

SENATE FINANCE COMMITTEE  
February 1, 2017  
9:03 a.m.

[9:03:45 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 Mike Dunleavy  
Senator Peter Micciche  
Senator Donny Olson  
Senator Natasha von Imhof

MEMBERS ABSENT

None

ALSO PRESENT

Deven Mitchell, Debt Manager, Department of Revenue.

SUMMARY

^PRESENTATION: STATE DEBT AFFORDABILITY ANALYSIS and DEBT SERVICE

[9:04:37 AM](#)

DEVEN MITCHELL, DEBT MANAGER, DEPARTMENT OF REVENUE, discussed the PowerPoint, "2017 Credit Review and State Debt Summary" (copy on file). He would discuss how the credit rating was established, reviewed, and portrayed to analysts outside of the state.

[9:05:25 AM](#)

Mr. Mitchell highlighted Slide 2, "Alaska Ratings Timeline." The slide charted savings accounts, general fund unrestricted revenue (UGF), along the ratings timeline. He

pointed out to the committee that in the past the state had enjoyed a high credit rating and high revenue, but as reserves had diminished over time due to lower revenue, the credit rating had lessened. He said that there was the expectation that the reserve position of the state would continue to progress downward, with a stabilization of UGF, with potentially slight growth, predicted in the Fall 2016 Revenue Sources Book. He related that the rating outlook for the state was pessimistic at the current moment.

[9:06:34 AM](#)

Mr. Mitchell addressed Slide 3, "Rating Agency Views - State of Alaska." The slide included ratings from Moody's (Aa2), Standard & Poor's Ratings Service (AA+), and Fitch Ratings (AA+), all had a negative outlook:

**POSITIVES**

- Large Reserves provide time to determine what fiscal future will look like
- Some combination of re-casting the treatment of various available revenue streams currently restricted, creating new revenue, or reducing expenditures can resolve funding gap
- Baseline assumption that the State will correct deficit trend before coming close to reserve depletion
- Strong management of financial operations

**NEGATIVES**

- Future of Alaska's creditworthiness hinges on the ability of its political leaders to reach agreement on substantive fiscal reforms during the 2017 Legislature
- Narrow revenue sources continue to reflect economic volatility
- Alaska's share of the PERS/TRS net pension liabilities translates to a very high \$7,402 per capita

Mr. Mitchell noted that the earnings reserve and the permanent fund were considered as a reserve of the state, available for expenditure, when viewed from a credit perspective.

[9:08:14 AM](#)

Co-Chair MacKinnon queried the past practice of not using the earnings reserve in debt analysis.

Mr. Mitchell responded that rating analyst perspective an opinions were evolving concerning the question of using the reserve, but that credit describers for the had always included the earnings reserve; the permanent fund could not be ignored as a credit strength, and the choice could be made to appropriate from the earnings reserve. Mr. Mitchell related that, historically, the UGF had been sufficient to pay for the needs of the state, but that at current numbers the UGF was coming up short, resulting in a fiscal imbalance noted in rating agency reports. He highlighted that there were alternative funding avenues that the state could take in order to achieve a balanced budget. He reiterated the sentiment that the Legislature would possibly need to agree on new ways of balancing the budget through new taxes or revenues.

Co-Chair MacKinnon opined that the Governor's proposed budget did not reflect the sentiment from his recent State-of-the-State address in which he referred to the state's budget situation a "crisis." She lamented that the administration had control in proposing a budget that contained significant reductions, and had failed to do so. She wondered why the Legislature was being taken to task by the rating agencies when the administration had failed to present a smaller budget.

Mr. Mitchell replied that the ratings reports had been written before the release of the Governor's FY 18 budget. He thought that the ratings agencies were suggesting that a combination of budget reduction, new revenues, or the reclassification of existing revenues could solve the state's fiscal imbalance. He stated that if the Governor proposed a budget that relied on new revenue that would be an alternative, but not the only solution.

Co-Chair MacKinnon hoped that the rating agencies would notice that the administration had put forth a budget that did not reflect reductions that responded to the current fiscal crisis.

Mr. Mitchell thought that it would prove difficult for the ratings agencies to make determinations until the legislative process had concluded. He said that analysts from each service had followed the state's struggles for

the past several years, and understood that the process between the executive and legislative branches needed to be collaborative, which meant that they would be watching the current legislative session closely. He stressed that the fiscal situation of the state simply came down to hard choices and should not be considered a "now or never" situation, but that the 2017 legislative session was a proverbial line in the sand for potential rating action against the state.

Senator Olson spoke of the year and a half of warning the state had received before the drop in credit rating. He wondered how long it would be until the state was downgraded again.

Mr. Mitchell replied that it would depend on how the legislative session unfolded. He felt that if there could be a recognition that the budget could not be funded using one-time savings, but by using resources that recur, that would be an accomplishment towards a stable credit rating.

Senator Olson assessed that the burden to facilitate the recognition towards accomplishment rested with the legislature rather than the administration.

Mr. Mitchell noted that the Governor would have to sign the legislation. He reiterated that it should be a collaborative process between the executive and legislative branches.

Senator Olson asked whether the state would be downgraded if a budget were passed without new revenue sources.

Mr. Mitchell believed that the state's fiscal rating would be downgraded if a budget were to pass that did not include new sources of revenue.

Co-Chair MacKinnon wondered whether the past two years of oil tax credit vetoes by the Governor would affect the state's credit rating.

Mr. Mitchell responded that the agencies had acknowledged the possible liability in vetoing the tax credits, but that they had not been focused on the issues as they are unique to Alaska. He spoke to the positive bullet point on Slide 3, strong management of financial operation, which he stated included the Legislature. He remarked that the

Legislature had historically demonstrated fiscal prudence with the funding of reserves and the use of excess revenues. He shifted to the last two negative bullet points that indicated that the state's economy was narrow and volatile, and that the state's long-term liabilities were high at \$7,402 per capita.

Co-Chair MacKinnon spoke to the "Three Legged Stool" nature of the state's economy; one-third oil and gas, one-third federal spending, and one-third everything else.

Mr. Mitchell clarified that the one-third attributable to government included local, state, and federal government.

[9:21:15 AM](#)

Mr. Mitchell looked at Slide 5, "Executive Summary", which was an example of a slide the department recently used in a presentation to ratings analysts on the strengths and weaknesses of the state:

**The State continues to make progress in implementing a sustainable fiscal plan.**

#### **Fiscal and Budget Update**

- Budget passed with substantial reductions in operations and capital spending
- The Governor showed strong fiscal discipline, cutting costs and exercising his veto powers to significantly reduce state spending
  - Unrestricted General Fund expense reductions from FY2015: \$1.2 billion
  - Oil and gas tax credits: \$430 million
  - Paused capital projects totaling \$250 million and closed down mega-projects
  - Permanent Fund Dividend: \$665 million
- The State is continuing to drive towards long term solutions

#### **Substantial Reserves and Resources**

- General Fund balance: \$3.5 billion
- Constitutional Budget Reserve ("CBRF"): \$7.3 billion<sup>1</sup>
- Permanent Fund: \$52.8 billion, comprised of \$44.2 billion corpus and \$8.6 billion Earnings Reserve

- Oil, gas and other resource-based industries provide substantial annual revenue that is available for appropriation
- Alaska has taken extraordinary steps to improve pension funding over the past ten years including \$3 billion deposit from its CBRF in FY 2015

He pointed out that the Legislature had not overridden the Governor's previous vetoes of the oil tax credits.

[9:21:58 AM](#)

Senator Dunleavy stated that, over the previous two years, the administration had not been helpful or cooperative in reaching a sustainable fiscal plan.

[9:22:42 AM](#)

Co-Chair MacKinnon interjected that the problem effected the Operating and Capital budgets.

[9:23:03 AM](#)

Mr. Mitchell addressed Slide 6, "Revenue and Expenses: The Status Quo and Future Flexibility." The slide used the Spring Revenue Forecast:

**Absent other action, the State will continue to draw down substantial accumulated reserves.**

- Short-term balances reflect "status quo" projections (i.e., no change in dividend payout, General Fund expense, or reserve drawdown)
  - Earnings Reserve balance 2017 and beyond assumes dividend is based on statutory formula and total return of 6.9 percent
- However, under the "do-nothing" scenario, the State would still have access to substantial incremental revenue that is currently restricted by custom only **and is not included in the analysis above**
  - Includes (i) additional royalties beyond 25 percent Permanent Fund dedication; (ii) Designated General Fund Revenue; and (iii) annual investment income currently used to inflation proof the Permanent Fund, pay the Dividend and fund the Earnings Reserve

Mr. Mitchell offered that the numbers used for the slide could have changed since the Fall Forecast was released. He stated that the "Surplus/Deficit" line on the slide represented the crux of the state's difficulty when dealing with rating analyst; the line reflected a deficit every year, from \$3.9 million in FY 16 to a projected \$2.8 million in FY 21. He noted the Constitutional Budget Reserve (CBRF) was reflected to disappear by FY 19, and that the earnings reserve balance would shrink from \$8.6 million to \$3.5 million by FY 21. He reminded the committee that the numbers on the slide were based on the status quo and did not make assumptions about changes that could be made. He pointed to the bottom of the slide and highlighted that there was revenue available for appropriation that could help with the deficit, if necessary, which was a credit strength.

[9:25:06 AM](#)

Senator Micciche requested that Mr. Mitchell recap the positive information listed on Slide 5.

Mr. Mitchell recapped Slide 5.

[9:28:03 AM](#)

Senator Micciche wondered what the state's rating would be if the legislature had passed SB 128, in 2016.

Mr. Mitchell responded that if actions had been taken at the table that would have reduced deficits then the results would have been positive.

[9:29:06 AM](#)

Senator Micciche wondered whether the reductions would have still be considered positive by raters if the deficit had been brought down to approximately \$1 billion, thereby demonstrating the willingness to move forward on difficult decisions.

Mr. Mitchell reiterated that a lower deficit number would benefit the ratings number. He said that a shift to recognize a new revenue source on an annualized basis would have positive effects.

[9:29:58 AM](#)

Vice-Chair Bishop asked whether the agencies used a consistent matrix for weighting and measuring the state's assets.

Mr. Mitchell said that he could provide further information pertaining to how the rating agencies looked at state ratings. He added that he could provide information on how Alaska compared to other states. He stated that Alaska had a small population and a lot of wealth, which meant that the state received "extra credit" for the reserve position of the state relative to other states. He opined that the state does not have stable and diversified economy, and that that was what the rating companies preferred.

[9:32:16 AM](#)

Senator Dunleavy asked whether the governor would support the \$750 million in budget reductions proposed by the senate.

Mr. Mitchell asserted that he did not know what the governor would support. He predicted that a \$750 million budgetary reduction would not go unnoticed. He believed that the senate would need to weigh how those cuts would impact activities in the state, but felt that the sizeable reduction would result in a strengthening of the state's credit score.

[9:33:19 AM](#)

Co-Chair MacKinnon stressed that FY 18 was the final year that the state could draw from the constitutional budget reserve (CBR). She asked how long it would take the credit agencies to recognize action taken by the state.

Mr. Mitchell said that he did not believe that it would take much time. He restated that they would not be slow to notice significant cuts or additional revenue streams.

[9:36:05 AM](#)

Senator Micciche spoke to post employment costs, noting that prefunding those cost had always been included in funding ratios. He asked whether that forethought would improve Alaska's outlook or drag down other states outlooks that currently did not include those costs.

Mr. Mitchell believed that it would drag down other states. He said that states that had yet to identify those liabilities would have additional issues to face, rather than Alaska receiving a benefit.

[9:37:17 AM](#)

Co-Chair MacKinnon reinterpreted that Alaska recognized health benefits and the pension obligation in its funding ratios, but that other states did not.

Mr. Mitchell agreed that Alaska was better prepared for accounting changes in the future because of the attention to pension obligation, and would fare better as the changes were implemented than states that had not.

[9:38:33 AM](#)

Mr. Mitchell highlighted Slide 7, "FY 2017 Enacted Budget Overview":

Spending has been significantly reduced over the last five years from \$8 billion to less than \$4.4 billion while maintaining essential services.

Mr. Mitchell pointed out to the committee that the top left chart showed that the UGF spending had been reduced each year since 2013; the chart below illustrated composition funding sources, the largest part of which is the UGF. The upper right chart showed the Capital Budget. The lower left chart detailed the spending by funding type. He noted that federal funds had grown in 2017, while the permanent fund had diminished due to the governor's veto and inflation proofing.

[9:40:21 AM](#)

Co-Chair MacKinnon explained the committee's leveraging of designative funds that could be redeployed. She expounded on the uses of designated and undesignated general funds.

[9:42:10 AM](#)

Mr. Mitchell addressed Slide 8, "PERS and TRS Funding Status":

- FY2015 valuations illustrate the State's improved funding status across all areas of its PERS and TRS programs(1)
- FY2015 figures reflect the impact of the State's \$3 billion transfer from the CBRF
  - \$1 billion PERS / \$2 billion TRS
- Defined Benefit OPEB funding is near or above 100 percent for both PERS and TRS
- FY2015 final valuations were adopted by the ARM Board in June, were used for the purpose of determining the FY2018 funding amount, and will be included in the FY2016 CAFR

#### **Preliminary FY2016 Results**

- Preliminary FY2016 returns were -0.36 percent, well below actuarial assumptions, but consistent with other national pension returns
  - Estimated funded ratio of approximately 76.9 percent (PERS) and 81.9 percent (TRS)
- Draft FY2016 actuarial valuation incorporating FY2016 returns is expected to be available in early 2017

Mr. Mitchell relayed that the slide showed pension funding from 2014 to 2015, for both PERS and TRS, delineated by actuarial accrued liability, valuation assets, and funded ratio based on valuation assets. He noted the PERS increase from 70.1 percent in 2014 to 78.3 percent in 2015, and the TRS increase from 61.2 percent in 2014 to 83.3 percent in 2015.

[9:43:51 AM](#)

Senator Micciche harkened back to Slide 3, which listed Alaska's share of the PERS/TRS net pension liabilities at \$7,402 per capita. He wondered which metric was more important, the one on Slide 3, or on Slide 8. He assumed that current funding ratios were healthy in comparison to other states, but wondered which numbers the state should evaluate as a priority.

Mr. Mitchell thought that the pension funding had become the largest single liability of the state, and the only liability that increased from year to year after 2018. He noted that the state had hired private consultants in the fall of 2015 to analyze the unfunded liability and the

concern had been raised that the pre-funded pension program could end up costing the state an unsettling amount in future payments to employees. He believed that the biggest risk the state took was in managing the future liability.

[9:48:00 AM](#)

Co-Chair Hoffman wondered how the rating agency viewed past legislative action to close the system.

Mr. Mitchell replied that the rating agency report likely had reference to the state's attempt at restructuring the pension system. He remarked that employers of defined contribution employees, or Tier 4, paid 22 percent to fund the employee's retirement and a portion of the unfunded liability. He did not think that the payment had impacted the payments that otherwise would flow to the unfunded liability as a result of the Tier 4 structure.

[9:50:09 AM](#)

Co-Chair Hoffman clarified that the rating agencies had acknowledged the closure of the system by the legislature.

Mr. Mitchell replied that the agencies had acknowledged the closure, and saw it as a credit positive.

[9:50:28 AM](#)

Senator von Imhof queried other ideas and opportunities the administration had to offer in discussion of the future of the unfunded liability risk.

Mr. Mitchell replied that he was not aware of other alternatives offered by the administration. He felt that the alternatives were apparent; the state could make additional cash deposits into the system or pay more on an annual basis.

[9:52:06 AM](#)

Vice-Chair Bishop noted that budget cuts would result in less employees that could pay into the system.

[9:52:39 AM](#)

Senator Micciche wondered whether increasing payments over time by \$50 million per year; or a one-time large cash infusion would be better over time.

Mr. Mitchell replied that the assumption was that the invested funds would earn 8 percent, which would likely result more of a return on a large cash deposit early, rather than contributions over time.

Senator Micciche wondered what happened if the funds failed to earn 8 percent.

Mr. Mitchell responded that that in that case it could be prudent to have deposits that were staggered, over several years.

[9:54:23 AM](#)

Senator Dunleavy questioned the achievability of the targeted 8 percent return.

[9:54:47 AM](#)

Co-Chair MacKinnon interjected that there would be a future conversation in committee regarding pension and liability. She shared that the 8 percent return rate was a policy that had been adopted by the Alaska Retirement Management Board (ARM). She felt that the question should be directed to the board, and believed that conversations about lowering the interest rate return assumption had been held by the board. She noted that the current rate was optimistic, but had been achieved over the past 30 years. She added that cash flow was an issue for the board, and when they had assets in their portfolio that could generate a higher rate of return above 8 percent, the assets may need to be sold. She stressed that the issue of unfunded liability needed to be addressed by the state.

[9:57:52 AM](#)

Mr. Mitchell discussed Slide 10, "State Debt Obligation Process":

- All Forms of State Debt are Authorized First by law
  - May be a one-time issuance amount or a not-to-exceed issuance limit in statute

- o General obligation bonds must then also be approved by a majority of voters
- All State Debt must be structured and authorized by the State Bond Committee
  - o Includes general obligation bonds, subject to appropriation issues, and state revenue bonds
- The State Bond Committee determines method and timing of debt issues to best utilize the state's credit and debt capacity while meeting the authorized projects cash flow needs
- The State has established other debt obligations
  - o Reimbursement Programs
    - The School Debt Reimbursement Program or HB 528 reimbursement
    - Communities issues bonds and the State agrees to reimburse at a certain level
  - o Not currently authorized for new debt and periodically partially funded
- Retirement Systems
  - o Unfunded actuarially assumed liability (UAAL) for defined benefit employees is guaranteed by the Constitution creating a state debt
  - o Annual payments on the UAAL of other employers is reflected as State debt in the CAFR
  - o Some flexibility in how payments are made

[9:59:48 AM](#)

Co-Chair MacKinnon shared that the State Bond Committee consisted of the Commissioners of the Department of Revenue, the Commissioner of the Department of Administration, and the Commissioner of the Department of Commerce, Community and Economic Development.

Mr. Mitchell replied in the affirmative.

[9:59:58 AM](#)

Co-Chair MacKinnon surmised that decisions made concerning changes in the debt affordability analysis, or Alaska public debt, would be made by those commissioners.

Mr. Mitchell agreed.

10:00:20 AM

Mr. Mitchell looked at Slide 11, "Total Debt in Alaska at June 30, 2016." He shared that the table was from the "Alaska Public Debt" book (copy on file). He stressed that the chart had been reorganized for 2016, based on conversation with the banking community, to provide a fairer characterization of each monetary commitment. He detailed the line items listed on the table.

10:04:42 AM

Co-Chair MacKinnon jumped ahead to Slide 19, which showed that the state was noting for debt obligations the ability to further encumber itself. She wondered whether having \$5 billion available for pension obligation bonds was the right amount to have written into the books. She asked whether there would be an advantage to the state to lower the number to the \$2 billion range.

Mr. Mitchell looked ahead to Slide 19. He responded that he was not sure whether lowering the number would make a difference to the ratings agencies. He stressed that the general obligation bond obligation could not be rescinded without a public vote. He said that the Knik Arm Crossing (subject to appropriation) had an uncertain future. He did not believe that the pension obligation bonds would be double counted. He stated that the ratings agencies acknowledged that if the state were to issue bonds under that authorization, liability would be diminished elsewhere on the balance sheet. He relayed that any governor could choose to issue bonds with either of the previously mentioned authorizations.

10:08:00 AM

Mr. Mitchell addressed Slide 12, "Total Debt in Alaska at June 30, 2016." He detailed the table on the slide.

Co-Chair MacKinnon relayed that she had observed a significant differences in ratios of the principal interest and total debt reflected on Slides 11 and 12.

Mr. Mitchell suggested that individually examining the average life of each obligation could be helpful. He noted

that some obligations had longer life spans than others and that the bond bank currently had an AA bond rating for a 20 year loan and achieve a rate of approximately 3 percent, but some loans went out for 40 years.

[10:11:12 AM](#)

Vice-Chair Bishop referred to a 2008 bond package that was passed by voters for a road project in Fairbanks. He asked if the debt on the project was sold on the project in 2008, or would it encumbered in 2016.

Mr. Mitchell recounted that the 2008 Transportation Act was unusual because the state sold half of the authorization in 2009, which provided funding for a little over two years. In 2012, an appropriation of general fund dollars was made to replace the general obligation bond authorization. The Fairbanks in project was being funded with general funds based on the 2012 appropriation.

Vice-Chair Bishop asked whether bonds had been sold for the total cost of the project.

Mr. Mitchell answered in the affirmative, and expanded that bonds would not be sold for the total cost of the project, because the project would be paid for out of the general fund based on the 2012 appropriation.

[10:12:53 AM](#)

Co-Chair MacKinnon mentioned funds for a bridge in Eagle River that was included in the bond package, which could be reallocated to finish the second bridge.

Mr. Mitchell relayed that there were rules about how general obligation bonds could be reallocated. The funds were limited to the project list; if the project list included the project that the state wanted to transfer funds to, it would most likely be possible, but if the project was not on the list s transfer would not be allowed.

Co-Chair MacKinnon confirmed that the project had been on the list.

[10:13:38 AM](#)

Mr. Mitchell discussed Slide 13, "State Debt Obligations Outstanding." He noted that Slides 11 and 12 had come from the state Debt Book, and Slide 13 was from the Debt Affordability book. He thought the FY 18 UGF Payment column, which reflected \$85 million, was the most important information on the slide.

[10:14:46 AM](#)

Mr. Mitchell looked at Slide 14, "General Obligation Bonds Current Financing":

**G.O. bonds outstanding gradually decline**

**Recent Activity:**

- To date, \$342.8million of the State's 2012 GO bond authorization (\$453.2 million) has been funded
- Remaining \$110.4 million won't be issued before fiscal year 2018

Mr. Mitchell commented that the state expected to have less of an outstanding principal balance in the coming years.

[10:15:07 AM](#)

Mr. Mitchell displayed Slide 15, "General Obligation Bonds":

**Existing G.O. debt service stable and expected to gradually decline**

- Annual debt service remains well below the 1985 peak of \$169.5 million
- G.O. debt service represent 5.4% of projected unrestricted revenue for FY 2017, but declines to 2.5% by 2026

Mr. Mitchell stated that the state would face a hurdle in 2018 and 2019 with annual debt service, but the trend line for principal interest would maintain itself, even after the issuance of the \$110.4 million, and would gradually diminish.

Senator von Imhof spoke to her time on the Anchorage School Board. She wondered what would happen if the state reissued new debt, and whether a refinancing, rate lowering, or

changing of terms was possible at some point. She queried whether the state could sell assets in order to pay debt service.

Mr. Mitchell relayed that there was more regular and routine usage of geo bonds on the city level, versus the state. He shared that the state's portfolio was regularly scrutinized for refinancing opportunities, but at this time had no additional long term bonds that would be candidates for refinancing for several years.

Co-Chair MacKinnon commented that the issue of refinancing was twofold when looking at debt reimbursement for schools. She stressed that Anchorage could make a choice that benefitted them in the cost for refinancing that might not benefit the state. She mused that if the state was covering a 70 percent debt reimbursement, it would be advantageous from the state's perspective, for the bond holder to refinance. But to the bond holder, the cost would not be worth the refinance. She believed that the state could look into refinancing for the benefit of the state, but that action would impact the cost to municipalities.

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Mr. Mitchell noted that G.O. debt service represent 5.4 percent of projected unrestricted revenue for FY 17, but declines to 2.5 percent by 2026. He remarked that it was built into the primary debt capacity calculator that the state used for determining debt capacity. He said that the slide reflected outstanding payments.

[10:22:02 AM](#)

Mr. Mitchell looked at Slide 16, "Bonds Authorized by Law and Paid from General Fund":

**Existing State debt service stable and expected to gradually decline**

- Annual debt service remains well below the 1985 peak of \$182.2 million
- debt service represent 7.5 percent of projected unrestricted revenue for FY 2017, but declines to 3.7 percent by 2026
- Currently exceeds Debt Affordability Policy of 5 percent

Mr. Mitchell noted that the unrestricted revenue number being greater than 5 percent was not due to debt increasing, but rather revenues declining.

[10:22:57 AM](#)

Co-Chair MacKinnon asked whether the use of currently approved bonds, or something new, would cause the previously mentioned uptick in 2018.

Mr. Mitchell replied that he was referring to annual debt service increasing from 2017 to 2018, due to the issuance of bonds issued in 2016, which totaled approximately \$330 million and are a significant amount of the 2012 Act authority.

[10:24:27 AM](#)

Co-Chair MacKinnon understood that that was approximately a \$330 million difference.

Mr. Mitchell replied yes, of long term outstanding debt. He furthered that it was nearly \$160 million of increased outstanding debt.

[10:25:13 AM](#)

Co-Chair MacKinnon recalled a presentation that highlighted that the bond bank kept a reserve for different types of bonds. She asked whether the department was asking for any funding for a bond bank reserve.

Mr. Mitchell replied no. He furthered that the reserve fund was required by statute for the moral obligation commitment of the state, there was an annual reporting requirement on the reserve, as well. He said that there had never been a draw on the reserve due to a default of an underlying borrower. He added that the bond bank had received an

appropriation of \$13 million from the legislature in 2012, which was part of how the reserve was currently funded.

[10:26:27 AM](#)

Mr. Mitchell highlighted Slide 17, "Bonds, Bond Reimbursements and Statutory UAAL Debt":

**Bonds/Bond Reimbursements are Stable and declining versus Volatile and Growing UAAL Debt**

- The impact of UAAL debt dwarfs other debt and reimbursement commitments
- Annual payments grow by 108 percent over the next 23 years
- Annual payments represent 28.7 percent of projected unrestricted revenue for FY 2017, and remain over 25 percent through 2026
- Exceeds Debt Affordability limit of 8 percent

Mr. Mitchell relayed that the state bond committee had not convened to take formal action on how to address exceeding the 8 percent, but that the issue should not be ignored.

[10:28:06 AM](#)

Co-Chair MacKinnon noted that language had been changed in the description of the state's fiscal situation to ratings agencies to accurately describe the state's financial circumstance. She pointed to Page 7 of the Debt Affordability Analysis (copy on file), which reflected those changes. Co-Chair MacKinnon asked whether those changes provided a more accurate reflection.

Mr. Mitchell replied in the affirmative.

[10:29:19 AM](#)

Senator von Imhof queried the unfunded liability for pension payments compared to payments for health benefits.

Mr. Mitchell said that the majority of the payments were for pensions.

[10:29:57 AM](#)

AT EASE

[10:30:25 AM](#)

RECONVENED

Co-Chair MacKinnon directed committee attention to Slide 8.

[10:30:36 AM](#)

Mr. Mitchell stated that the slide reflected the funding ratios questioned by Senator von Imhof. He pointed to the middle of the chart, Mr. Boyle - Healthcare, c, which showed the 99.1 percent funding level for 2015, as of June 30, 2015; the TRS level was 100.3 percent. He said that the unfunded actuarial assumed liability currently resided primarily within pensions.

[10:31:18 AM](#)

Senator Micciche spoke to Slide 17. He queried the effect of adjusting for inflation. He thought that over 23 years the line would be flat, or reduced, and at some point would cross over below the debt affordability limit of 8 percent.

Mr. Mitchell agreed that, absent the revenue projections, if reliable revenue was incoming then Senator Micciche's scenario would be plausible.

[10:32:40 AM](#)

Co-Chair MacKinnon looked at Slide 8. She recognized that the state had infused \$3 billion in assets, a portion of which was an annual due payment and not an additional expense. She wondered why the payment went to health benefits and not pensions. She offered a recap of the debate that had occurred in 2014 concerning the \$3 billion transfer from the CBR. She requested a response from the ARM board.

[10:36:40 AM](#)

Vice-Chair Bishop referred to the bullet on Slide 16:

- Currently exceeds Debt Affordability Policy of 5 percent

He asked whether the state was over sold by 5 percent.

Mr. Mitchell replied that the state has a policy of the debt service should not equal greater than a certain percentage of unrestricted general fund revenue; 5 percent. For example, if the state had \$100 million of unrestricted general fund revenue, debt service should be no more than \$5 million per year. He said that the slide reflected that the state was above the 5 percent target at 7.5 percent, but in the 10 year forecast period in the Revenue Sources book, the number drops to 3.7 percent by 2026. He shared that the state was above 7.5 percent because the unrestricted general fund had declined. He thought that a more stable revenue stream would help to raise the percentages because the state would have a more predictable annual payment from year to year.

[10:38:27 AM](#)

Co-Chair MacKinnon directed committee attention to Page 3 of the Debt Affordability Analysis (copy on file). She said that she had compared the current report to the reports put out over the past three years in order to see the consistency and differences of the ways the state had lost revenue coming into the state. She noted Page 14 of the report, which reflected that short term debt capacity for the state was approximately \$50 million. She relayed that Page 3 reflected that over the next 10 years debt capacity only increased to \$100 million. She agreed that if the state could do something to fix revenue, the opportunity to look at debt as a resource could be there, but current conditions required an aversion to debt in order to remain attractive to credit rating agencies. She noted that the state had lost \$75 million in debt opportunity in the recent year. She praised the report as a resource for working towards a sustainable fiscal plan.

[10:40:57 AM](#)

Mr. Mitchell looked at Slide 18, "Largest State Debt Payment Volatility." He stated that the slide showed the state assistance payments that the state was obligated to make on the actuarially determined percentage of payroll for PERS, above 22 percent, and for TRS, above 12.56 percent. He said that current payments totaled \$11.23 billion through 2039, including FY 17. He relayed that a 7 percent return raised the total to \$19.6 billion. He stated that the impact would be mild in the short term, but further down the line the payments increased significantly

under 7 percent. The table offered projections at a 5 and 6 percent return.

[10:43:43 AM](#)

Co-Chair MacKinnon reiterated that there would be a PERS and TRS discussion the following day. She hoped that the conversation would be focused on the cost drivers of benefits and contracts. She urged the committee to generate questions for the presenters in advance in order to expedite the conversation.

[10:44:39 AM](#)

Senator Micciche wondered whether the administration could provide the probability matrix using the 8 percent number. He was interested in determining the actual risk to the state.

Mr. Mitchell deferred the question to the ARM Board staff, because they made the investment decisions. He asserted that the intent of the slide was not to question the assumptions. He said that history had shown that the targeted 8 percent return was reasonable, but from a budgetary perspective, new revenue would be necessary in the future.

[10:47:08 AM](#)

Mr. Mitchell addressed Slide 19, "State Debt Obligations Authorized But Unissued." He solicited further question concerning the slide.

[10:47:15 AM](#)

Vice-Chair Bishop queried the reasonable level of general obligation bond debt needed to begin dealing with the state's deferred maintenance schedule.

[10:47:49 AM](#)

AT EASE

[10:48:52 AM](#)

RECONVENED

Co-Chair MacKinnon pointed to Page 20 of the Debt Affordability Analysis(copy on file). She spoke to the

heading of "Consideration Debt Structuring Elements". She listed the different types of instruments available to the state for restructuring. She queried whether any changes had recently been made to the paragraph concerning negotiated sales.

Mr. Mitchell replied that he was unaware of any changes that had been made to the document.

[10:50:27 AM](#)

Co-Chair MacKinnon expressed interest in the language under the "Negotiated Sales" heading, number (4):

(4) if the State feels that a negotiated financing would enhance the financing marketing process and outcome

Co-Chair MacKinnon wondered what was meant by the marketing and negotiated sales.

Mr. Mitchell replied that any changes would have been made based on the judgment that a better description of why negotiated sale would be used. He offered a comparison of competitive and negotiated sales. He explained that the rationale for one sale method versus another was simplicity, market understanding, and potential volatility and credit stress.

[10:53:25 AM](#)

Co-Chair MacKinnon recalled that the report previously contained language ensuring evaluation by an underwriter or third party.

Mr. Mitchell replied that there was a financial advisor who represented the state in interactions with the market and with bankers, who made recommendations on method of sale.

[10:54:38 AM](#)

Co-Chair MacKinnon hoped for further discussion of the process of negotiated sales.

[10:54:49 AM](#)

Co-Chair MacKinnon discussed housekeeping for the following day.

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ADJOURNMENT

10:55:12 AM

The meeting was adjourned at 10:55 a.m.