

HOUSE FINANCE COMMITTEE
October 25, 2017
1:14 p.m.
FOURTH SPECIAL SESSION

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CALL TO ORDER

Co-Chair Seaton called the House Finance Committee meeting to order at 1:14 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 (Via Teleconference)

MEMBERS ABSENT

None

ALSO PRESENT

Ed King, Special Project Assistant, Commissioner's Office, Department of Natural Resources; Paul Decker, Acting Director, Division of Oil and Gas, Department of Natural Resources; Sheldon Fisher, Commissioner, Department of Revenue; Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue; Representative Collen Sullivan-Leonard; Representative Justin Parish; Representative Delana Johnson.

SUMMARY

2107 FALL Production Forecast Presentation: Department of Natural Resources

2017 FALL Revenue Forecast Presentation: Department of Revenue

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Co-Chair Seaton Relayed the agenda for the meeting.

^2017 FALL PRODUCTION FORECAST PRESENTATION: DEPARTMENT OF NATURAL RESOURCES

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ED KING, SPECIAL PROJECT ASSISTANT, COMMISSIONER'S OFFICE, DEPARTMENT OF NATURAL RESOURCES, introduced himself.

PAUL DECKER, ACTING DIRECTOR, DIVISION OF OIL AND GAS, DEPARTMENT OF NATURAL RESOURCES, introduced himself.

Mr. King introduced the PowerPoint Presentation "Preliminary 2017 Fall Production Forecast" (copy on file). He began with slide 2, "2 Years of Production Increases." He stated that the FY 17 was not official, but it was approximately 524,000 barrels. The number was up 9,000 barrels from the previous year. He stated that FY 18 was on track to be the third consecutive year of production increases.

Mr. King familiarized committee members with slide 3: "Short-Term Forecast." He stated that the solid line was the actual production for FY 17. The dashed line was the forecast, with seasonality included, of what would occur in the current fiscal year. The red dots were the preliminary actual production numbers so far in the current year. He remarked that the actual production in July was a slightly lower forecast, and was slightly higher in August. The preliminary numbers for September and October seemed to track the forecast relatively well. He noted that the production was slightly above the year prior. He shared that, year-to-date, there was approximately 488,000 barrels per day, which was nearly 4000 barrels above the prior year. He stated that the forecast was 533,000 in the current fiscal year, which was up approximately 9,000 year over year.

Mr. King reviewed slide 4, "Where the Increases Came From." He stated that the slide showed the year over year increases in production. The FY 16 increase over FY 15 was

due to the Colville River accounted for approximately 7,000 or 8,000 barrels of additional production above their previous year rate. He stated that most of the increase could be attributed to the ConocoPhillips CD5 drill site. He remarked that Prudhoe Bay had also increased its rate year over year. He stated that the increase probably due to operational efficiencies. He noted the slight increase in Nikaitchuq, mainly from the continual well drilling. He remarked that there were continual increases from those sites in the current forecast. He remarked that everything else was relatively flat.

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Mr. King moved to slide 5, "Impressive Industry Performance." He remarked that the actual increase in production was more impressive than one would believe. He stressed that the operators were able to get more production out of the units.

Representative Guttenberg wondered how much the production out of Prudhoe Bay was due to operational efficiencies, rework, and new wells within the field.

Mr. King responded that Prudhoe Bay was only running one or two rigs. He stated that the production was probably not coming from new well drilling. He stressed that it was due to effective base rate management and deferral management.

Representative Guttenberg wondered whether there could be a discussion about the expectation of production in Prudhoe Bay.

Mr. King did not want to deflect the question. Furthermore, he recommended the question be directed to the operator.

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Mr. King advanced to addressed slide 6, "10-Year Forecast." He relayed that the slide was an illustrious. He thought the range of outcomes shown on the slide was reasonable to expect.

Co-Chair Seaton queried the high and low range.

Mr. King responded that it was an 80 percent confidence range, so there was a 10 percent chance of it being higher than the high and 10 percent chance of lower than the low.

Co-Chair Seaton wanted to make sure committee members understand the dotted lines.

Co-Chair Seaton acknowledged Representative Garen Tarr in the audience.

Mr. King discussed slide 7, "Lessons Learned":

- We assumed reduced capital expenditures and rig layoffs would result in accelerated decline
- The operators outperformed expectations, doing more with less

Mr. King advanced to slide 8, "Lessons Learned." He remarked that the actual numbers came in higher than the operators' expectations.

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Representative Kawasaki noted that there was a change in the development of the production forecasts. He remarked that there was the calculation of volumes under development and volumes for projects that were under evaluation. He surmised that the lesson was that it was not a predictive model. He wondered whether the model was flawed, and whether it needed to be refined going forward.

Mr. King replied that there would be further explanation about the methodological changes in the previous year. He shared that the prior year was the first year that Department of Natural Resources (DNR) took over the forecast. He stated that DNR made some changes in the forecast model. He shared that the model incorporated some economic testing to ensure that the projects would turn a profit before plugging them into the model. He stressed that once the projects were sanctioned by the companies, they would be developed regardless. He stated that the previous year's model was slightly ambitious in attempting to predict the operator behavior in pulling back on capital. He remarked that the operators were able to improve efficiencies within their existing assets. He stated that that the lower price environment forced them

into finding efficiencies. He did not feel that the model was flawed, but it was an evolution.

Representative Grenn wondered how often the actuals had outperformed the forecasts in previous years.

Mr. King jumped to slide 17, to answer Representative Grenn's question. He plotted every forecast versus the actuals before the year prior. He noted that in all the cases where the dot was above the zero line were cases where the consultant had forecast higher than actual production. He noted that the reason for the over-forecasting was because the consultants were looking at future projects that were under development or under evaluation and were included in their forecasts. He stated that, for various reasons, those projects would not manifest. He stressed that there was a consistent bias where the consultants were providing forecasts that did not come to fruition. He stated that the Department of Revenue (DOR) had attempted to use some risk methodology, because it was unreasonable to assume that everything would work out perfectly.

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Mr. Decker drew the committee's attention to slide 10, "Changes - Fall 2016 to Fall 2017":

Fall 2016:

- 5 yr future projects outlook
 - Beyond 5 yrs was treated as "Pot of Gold" (outside official forecast, excluded from Revenue Sources Book)
- Annualized rates without seasonal fluctuations shown
- Emphasized improving long term predictions
- Under Evaluation projects were not risked for chance of occurrence

Fall 2017:

- 10 yr future projects outlook

- Beyond 5 yrs considered "Under Evaluation 2"
(part of official forecast, included in Revenue
Sources Book)

- Monthly rates with seasonal fluctuations shown
- Near term emphasis w/ attention to realistic long-range outlook
- Under Evaluation projects risked for chance of occurrence within ten-year forecast window, first oil start date, and probabilistic range in production profiles

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Representative Pruitt mentioned Armstrong oil and the company's project, and whether it was included.

Mr. Decker responded that the speculative projects were not included in the official forecast. The forecast, therefore, would look more pessimistic.

Representative Pruitt indicated that in the prior year there was concern about the outlook. He wondered if the department was confident that the inclusion of projects such as Armstrong's in the forecast going forward.

Mr. Decker was confident that the department had made substantial improvements to the forecast. He thought the department was doing a portfolio forecast rather than focusing on individual projects.

Representative Kawasaki wondered where the future projects were included in the new production prediction methodology.

Mr. King answered that the resources were evaluated, and the profile that the resource could generate. He also stated that there was a commercial team in the Division of Oil and Gas, which would conduct economic analysis. He stated that there was an analyst who did work on the economics associated with the forecast. He stated that, prior to the previous year, there was not an economic test about whether a project or well would be included in the forecast. He stated that the economic analysis was included in the prior year for the first time. He stated that the economic analysis was maintained in the current model, but

was not as heavily weighted on projects in the near-term. H stated that a project must pass the economic tests in order to be included in the forecast. He stated that if a project does not work, it did not get included.

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Representative Kawasaki surmised that there was no link to production increases and capital expenditures in the previous year.

Mr. King replied that production did not come in the same year as the initial investments. He remarked that the capital expenditures occurred in years prior. He felt that there was not a direct correlation, rather a lagged correlation between the investment and the production. He remarked that decreased capital expenditures in 2016 resulted in an expectation of a reduction in production.

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Representative Kawasaki stressed that there was a lag time between capital expenditures and production. He wondered why a lower expenditure was not reflected in the production forecast.

Mr. King replied that the capital expenditures did not always equal increases in production. He remarked that the development of new projects would first see an increase in capital expenditures. He remarked that the capital expenditures were not happening, except for a few. He remarked that the additional data would change the trajectory of the decline.

Co-Chair Seaton referred to risk evaluations. He wondered how the department evaluated a field's potential risk.

Mr. Decker replied that year an assessment would be made if the same methodology was used in the future.

Co-Chair Seaton suggested that if there was a field given a risk assessment of 50 percent probability, that there be an elimination of that consideration.

Mr. Decker responded that the department did not have an exact assessment criterion.

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Mr. King wanted to clarify that the department did not evaluate projects based on a percentage of its chance of development. He stated that there was a Monte Carlo simulation, which considered a vast number of uncertainties: price uncertainty, volume uncertainty, timing uncertainty, and multiple other uncertainties. He stated that the distribution would be around those uncertainties, and the model would pick randomly different scenarios. He stated that the model used the middle scenario. He stressed there was not a subjective assessment.

Co-Chair Seaton surmised that each assessment was a Monte Carlo.

Mr. King agreed.

Representative Guttenberg stated that many assumed that an outcome of a plan was entirely based on Alaskan activity. He stressed that there were other factors such as international markets, international competing projects, alternative energies, and the change to using gas. He queried the impact of the international factors on the methodologies. He remarked that slide 6 showed a wave in the high estimate and wondered whether that was due to the unknown factors.

Mr. King responded that the international markets affected the price forecast. He stated that a corporation's decision to invest Alaska was because of their price expectations. He agreed that there was not control over the entire marketplace, but stressed that there was some control over some considerations.

Representative Guttenberg wondered how many factors, besides price, was figured into the methodology.

Mr. King responded that he did not forecast the international markets. He furthered that there was an appreciation in price uncertainty, and assume that the price uncertainty captured all the other uncertainties.

Representative Guttenberg asked if the previous forecasters take those things into consideration.

Mr. King replied that he could not speak for the previous forecasters, but guessed that they did not take those considerations.

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Co-Chair Seaton asked if Representative Wilson had any questions.

Representative Wilson wondered whether DNR had an idea of how much oil was still in the ground, and whether different technology needed to be invented to extract heavier oil.

Mr. Decker responded that there were estimates of very large quantities of undiscovered resource. He replied that new technology was absolutely needed to extract the resource.

Mr. Decker skipped to slide 13: "Methodology."

- Currently producing:
 - Small uncertainty range due to established behavior of production pools
 - Quantitative probabilistic range of outcomes for CP pools
- Projects Under Development:
 - Applied quantitative probabilistic ranges using type wells
 - Some financial risk: Addressed using estimated project breakeven price and Department of Revenue oil price forecast
 - Projects detailed in plans of development or in confidential meetings with DOR
- Projects under Evaluation
 - Projects that have been announced, but are premature for sanctioning
 - Applied quantitative probabilistic ranges using type wells

- Financial risk using project breakeven price and Department of Revenue oil price forecast
- Other uncertainties included
 - Project chance of occurrence
 - Project timing risk

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Mr. Decker moved to slide 14, "Fall 2017 Forecast Results." He indicated that the slide was the most important because it showed the best representation of the entire forecast. He stated that it was the entire official ten-year forecast statewide. He remarked that it had all three categories, all included. He stated that there was approximately 3.5 years of history; the ten-year forecast; and the 80 percent confidence bands.

Mr. Decker discussed slide 15, "Currently Producing Forecast." He stated that the slide only showed the currently producing pools, and did not include the activity expected in the next first year. The slide also did not show the seasonality. He stated that the slide showed that the existing fields would decline if the work was to stop.

Mr. Decker reviewed slide 16, "Where Will the New Oil Come From?" He stated that there were new pools, and some expansion of production in the existing pools that were slated to come on. He remarked that it should be considered a full portfolio roll up.

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Co-Chair Seaton noted that the combination of slides 15 and 16 equaled the forecast of FY 17 on slide 14.

Mr. Decker agreed, and stated that there were also the activities in the underdeveloped areas.

Representative Grenn requested actual numbers rather than a colored chart on slide 16

Mr. Decker wondered whether the numbers would be totals or by pool. Representative Grenn replied that he wanted the numbers by pool

Mr. King indicated he could provide the final numbers when DOR released their Revenue Sources Book.

Representative Pruitt felt that a slide that combined the two slides would show forecast over ten years.

Mr. King replied that there was some growth in the out years. He noted that much of the new production on slide 16 was offsetting the decline on slide 15. He understood that it looked relatively flat. He stressed that the numbers on slide 16 were risk-weighted numbers, and were not the actual production profiles.

Co-Chair Seaton surmised that slide 6 would correspond better with the forecast in slide 14.

Mr. King agreed.

Co-Chair Seaton asked whether it was an annual basis.

Mr. Decker responded in the affirmative.

Mr. King reported on discussed slide 18, "How Should We Interpret This Forecast":

- There's a lot to be excited about
 - but there is still a lot of uncertainty in future projects
- The forecast is a probability weighted average of many possible outcomes
 - It is not a prediction of exactly which scenario will come to be
- Each year in the forecast is its own best estimate
 - The year to year changes are not actually predictions of decline rates

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Vice-Chair Gara wondered whether the Caelus play was included in the highest amount.

Mr. Decker responded that the company was included, and was a very thin band.

Mr. King furthered that the project was very early in the stage of development, so there were a significant number of risks associated with the project.

Vice-Chair Gara recalled a conversation about the accessibility of the wells.

Mr. King answered that it was still very early in the process, so there were many risks associated with the project.

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Co-Chair Seaton noted that Representative Ortiz had joined the meeting.

^2017 FALL REVENUE FORECAST PRESENTATION: DEPARTMENT OF REVENUE

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SHELDON FISHER, COMMISSIONER, DEPARTMENT OF REVENUE, introduced himself.

DAN STICKEL, CHIEF ECONOMIST, ECONOMIC RESEARCH GROUP, TAX DIVISION, DEPARTMENT OF REVENUE, introduced himself.

Commissioner Fisher discussed, "State of Alaska Department of Revenue, Fall 2017 Preliminary Revenue Forecast Presentation, Preliminary Forecast released October 25, 2017" (copy on file).

Commissioner Fisher looked at slide 2, "Forecasting Methods Timeline":

December 2016: Fall 2016 forecast and Revenue Sources Book

Early April 2017: Spring 2017 forecast

Late April 2017: Spring 2017 Alternative Scenario
4 percent Production Decline Scenario, Letter to Co-
Chairs

October 2017: Preliminary Fall 2017 forecast

non-standard, provided to assist special session

December 2017: Final Fall 2017 forecast and Revenue
Sources Book

March or April 2018: Spring 2018 forecast

Co-Chair Seaton recognized Representative Justin Parish in
the audience.

Commissioner Fisher moved to slide 3, "Forecasting Methods:
Introduction":

All data is based on the DOR Fall 2017 Preliminary
Forecast.

This is a preliminary forecast and some numbers will
change before the final submittal in December.

Changes to unrestricted revenue between the
preliminary and final forecast are expected to be
less than \$100 million in any given year.

Note: This is a forecast. All figures and narratives
in this document that are not based on events that
have already occurred, constitute forecasts or
"forward-looking statements." These numbers are
projections based on assumptions regarding uncertain
future events and the responses to those events. Such
figures are subject to uncertainties and actual
results will differ, potentially materially, from
those anticipated.

He was confident that in any given year the errors would be
less than \$100 million in range.

Commissioner Fisher turned to slide 4, "Forecasting
Methods: What Do We Forecast at DOR?":

We directly forecast Petroleum Revenue

Accounted for 65 percent of state unrestricted revenue in FY 2017

Projected to be 70-72 percent in FY 2018 and FY 2019

Includes severance taxes, royalties, corporate income tax, and all other revenue from oil companies

We directly forecast Non-Petroleum Revenue

We use Alaska Permanent Fund Corporation and Treasury Division forecasts for Investment Revenue

We use the Federal Revenue authorized for spending as the forecast

It is typically 20 percent-30 percent more than actually gets spent

Compile all of these into Revenue Sources Book once the forecasts are finalized.

Commissioner Fisher continued to address forecasting methods - specifically related to what the department forecasted.

Commissioner Fisher looked at slide 5, " Fall 2017 Preliminary Petroleum Revenue Forecast."

Commissioner Fisher addressed slide 6, "Petroleum Revenue Forecast: Factors":

Four Factors for Petroleum Revenue Forecast

1. Production
2. Price
3. Costs

Capital Expenditures

Operating Expenditures

Transportation Costs

4. Credits

Commissioner Fisher discussed slide 7, "Fall 2017 Preliminary Production Forecast."

Commissioner Fisher addressed the petroleum revenue forecast on slide 8, "Production Forecast: ANS History and Forecast by Pool." He shared that legacy fields still accounted for a substantial portion of production.

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Commissioner Fisher advanced to slide 9, "Production Forecast: ANS by Case", and continued to discuss the production forecast with a chart related to ANS by case. He turned to slide 10 and addressed ANS details for the North Slope only. The projection assumed about 533,000 barrels per day with a decline to just under 500,000 barrels.

Commissioner Fisher looked at slide 10, "Production Forecast: ANS Details."

Commissioner Fisher discussed the ANS comparison to the prior forecast. Over time the gap between prior and new forecasts would widen. He advanced to slide 12 and provided a National Petroleum Reserve-Alaska (NPRA) update.

Commissioner Fisher moved to slide 11, "Production Forecast: ANS Comparison to Prior Forecast."

Commissioner Fisher looked at slide 12, "Production Forecast: NPR-A Update":

Royalty Revenue and Volumes from NPRA

Alaska's share of revenues fund the Alaska Impact Grant Program

Forecasted volumes from Moose's Tooth (GMT1 and GMT2) and Willow

Vice-Chair Gara asked what portion of the royalty the state received on federal lands.

Commissioner Fisher answered that the state received 50 percent of the royalty on federal lands.

Vice-Chair Gara was not aware the money had been dedicated. He asked about the limitations with the money.

Mr. Stickel answered that most of the NPRA royalties were one-sixth royalties.

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Vice-Chair Gara asked about the offshore fields, such as Liberty Fields. He remarked that those fields did not yield revenue for the state, but had an impact on the TAPS rate.

Mr. Stickel replied that Liberty fell in the three to six-mile range, so the state had 27 percent of the federal royalty within that range. He stated that beyond six miles offshore, in that portion of the federal outer continental shelf (OCS), there would be no state share in the royalty production.

Vice-Chair Gara surmised that the state received one-quarter of the federal royalty for Liberty and Northstar, and no production tax. He recalled that Northstar was a production tax field.

Mr. Stickel replied that Northstar was an offshore island, but a portion of the reservoir extended into federal waters. Therefore, approximately 80 percent of the production was considered state waters. The production tax was applied to that portion, and 20 percent of production was in the federal portion.

Commissioner Fisher moved to slide 14, "Price Forecast: Historical ANS West Coast, West Texas Intermediate (WTI) and Brent Crude Prices 2009+." He addressed a chart showing historical ANS West Coast, West Texas Intermediate, and Brent Crude prices. The prices were relatively tight at present. He pointed out the significant volatility.

Commissioner Fisher moved to slide 15, "Price Forecast: Historical ANS West Coast Price 2016+." He addressed the ANS West Coast price.

Commissioner Fisher moved to slide 16, "Price Forecast: Key Drivers":

Supply, Demand and Spare Capacity in FY 2018

Global Supply - 99.08 million barrels per day

Global Demand - 99.05 million barrels per day

Supply / Demand roughly in balance

Current Events

Supply and demand balancing out

OPEC and Russia are maintaining decreased production until at least March 2018

Compliance with this cut has been relatively high

Recent unrest in the Middle East due to the Kurdish independence vote may disrupt supply

Commissioner Fisher continued to slide 17, "Price Forecast: Impact of Spare Capacity."

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Commissioner Fisher looked at slide 18, "Price Forecast: Base Price Method":

Price forecast is based on Fall 2017 forecasting session held on October 9th

Participants gave 10th, 50th, and 90th percentile paths

Average of these paths used to derive distribution of possible prices

Base case is the median of the distribution

Commissioner Fisher scrolled to slide 19, "Price Forecast: Nominal ANS Price Distribution." He noted the range and growth. He pointed out that the out years showed a wider

range and the closer years showed a consensus around where the pricing range would fall.

Commissioner Fisher pointed to slide 20, "Price Forecast: Historical ANS West Coast Price FY Oil Price Bands (Annual Average and Fall 2017 Forecast)." He noted that the bands had different meanings depending on either the actual or the forecast phase.

Commissioner Fisher scrolled to slide 21, "Price Forecast: Consensus View of Wide Distribution." He stated that the slide represented a number of different sources for future pricing.

Commissioner Fisher advanced to slide 22, "Price Forecast: Brent Forecasts Comparison to DOR ANS Forecast." The pricing was from January of the current year.

Commissioner Fisher looked at the comparison on slide 23, "Price Forecast: ANS Comparison to Prior Forecast." He remarked that there was a revision downward in expectations in the longer term.

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Mr. Stickel explained slide 25, "Cost Forecast: North Slope Capital Lease Expenditures." He reported that the capital expenditures had decreased, and suggested that companies were doing more with less money.

Mr. Stickel reviewed slide 26, "Cost Forecast: North Slope Operating Lease Expenditures." On the operating side the trend was similar in that there was much downward pressure on cost by the operators.

Co-Chair Seaton referred to the note at the bottom of the slide. He wondered if estimates included both the expenditures by those with a tax liability and those that did not have a tax liability.

Mr. Stickel responded in the affirmative. He elaborated that there was a representation of the total lease expenditures and deductible lease expenditures.

Representative Wilson wondered why there was a large difference in the 2021 operating to 2023.

Mr. Stickel responded that the increase in the operating costs was consistent with some of the new fields in the DNR production profile.

Representative Guttenberg surmised that there was a transition from capital expenditures to operating expenditures.

Mr. Stickel agreed. He stated that the capital expenditure slide showed spending in the 2020 to 2022 range, and as the new fields came into production the ongoing costs would be considered.

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Mr. Stickel discussed slide 28, "Credits Forecast: Compared with Production Tax." He stated that the credits were integral to the production tax calculation. He stressed that a portion of tax credits had been historically repurchased by the state by appropriation. He noted that the first set of charts showed production tax, which was the statutory production tax rate on the North Slope. That rate was typically 35 percent of net profits before subtracting out any tax credits. He stated that the orange bar was net of any tax credits against liability. The gap could be somewhat misleading, because some of the credits were an integral part of the tax calculation. He explained that the formula calculated the 35 percent and then subtract the per taxable barrel credits to get the minimum tax. He remarked that there were some slides that outlined how the tax calculation worked. He explained that the grey bar showed the net fiscal impact of the production tax system to the state in a given fiscal year. He stated that it took the actual tax collections and subtracting out the appropriation for repurchased tax credits in the year. He noted that FY 17 had approximately \$700 million in production tax at the statutory 35 percent rate, subtracting \$565 million in credits against liability to achieve \$134 million in actual tax receipts. He noted that the state also paid out an addition \$33 million in repurchased tax credits in FY 17. He noted that the state expected to receive \$285 million in production tax after credits against liability in FY 18. The state had paid out \$77 million for the credits against liability, which left a net balance of almost \$200 million in FY 18. The projection for FY 19 was that there would be approximately \$1.2 billion of production tax before credits, subtracting \$874

million of credits against liability, which left the state with \$300 million in actual receipts. He stated that there was a projection of statutory appropriation of \$175 million for FY 19. He stated that under the Oil and Gas Tax Credit Fund Language, either 10 or 15 percent of the tax levied under the production tax statutes before applications of credits was the statutory appropriation for the Tax Credit Fund.

Mr. Stickel highlighted slide 29, "Credits Forecast: Compared with Unrestricted Petroleum Revenue." He stated that the slide included other unrestricted petroleum revenue to give a more complete picture. The revenue included unrestricted royalty, corporate income tax, and property tax. He noted that after credits, the state was still netting between \$1 billion and \$1.5 billion in revenue from the oil industry in FY 19. He stated that included the restricted portions of revenue such as the CBR deposits and Permanent Fund royalties pushed the revenue close to \$2 billion.

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Co-Chair Seaton asked Mr. Stickel to return to the previous slide, slide 28. He surmised that the difference between FY 18 and FY 19 was the same. He queried the reason that the same percentage resulted in a \$100 million increase.

Mr. Stickel answered that the appropriation for FY 18 was based on the forecast when the budget was set. That was the spring forecast, and the 4 percent decline scenario may have factored into that adjustment. He remarked that, at the time, there was an expectation of a lower production amount in the forecast as well as higher company spending.

Co-Chair Seaton queried the appropriated amount.

Mr. Stickel replied that the estimated amount for FY 18 was approximately \$50 million. He announced that there were two appropriations, which totaled \$77 million. He stated that there was an appropriation in the operating budget and an additional supplemental appropriation in the capital budget.

Co-Chair Seaton asked Mr. Stickel to review the estimate for FY 19.

Mr. Stickel jumped to slide 31, "Illustration of Tax and Credit Calculations." He remarked that the slide addressed the reason for the increase to the statutory forecast increase from the spring. He stated that the slide walked through the production tax calculation for FY 19. He stated that it was an illustration of the production tax calculation with some simplifications for some of the nuances in the tax code. He noted that there was an expectation of approximately \$140 million taxable barrels in FY 19. He stated that it was a price of \$60 per barrel, subtracting transportation costs would equal a gross value of approximately \$50 per barrel. He furthered that multiplying that \$50 by the number of taxable barrels expected approximately \$7 billion in gross value at the point of production, and approximately \$5.6 billion in deductible lease expenditures resulting in a production value of \$1.4 billion. He stated that the \$1.4 billion times the 35 percent statutory tax rate that would be the basis for the statutory appropriation. The 35 percent tax rate yielded approximately \$490 million in base tax in the spring forecast, which was multiplied by 10 percent under the oil and gas tax credit fund statutes. The multiplier was 10 percent of the levied tax if the price forecast was \$60 or higher. He stated that the price forecast was exactly \$60, so it initiated the 10 percent multiplier. The result was in the \$49 to \$50 million range.

Mr. Stickel advanced to slide 32, "Illustration of Tax and Credit Calculations." The currently preliminary fall forecast showed an expectation of 169 million taxable barrels of production in FY 19 at a market price of \$56 per barrel. He remarked that there was \$7.8 billion in gross value expected, which was up \$800 million from the previous forecast. He noted that it was slightly lower, but there was a higher amount of production. He remarked that companies had reduced other expenditures significantly. He stated that there was an expectation of \$4.5 billion in deductible lease expenditures in FY 19, which would yield a production tax value of approximately \$3.3 billion.

Representative Pruitt wondered whether the statute required that payment based on the final result. He asked whether the estimate was lower than what the statute required, and whether a supplemental was imminent.

Mr. Stickel did not want to make a definitive statement, but understood that some of the language referenced the

forecast. He agreed to provide further technical information.

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Mr. Stickel moved to slide 33, "FY 2019 Statutory Credit Appropriation":

Key Changes Spring to Preliminary Fall:

Production forecast increased

29 million more taxable barrels

\$800 million more gross value

Cost forecast decreased

\$1.1 billion less deductible costs

Tax before credits increased

\$1.9 billion more profit x 35 percent = \$660 million

Different Statutory Appropriation Multiplier

Appropriation is 15 percent of tax before credits when price forecast <\$60, 10 percent when price forecast is \$60+

Representative Pruitt wondered whether there was fair confidence from DOR in the spring that \$60 would be the average price for the year.

Mr. Stickel replied that the spring forecast impacted the statutory appropriation for FY 18. He stated that there was an

Representative Pruitt thanked Mr. Stickel for his clarification.

Co-Chair Seaton directed Mr. Stickel to return to slide 30, a slide that was skipped.

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Vice-Chair Gara mentioned that the state had a system of companies buying other credits.

Mr. Stickel responded in the negative.

Vice-Chair Gara surmised that BP could purchase someone's tax credit for 50 cents on the dollar, but deduct it from their taxes as if the credit was purchased for 100 percent. He stated that the state would lose tax revenue on that transaction. He wondered whether that was the law, and why that occurrence was not more frequent.

Mr. Stickel responded that it was still a law and the state continued to provide guidance related to the regulations.

Representative Wilson wondered whether the \$175 million was the statutory amount after the calculation.

Mr. Stickel asked Representative Wilson to repeat her question.

Representative Wilson restated her question.

Mr. Stickel responded that the \$175 million was the current estimate in the preliminary fall forecast of the statutory appropriation for the Oil and Gas Tax Credit Fund. He stated that the legislature could appropriate a different amount.

Mr. Stickel looked at slide 35, "Forecast Change: FY 2017 Forecast vs Actuals":

About \$125 million of "miss" due to transfers to the CBRF from General Fund - prior-year adjustments

Remaining \$170 million of "miss" due to Corporate Income Tax forecast - primarily oil and gas

Mr. Stickel reviewed the highlights on the revenue forecast on slide 36, "Forecast Change: Production Tax Revenue Highlights":

Oil price forecasts decreased slightly from spring forecast

Long-term prices (FY2022+) now expected to settle around \$60 real

Oil production forecast methods

Forecast process by technical experts at DNR improved from last year.

Long term forecasts have stabilized.

Unrestricted revenue forecast increased somewhat mostly due to higher oil production forecast

Lease expenditures expected to fluctuate over the forecast period due to forecasted new production: Companies have cut costs for existing fields, but new fields will add costs

Companies cited Alaska investment instability and uncertainty regarding the state fiscal system, as factors impacting decision making

Mr. Stickel continued to slide 37, "Forecast Change: Comparison from Spring 2017 Forecasts for FY 2018." He stated that the comparison showed that production forecast for FY 18 was up and lease expenditures were down. The numbers put the unrestricted petroleum revenue at approximately \$40 million higher, versus the official spring forecast. It was approximately \$70 million below the 4 percent decline scenario. He stated that the reason for the lower number versus the 4 percent decline scenario was due to the corporate income tax. He stated that there was a forecast of \$235 million in corporate income tax for FY 18, and reduced oil and gas to \$130 million. He stated that the expectation of production tax and royalties was slightly higher than the spring.

[3:04:50 PM](#)

Mr. Stickel moved to slide 38: "Forecast Change: Comparison from Spring 2017 Forecasts for FY 2019." He noted that there was a higher production expectation with a lower lease expenditure. The FY 19 price forecast was reduced slightly, with a net result of a forecast that was slightly higher than the official FY 19 spring forecast and slightly lower than the 4 percent decline scenario due to corporate income tax.

Vice-Chair Gara noted that there was a presentation that stated that the budget should provide the previous year's level of service due to statewide and unexpected expenses. He stated that there would be an additional \$300 million extra cost at the previous year's level of service. He stated that there was a miss on the corporate income tax of approximately \$170 million. He felt that there was a total of \$470 million needed. He wondered whether the \$70.6 million was the fall forecast adjustment minus the miss in corporate income taxes.

Mr. Stickel responded that the \$70.6 million represented the difference between the 4 percent decline scenario and the current revised forecast.

[3:06:50 PM](#)

Vice-Chair Gara wondered whether the decline was because of the corporate income tax.

Mr. Stickel replied in the affirmative.

Commissioner Fisher furthered that there would be a slide related to the total revenue delta.

Mr. Stickel reviewed slide 40: "Revenue Forecast: 2017 to 2019 Totals." There were more modest expectations for investment returns.

Co-Chair Seaton queried the encompassed investment returns.

Mr. Stickel detailed slide 41: "Revenue Forecast: By Spending Category."

[3:11:15 PM](#)

Mr. Stickel scrolled to slide 42: "Revenue Forecast: 2017 to 2019 Petroleum Unrestricted Revenue."

Mr. Stickel explained slide 43: "Revenue Forecast: 2017 to 2019 Non-Petroleum Unrestricted Revenue."

Co-Chair Seaton asked about what from the previous session changed the motor fuels from UGF to DGF.

Mr. Stickel responded that he did not have the reference. He stated that DOR met with OMB and LFD in order to determine how the various revenues were categorized.

Co-Chair Seaton thought he would need some explanation on the topic.

Representative Pruitt believed in the budget.

Co-Chair Seaton asked Mr. King to clarify.

Representative Thompson reported that there had been language that was not consistent with his understanding.

Co-Chair Seaton indicated his office would follow-up with the department and get back to the members.

[3:16:07 PM](#)

Vice-Chair Gara felt that shifting money between pots made it difficult to follow the budget.

Commissioner Fisher asked that he has time to investigate.

[3:20:25 PM](#)

Mr. Stickel reviewed slide 44: "Revenue Forecast: Corporate Income Tax":

Challenging to forecast in changing price environment

Based on U.S. or worldwide profitability,
apportioned to Alaska.

Estimated payments - lower than expected

Expecting a rebound as companies return to
profitability

Refunds - higher than expected

Partially due to Net Operating Loss carry-backs

Expecting smaller impact going forward (if price
remains stable)

CBRF movement of funds in FY 2017 - unexpected

In consultation with Legislative Audit

Did not impact cash received but did impact
general fund / CBRF split

Preliminary Forecast: FY 18 \$130 million oil, \$150
million general; FY 19 \$170 million oil, \$155 million
general

3:23:58 PM

Mr. Stickel reported on slide 45: "Revenue Forecast:
Corporate Income Tax."

Co-Chair Seaton asked if the \$50 million was for carry
back, or was there a negative tax implication.

Mr. Stickel replied that companies would make an estimated
payment.

Co-Chair Seaton wanted the public to understand that it was
not an additional expense.

Vice-Chair Gara felt that the state had a lose-lose
corporate tax system.

Mr. Stickel supposed that there was a reference to the lost
carry backs.

Co-Chair Seaton announced that there was separate
accounting. The request had been made to the department.

3:30:06 PM

Vice-Chair Gara wondered whether a tax based on profits
would be a positive number.

Mr. Stickel responded that there was work on that analysis.
He stated that an alternative to the corporate income tax
depended on the different provisions about the ability to
estimations.

Mr. Stickel further reviewed slide 46, "Revenue Forecast:
Revenue Available for Appropriation":

Useful for outside analysts not familiar with Alaska's budget conventions

Better reflects ability of state to meet its obligations

Alaska has a budget framework that restricts certain revenue based on constitution, statute, of customary practice

The ability of the state to meet its obligations is not fully reflected by the General Fund Unrestricted Revenue category

All revenues subject to appropriation for any purpose can be used by the legislature to fund government services or obligations, including:

Constitutional Budget Reserve Fund

Earnings Reserve of the Permanent Fund

[3:32:42 PM](#)

Mr. Stickel returned to slide 47, "Revenue Forecast: 2017 to 2019 Available for Appropriation."

Commissioner Fisher wanted to return to UGF. on slide 48: "Wrap-up: Changes to 10 - Year Unrestricted Revenue Outlook."

Representative Ortiz asked about the 4 percent decline.

Commissioner Fisher explained that the spring had a pricing forecast with a production forecast from DOR that represented a 12 percent decline year over year in oil production. He remarked that there was concern that the forecast was too conservative. He stated that there was a change to a 4 percent decline in an alternative scenario.

[3:40:08 PM](#)

Vice-Chair Gara stated that he had heard a constituent say that there would be so much money in the current year, so there was no need for a fiscal plan.

Commissioner Fisher agreed.

Commissioner Fisher summarized the presentation as detailed on slide 49: "Wrap-Up: Big Picture Takeaways for Forecast Period":

Oil Prices for FY19+ decreased for the forecast period

Current prices trending slightly higher than forecasted price for FY 2018

Oil Production is forecasted to be steady

Includes some new fields on a risked basis.

Current production on track with forecast so far for FY 2018

Petroleum Revenue represents 65 - 74 percent of our unrestricted revenues over the forecast period

Unrestricted revenue trend over forecast period (year-over-year):

Increases of \$483M in FY 2018 and \$185M in FY 2019

Revenue grows 1-5 percent per year FY 2020-2024 then 7-10 percent in FY 2025-2027

In real terms, GFUR grows 2.5 percent per year between FY 2018 and FY 2027

Structural budget deficit remains

[3:44:30 PM](#)

Representative Wilson asked when the numbers would be trued up with actual numbers.

Mr. Stickel indicated the department had trued up. He was fairly confident the numbers would not change much in the final document.

Co-Chair Seaton asked Mr. Stickel to return to slide 41. He asked about the forecast amount on the top purple line.

Mr. Stickel responded that the blue bar was the full PFD according to the current statute.

Representative Pruitt asked that as it related to petroleum income. He asked if it was a realistic outcome. He had not made the calculation based on the forecast.

Co-Chair Seaton discussed committee business.

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ADJOURNMENT

3:48:14 PM

The meeting was adjourned at 3:48 p.m.