

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

April 7, 2018

2:03 p.m.

MEMBERS PRESENT

Representative Andy Josephson, Co-Chair
Representative Geran Tarr, Co-Chair
Representative John Lincoln, Vice Chair
Representative Justin Parish
Representative David Talerico

MEMBERS ABSENT

Representative Harriet Drummond
Representative Chris Birch
Representative DeLena Johnson
Representative George Rauscher
Representative Mike Chenault (alternate)
Representative Chris Tuck (alternate)

COMMITTEE CALENDAR

HOUSE BILL NO. 331

"An Act establishing the Alaska Tax Credit Certificate Bond Corporation; relating to purchases of tax credit certificates; relating to overriding royalty interest agreements; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 331

SHORT TITLE: TAX CREDIT CERT. BOND CORP; ROYALTIES

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

| | | |
|----------|-----|---------------------------------|
| 02/07/18 | (H) | READ THE FIRST TIME - REFERRALS |
| 02/07/18 | (H) | RES, FIN |
| 03/30/18 | (H) | RES AT 1:00 PM BARNES 124 |
| 03/30/18 | (H) | Heard & Held |
| 03/30/18 | (H) | MINUTE(RES) |
| 04/04/18 | (H) | RES AT 1:00 PM BARNES 124 |
| 04/04/18 | (H) | Heard & Held |
| 04/04/18 | (H) | MINUTE(RES) |
| 04/06/18 | (H) | RES AT 1:00 PM BARNES 124 |

04/06/18 (H) Heard & Held
04/06/18 (H) MINUTE (RES)
04/07/18 (H) RES AT 2:00 PM BARNES 124

WITNESS REGISTER

KEN ALPER, Director
Tax Division
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Provided a PowerPoint presentation entitled, "State of Alaska Department of Revenue HB 331: Oil & Gas Tax Credit Bond Proposal," dated 3/30/18, and answered questions.

MIKE BARNHILL, Deputy Commissioner
Office of the Commissioner
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Answered questions during the hearing of HB 331.

DEVEN MITCHELL, Executive Director
Alaska Municipal Bond Bank Authority
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Answered questions during the hearing of HB 331.

ACTION NARRATIVE

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CO-CHAIR GERAN TARR, following a recess from 4/6/18, called the House Resources Standing Committee meeting back to order at 2:03 p.m. Representatives Tarr, Parish, Talerico, and Lincoln were present at the call back to order. Representative Josephson arrived as the meeting was in progress.

HB 331-TAX CREDIT CERT. BOND CORP; ROYALTIES

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CO-CHAIR TARR announced that the only order of business would be HOUSE BILL NO. 331, "An Act establishing the Alaska Tax Credit Certificate Bond Corporation; relating to purchases of tax

credit certificates; relating to overriding royalty interest agreements; and providing for an effective date."

REPRESENTATIVE PARISH directed attention to slide 14 and asked whether the information provided on the slide would be determined by future directors of the [Tax Credit Certificate Bond Corporation, the commissioners of DOR, the Department of Commerce, Community & Economic Development, and the Department of Administration].

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KEN ALPER, Director, Tax Division, Department of Revenue (DOR), explained the structure of the bonds related to the timing of the interest and principal payment, does not bear on the calculation of the buyout, thus all of the math used to determine what a credit holder would receive from the state does not matter because the lump sum would be financed. However, the variable on slide 14 is the term length of the payback; for example, five years to ten years does not affect the initial amount of the principal. He confirmed the [three commissioners who are the directors of the] proposed bond [corporation] would determine the best way to structure [the payment schedule].

REPRESENTATIVE PARISH surmised the state would delegate to the [directors] the authority to - from a general obligation (GO) fund - [make payments] of between approximately \$13 million and approximately \$130 million, and "therefore bind our hands ... relative to the amount of the loan that we wish to repay at any given time

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MIKE BARNHILL, Deputy Commissioner, Office of the Commissioner, DOR, pointed out [HB 331] does not fall into "the general obligation context."

REPRESENTATIVE PARISH directed attention to the aggregate payments from the general fund (GF), shown on slide 14, which range from \$12.9 million in [fiscal year 2031 (FY 31)] to close to \$130 million in FY 23-FY 28. He questioned the large variance in the state's debt obligation between FY 23 and FY 31 and asked, "Is it usual for the state to delegate that degree of authority?"

MR. BARNHILL explained the four cohorts shown on slide 14 represent separate bond issuances that would address tax credit

certificates as they are submitted for payment. The totals for cohorts 2, 3, and 4 are relatively small compared to cohort 1, which would be a large bond issued [in 2018]. In fact, cohort 4 [\$12.91 million in FY 31] would pay the last tax credits. Because cohorts 2, 3, and 4 are relatively small, the payment schedules are structured with balloon financing: interest only payments until at the end of ten years a balloon payment of the principal amount becomes due. Mr. Barnhill said balloon financing is a standard approach that is utilized because it is anticipated the state cashflow would maintain a static percentage to unrestricted general funds, and to maintain parity, balloon financing is the most prudent. He was unsure how often balloon financing is utilized in state obligations and deferred to the state's debt manager.

REPRESENTATIVE PARISH clarified his question was how often the [legislature] has delegated to a board the authority to obligate future legislatures.

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MR. BARNHILL said there are multiple authorizations in statute to issue bonds such as the State Bond Committee, Treasury Division, DOR, the Alaska Housing Finance Corporation, and the Alaska Pension Bond Obligation Corporation, each of which have discretion to set the terms of the bonds. He said he was unaware of any large issuance by the state that was structured with a balloon payment after a long term. Further [the cohort 4] bond issuance is "not a large bond issuance, it's a bond issuance for something less than \$15 million." In further response to Representative Parish, he confirmed the cohort 3 bond issuance, with a \$70 million balloon payment, is also not a large bond issuance.

MR. ALPER further explained cohort 1 is the bond issuance to pay \$807 million of known and current tax credits; payment of the subsequent cohorts was modeled by DOR in multiple ways in order to establish the present value to the state, when compared to the existing statutory payment schedule, and [the proposed bond program] is a moneymaker for the state. Furthermore, he cautioned bond committees can ask for certain terms, but in a free market transaction, terms must be attractive to buyers.

CO-CHAIR TARR asked Representative Parish if the bill needs additional prescriptive language related to the activities of the proposed bond corporation.

REPRESENTATIVE PARISH opined it is up to the committee to decide how much latitude to grant the bond corporation, related to issuing bonds for an amount near \$1 billion, and urged for further restrictions on incurring state debt.

CO-CHAIR TARR inquired as to why three department commissioners would comprise the board of directors of the proposed bond corporation, which differs from the boards of other state corporations.

MR. BARNHILL stated the language of HB 331, Section 2, is based on statutes creating the Alaska Pension Obligation Bond Corporation and authorizing the State Bond Committee to issue debt. By drafting the bill in this manner, DOR's intention was to demonstrate that the structure within HB 331 has previously been enacted into law.

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DEVEN MITCHELL, Executive Director, Alaska Municipal Bond Bank Authority, DOR, said the structures of both the board of the Alaska Pension Obligation Bond Corporation and the proposed Tax Credit Certificate Bond Corporation are designed to administer bonds issued for the sole purpose of paying a debt related to a state activity; the state is the obligor, thus at-large members are not necessary as they are for a board such as the board of directors of the Alaska Housing Finance Corporation.

REPRESENTATIVE PARISH questioned why the Alaska Pension Obligation Bond Corporation failed to issue bonds.

MR. MITCHELL recalled there were legislative concerns about the transaction. Although all the aspects of the transaction were completed, "a decision was made that due to legislative concerns about the transaction, that we should hold off." In further response to Representative Parish, Mr. Mitchell explained the Senate Finance Committee sent a letter to the governor about its concerns in this matter, which raised the issue with the underwriting community, and the governor canceled the transaction [in the fall of 2016].

MR. ALPER stated the [legislation creating the Alaska Pension Obligation Bond Corporation] differs from that of [HB 331] because [issuance of the] pension obligation bonds was intended to address the unfunded pension liability, and he provided details.

REPRESENTATIVE PARISH said it is "a little bit odd to borrow money to get out of debt"

MR. MITCHELL, in further response to Representative Parish, said he did could not summarize the concerns within the letter from the Senate Finance Committee, however, the letter is available to the public.

REPRESENTATIVE PARISH redirected his question, as to the specifics of said letter, to Mr. Barnhill and Mr. Alper.

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MR. BARNHILL noted there are philosophical differences about the merits of pension obligation bonds within the state and nationwide. He opined certain legislators regard the state's pension obligation as a "soft liability." However, nonpayment transforms debt into a "hard liability" with debt service that must be paid; in fact, nonpayment of debt service on bonds issued by a state corporation would have ramifications to the state's credit rating. Mr. Barnhill further described aspects of pension obligation bonds. He affirmed [HB 331] differs in that there is no ongoing liability, but instead creates a mechanism so the state can make payments to small oil and gas explorers who were attracted to Alaska by the offering of cashable oil and gas tax credits. The state has not fully paid the credits that have accrued, resulting in disruption to the industry, and this form of financing can provide some immediate relief. He discussed how DOR modeled alternative bond structures.

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CO-CHAIR TARR observed [HB 331] proposes a bond of approximately \$1 billion, which is much larger than the previous general obligation (GO) bond issued in 2006.

MR. BARNHILL said the size of the proposed bond issuance has been determined by the purpose of the legislation, which is to pay off accrued tax credits estimated to be \$800 million.

MR. ALPER stressed there was concern about the state's risk with pension obligation bonds because the value of the securities bought by the bond money can go down; however, the bond program proposed by HB 331 does not buy securities, but pays a fixed obligation, thus there is not a comparable risk.

REPRESENTATIVE PARISH posed the scenario in which the bill was enacted and the companies holding credits accepted the terms of the legislation: the state would still have \$184 million in outstanding tax credits, through the existing statutory program, and he asked whether the state would pay tax credits both through the statutory program and through the tax credit bond proposal.

MR. BARNHILL opined if the bill were enacted, the \$184 million in the operating budget [for the existing statutory payment program] would be reduced to the first-year debt service; in fact, the Alaska State Senate put \$184 million in the budget in order to reflect existing statute and fund [AS 43.55.028. Oil and Gas Tax Credit Fund]. He explained:

[The view of] some stakeholders of the legislature [is] that the budget should have been submitted initially, with respect to existing statute, as opposed to a proposed bill. So, the way the governor submitted the budget in December reflected debt service on a bill that had yet to be enacted. So, what the Senate has done is essentially put the budget back to existing state law and then it would change to reflect that debt service if the bill were to pass.

REPRESENTATIVE PARISH surmised a company that does not participate in the proposal would have a legitimate grievance against the state if repurchases are not made according to the schedule in statute.

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MR. ALPER acknowledged the possibility a company would not participate and would expect full access to the money available [in the existing payment program]. He stated DOR's interpretation of existing statute:

Our interpretation of the tax credit fund and how money is spent from it is we would not have to do that. ... We would look at the holder of that \$184 million credit and say, "Where would they normally have been paid, in the absence of this bill?" If their credits are further down the chain enough, they might not get anything in FY 19, if they're toward the front they might get some proportional share of the [\$184 million]. And we would intend to pay any individual that held back at the same rate, and along

the same formula, that they would have been paid had the bill not passed.

REPRESENTATIVE PARISH asked how HB 331 would facilitate the department's interpretation.

MR. ALPER stated the language mandating DOR's discretion is not explicitly in the bill; however, elsewhere in existing statute it is established that it is discretionary for DOR to purchase tax credits. He clarified:

It is our intent, and I'm happy to say it on the record, to, to not allow that sort of gaming by only making payments. We don't want anyone to be unduly helped by choosing to not participate in the program. And we would, to the best of our ability, endeavor to interpret future purchases along those lines.

REPRESENTATIVE PARISH inquired as to whether a future administration could choose a different interpretation.

MR. ALPER said yes.

REPRESENTATIVE PARISH observed implicit in HB 331 would be the legislature's expectation that the state would depart from the statutory payment schedule and reduce the allocations to a level proportionate to the number of credits [for companies] that don't participate in the program.

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MR. ALPER agreed and suggested other options could be to veto an appropriation "down to that number," or simply "not spend all of it, [and DOR] ... holding some back, perhaps to spend the next year." In further response to Representative Parish, he confirmed the third alternative would be an administrative choice.

REPRESENTATIVE PARISH posed a scenario in which one company has [\$184 million] in credits, and the state allocates \$184 million for the statutory payment, and asked whether the administration could purchase said credits for full value.

MR. ALPER said yes.

REPRESENTATIVE PARISH continued:

If that were to happen, if we followed the statutory payment schedule and had the passage of this bill removing the large majority of the credits outstanding, then in the next year we might, while the statutory payment schedule under the, the pretend tax rate of 35 percent instead of the actual, including the \$8 per barrel credit, would be enough to wipe out all credits earned next year. And credits, or the statutory payment the next year would be enough to wipe out all credits claimed that year, and so forth, so forth. So, the, the following three cohorts, if the administration decided to follow the statutory payment schedule, well, they'd have no incentive to participate, would they?

MR. ALPER said yes. If cohort 2 represents approximately \$100 million worth of credits and \$100 million is appropriated, companies may assume if they hold back, they'll be paid in full; however, he opined that would be "a profound unfairness" and a situation DOR would seek to prevent. In fact, DOR would support an amendment to subparagraph (k) that would prevent the aforementioned situation.

REPRESENTATIVE PARISH suggested companies "retain all of their, their credits but have them sign off the value of using them against their taxes and say that they're willing to give this portion to the state for a, a payment of \$1 or zero dollars even." If so, the state could justify leaving companies "in their place in line ... in determining the order at which people got repaid" Representative Parish provided an example.

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MR. ALPER cautioned negotiations in this regard would begin soon; the \$100 million expected in cohort 2 are credits that are largely tied to last year's activity on tax returns that have been filed, and the credits will be issued in July [2018]. Further, depending upon the effective date of the bill, some cohort 2 credits may be included in cohort 1 which, ideally, could eliminate cohorts 3 and 4. However, with 37 active credit holders who received pro rata shares of FY 18 funding, and others who did not, he said he was unsure whether DOR could negotiate term changes with all the parties.

REPRESENTATIVE PARISH noted the state would be negotiating term changes with all 37 credit holders if HB 331 were enacted.

MR. ALPER said yes; however, [HB 331] does not provide for negotiations, but provides a mathematical formula to determine offerings based on a party's credits.

REPRESENTATIVE PARISH posited a situation in which there were two companies that each held \$300 million in tax credits for a total value of \$600 million: company "A" agrees to participate, takes a 7 percent discount [referred to as a haircut] and accepts a payment, leaving the state with \$200 million in statutory payments; company ["B"] gets \$200 million plus \$100 million next year.

MR. ALPER restated DOR's intent that, in the aforementioned scenario, if the amount appropriated was \$200 million, each of the companies would get one-third, and the second company would also be paid \$100 million. Although not explicit in the bill, this is DOR's interpretation of "how it should be done in the name of fairness, and again, if we would like to find a way to get it locked into statute, I'm happy to try to work with you for that."

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REPRESENTATIVE TALERICO, from his interpretation of the bill, opined once the state offers a certain bond package, existing statute would allow a particular percentage of tax credits to be paid; however, if a company chooses a bond package, and its tax credit is paid, the state's tax credit liability disappears to whatever volume was paid off, and is no longer a tax credit. He gave the following example:

We'll use a billion dollars, and half a billion gets paid out in bonds, our previous liability was a billion dollars. We have a bond financing liability that we're dealing with but, that, we make that, that annual payment on, but our actual, legal definition of a tax credit liability has just been cut in half. Am I mistaken there? ... I think that, due to level of participation. There's seems to be a concern ... because we've got this statutory requirement, and say we had to put \$150 million in there, we're going to have to do that forever until all these people are paid off. My argument would actually be, no, those, those people that participate in the bond have been removed, whatever tax credit they had is removed from the tax credit liability

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CO-CHAIR TARR asked Mr. Alper to respond to Representative Talerico within the context of House Bill 111 [passed in the Thirtieth Alaska State Legislature]; she expressed her understanding [AS 43.55.028. Oil and Gas Tax Credit Fund] would exist until all of the credits were paid, and HB 331 would not repeal the statutory payment formula.

MR. ALPER stated House Bill 111 provides for a repeal of AS 43.55.028 one year after the last tax credit is claimed. Although HB 331 may or may not foreshorten that period, appropriation of the statutory formula is fully up to the will of the legislature. He remarked:

If half the credits left the field one reasonable way to approach that ... [is to] figure out the statutory appropriation and cut it in half to address the idea that half of the credits are no longer in play. ... But again, there's a lot of individual will at stake, because you're talking about budgets for legislatures that haven't been elected yet.

MR. BARNHILL added DOR has been in contact with all 37 tax credit holders and all have been provided with estimates of their tax credits under a 10 percent discount rate and an estimated 5.1 percent discount rate. In response to an informal poll, at this point no tax credit holder has declined to participate in the program, and DOR expects most, if not all, to participate, eventually. Although the final version of the bill is unknown, he said DOR seeks legislation to eliminate the state's obligation in a manner attractive to tax credit holders and tolerated by stakeholders.

CO-CHAIR TARR returned attention to slide 10 which illustrated payments to a credit holder due \$100 million in credits would be paid over four years; however, a company with certificates in the amount of \$100 million would have the expectation to be "first in, first out."

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MR. ALPER acknowledged slide 10 is a stylized and simplified model of no specific company; he gave an example of a company with \$100 million in tax credits, there are \$400 million worth of [outstanding] credits, and the state appropriates \$100 million per year for four years: under the existing statutory

formula, the company would get paid its pro rata share 25 percent per year. Instead, under the bond program, as shown on slide 14, the payment schedule would actually be a six-year plan; \$89 million, paid in FY 24, would be less than the full year's appropriation per the statutory formula, but is all the state would need given the known amount. He pointed out slide 14 assumes no credits are sold to major producers even though DOR believes \$125 million in credits will be sold to producers, and that would reduce the total outstanding to \$821 million, and other effects. Mr. Alper stressed all of the math presented is preliminary and presumptive of certain possibilities; in fact, the language of the bill allows DOR to "lock down all the numbers in the weeks and days, literally, before the actual market transaction of selling the bonds goes through."

CO-CHAIR TARR observed:

If you just take the face value of \$100 million, with a 10 percent discount, then you'd be getting \$90 million, but if you allow ... it to go in the other direction, and just apply the discount on that annual basis, as you're continuing to reduce the value, then ... it's a few million less. ... [Conversely], if I'm holding a \$100 million certificate today and I sign up for the program as it begins, because I'm holding certificates from two prior years, possibly, that haven't been paid, that I would only want you to discount ... that, but not be able to apply some delayed ... payment schedule to it because, you know, it further is going to reduce the value.

MR. BARNHILL assured the committee every company has received the pertinent information illustrated on slide 10; from his discussions with the tax credit holders, he advised the majority of companies are willing to accept a payment "that seems fair." [DOR] decided to offer a 10 percent discount rate because it is a midpoint between the state's 5 percent cost of borrowing and the average cost of capital for the companies, which is in the 15-18 percent range. Mr. Barnhill opined, "They're not wildly enthusiastic about a 10 percent discount rate, or even a 5.1 percent discount rate, but I think at the end of the day, if it's that or nothing, they'll be in."

CO-CHAIR TARR expressed her understanding if, instead of directing money in the budget plan [to pay tax credits], the state applies a discount rate and borrows, the net present value is greater.

MR. ALPER mentioned other informal ideas, such as negotiating with individual companies, and cautioned the state would still need to appropriate money; the bonding proposal is the only scenario that avoids appropriating \$200 million to \$300 million during a fiscal crisis.

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REPRESENTATIVE PARISH returned attention to slide 10 and asked whether four years would be the typical anticipated payback period.

MR. BARNHILL said three to four years.

MR. ALPER returned attention to slide 14 and explained credits with a 2016 origin date - under normal circumstances - would be paid between FY 19 and FY 20, and "the first small portion of the FY 21 money would pay off the last of them" Credits originating in 2017 would be paid for with FY 21, FY 22, and FY 23 money; FY 23 and FY 24 money would pay the remaining. He offered to provide the committee with a model to show how a company with tax credits originating in two different years would normally be paid. In further response to Representative Parish, he said he would also provide the statutory payment schedule previously reported to the House Finance Committee.

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REPRESENTATIVE PARISH stated the statutory payment schedule and the proposed payment schedules differ from "existing practice" with regard to term and rates, and the original practice was to pay full face value every year, which he opined was a mistake. He returned attention to the aforementioned hypothetical situation he posed with two companies, each of which holds \$300 million in tax credits [documentation not provided]. In the foregoing scenario, the statutory [payment] amount would be \$200 million and, if the bill were enacted, the state could pay one company for its existing credits at a 7 percent discount, and the other company could get full face value over two years. He proposed that if a company choose to participate, the state could eliminate one tranche of its payments according to "current statutory guidance." Representative Parish continued with further details of this hypothetical situation and asked Mr. Barnhill, "Do you follow?"

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MR. BARNHILL said he did not. However, DOR would be happy to discuss ideas proposed by the committee in this regard, and then present its response at a subsequent hearing. He recalled the months of work necessary to draft HB 331, which is a complex bill, and one that is guided by policy objectives.

CO-CHAIR TARR questioned whether the bill addresses DOR's concern that companies could choose from two options and thereby obtain near-term cash now, and later rely on the statutory formula, which would not pay down all the debt.

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MR. BARNHILL assured the committee the bill addresses the hypothetical related to two options because all parties who participate get paid from the \$184 million allocated in FY 19, 100 cents on the dollar; further, the bill requires all participants to include all of their credits. He restated no company has refused to participate at this point in time. Although there is no reason not to explore other options, DOR needs a full understanding of each proposal prior to responding [to proposals offered by the committee].

MR. ALPER added there are multiple aspects of the bill that intend to restrict the freedom of companies to take advantage by choosing not to participate; furthermore, DOR does not wish to discourage companies from participating. However, he restated his concern that a future administration may interpret the bill differently, and therefore, if the committee seeks to constrain participants - by directing DOR to pay a pro rata share - an amendment could be drafted to do so. The department fully supports the goal of preventing one company from getting a financial advantage over another company by not participating.

CO-CHAIR TARR suggested Representatives Parish and Talerico co-draft an amendment. She stated her reluctance to support HB 331 instead of legislation that would establish a three-year timeline, rather than ten years, and reviewed several other aspects of the bill. She said her preference would be to pay the credits off sooner, through a fiscal plan, although the bill "may be the best option."

MR. BARNHILL said if the bill were enacted the legislature would have the option to prepay the debt.

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MR. MITCHELL cautioned typical municipal bonds are issued for a standard ten-year par call; if the term is shortened to less than seven years, a penalty must be paid, and he provided details.

REPRESENTATIVE LINCOLN, regarding DOR's interpretation of the statutory payment schedule, asked how long the state has used the aforementioned interpretation to pay credits, and how firmly this precedent is established.

MR. ALPER said the formula was established in 2007 by [House Bill 2001, Alaska's Clear and Equitable Share (ACES) passed in the Twenty-Fifth Alaska State Legislature], with little indication of legislative intent; more importantly, under the ACES tax structure, there was not as much of an impact from credits used against [tax] liability and thereby reducing tax calculations. However, beginning in 2013, subsequent to passage of [Senate Bill 21, More Alaska Production Act, passed in the Twenty-Eighth Alaska State Legislature], oil and gas taxes were greatly reduced by the credits, which created "distortions," and DOR's interpretation of the language in the legislation was that the tax should be a percentage of the amount levied by [AS 43.55.011 Oil and Gas Production Tax.] Therefore, during the 2015 legislative session, following the collapse of oil prices and increasing state deficits, and in response to requests from legislators, DOR's interpretation of the statute resulted in \$91 million for a tax credit appropriation. However, in 2015, the budget passed with an open appropriation which was vetoed by the governor to \$500 million; in 2016, \$30 million - based on the funding formula - was placed in the operating budget for funding tax credits; in 2017, \$77 million was agreed upon by the legislature. He advised between 2017 and 2018 - because the price of oil rose - attention was turned to the formula and to DOR's alternative interpretation. Mr. Alper was unsure as to whether the alternative formula calculation was contemplated before this session.

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REPRESENTATIVE LINCOLN inquired as to the expectations of the companies that chose to invest in the tax credit program, related to the "minimum payment," when many investment decisions were made by companies during 2014-2016, prior to awareness of this issue.

MR. ALPER, speaking from industry's perspective, affirmed industry's first choice would be for full payment, its second choice would be a plan to pay off \$300 million per year for the next three years for the sake of certainty, and its third choice would be knowing that statutory appropriations - as DOR has been currently calculating them - are coming. Although buoyed by rising oil prices, debate over two interpretations of the statutory payment schedule give industry substantial anxiety about years of continued debate leading to unresolved and undependable appropriations; he said the intent of HB 331 is to forestall further argument.

REPRESENTATIVE LINCOLN asked whether it is reasonable for industry to expect more than a minimum payment after the state marketed a program which urged exploration companies to invest in Alaska.

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MR. BARNHILL advised the statutory formula is based on the highly volatile price of oil, thus industry's expectation of a legislative appropriation should be tempered with the knowledge the price of oil is very difficult to know. However, industry's expectations, when based on the state's marketing program and previous funding of tax credits, are that "money would be paid sooner rather than later." He cautioned the legal ramifications of various statutory interpretations are ultimately unknown because for many years, the legislature paid all [the tax credits] when presented, marketed Mr. Moose, and made promises of cash.

CO-CHAIR TARR restated her interest in a fiscal plan, without borrowing money. She observed tax credits in the amount of \$807 million are outstanding now, and an additional \$139 million are expected in calendar year 2017 (slide 14).

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MR. ALPER said correct; the forecast is \$807 million, as of 12/31 [2017]. Further, as provided by House Bill 111, of operating loss credits earned in calendar year 2017, only one-half are eligible for cash repurchase, and he gave an example. Thus, the anticipated total of [2017] credits is one-half what it would have been, and there have been other reductions to cash repurchase aspects of the tax credit program.

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CO-CHAIR TARR returned to the \$807 million forecast and surmised with a buyout of the three major [oil companies] of \$125 million at a 10 percent discount rate, the state could "whittle this down," to a manageable two-year payout schedule. She restated she would prefer to issue bonds for capital and infrastructure improvements and not to borrow money.

MR. ALPER pointed out the administration unsuccessfully proposed a revenue bill that would have raised about \$300 million per year by assessing a [new] statewide tax of approximately \$2,000 upon every working person. He further discussed the difficulties the state would have to raise \$300 million, and restated industry's support for HB 331 is based on the certainty companies would be paid, at a discount, in full. In further response to Co-Chair Tarr, he said, to his knowledge, DOR did not evaluate whether companies could be paid, first with a lump sum, and debt financing afterward for the remainder.

CO-CHAIR JOSEPHSON opined the administration seeks a solution [to pay tax credits]; although there could be litigation in this regard, in court, the statute favors the state's position on the equity side of the statute, even though industry also has [valid] arguments. He recalled in January 2016, the administration unsuccessfully sought a 1 percent increase in the "gross floor, which would have brought in \$50 million" to "pay all these down." Co-Chair Josephson concluded industry has made substantial cuts, and it is logical for the state to do the same, in an equal response to a crash in the oil economy.

REPRESENTATIVE PARISH stated support for the bill with several reservations. He asked whether the estimated statutory payment schedule (slide 14) was based on [DOR's Spring 2018 revenue forecast].

MR. BARNHILL said yes.

[3:35:14 PM](#)

REPRESENTATIVE PARISH surmised a revenue forecast could be wrong.

MR. ALPER said the payment schedule reflects DOR's median forecast of the price of oil for the coming year, and whether it is above or below \$60 [per barrel]. Relatively fixed is the [statutory payment of] \$184 million, and in FY 20, the [statutory payment of] \$168 million. Subsequent revenue

forecasts in fall 2018, and spring 2019, will lead to new calculations based on the expected price of oil and other factors, although "there's a lot of swing," and he gave several examples of forecasts that were affected by rising and lowering oil prices. He offered to provide information from the spring revenue forecast to the committee.

CO-CHAIR TARR returned attention to [slide 10] and asked for a further review of the [two alternative discount] rates.

MR. MITCHELL explained 3.6 percent is the estimated cost of a taxable transaction with amortization of [payment schedules] as shown on slide 14. An additional 1.5 percent is embedded in the bill to maintain a 1.5 percent spread between the state's cost of capital and the [companies'] discount rate; therefore, as the state's rate increases or decreases, the discount rate for the participating companies would also adjust to the market, between now and pricing.

CO-CHAIR TARR noted the program may span ten years, and questioned if, in the event interest rates rise, the 5.1 percent rate would automatically increase, so the state would maintain a 1.5 percent "cushion."

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MR. MITCHELL said yes, and added the 3.6 interest is somewhat high; in fact, some of the bonds may be eligible for tax exemption, which would be favorable to the state.

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CO-CHAIR TARR asked whether the 1.5 percent represents the administrative cost associated with the bonding process.

MR. BARNHILL clarified the 1.5 percent is intended to protect the state's attempt to achieve equivalency in net present value terms: if interest rates increase, the discount rate increases, and the state is protected. He remarked:

If we didn't have that cushion in there, it would be much more difficult for us to sit before you and say that, "This is all going to pencil out in net present value terms that are favorable or equivalent to the state."

CO-CHAIR TARR concluded the percentage of cushion is arbitrary, and a more conservative percentage would be 1.75.

MR. BARNHILL cautioned an increase would be less attractive to participants.

MR. ALPER, in further response to Co-Chair Tarr, pointed out a company's commitment would be made within a period of a couple of weeks and would be for a fixed rate; if interest rates increase within said two-week period, the state could lose [a portion of its cushion], but would never "go negative." The bond offer and timing are part of the bill in Section 10, subsection (k). Although the 3.6 interest rate is not specified in the legislation, subsection (m) defines the term "true interest cost plus 1.5 percent"; thus the 1.5 [cushion] is established in the bill, and the true interest cost would be determined by market conditions.

CO-CHAIR TARR pointed out a cushion is not built into the [alternative] 10 percent discount rate.

MR. APLER said no.

MR. BARNHILL restated DOR's reasoning for the bill was to find a fair midpoint between the state's cost of capital and that of small oil and gas companies.

REPRESENTATIVE LINCOLN asked for clarification that the bonds are offered at a fixed rate over a certain term.

MR. MITCHELL said, although not a requirement in the bill, fixed rate bonds have been modeled and are the most conservative mode; however, in shorter term transactions, the bill allows for the use of variable rates. Returning to the issue - raised by Representative Parish - concerning the latitude afforded the bond corporation within the bill related to the structure of the bonds, he said this latitude is intentional because the bond corporation must respond to market conditions; therefore, this function in state public corporations, and for state revenue and GO bonds, needs to be delegated to the executive branch.

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REPRESENTATIVE LINCOLN cautioned there could be a lot of variance in interest rates between cohorts and thus the state could experience a much different outcome.

MR. MITCHELL affirmed the bond corporation would have to issue fixed rate bonds or the state would incur "interest rate risk" for the life of the transaction. [A variable interest rate] would only be an option for participants who were receiving the 10 percent discount rate and hadn't bought down their rate.

REPRESENTATIVE PARISH added the state is also exposed to the risk of the price of oil dropping, and thereby lowering the state's net present value.

MR. ALPER answered if the bill were enacted and the bonds sold, that would lock in the assumptions illustrated on slide 14; for example, if the price of oil goes down, the payment schedule would be extended and payments would be delayed at a cost to the state, however, if the price goes up, the statutory payment would respond, and the state would make money.

REPRESENTATIVE PARISH directed attention to the bill on page 13, line 29, which read [in part] [original punctuation provided]:

A discount rate based on the true interest cost plus 1.5 percent and is less than ten percent

REPRESENTATIVE PARISH asked why the language includes, "and is less than 10 percent."

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MR. ALPER explained 10 percent, [on page 13, line 29] and elsewhere in the bill, describes the base rate available to everyone, and is there for drafting consistency.

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REPRESENTATIVE PARISH surmised, if due to market conditions, the true interest cost to the state became 9.99 percent, the incentive to participate at the discount rate could disappear because the discount rate would become the state's actual borrowing cost. He suggested a remedy for this possibility would be to specify the "standard" rate would be based on the true cost of interest, plus 5.5 percent.

MR. ALPER acknowledged there is a risk to the state - at the 10 percent discount rate - if interest rates "spike," and in order to protect the state, the interest rate would have to "float." He advised a dramatic swing in interest rates is unlikely to happen to affect cohort 1, and the impact on cohorts 2, 3, 4

would be much smaller. He directed attention to the bill on page 14, line 3, which read:

AS 43.55.025, a discount rate based on the true interest cost plus 1.5 percent and is

MR. ALPER said the first reference [on page 13, line 29] refers to corporate income tax credits and refinery credits, and the reference on page 14, line 3, is applicable to the "other three conditions."

REPRESENTATIVE PARISH asked whether any companies holding tax credits have promised to participate [in the tax credit bond proposal].

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MR. BARNHILL said yes, the majority of companies have indicated they would, in an informal and nonbinding sense.

[HB 331 was held over.]

[3:55:10 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:55 p.m.