

HOUSE FINANCE COMMITTEE
January 19, 2018
1:34 p.m.

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CALL TO ORDER

Co-Chair Seaton called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

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

Representative Neal Foster, Co-Chair

ALSO PRESENT

Sheldon Fisher, Commissioner, Department of Revenue; Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue.

SUMMARY

OVERVIEW: REVENUE SOURCES BOOK, FALL 2017

Co-Chair Seaton reviewed the agenda for the day.

^OVERVIEW: REVENUE SOURCES BOOK, FALL 2017

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Co-Chair Seaton invited presenters to the table. He directed testifiers to proceed.

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

Commissioner Fisher introduced the PowerPoint Presentation: "Fall 2017 Revenue Forecast Presentation." He indicated that the presentation was shorter than the department's previous presentation. He had heard from both chambers that the department had gone too far into the weeds and asked that the presentation be shortened. He signaled that if committee members wanted to see a slide reinserted, they should let him know.

Commissioner Fisher tuned to slide 2: "FORECASTING METHODS: Timeline." He indicated that traditionally the department had a fall forecast and a spring forecast. The fall forecast was issued in December and the spring forecast was typically issued in April. In the current year, because of the importance of the revenue forecast in all of the discussions by the legislature, the department had two additional forecasts. First, the department had an early spring forecast and a revised forecast which increased some assumptions around production. Also, because of the special session in the previous fall, the department issued a preliminary fall forecast in October to help inform the discussions in the special session. At the time, the department signaled that it was a preliminary forecast and it expected some changes between the preliminary and final forecasts. He would be reviewing the fall forecast issued in December. The department hoped to come out with a spring forecast in March rather than April to help facilitate the consideration of the budget. He would be highlighting some items important to legislators while considering the budget.

Commissioner Fisher explained that the first section would provide a high-level view of the production forecast. The production forecast was a product from the Department of Natural Resources (DNR) and had not changed from what the Department of Revenue (DOR) issued in the fall - the preliminary fall forecast issued for special session. He thought it was useful for people to see where the state was at.

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Commissioner Fisher moved to slide 4: "PRODUCTION FORECAST: ANS History and Forecast by Pool." The slide showed a macro level point of view. He reported that from the beginning the state was currently at about a quarter of the overall production. He noted the dotted line on the right side of the chart. The left side of the dotted line showed actual production and the right side of the dotted line showed the forecast. There had been a couple of years where production increased which was different than the department had expected. Looking forward, he pointed out the pink slice to the far right which represented new fields that were coming online, flattening the production curve, and allowing for a flatter production expectation into the future.

Commissioner Fisher advanced to slide 5: "PRODUCTION FORECAST: ANS High and Low Case." He reported that the slide was a product from DNR. The official forecast was represented by the solid blue line in the middle. It reflected the expectation of a 50 percent likelihood of what would be achieved. There was a low case and a high case at the extremes. The low case meant a 90 percent confidence that production would be at or above the level. The high case represented a 10 percent confidence level. He noted the variability between them.

Representative Guttenberg wondered, since DNR had taken over producing the forecast, if the department was tracking accuracy in the short-term and the long-term. He asked how the department was performing in terms of accuracy.

Commissioner Fisher responded that he could not speak for DNR in terms of how they were tracking their accuracy. He noted he would be showing a slide that reflected the revision from the spring forecast. It would demonstrate that the department's current forecast had moved materially. He thought if DNR was present they would acknowledge that they had refined their process and made improvements in their accuracy. He could not speak for DNR.

Representative Guttenberg asked which part of the forecast DOR was responsible for. Commissioner Fisher replied that DNR was responsible for the production forecast, and DOR was responsible for the rest of the forecast.

Co-Chair Seaton recognized the committee had been joined by Representative Pruitt.

Representative Ortiz referred to slide 4. He wondered about the new fields represented in pink. He clarified that the new fields were known fields with their potential production. Commissioner Fisher responded that in the fall, DNR explained that it had different levels of confidence in production for different new fields. The fields in which the department had a higher level of confidence about production were included in the forecast. The fields that the department was not as confident in were not included. He noted that DNR applied a discount to some fields in the forecast in which the department expected less production than the developer. The resulting DNR forecast was the 50 percent estimate of what was going to happen.

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Commissioner Fisher continued to slide 6: "PRODUCTION FORECAST: ANS Comparison to Prior Forecast." He pointed to the burnt orange line that represented the original Spring 2017 forecast from DNR. The grey line represented the revised Spring 2017 forecast. He noted the difference between the two forecasts and production declining at a reduced rate. The blue line represented the current forecast. It showed that the production rate was largely flat. He also pointed out that the delta growing between the lines farther out in time. In examining the budget from the Office of Management and Budget (OMB), the state's fiscal challenges get less over time, in part, because of the assumption that the state would have increased production. He added that the delta would be less impactful in the following year or two. However, they were still meaningful.

Representative Wilson asked how the spring forecast compared to what actually happened.

Commissioner Fisher responded that the spring forecast was too low. The state had predicted a decline and the state actually enjoyed an incline. He pointed out that the state was anticipating another increase in FY 18, whereas the spring forecast would have predicted a decline.

Representative Wilson asked if the department could add a line to include the actuals for FY 17. She wanted to see a comparison.

Co-Chair Seaton suggested that the blue line represented current history.

Representative Wilson was asking for the actuals for 2017. She thought it would be nice to be able to see the level of accuracy in the forecast. Commissioner Fisher would provide the information to Representative Wilson. He commented that with each revision of the forecast DOR addressed any deltas between actuals and forecasts so that the budgets the department was releasing were catching up to the changes.

Vice-Chair Gara figured the commissioner would rather legislators ask questions about which fields were doing better than expected to DNR rather than to DOR. Commissioner Fisher responded affirmatively.

Commissioner Fisher turned to slide 7: "Fall 2017 Price Forecast." He remarked that he would move to the price forecast. Regarding questions about learning from mistakes, he felt he had undershot the price forecast. He would discuss why and what the department was looking at when the department was doing the forecast. He noted that the market moved in a way the department had not anticipated. He would discuss the issue in greater detail.

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Commissioner Fisher advanced to slide 8: "PRICE FORECAST: Historical Real ANS Price, 2006+." He explained that the chart showed what had been happening regarding price in the previous couple of years. The average price of the period was \$52 per barrel. He pointed out that for FY 15, DOR's forecast was \$56. In other words, the department's forecast assumed oil would be at \$56 per barrel on average in FY 18. At the current time the average oil price of the present was just over \$58 per barrel. There was a delta of about \$2. He reported that a \$1 change in price equated to \$30 million to \$40 million in revenues to the state. Therefore, if the price held, the state would receive an additional \$75 million to \$80 million if the price were to hold through FY 18.

Commissioner Fisher reviewed slide 9: "PRICE FORECAST: Impact of Spare Capacity." He relayed that the chart came from the Energy Information Agency (EIA), an agency within the federal government. He indicated that to the left of the yellow line represented actuals. To the right of the

yellow line represented forecasts. He pointed to the green bars above and below the line. If the bars were above the line, it meant inventories were growing. If the green bars went below the zero line, it meant inventories were shrinking. In looking back over the previous 4 quarters, the state had shrinking inventories which was partially driving the price increase. He reported that EIA anticipated the growth of inventories looking forward in time. It would also be a primary driver around pricing.

Commissioner Fisher discussed slide 10: "PRICE FORECAST: Nominal ANS Price Distribution." He noted members might have seen the chart previously. It represented the exercise DOR went through in the fall. It was similar to DNR having a P50 which was the forecast and a range of scenarios with different probabilities associated with it. The department went through a similar exercise around pricing. In the fall the department examined pricing and developed the P50 row [highlighted in red on the chart]. The department made some changes between the fall preliminary forecast and the final forecast which were highlighted in the red boxes on the slide. The Department of Revenue increased its FY 18 budget by a couple of dollars. Fiscal Year 19, which had sat between the P50 and P60 line, was taken to 57 percent. He returned to the P50 for FY 20 and beyond. He reiterated that the market had gone higher. The following two slides showed different time frames with the same information.

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Commissioner Fisher spoke to slide 11: "PRICE FORECAST: Brent Forecasts Comparison to DOR ANS Forecast: November 2017." The chart showed Brent crude oil reflecting the international market on the seas. The other bench mark people used was the West Texas intermediary. The Department of Revenue thought Brent was a better proxy for North Slope oil. Presently, both proxies were within a few cents of each other in pricing. The blue line represented Wall Street Analysts expectations. The department took an average of all of the analysts' presentations. The red line represented the futures market [NYMEX]. He conveyed his interest in the amount of difference between the analysts' predictions and the futures market. The green line represented the EIA's estimate of oil prices. He noted the large jump in their forecast. He explained that they had a dated long-term forecast and issued short-term forecasts underneath. In order for DOR to get a long-term EIA

forecast and present it to the legislature, the department had to marry the two. The steep curve was the jump between their more current short-term forecast and their longer-term forecast. The department expected EIA to update their long-term forecast in February. By the time DOR returned in the spring, it would have the benefit of EIA's long-term forecast. He pointed to the dotted black line. The state's forecast was in the range between the EIA forecast and the analysts' forecast - slightly below the futures market.

Commissioner Fisher continued to slide 12: "PRICE FORECAST: Brent Forecasts Comparison to DOR ANS Forecast: January 2018 (current)." The slide depicted the current market. He noted that the analysts, EIA, and the futures market had moved higher. The state had not because it had not updated its forecast. He mentioned the interesting fact that on a long-term basis the forecast and the market tended to forecast pricing around \$60. The futures market was materially below that. The department's forecast long-term in real dollars assumed that the pricing would stabilize around \$60 per barrel. The department thought it was fairly consistent with other analysts in the prediction. He noted that the good news was the department had been conservative in its pricing. It would be revised when the department produced its spring forecast.

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Representative Grenn asked Commissioner Fisher to comment on the benefits of the state doing its own forecasts rather than contracting the task out to someone else.

Commissioner Fisher thought Representative Grenn had a great question. The department was having a debate internally on the same issue. The department was asking if there was a better way of forecasting. He conveyed that when the department did the forecast, it did not do it in a vacuum. The department tried to bring in other parties. He explained that the department had an all-day forecasting session in the fall. State agency people and other third-party experts were brought in to gather information and develop a forecast. Historically, the department felt that its approach had been appropriate and served the state well. The department was looking at the best way to complete the forecasting process.

Co-Chair Seaton asked the commissioner to return to slide 10. He indicated that in previous presentations P10 had been the high price. On the slide the P10 appeared to be the low price and a 90 percent probability of having the higher price. He asked if there was a mistake on the graph.

Commissioner Fisher thought there was a difference between how DNR and DOR conveyed the information. The Department of Revenue's belief was that it had a 90 percent confidence that the price would be a certain amount or less. He asked Mr. Stickel to comment.

DAN STICKEL, CHIEF ECONOMIST, ECONOMIC RESEARCH GROUP, TAX DIVISION, DEPARTMENT OF REVENUE, responded that in typical statistical analysis the P10 was the low end of the range and the P 90 was the high end of the range. The oil industry tended to do things differently. He continued that when looking at a production estimate from an oil company, they looked at the low end of the range as being the P90, which was a 90 percent chance of occurring. The department had used the traditional statistical P10 and P90 versus the oil industry P10 and P90.

Co-Chair Seaton asked the department to identify the P10 and P90 items accordingly on future slides. Mr. Stickel responded affirmatively and apologized for any confusion.

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Vice-Chair Gara commented that predictions were nice, however, he wondered if the department would advise the legislature to be cautious about price predictions in devising a fiscal plan. He suggested that they were almost always wrong. No one was at fault.

Commissioner Fisher thought the department shared Vice-Chair Gara's sense that it was more important to be cautious and conservative. He indicated the department had received feedback from Wall Street analysts that they appreciated the state had historically had a conservative view on pricing. He thought the department had tried to be fair and in the range without chasing a high price. He added that he cautioned people to assume the current pricing regime would remain over the long-term. For example, on slide 12, it suggested that most analysts believed pricing would be in the range of \$60 per barrel - a little higher than the state, but not by much. He read

earlier in the day EIA had issued their expectation that for FY 19 oil would be \$60 per barrel and for FY 20 it would be \$61 per barrel. He agreed with the legislator that the forecasts would never be completely accurate. However, he hoped it would be close enough that the forecast would help in drafting a meaningful budget the legislature could rely upon.

Mr. Stickel turned to the chart on slide 14: "COST FORECAST: North Slope Capital Lease Expenditures." He explained that when the State of Alaska did its revenue forecasting the department looked at three different types of costs. It looked at transportation costs which were deducted in determining the gross value of oil for production tax and royalty. The department looked at lease expenditures, the direct operating and capital expenditures incurred in exploring and producing oil. The first chart looked at what was happening with capital expenditures on the North Slope. As a response to lower prices over the past few years, the state had seen a substantial decrease in company spending. Capital expenditures on the North Slope were currently below \$2 billion in FY 17 and FY 18.

Mr. Stickel continued to explain that the chart compared the current fall forecast, represented in blue, and the current spring forecast, represented in orange. He noted seeing that capital expenditures had been cut for the following couple of years compared to the previous forecast. However, he pointed to the bump in FY 20 and FY 21 and beyond. It represented the new fields that had been added to the forecast beginning with the fall forecast. He listed a number of the new developments including Pikka and Smith Bay.

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Co-Chair Seaton asked if Point Thompson and the Alaska Liquefied Natural Gas (AKLNG) Project were included in the forecast. Mr. Stickel responded that Point Thompson for the current development was in the forecast. He relayed that DNR had a risked partial inclusion of an expansion to Point Thompson. No expenditures for AKLNG were included in the forecast. He elaborated that presently the entire revenue forecast was based on oil only.

Representative Wilson asked if 2017 numbers were forecasted or actual numbers. Mr. Stickel responded that the Fall 2017

numbers in the chart reflected the actuals compared to what the Spring 2017 forecast was.

Representative Wilson asked why more activity was reflected in the fall and then switched to the spring. Mr. Stickel responded that the spring 2017 line represented the spring forecast for each fiscal year. For example, when the department issued the spring 2017 the previous April, it anticipated \$2.5 billion of North Slope capital expenditures in FY 18. It was based on information the department received from the operators as well as public information. When the department issued the fall revenue forecast for FY 18, it projected \$1.8 billion for capital spending for the entire FY 18.

Representative Wilson did not understand Mr. Stickel's response. She asked for further clarification. Commissioner Fisher clarified that the numbers represented annual periods. The blue line going above the orange line reflected the department's prediction of additional investment in the new fields. The investment was partly driven by the a rebound in oil pricing. In the out years of 2021 the department was expecting that oil companies were going to invest more than the department had predicted in the Spring of FY 17. The department was updating its forecast of oil company spending because of changes in market conditions.

Representative Wilson wanted to make sure she was not adding the two figures together. Commissioner Fisher responded, "No."

Co-Chair Seaton recommended having bars representing the years, so it would not appear that spending was changing from the start of the year to the end of the year. He recommended a series of bars. He did not believe the department was representing a change of expenditures during the year. He asked if he was correct. Commissioner Fisher responded affirmatively.

Representative Guttenberg asked about the derivation of the expenditure projections. He wondered if they originated from DNR's production plan or other sources. Mr. Stickel responded that the answers were all of the above. The primary source of the department's expenditure estimates was based on a return submitted by each operator. They submitted a 5-year outlook for operating and capital costs

for each of their units that became the main basis of the department's expenditure forecast. The department also looked at company presentations and news articles. The department applied a risk factor to associated costs for some of the new units. The main source of information came directly from the operators.

Representative Guttenberg asked how accurate the department was in its predictions, as the legislature used it to build the state budget. He remarked that \$2 billion was a significant expenditure to the state.

Mr. Stickel admitted that cost forecasting was challenging for two main reasons. First, similar to production forecasting, there was the question of what the companies would actually do. The state experienced a few years where companies did a little bit less than they thought they would. The state had experienced other years where companies had figure out how to do a little bit more. The other piece was the overall cost of doing business. There had been several years of fairly extreme cost inflation. In the past couple of years, there had been cost deflation where the companies had been very aggressive in reducing their costs to make operations in Alaska work at lower price levels. Representative Guttenberg made a comment about inaccuracy.

Co-Chair Seaton asked if gross costs were reflected in the cost forecasts. It did not account for tax credits or writing off expenditures against a 35 percent production tax.

Mr. Stickel responded, "Yes."

Co-Chair Seaton asked how much of the increase reflected in the blue line would be associated with the Point Thompson expansion. Mr. Stickel replied that the Point Thompson expansion would be a relatively small contribution to the increase in the chart. He thought some of the newer developments were more significant.

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Mr. Stickel moved to slide 15: "COST FORECAST: North Slope Operating Lease Expenditures." He remarked that the chart was similar to the last chart. It looked at operating expenditures as opposed to capital expenditures. He pointed

out that relative to the spring forecast, there had been an across-the-board downward shift in expected operating expenditures, even with the higher levels of production. He continued that the chart represented the efforts of companies to reduce the cost structure in Alaska. It was the case through 2021. In 2022 and 2023, the department had increased the overall operating cost estimate versus the previous forecast. It represented the new fields coming online. Two dynamics existed, a reduction in the cost of existing fields and additional costs anticipated for some of the new fields that were added to the forecast.

Co-Chair Seaton asked Mr. Stickel to elaborate about the note at the bottom of the slide. Mr. Stickel indicated that the note said that the estimates included lease expenditures by companies that were not expected to have a tax liability. The department included the note for clarity. Sometimes the department published numbers for spending that represented only costs that actually got deducted from a tax calculation, which would be lower than what was shown on the slide. He continued that what was shown on the chart was all companies regardless of whether they were making enough money to owe tax or whether they were an explorer without a tax liability.

Mr. Stickel advanced to slide 16: "COST FORECAST: North Slope Transportation Costs." He relayed that the slide reflected the third type of cost, transportation costs. The largest piece for transportations costs to get North Slope oil to market was the cost of the Trans Alaska Pipeline including feeder pipeline costs and marine costs. In the spring forecast DOR was forecasting a dramatic increase in transportation costs from a little over \$9 per barrel up to over \$14 per barrel over the 10-year time horizon. Currently, in the fall forecast the department was expecting a much more gradual increase in transportation costs. The slide reflected the impact of higher production in the Trans Alaska Pipeline. There was a roughly similar cost in maintaining the pipeline infrastructure which was divided by a larger number of barrels. Therefore, the per barrel cost of transportation came down, which was a benefit to royalty and production tax.

Representative Guttenberg asked how much of the amount was calculated using the settlement agreement the state had with producers over tariffs. Mr. Stickel responded that if the representative referring to the recently announced

settlement in the past month, the transportation costs were calculated prior to announcing that settlement.

Representative Guttenberg asked what the chart would look like post the settlements. Mr. Stickel would have to get back to the committee with an estimate.

Mr. Stickel moved to the next piece, tax credits. The legislature acted over the past couple of sessions to phase out the programs for tax credits that could be funded by the state in cash. However, DOR anticipated that by the end of FY 18 there would still be approximately \$2 billion in tax credits outstanding. The revenue forecast assumed that \$100 million of the credits would be transferred to the major producers to offset tax liability, which still left \$900 million of outstanding tax credits eligible for state purchase going into FY 19.

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Mr. Stickel reviewed slide 18: "Illustration of Tax and Credit Calculations: FY 2019 production tax illustration - Spring 2017." He relayed that in AS 43.55.028 regarding production tax there was a statutory formula that provided guidance about what the appropriation might be to help fund some of the credits. The department included two slides. The current slide, slide 18, was the Spring 2017 forecast estimate of the statutory appropriation. Slide 13 reflected the current calculation. He continued that when the department issued the spring forecast, the state had about \$8.4 billion in market value for North Slope oil minus transportation costs and lease expenditures. The resulting production tax value would be \$1.4 billion, of which the tax would be about \$490 million. The statutory guidance, when Alaska North Slope prices were \$60 or higher provided that the appropriation was 10 percent of the revenue collected under the production tax statutes. Under the spring forecast, the statutory appropriation would be about \$49 million.

Mr. Stickel discussed slide 19: " Illustration of Tax and Credit Calculations: FY 2019 production tax illustration - Final Fall 2017." The slide reflected the current calculation. Relative to the previous forecast, the price forecast came down slightly but was offset by the increased production forecast. Also, the lease expenditures were lower in the revised forecast versus the spring forecast.

The net result was that the production tax value on the slope was expected to be about \$3.5 billion for FY 19 giving a 35 percent net tax of between \$1.2 and \$1.3 billion. The statutory appropriation language stated that when the Alaska North Slope (ANS) price forecast was less than \$60, the state took 15 percent of the tax levied resulting in an appropriation of about \$190 million. There was some Cook Inlet production that was added to the calculation that brought the official forecast up to \$206 million. He mentioned that when the department did the 35 percent tax calculation, it looked at the tax before the application of credits. In other words, when adjusting for the per barrel and the minimum tax, a resulting lower number was paid. The two slides helped explain where the statutory appropriation number came from and why it was higher than in the previous forecast.

Co-Chair Seaton noted there were 2 different interpretations of the statute. The only legislative history that he had found was introduced by Governor Parnell. The governor specified that the amount received by the state would be available. Since the state did not receive the amount, the calculation would be after tax credits, not before. He asked Mr. Stickel if he was aware of any statutory or legislative history that lead DOR to select a pre-tax liability instead of the actual amount received by the state in production tax.

Commissioner Fisher thought the department heard a question about the appropriate interpretation of the statute. The department believed that the structure of the statute, the way it was written and the way the department applied it, was correct. The department also believed that there was a history to refer to. There had been legislative debates on the topic that assumed that it would be applied to the gross number. The governor's budget assumed the gross number, and the department used the gross for the past couple of years publishing the numbers in the Revenue Sources Book. He did not think the wrong thing should be continued just because of doing the wrong thing in the past. However, he felt that if the state was going to take a position, it was important to maintain consistency, especially when the state articulated its position. He added that the department determined that its statutory interpretation was appropriate after walking through the structure of the statute, the way the sections referred to each other, and the 15 percent gross tax.

Co-Chair Seaton thought there would be debate on the issue.

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Vice-Chair Gara asked if the department was expecting \$320 million in production taxes for FY 19. Mr. Stickel responded that the slide was an illustration of the tax calculation and was not precisely the forecast, but a rough estimate.

Vice-Chair Gara remarked that there was no 35 percent tax. He argued that at \$160 per barrel it was 35 percent of profits, but below \$160 per barrel it was a smaller percentage of profits. He was frustrated with the 35 percent listed because it did not exist.

Mr. Stickel moved to slide 20: "FY 2019 Statutory Credit Appropriation." He indicated that in applying the interpretation of the statute that the department had been using and published, the slide looked at the key changes from spring to fall. The production forecast increased significantly, with 29 million more taxable barrels in the FY 19 forecast which added about \$1 billion to the gross value. The cost forecast decrease, companies cutting back in response to lower prices, added about \$1.1 billion to the production tax value. There was about \$2.1 billion more profit on the North Slope. If the profit was multiplied by the statutory tax rate of 35 percent, it would provide an additional \$750 million in taxes and would be before the application of the per barrel tax credit Representative Gara mentioned.

Mr. Stickel continued to elaborate that the department also had a different statutory appropriation multiplier. The guidance language in statute allowed for 15 percent of the tax before credits when the price forecast was less than \$60 per barrel for the credit appropriation and 10 percent when the price forecast was \$60 or higher. In the spring forecast the department forecasted \$60 per barrel for FY 19, and the current forecast was \$57 per barrel. The multiplier went from 10 percent to 15 percent. The combination of higher production, lower costs, and the different multiplier resulted in a significantly higher calculation for the statutory credit appropriation.

Mr. Stickel advanced to slide 21: "CREDITS FORECAST: Outstanding Tax Credit Obligations." He commented that the chart was interesting because it showed the credits that had been repurchased by the state each year represented by the grey bars. He reported that the 2017 and 2018 credits had been purchased and reflected actual numbers. The grey bars from 2019 on reflected projections based on the statutory appropriation just discussed. The blue bars represented the ending balance of outstanding tax credits available for purchase at the end of the fiscal year. He relayed that for FY 18 the state repurchased \$78 million tax credits. At the end of FY 18 the state would have a little over \$700 million outstanding. He estimated that for FY 19 the statutory appropriation would be over \$206 million. There were some credits that would become payable in FY 19. Assuming the statutory appropriation, there would be a little over \$600 million outstanding at the end of FY 19. As the department proceeded in the following years, if the statutory appropriation was made according to the calculation, the state would exhaust all of the outstanding tax credits by the end of FY 24.

Representative Ortiz thought a previous slide had shown an outstanding tax credit amount of \$1 billion, yet the slide indicated \$700 million. He asked Mr. Stickel for clarification. Mr. Stickel responded that the \$1 billion represented the department's estimate of the entire future liability of the outstanding tax credits. The forecast assumed that \$100 million of the credits would be transferred to the major producers and applied against liabilities which would leave about \$900 million of credits eligible for state purchase. He continued that \$700 million of the \$900 million would be available at the end of FY 18. In FY 19 and FY 20 the remaining \$200 million would trickle in.

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Co-Chair Seaton asked to return to the example on slide 19 looking at the "Total" column. He wondered whether the state would still owe \$190 million to companies, even if the state did not have a 4 percent minimum gross tax and did not receive any tax payments. Mr. Stickel replied that Co-Chair Seaton was correct for production tax. If there was no minimum tax per barrel credits at \$57 per barrel, the production tax liability would be wiped out. The state

would still receive corporate tax, property tax, and royalties.

Co-Chair Seaton asked for verification that there would be zero production tax the state would receive without a minimum gross tax. The state would owe \$190 million to oil companies under the scenario on slide 19. Mr. Stickel replied in the affirmative.

Vice-Chair Gara asked, based on the forecast of production tax revenue for the state in FY 19 and the forecast of the statutory payments due for prior tax credits, what the net would be to the state. Mr. Stickel responded that for FY 18 the department was forecasting a \$206 million statutory appropriation. The department's official forecast for production tax for FY 19 was \$339 million. There was a difference of about \$130 million. Commissioner Fisher indicated he would be reviewing the last section of the presentation which covered the changes from prior revenue forecasts. The last slide gave an overall comparison. He would talk about some of the components and conclude with the comparison.

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Commissioner Fisher turned to slide 23: "FORECAST CHANGE: Production Tax Revenue." The slide listed some of the changes that occurred from prior forecasts. The department's oil price forecast declined slightly compared to the spring forecast. In the spring, for FY 19, the department thought the price of oil would be \$60 per barrel and in the most current forecast the department estimated the price would be \$57 per barrel. The production would stabilize rather than declining as the department had previously anticipated. In addition, the production tax revenue forecast in the current presentation compared to the preliminary fall forecast was greater by about \$173 million. He explained that between the preliminary fall forecast and presently, the department increased its expectation of the price per barrel and received a larger-than-expected number of tax payments. The department had talked about lease expenditures and how they were expected to fluctuate as a result of new production coming in as well as company costs.

Commissioner Fisher relayed that finally, underlying all of the information, the department had proposed a structure to

repurchase the oil tax credits in a way thought to be fair to everyone. It was cost neutral, meaning that the cost of the financing would be borne by the companies because of a discount to the credits. He thought the last bullet point on the slide about the instability and uncertainty was the most important issue to address. Oil companies and financial investors had frequently voiced their concerns to the department about the need to address the issue.

Representative Ortiz referred to the bullet point that stated that the FY 18 production tax revenue forecast increased from the preliminary fall forecast by \$173 million. He wondered if it was safe to say that in order for the state to meet its obligations for the FY 18 budget, the state would have \$173 million more dollars to put towards its obligations. Therefore, there would be \$173 million less of a draw on other sources of money.

Commissioner Fisher jumped forward to the final slide, slide 31: "WRAP-UP: Changes to 10-Year Unrestricted Revenue Outlook." He drew attention to the middle set of columns which reflected the final fall forecast. For FY 18 the unrestricted revenue was \$2.082 billion, which represented all sources for FY 18. The prior slide Representative Ortiz was reviewing showed only production taxes. The department was predicting that the state would have \$248 million more in undesignated general fund (UGF) revenue which would be \$248 million less than the state would have to draw from other sources.

Representative Ortiz suggested the constitutional budget reserve (CBR) or another account. Commissioner Fisher responded affirmatively.

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Representative Guttenberg thought the last bullet on slide 23 was something to be concerned about. He recalled a presentation he had heard in a December House Resources Committee meeting on the AKLNG project. He noted a comment made by Mr. Myers about the Chinese outlook on investing in Alaska. He had a completely different focus than the Chinese on the perspective in the bullet point. He had asked Mr. Myers to elaborate. Representative Guttenberg had a written statement from Mr. Myer which indicated that the Chinese appreciated the stability of Alaska's tax regime and its certainty. It was a factor why the Chinese were

looking to Alaska in a positive way. He thought the overall picture of Alaska's investment climate was attractive. He provided some examples of instability around the globe.

Commissioner Fisher thought Representative Guttenberg made a fair point. However, he wanted to provide a slightly different perspective. He spoke of a conversation with a bank earlier in the day. The bank had lent to Alaska under a set of assumptions about the way the oil tax credits would be treated. The banker had approached his credit committee making certain representations about Alaska. He stated that he would presently be uncomfortable going back to the same credit committee in the current environment to try to get a future loan approved for a business, whether in the oil and gas industry or another because of questions he anticipated he would receive about the topic. He also offered that he had received a call recently about investing in Venezuela, which he absolutely had no interest in doing. He did not disagree with Representative Guttenberg that it depended on the filter a person applied. There was no question that Alaska, as part of the United States, had tremendous benefits to its regime. However, he thought the state should be cognizant and careful about the way the state made changes because other people were relying on the statements by the state. Entities were impacted by the changes which would impact their behavior in the future.

Commissioner Fisher continued to slide 24: "FORECAST CHANGE: Comparison of Spring and Fall 2017 Forecasts for FY 2018." He would not spend a lot of time on the slide but highlighted the left slide showing changes between the final forecast and the preliminary fall forecast. On the righthand side it showed the changes between the final fall forecast and the spring forecast. He noted the different categories: prices, production, lease expenditures, transportation costs, and revenue. He indicated the slide reflected petroleum revenue and numbers for FY 18.

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Commissioner Fisher discussed slide 25: "FORECAST CHANGE: Comparison of Spring and Fall 2017 Forecasts for FY 2019." The slide reflected numbers for FY 19. There were similar changes between oil prices, production, and other various aspects.

Commissioner Fisher scrolled to slide 26: "GFUR Relative to Price per Barrel, FY 2019." The slide helped viewers to better understand that changes in oil price impacted predictions around general fund revenue. He pointed out that the curve was not flat. As companies hit a break point in which they began to pay above the minimum tax, the value of each additional dollar that the state received changed. In the \$50 to \$60 range it would be somewhere between \$30 million to 40 million. When above \$65, it became closer to \$70 million of additional revenue for the state for each dollar per barrel. The chart was available for people to refer to with questions.

Representative Wilson returned to slide 25. She asked about the \$1.4 billion number listed under the final fall forecast. She wondered if the money was comprised of all monies that came in because of oil. Commissioner Fisher responded that it was UGF petroleum revenue.

Representative Wilson asked if the only portion that would not be included would be what the committee put away to pay for oil tax credits. She asked if there were other pots of money to be deposited. Commissioner Fisher answered that the slide did not include the royalties deposited into the Permanent Fund. He asked Mr. Stickel to comment on items that would not be included.

Mr. Stickel responded that the restricted petroleum revenues not included would be the portion of royalties that went to the Permanent Fund, the .5 percent of royalties that went to the school fund (both were mandated by the constitution), any deposits to the CBR fund that were made for settlements or termination of litigation, and any payments to the federal government for the national sharing of royalties in the National Petroleum Reserve Alaska (NPR).

Vice-Chair Gara remarked that the state did not keep most of the property, the state gave most of it to municipalities. He wondered if property tax that the state did not end up keeping was reflected in the \$1.4 billion figure. Mr. Stickel answered that the \$1.4 billion included the state's share of property tax which was a little over \$100 million. The department allowed a credit for municipal taxes paid but did not actually share the money directly with them. The total property tax amount was about \$500 million. The state kept a little over \$100 million.

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Vice-Chair Gara asked if approximately \$1.2 billion of \$1.4 billion reflected the amount of royalties in the figures. Mr. Stickel encouraged members to refer to page 26 of the Revenue Sources Book for Fall 2017 [slide 25 was on the screen]. It contained the detail for the \$1.4 billion figure.

Co-Chair Seaton asked about the property tax figure. He wondered what was included in the figure. Mr. Stickel responded that the fall forecast, looking at FY 19, showed \$110.8 million in state property tax. The department's estimate of the gross tax statewide for oil and gas property was \$567 million in FY 17. He furthered that of the \$567 million, \$443 million went to municipalities. The department allowed the municipal payment as a credit against the state tax. The state's net state tax was a little over \$120 million.

Co-Chair Seaton suggested that only the net amount was shown in the unrestricted petroleum revenue on the bottom line of the slide. Mr. Stickel replied, "Correct."

Representative Guttenberg asked what the figure would look like post settlement. He asked Mr. Stickel to get back with him with the figures. Mr. Stickel confirmed he would provide the information. Commissioner Fisher relayed he would try to flag the total revenue forecast that included other revenue beyond that of oil in the last few slides.

Commissioner Fisher continued to slide 28: "REVENUE FORECAST: 2017 to 2019 Totals." The slide indicated the department was forecasting that the total unrestricted revenue would increase from \$1.35 billion in FY 17 to just over \$2 billion. The amount would stay relatively constant in FY 19. The total state revenue appeared to be declining. Most of the decline was associated with investment revenue. The state had a great year in FY 18, and the forecast presumed a more traditional assumption on investment income.

Co-Chair Seaton asked about the 6.95 percentage. He thought in meant that the department had not adopted the same actuarial return of 6.5 percent that the Permanent Fund

had. Commissioner Fisher responded in the negative. The forecast was based on 6.95 percent.

Commissioner Fisher moved to slide 29: "REVENUE FORECAST: 2017 to 2019 Unrestricted Petroleum Revenue." The slide provided additional information relating to petroleum corporate income tax as well as royalties, rents, and other categories in historical detail.

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Commissioner Fisher scrolled to slide 30: "REVENUE FORECAST: 2017 to 2019 Unrestricted Non-Petroleum Revenue." The slide showed the non-petroleum revenue and provided additional detail.

Co-Chair Seaton returned to slide 29. He referred to the petroleum corporate income tax for FY 17 in the history column. He wondered about the -\$59.4 million figure. Mr. Stickel responded that as a result of the decrease in oil price a few years prior, the state had some significantly large refunds. There was a provision in the tax code that allowed companies to carry back a loss to prior years. The combination of those two things resulted in net refunds paid out for petroleum corporate tax for FY 16 and FY 17. So far, payments were positive for FY 18. He noted that with the recovery in price the department expected a return to positive payments in FY 18 and beyond.

Co-Chair Seaton asked for clarification around the terms refund and positive payment. Mr. Stickel replied that every year the department received payments from companies and paid out some amount of refunds. The amount was for refunds for overpayments in a prior year similar to how an individual would receive a refund on their federal income tax. It just so happened that in FY 16 and FY 17 the refunds exceeded the current year payments. Companies that saw a loss in the current year with low oil prices were able to carry back a portion of the loss to claim a refund for prior years. In the long version of the presentation or a follow-up the department had a chart that broke out the information which he could provide to the committee.

Commissioner Fisher again looked at slide 31 which provided a long-term view. He highlighted that the total UGF for FY 18 was predicted to be just under \$2.1 billion, remaining relatively flat for a few years, and growing in

the out years. In particular, compared to the spring forecast, FY 18 was about \$250 million more, and FY 19 was about \$127 million more. There was meaningfully more expectation of revenue in the coming years. He concluded his presentation and was available for questions.

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Vice-Chair Gara thought the state was expected to receive about \$173 million more in production tax revenue than was forecasted earlier. The state had also been sticking to the statutory formula for paying out tax credits. He asked whether the amount going out was adjusted with the change in prices or production. In other words, when it turned out the state expected to get \$173 million more in production tax revenue, he wondered if there was a higher payout for the statutory credits payment. Commissioner Fisher responded in the affirmative. He suggested it was worth returning to slide 19.

Vice-Chair Gara asked if the net was \$173 million if the state stuck with the statutory tax credit. Commissioner Fisher thought Representative Gara was correct. He would get back to the committee to provide a precise answer.

Co-Chair Seaton asked about the total tax per barrel on slide 19. He suggested that at \$57 per barrel under the current profit tax regime there would be zero tax paid. The gross minimum tax of 4 percent was less than \$2 per barrel, \$1.89 per barrel, which would be the amount the state would receive per barrel. He wondered if he was accurate. Commissioner Fisher replied, "That's correct."

Representative Wilson asked about the royalty amount per barrel. Commissioner Fisher answered that it varied by field. He encouraged Mr. Stickel to respond further. Mr. Stickel replied that the average royalty on the North Slope was about 12 percent. Most of the legacy leases were at the 12.5 percent rate. There were some that were higher and some that were lower.

Co-Chair Seaton asked if it was based on the production tax value. Mr. Stickel responded that the royalty was based on the gross value. The royalty would be roughly based on the \$47.14 number. At current price levels, royalty was the largest component of the state's oil revenue.

Representative Grenn referred to Representative Gara's question regarding a production tax increase. He referred to slide 23 and the increase of \$173 million in the forecast. He asked if the number represented the difference between the spring forecast and the fall forecast. Mr. Stickel answered that the \$173 million was the difference between the preliminary fall forecast and the final fall forecast for FY 18.

Representative Grenn asked for the difference in the increase of production tax credits now due from the preliminary forecast to the final forecast. Commissioner Fisher stated that it was only a few million, a small increase.

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

Representative Wilson noted the committee would be starting to review departments. She asked if there was a deadline for information to be posted on Basis. She wondered if it was 24 hours prior to a hearing or an hour before a hearing. She thought it would be nice to know when to start looking for presentations for the following day in order to be better prepared. Co-Chair Seaton responded that they were published currently.

Representative Wilson asked if there was a standard set for agencies to provide presentation information. Co-Chair Seaton would discuss the issue with the agencies.

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Co-Chair Seaton detailed that his office had requested that the agencies provide his office with the information at noon the day prior to their presentations. An email would be sent out when the items were available online.

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ADJOURNMENT

The meeting was adjourned at 3:01 p.m.