB 59 was HEARD and HELD in committee for further consideration.

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

ADJOURNMENT

3:47:05 PM

The meeting was adjourned at 3:47 p.m.