

SENATE FINANCE COMMITTEE  
January 19, 2017  
9:03 a.m.

[9:03:34 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:03 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair  
Senator Anna MacKinnon, Co-Chair  
Senator Click Bishop, Vice-Chair  
Senator Natasha von Imhof  
Senator Mike Dunleavy  
Senator Peter Micciche  
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Randall Hoffbeck, Commissioner, Department of Revenue; Senator David Wilson; Dan Stickel, Assistant Chief Economist, Tax Division, Department of Revenue; Chantal Walsh, Director, Division of Oil and Gas, Department of Natural Resources.

SUMMARY

^2016 FALL REVENUE FORECAST

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RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, introduced himself. He noted the first change, which was the detail of production forecasting. He explained that the most recent contract expired, so there was a choice to make an independent forecast through the Department of Natural Resources (DNR). He explained that Department of Revenue (DOR) worked with DNR to create a methodology. He stated that DNR had data, which a contractor did not have access.

He also noted that the contractor was from out of the state, so the contractor did not have immediate access to the field. He remarked that the FY 17 forecast was 490,000 barrels per day, and the current daily average was 550,000 barrels per day. He noted that the higher average was due to the cold and highly producing winter months. He stressed that production was higher than the forecast.

Commissioner Hoffbeck remarked that the daily price was currently between \$52 and \$54 per barrel. He stated that there would be a chart in the presentation that would reflect the impact on the price of oil. He stated that one dollar per barrel was worth approximately \$30 million in long-term revenue.

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Co-Chair MacKinnon noted that there were various testifiers available for comments.

Senator Micciche remarked that there was an increase to an average of 531,500 barrels per day, which was an increase from the 519,200 per day in FY 15. The increase was the first since 2002. He queried the reason for the increase in the current challenging price environment. Commissioner Hoffbeck replied that there were several factors that contributed to the increase. He explained that there was a statistically anomaly. He remarked that the years prior saw a lengthy and robust turnaround in the fields, which created some "de-bottlenecking" to allow for additional gas and water handling. He added that there was also new oil brought online.

Senator Micciche wondered whether the change in the tax policy may have caused greater investment in the fields, therefore increasing the number of barrels per day. Commissioner Hoffbeck responded that tax policy made a difference. He explained that some of the fields that came online were "pre-tax policy" change, others came online due to the investments made because of the tax policy.

Co-Chair MacKinnon queried the number related to "new oil." Commissioner Hoffbeck agreed to provide that information.

Co-Chair MacKinnon remarked that there were recent announcements by some companies asserting that they may put 100,000 barrels of new oil in the pipeline.

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Senator Dunleavy felt that worldwide exploration was down, and felt that the decisions of Oil Producing and Exporting Countries (OPEC) had an impact on the numbers. He asserted that some felt that the price oil would rebound. He wondered why the state forecast was counter than the optimistic international forecasts. Commissioner Hoffbeck replied that the forecast was made prior to Saudi Arabia agreeing to the OPEC reduction in production. He stated that the agreement had almost instantaneous seven to ten-dollar bump in the price of oil. He stressed that there was already a response to the oil patch in the lower 48, because rigs were coming back online. He remarked that some were looking at the \$60 price point as a temporary ceiling, and there may be another oversupply. He stated that the forecast for the following years were \$56 and \$60. He shared that the price forecast would be reexamined in the spring, observing whether the OPEC deal would hold.

Vice-Chair Bishop appreciated the cautious approach to forecasting. He felt that the approach helped the legislature to keep the pressure on the budget, notwithstanding the other departments to provide services to the state.

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DAN STICKEL, ASSISTANT CHIEF ECONOMIST, TAX DIVISION, DEPARTMENT OF REVENUE, discussed the PowerPoint, "Fall 2016 Revenue Forecast Presentation; Forecast Released December 15, 2016" (copy on file).

Mr. Stickel looked at slide 2, "Alaska Department of Revenue":

The mission of the Department of Revenue is to collect, distribute and invest funds for public purposes

Major Programs

Tax Division

Enforces the tax laws of the state; forecasts, collects and accounts for tax revenues

Treasury Division

Manages and invests state funds

Permanent Fund Dividend Division

Administers the PFD program and distributes the annual dividend payment to eligible Alaskans

Child Support Services Division

Collects and distributes child support to custodial parents

Mr. Stickel highlighted slide 3, "Forecasting Methods: Trends for Forecast Period":

Oil Price is projected to increase 7 percent on average over the forecast period (FY 2017-2026)

Oil Production is projected to decrease 4 percent on average over the forecast period

Unrestricted General Fund Revenue is projected to increase 5 percent on average over the forecast period

Investment Income is projected to increase 5 percent on average over the forecast period

Total State Revenue is projected to increase 2 percent on average over the forecast period

Mr. Stickel addressed slide 4, "Forecasting Methods: Introduction":

All data is based on the DOR Fall 2016 Forecast.

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

This forecast supersedes all prior estimates or forecasts as the official forecast of the department. Therefore, all prior forecasts should be used only for comparison purposes.

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Senator Micciche reiterated his appreciation for the DOR conservatism in the current forecasting. He stated that in his first two years of the legislature, he observed a "rosy" forecast of oil prices by DOR and DNR. He remarked that the management must be based on a realistic case. He felt that the celebration of the conservatism results at a higher number at the end of the fiscal year. He felt that the state could not count on an oil price above \$60 in the distant future.

Mr. Stickel highlighted slide 5, "Forecasting Methods: What Do We Forecast at DOR?":

We directly forecast Petroleum Revenue  
Accounted for 72 percent of state unrestricted revenue in FY 2016  
  
Projected to be 67-68 percent in FY 2017 and FY 2018  
  
Includes severance taxes, royalties, corporate income tax, and all other revenue from oil companies

Mr. Stickel addressed slide 7, "Petroleum Revenue Forecast: Factors":

Four Factors for Petroleum Revenue Forecast

1. Production
2. Price
3. Costs
  - Capital Expenditures
  - Operating Expenditures
  - Transportation Costs
4. Credits

Mr. Stickel addressed slide 9, "Fall 2016 Production Forecast":

COMPONENT: Forecast Level  
2011-2016: Well-by-Well Forecast  
2016-Present: Pool Level Forecast

COMPONENT: Uncertainty Handling  
2011-2016: Deterministic  
2016-Present: Probabilistic

COMPONENT: Risking  
2011-2016: Unrisked CP; First attempts in UD/UE  
risking in 2013 Fall Forecast  
2016-Present: Probabilistic technical and Non-  
Technical risk

COMPONENT: Type Wells  
2011-2016: Some type wells  
2016-Present: Pool-by-Pool type wells

COMPONENT: Oil Price Dependency  
2011-2016: None  
2016-Present: Some dependence on price

COMPONENT: UD Production  
2011-2016: 10-Year Outlook  
2016-Present: 1-Year Outlook (1)

COMPONENT: UE Production  
2011-2016: 10-Year Outlook  
2016-Present: 5-Year Outlook (1)

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Senator Micciche remarked that the federal revenue in the total state revenue for FY 16 was \$2.5 billion, \$3.5 billion in FY 17, and \$3.1 billion in FY 18. He wondered how one would account for a \$600 million difference in the forecast. Commissioner Hoffbeck replied that the authorized amount was the amount the state could capture in federal revenue. He remarked that most of the revenue was match-associated revenue. He stressed that the state must do a 100 percent spend to qualify for the federal match dollars, but typically the state did not meet all the qualifying expenditures. Therefore, the state came up 20 to 30 percent less than would have been achieved.

Senator Micciche surmised that the prediction was the total program dollars available if every match was achieved. He assumed it was not a revenue number, and wondered if there was a realistic reflection of the actual federal receipts. Commissioner Hoffbeck replied that the annual percentage could be adjusted downward in future forecasts.

Senator von Imhoff noted that the federal dollars could decrease, because of the new presidential administration. She expressed concern over the decrease in Medicaid funding, and how that might affect the state's budget. She remarked that there had been a recent expansion in health care, and wondered how the decrease in federal funding would affect the health care expansion. She queried the modeling of potential outcomes. Commissioner Hoffbeck replied that DOR had not modeled that unwinding, and assumed that the Department of Health and Social Services (DHSS) had modeled that unwinding of the Medicaid expansion.

Mr. Stickel addressed slide 10, "Production Forecast: ANS History and Forecast by Pool." He stated that the slide showed a history of oil production on the North Slope since the start of production, and a ten-year forecast. He remarked that in the late 1980s Alaska North Slope oil production peaked at just over 2 million per day. He stated that since the 1980s, with a few exceptions, production had been declining. He announced that the state was currently at slightly above 500,000 barrels per day, and was projected to decline at 4 percent annually during the forecast period.

Co-Chair MacKinnon noted some individuals who may be available for questions.

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Mr. Stickel highlighted slide 11, "Production Forecast: Currently Producing":

Volumes from Currently Producing (CP):

Oil from all currently producing pools and wells

Decline curve analysis forecast at pool level inherently includes 'background' ongoing

development activity, facility maintenance,  
turnaround events

Mr. Stickel addressed slide 12, "Production Forecast: Under Development":

Volumes from Under Development (UD):

Ongoing development wells in existing, mature fields above and beyond CP

New fields expected to produce within 1 year (by 6/30/2017)

Mr. Stickel looked at slide 13, "Production Forecast: Under Evaluation":

Volumes from Projects Under Evaluation (UE):

New fields expected to produce within 2-5 years (7/1/2017 to 6/30/2021)

UE 1: Facilities in place, significant sunk cost, well locations finalized, drilling plans in place

Examples: Nuna, GMT1, Mustang, Moraine, 1H NEWS, Nuiqsut expansion

UE 2: Facility-sharing agreements in place, source of funding identified, EIS progress

Example: GMT2

Risk factors internalized in forecast based on breakeven price

Mr. Stickel addressed slide 14, "Production Forecast: Excluded from Forecast":

Characteristics:

Unknown first-oil date/estimated greater than 5 years

Discovery (contingent resource) or just prospects (prospective resource)

Uncertain finances (e.g., sourcing for private equity)

Facilities incomplete or nonexistent

Projects in Appraisal

Technological Uncertainty

Environmental/Permitting Uncertainty

Economic Uncertainty

Examples: Pikka, Ugnu, Placer, Tofkat, Pt Thomson (MGS or full-cycling), Liberty, Fiord West, Smith Bay

Senator Micciche wondered whether there was work with DOR with the accuracy probabilities. He felt that many companies did not evaluate as accurately as others. Mr. Stickel replied that evaluation involved a comparison to the criteria for the under-evaluation category. He referred to slide 13.

Co-Chair MacKinnon wondered if the characteristics were different that forecasts from years past. Mr. Stickel replied that there was a desire to develop a more robust definition.

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Co-Chair MacKinnon appreciated the conservative approach to accurately defining each category. She wondered whether the Willow field was the recent ConocoPhillips announcement Mr. Stickel replied in the affirmative.

Co-Chair MacKinnon wondered what was moved into the "undefined" or current forecast versus "under development." Mr. Stickel responded that he would provide a specific list. He announced that no fields were moved out of the forecast. He stressed that there was some moving between "under development" and "under evaluation" given the new time horizons.

Co-Chair MacKinnon wondered whether that was consistent with general accounting practices, or if the projection was a more conservative approach. Mr. Stickel replied that DNR evaluated reserves. He stated that the categories set up by

DNR were not exactly mimicking accounting definitions of "reserves."

Co-Chair Hoffman looked at the 100,000 barrels in the Willow field, and wondered whether that was considered "new oil." He asked how that field fell into the definition of 21. Mr. Stickel replied that field would most likely qualify as "new oil" under the gross value reduction provisions of the tax law.

Co-Chair Hoffman recalled that there was a declaration that decline was at 4 percent. He queried the year envisioned that the Willow field would be included in reversing the 4 percent decline. Mr. Stickel replied that he had not studied the development in detail. He remarked that the announcement was recent, and fell outside of the time horizon for the forecast. He stated that the field would be examined for the next forecast.

Senator Olson queried the timing of the opening of the 10-02 lands and the opening of the Alaska National Wildlife Refuge (ANWR). He asked what the numbers would like that with the anticipation with that opening. Commissioner Hoffbeck replied that there must be federal legislation that allowed for the opening. He remarked that there was only one current well, so there was work needed to delineate the field. He speculated that with the approval of drilling of ANWR in the current year, there would be 10 years until oil reached the pipeline from an ANWR development.

Senator Olson queried the general oil production anticipation of the opening of the lands. Commissioner Hoffbeck replied that he did not know enough to make that determination.

Senator Olson wondered whether production would be doubled. Mr. Stickel responded that there was a hypothetical analysis that was presented in a previous session to the House Resources Committee. He stated that, based on myriad assumptions, ANWR could potentially add 500,000 barrels per day.

Senator Olson stressed that he was referencing only the 10-02 lands. Mr. Stickel agreed to provide further information.

Co-Chair MacKinnon announced that the Senate Resource Committee would do a "deeper dive" into the production forecast.

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Mr. Stickel looked at slide 15, "Production Forecast":

Official Forecast=

Currently Producing + Under Development + Under Evaluation

Mr. Stickel highlighted slide 16, "Production Forecast: ANS." He stated that most of the oil in the forecast continued to come from the currently producing fields such as Kuparuk, Prudhoe Bay, Colville River, and some of the smaller current developments. He remarked that there was a small amount of underdevelopment oil that qualified in the one-year time horizon in 2018; and a modest amount of undervaluation from the new fields at a peak of 31,000 barrels per day in 2022.

Mr. Stickel looked at slide 17, "Production Forecast: DOR Cases":

High Case (P10):

Based on DNR modeling, oil production would have a 10 percent probability of exceeding this level

Official Forecast (P50):

Based on DNR modeling, oil production would have an equal probability of coming in above or below this level

Low Case (P90):

Based on DNR modeling, oil production would have a 90 percent probability of exceeding this level.

Note: None of the cases include any of the "Excluded from forecast window" fields

With these fields, production could exceed the high case

Mr. Stickel discussed slide 18, "Production Forecast: ANS by Case." The slide showed the official forecast and the high case and low case from DNR. He stated that the official forecast declined at 4 percent annually reaching 331,000 per day of ANS production by 2026. The high and the low case represented plus or minus approximately 40,000 barrels per day on that level. He stressed that the calculation was before any potential new developments that were excluded from the current forecast.

Mr. Stickel looked at slide 19, "Production Forecast: ANS Details." He stated that the table was from page 37 of the Revenue Sources Book, and presented the information from the previous graph in table form. He stated that the slide also showed the level of production estimated from the fields that qualified as new oil for the gross value reduction, which was a provision of the tax code. He noted that the gross value reduction eligible production by 2026 reduced to zero. That reduction was due to some of the reforms made to the tax system in the previous legislative session that set new time limits for how long a field can qualify for the new oil provision.

Mr. Stickel highlighted slide 20, "Production Forecast: ANS Comparison to Prior Forecast." The slide was a comparison of the fall forecast to the spring forecast. He noted that the forecast was reduced from the previous forecast for the next few years. He noted that beyond 2023 showed a slight increase to the overall production forecast.

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AT EASE

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RECONVENED

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Co-Chair MacKinnon looked at slide 19.

Senator Micciche looked at slide 10, and noted the decline rate from 1989 to 1999. He noted the flattening out from 1999 to 2004. He wondered whether there was a consideration of those time periods, or whether there was an adjustment

for the changes in production. He felt that there was a default to 4 percent to 6 percent. He wondered how many years of relatively flat production or increased production before the decline rate assumptions would flatten. Mr. Stickel replied that DOR was looking at the range of potential developments and the level of drilling by the operators. He remarked that a significant uptick in drilling activity and significant new finds in production would cause the production forecast to have a lower decline rate or flatten.

Senator Micciche queried the point at which actual production entered that equation. Mr. Stickel replied that the DNR modeling showed that actual production used to derive the currently producing forecast. He noted that there was an examination of the production trends for each of the oil pools and the level of drilling and investment in those pools as compared to the projections going forward and development.

Senator Micciche wondered whether there was a segment in forecasting that realized certain findings that may not be pursued, should the price remain still. He asked if there was a probability at certain dollar points. Mr. Stickel replied in the affirmative, and explained that price was a risk factor in the DNR model.

Mr. Stickel displayed slide 21, "Fall 2016 Price Forecast." He stated that the slide compared the Fall and Spring Production Forecasts.

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Mr. Stickel looked at slide 22, "Price Forecast: Historical ANS West Coast, West Texas Intermediate and Brent Crude Prices 2009+." He stated that the chart showed a history over the most recent seven years of ANS oil prices, he US benchmark (West Texas Intermediate), and international benchmark (Brent Crude Prices). He stated that the Brent Crude Price had traded closer to ANS crude than the US benchmark in recent years. He noted that from 2011 to 2013, there was relative stability in oil prices at between \$100 to \$120. That stability made the oil price forecasting easier. He noted that prices began declining in 2014, and continued to decline through 2015. He stated that in 2016 the prices bottomed very early in the year at \$26 per

barrel, and the prices have increased throughout most of 2016.

Senator von Imhoff remarked the gap in 2012, and wondered which price would be used in the forecast. Mr. Stickel replied that there was an issue related to West Texas Intermediate (WTI) crude. The crude storage was landlocked, and with the rise in shale production there was too much crude to move out. He stated that, relative to worldwide prices, WTI was depressed for several years. He felt that the Brent Crude was more appropriate to compare with ANS, because it was not landlocked like WTI.

Vice-Chair Bishop remarked that there was a completion of the second leg of the Keystone Pipeline, which got ANS oil waterborne. He remarked that there were recent events which allowed WTI to trade par with Brent Crude.

Senator Dunleavy wondered how much the state relied on the international projection methodologies, versus the state's own methodology. Mr. Stickel replied that there would be slides in the presentation that would outline the price forecasting process.

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Mr. Stickel highlighted slide 23, "Price Forecast: Key Drivers":

Supply, Demand and Spare Capacity in CY 2017

Supply - 97.4 mb/d

Demand - 96.9 mb/d

Global Spare Capacity - 1.17 mb/d or 1.2 percent

Current Events

Weak global demand growth

Cost of supplying the marginal barrel has decreased

OPEC (Saudi Arabia) maintains market share and accepts lower prices - OPEC recently agreed to cut supply

Cost of supply has fallen as new sources have been defined and developed (i.e. Shale oil)

Mr. Stickel looked at slide 24, "Price Forecast: Historical ANS West Coast Price 2015+." He noted that the low of \$26.23 per barrel was reached in early 2016, which was just before the Iran nuclear sanctions were lifted. He remarked that there was some concern that Iranian oil would flood the market. He stated that, since that low point, demand had performed slightly better. He noted that there were "moves" by Oil Producing and Exporting Countries (OPEC) to restrain supply. He remarked that since the low point in 2016, prices had doubled. The closing price of ANS crude two days before the meeting was \$54.83 per barrel.

Mr. Stickel addressed slide 25, " Price Forecast: Impact of Spare Capacity." He stated that the slide provided some context for some of the previous statements. He remarked that the slide was from the U.S. Energy Information Agency that looked at the relationship between oil production and oil consumption. He remarked that, for the most recent 2.5 years production had significantly outpaced oil consumption. He remarked that, globally, the state was putting oil into inventories at record levels. The projections of the Energy Information Agency and several experts were that production and consumption would start to come into a balance, which would support price stability.

Mr. Stickel highlighted slide 26, " Price Forecast: Base Price Method":

Price forecast is based on fall 2016 forecasting session held on October 4

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

Average of these paths used to derive PERT distribution

Base case is the median of the distribution

Co-Chair MacKinnon queried the definition of PERT. Mr. Stickel replied that PERT was a statistical term. [PERT stands for "Program Evaluation Review Technique.]"

Senator Dunleavy wondered why the state came up with its own prices. Mr. Stickel replied that the price forecast had

been historically produced in this manner. He shared that DOR examined the comments from experts, and evaluated whether those comments were reasonable. He remarked that some analysts might differ in their projections. He stated that there was value in evaluating what the analysts were saying, and come to a consensus forecast.

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Co-Chair Hoffman noted that the governor had spoken about the demand for gas and the proposed gas line in the state. He wondered why there was not a focus of "cleaner" energy options. Mr. Stickel replied that DOR evaluated different projections for oil demand, and consumption growth over time. He agreed that consumption growth was expected to grow at a lower rate than in the past, which combined with potential new supplies may set a ceiling on oil price potential.

Co-Chair Hoffman wondered whether the new supplies for gas or oil had an impact on the oil price. Mr. Stickel replied that the impact was from new supplies for oil. He explained that there were many shale finds, unconventional oils, and fields that might provide new supply.

Senator Dunleavy wondered if past practices influenced the forecast outline. Mr. Stickel replied in the affirmative. He explained that there was not a strong reason to change the practice of determining the forecast.

Senator Dunleavy asked how closely those projections mirrored the actual price outcomes. Mr. Stickel responded that the success in projecting oil prices was like the success of other organizations. He remarked that a major run up or crash in price was missed in the projections, but other experts also missed those shifts in price.

Senator Dunleavy surmised that the results were similar. Mr. Stickel agreed.

Senator Dunleavy wondered why the state would create its own projection. Commissioner Hoffbeck replied that each forecast had its own bias. He remarked that Goldman Sachs usually had the lowest forecast, and other organizations had higher forecasts. He stressed that someone needed to analyze those different forecasts and compile them into an estimate of the oil price. He stressed that picking one

forecast would apply someone else's bias. He felt that many people hearing the same information would result in a less biased determination. He remarked that it was not necessary, but it was a process that had historically worked and was a relatively inexpensive way to forecast the price.

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Senator Dunleavy he felt that the internet was available for easy forecast, and felt that maybe the forecasting methodology was "an Alaska thing."

Co-Chair MacKinnon stressed that the state was in difficult financial times, so she wondered if there was another way to determine a forecast without expending the resources at a state level.

Senator Dunleavy furthered that as the state was beginning to enact potential revenue measures, there would be more scrutiny as to how the figures were determined that the state needed more revenue. He felt that the decades-old processes would be questioned, and evaluated whether politics may have impacted the forecast. Commissioner Hoffbeck agreed to take those points under consideration.

Mr. Stickel defined PERT, "Program Evaluation Review Technique."

Co-Chair MacKinnon discouraged the use of acronyms.

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Vice-Chair Bishop appreciated the discussion on price. He felt that without production and throughput the price conversation was a moot point.

Senator Micciche explained the history of PERT.

Mr. Stickel looked at slide 27, "Price Forecast: Nominal ANS Price Distribution." He remarked that there was a high-case and a low-case price path, the median 50 percent case, and some other cases within that range. The forecast was the 50 percent median most likely case that came out of the price session, which showed prices increasing slowly from current levels reaching slightly over \$91 in FY 27. He

stated that backing out inflation showed prices settling in the \$70 to \$75 range in real terms.

Co-Chair MacKinnon noted that there was an equal distribution on the present-day scenario over the future at different percentages. She wondered if there was volatility in the forecast with the overlay of the national organizations.

Mr. Stickel looked at slide 29, "Price Forecast: Consensus View of Wide Distribution." The slide showed the price forecast assumption from the Energy Information Agency and the futures curve. He noted that through the end of FY 17, the most likely case suggested prices in the \$50 to \$55 range. That range was similar to the DOR forecast. He noted that there was a high and low case, which showed potential volatility and uncertainty.

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Senator Micciche wondered whether there was a global average cost of supply, where Alaska was placed out of the market. He asked whether there was a local cost, that might revise the future value of Alaska away from that global cost of supply. Mr. Stickel replied that Alaska would compete on a global level in the oil investment and new finds.

Co-Chair MacKinnon noted that the comments were referencing slide 29.

Mr. Stickel addressed slide 28, "Price Forecast: Historical ANS West Coast Price FY Oil Price Bands (Annual Average and Fall 2016 Forecast)." He noted that the history of 2010 through 2016 the average price was shown for those fiscal years; and the range of prices within the fiscal years. He noted that in 2013 and 2014 the volatility of price within the fiscal year was low, which was unusual by historical standards. He noted that the average price in 2015 was slightly over \$70 per barrel, but within the year the price started over \$100 per barrel and ended around \$50 per barrel. He noted that the bars for the 2017 through 2026 forecast represented the official forecast, high case forecast, and low case forecast.

Mr. Stickel discussed slide 30, Price Forecast: Impact of other prices in FY 2017." He stated that the slide allowed

the user to answer the question of the ending price of FY 17 should the price remain at a certain level. He stated that the forecast for FY 17 prices was \$46.81 per barrel, based on five months of actual and seven months of forecast. He stated that there was an anticipation of \$45 and \$50 for the remainder of FY 17. He stated that the current day's price was closer to \$55 per barrel. He stated that the final FY 17 price would be close to \$51, should the price remain at the \$55 level.

Co-Chair MacKinnon wondered whether the production figures were given to the state monthly. Mr. Stickel replied that the state received daily production figures, and those were "trued up" to monthly production figures. He furthered that the state received production taxes monthly.

Co-Chair MacKinnon noted that the production could vary, based on the month. Mr. Stickel wondered whether her summation was relative to the forecast.

Co-Chair MacKinnon replied in the negative. She wondered whether the production was the same in January as it was in July. Mr. Stickel replied that the numbers were historically different between those months. He remarked that maintenance activity and turnaround was normally conducted in the summer.

Co-Chair MacKinnon felt that there was a solid base to project forward based on other years' activity. Mr. Stickel agreed.

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Mr. Stickel highlighted 31, "Price Forecast: ANS Comparison to Prior Forecast." He noted that there was an increased price forecast for the duration of the forecast period. He noted that the forecast did not go up to the \$100 per barrel range.

Co-Chair Hoffman queried the additional revenue with the revised forecast. He wondered whether the revenue was \$100 million per year. Mr. Stickel replied that it depended on the year.

Co-Chair Hoffman specifically queried the revenue for the next year. Mr. Stickel replied that a one dollar increase in oil price was a \$30 million revenue increase. He shared

that there was a set of slides that would address that question.

Mr. Stickel looked at slide 33, "Cost Forecast: North Slope Capital Lease Expenditures." He remarked that company lease expenditures were deductible from Alaska's production tax, because it was a net-based tax. Lease expenditures were also a factor in determining the value of many of the credits, and provided a barometer of industry activity in Alaska.

Mr. Stickel highlighted slide 33, "Cost Forecast: North Slope Operating Lease Expenditures." He remarked that there was a significant reduction to expected capital expenditures in FY 17 and FY 18. He stated that the companies would reduce costs in response to the low oil prices wherever and whenever possible. He stated that there were less operational rigs in the major fields, and certain projects were canceled or delayed. He remarked that FY 17 and FY 18 were down, and then stable capital expenditures expected after those years.

Mr. Stickel discussed slide 36, "Credits Forecast: Compared with Production Tax." He noted that Alaska had numerous tax credits in the tax code. Those credits could be taken against a tax liability, should a company have sufficient revenue to generate a tax liability to the state. He stated that certain credits, such as the net operating loss credit could be repurchased by the state in cash. The first chart showed the relationship between the 2016 actual; and the forecast for 2017 and 2018. The slide showed the relationship between production tax revenue before any tax credits, shown in the blue line. He noted that, in 2018, the state estimated approximately \$500 million in production tax liability before credits. He remarked that the following line showed production tax revenue after application of credits against liability. There was a forecast of \$100 million of production tax, that would be paid into the state as production tax revenue. He stated that subtracting against that resulted in an expectation for state repurchase of state tax credits took the revenue to just above zero. He stated that there was an assumption for FY 18, which showed the amount of tax credit repurchases was as proposed in the governor's budget. That forecast was based on a statutory appropriation in AS 43.55.028, which allowed for either 10 or 15 percent of the production tax revenue to be deposited into the oil and gas

tax credit fund. He stated that, under that assumption, the end of FY 18 showed approximately \$887 million of tax credits left in the books available for repurchase.

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Mr. Stickel looked at slide 37, "Credits Forecast: Compared with Unrestricted Petroleum Revenue." He stated that in FY 18, after application of credits, there was an anticipation of net unrestricted revenue to the state of over \$1 billion from the oil industry. He explained that including other revenue would bring the number to a higher amount.

Mr. Stickel highlighted slide 38, "Credits Forecast: Outstanding Tax Credit Obligations." The slide showed the relationship between total credits repurchased by the state for the companies that did not have enough tax liability to offset all the credits.

Co-Chair MacKinnon wondered whether the administration had a goal to change behavior by only paying out the statutory minimum. Commissioner Hoffbeck replied that there was not a goal to change behavior, but the administration recognized that only paying the minimum could change behavior. He stressed that some companies were relying on the cash repurchase of the credits, and therefore would then not be able to make those investments. He stressed that only paying the minimum would likely change behavior. He remarked that Alaska Oil and Gas Association (AOGA) would adapt, but could not adapt to previous actions.

Co-Chair MacKinnon queried the variables in adaption. She felt that there would be less production. She remarked that it was not a goal, but rather a possible outcome from only paying the minimum. Commissioner Hoffbeck replied that his comments reflected AOGA's concerns. He announced that oil companies had said that the use of credits to leverage capital would not occur. He stated that the companies would adapt to a payoff schedule.

[10:30:13 AM](#)

Commissioner Hoffbeck remarked that there was a series of bills introduced by the governor in the previous session which intended to pay off all the existing credits. He stated that the fiscal measures did not pass, and the governor felt that it was not prudent to pay off the

credits in the current financial situation. Therefore, the minimum statutory amount, with the knowledge that it would have a dramatic impact on some of the companies. He stressed that the revenue stream must be available to pay off the credits. He stated that the motor fuel tax and the permanent fund protection act would still leave a \$700 million gap to fill.

Co-Chair Hoffman felt that the gap would be closer to \$1 billion. He stressed that the proposals did not provide the necessary funds to pay off all the credits. Commissioner Hoffbeck answered in the affirmative. He stated that a long-term stable financial structure and the cash flow was sufficient to meet the needs, there could be an examination of using CBR funds to pay off the credit. He stressed that the CBR was currently used as a backstop for budgetary shortfalls, so the decision was directed at where the money would be spent.

Co-Chair Hoffman wondered if the administration planned on coming forward with structural changes to address the problem. Commissioner Hoffbeck relayed that the administration had a bill to deal with tax credit issues that was fair and balanced. He stated that the bill was not filed, but the administration was looking at all suggestions. He stressed that the bill would be introduced if necessary.

Vice-Chair Bishop did not want the stakeholders to forget about the struggling tertiary and secondary employers and employees who were waiting for a paycheck. Commissioner Hoffbeck recognized those entities, and stressed that there needed to be a stable and predictable plan to help everyone move forward.

Senator Micciche felt that the legislature may have complicated the growing debt with the \$70 million limit per company. He wondered whether the max payout complicated the total payout of those credits. Commissioner Hoffbeck replied that there was a backlog of nearly \$700 million of credits prior to the bill passing that needed to first be paid off. He felt that the companies would also adapt. He stressed that the companies depended on certainty, so they can expect the state's participation.

[10:36:03 AM](#)

Mr. Stickel addressed slide 40, "Forecast Change: Production Tax Revenue Highlights."

Oil price forecasts increased slightly from spring forecast

Long-term prices (FY2025+) now expected to settle around \$70- 75 real

Change to oil production forecast methods

Forecast now produced by technical experts at DNR

FY 2017-18 forecasts decreased, long-term forecast increased slightly

Unrestricted revenue forecast increased somewhat due to higher oil price forecast

Capital expenditures stabilize at lower level than last few years

Companies cited oil prices and uncertainty regarding the state budget and fiscal system, as factors impacting decision making

Mr. Stickel addressed slide 41, "Forecast Change: Comparison from Spring 2016 Forecast for FY 2017." He remarked that the assumption for FY 17 was increased by approximately 8 dollars, or 20 percent, over the previous forecast. The oil production forecast was decreased by 17,000 barrels per day, or about 3 percent compared to the previous forecast. He stated that the total deductible lease expenditures, which were the costs that could be taken in calculating a tax liability, were increased by \$400 million because of higher oil prices. There was more available revenue to offset. He remarked that DOR used two different terms for lease expenditures: deductible lease expenditures, which was available to offset revenue in the production tax calculation; and total lease expenditures. He announced that total lease expenditures had decreased, as companies were cutting back. The assumption of transportation costs decreased by approximately \$1.50 per barrel. The total unrestricted petroleum revenue forecast increased by \$262 million, or a 37 increase from the previous forecast, which was consistent with the value of the crude oil.

Mr. Stickel looked at slide 42, "Forecast Change: Comparison from Spring 2016 Forecast for FY 2018." He stated that the value of the assumption of the crude oil produced on the North Slope increased by 36 percent, which led to a 40 percent increase in the unrestricted petroleum revenue forecast, or about \$312 million more in anticipated petroleum revenue in the previous forecast.

Mr. Stickel highlighted slide 44, "Revenue Forecast: 2016 to 2018 Totals." The chart showed all revenues from all sources to the state for FY 16 history and two years of forecasts. He noted that the state received an estimated \$1.5 billion in unrestricted revenue in FY 16. The forecast showed \$1.4 billion of unrestricted revenue in FY 17, and \$1.6 billion of unrestricted revenue in FY 18. He explained that the unrestricted revenue was available for the legislature to appropriate for any purpose. He stated that the designated general fund revenue was approximately \$400 million in FY 16. The FY 17 forecast for designated general fund revenue was approximately \$450 million. He explained that the designated revenue was customarily appropriated for a specific purpose.

Mr. Stickel looked at slide 45, "Revenue Forecast: By Spending Category." He explained that the slide showed a ten-year history and ten-year forecast. He stated that the total state revenue was expected to have an upward trend, with the expectation of higher investment revenues as the asset balances grow. He stressed that the slide's numbers were before any possible changes to investment strategy.

[10:41:05 AM](#)

Mr. Stickel discussed slide 46, "Revenue Forecast: 2016 to 2018 General Fund Unrestricted Revenue (GFUR)."

Mr. Stickel addressed slide 47, "Revenue Forecast: Revenue Available for Appropriation":

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

Better reflects ability of state to meet its obligations

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

The ability of the state to meet its obligations is not fully reflected by the GFUR category

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

Constitutional Budget Reserve Fund

Earnings Reserve of the Permanent Fund

Mr. Stickel highlighted slide 48, "Revenue Forecast: 2016 to 2018 Totals to Appropriate." He stated that the category included any settlements to the Constitutional Budget Reserve Fund, and all its earnings. The largest addition in the revenue available for appropriation was realized earnings of the permanent fund were technically available for appropriation.

Mr. Stickel looked at slide 49, "Wrap-Up: Big Picture Takeaways for Forecast Period":

Oil Prices up by 7 percent and GFUR up by 5 percent

Current prices trending higher than forecasted price for FY 2017

Oil Production down by 4 percent but potential for upside

Forecast doesn't include recent announcements new finds (i.e. Smith Bay, Nanushuk, Pikka)

Current production trending higher than forecasted volume for FY 2017

Petroleum Revenue represents approximately 70 percent of our GFUR revenues

The GFUR trend over forecast period:

Increase of 12 percent in FY 2018 or \$177M

Increase of 15 percent in FY 2019, or \$249M

Increases taper off in FY 2020 to average of 3 percent per year until FY 2026

Still low compared to past decade but no longer decreasing as had since FY 2015.

Mr. Stickel looked at slide 50, "Wrap-Up: Big Picture Takeaways for Forecast Period (cont.)":

Investment Income is projected to increase 5 percent on average over the forecast period

Still have approximately \$53B in the Permanent Fund Account

Other Positive Revenue Trends:

Mining Taxes to recover from low of \$11M in FY 2016 to \$36M average over the forecast period

NPR-A Revenue is projected to increase 40 percent on average over the forecast period (from \$4M in FY2017 to a high of \$45M in FY2024)

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CHANTAL WALSH, DIRECTOR, DIVISION OF OIL AND GAS, DEPARTMENT OF NATURAL RESOURCES, explained DNR appreciated the conservative viewpoint of the committee in attempting to manage the budget. She stated that the production forecast was low as compared to current North Slope production, but the forecast was not a conservative forecast. She noted that the decline on the North Slope averaged closer to 5 percent, and the forecast showed a 4 percent decline. She stated that the facility maintenance programs had large downtimes in 2014 and 2015. She explained that there were recently enacted projects that would have an impact on future oil production. She stressed that there was no one who believed that reducing activity would result in bigger production from the heritage fields. She reiterated that a 4 percent decline was not conservative in the bigger picture.

Co-Chair MacKinnon discussed the following day's agenda.

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ADJOURNMENT

10:49:29 AM

The meeting was adjourned at 10:49 a.m.