

SENATE FINANCE COMMITTEE  
February 27, 2017  
9:05 a.m.

9:05:39 AM

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:05 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

Laura Cramer, Staff, Representative Anna MacKinnon; Rob Carpenter, Fiscal Analyst, Legislative Finance; Randall Randall Hoffbeck, Commissioner, Department of Revenue; Pat Pitney, Director, Office of Management and Budget, Office of the Governor; Ken Alper, Director, Tax Division, Department of Revenue; Jerry Burnett, Deputy Commissioner, Treasury Division, Department of Revenue.

SUMMARY

SB 70        APPROP. LIMIT/BUDGET PROCESS/PERM FUND

SB 70 was HEARD and HELD in committee for further consideration.

#sb70

SENATE BILL NO. 70

"An Act relating to an appropriation limit; relating to the budget responsibilities of the governor;

relating to the Alaska permanent fund, the earnings of the Alaska permanent fund, and the earnings reserve account; relating to the mental health trust fund; relating to deposits into the dividend fund; relating to the calculation and payment of permanent fund dividends; and providing for an effective date."

[9:06:23 AM](#)

Co-Chair Hoffman remarked that the Senate had introduced SB 70 primarily to address the deficit. He reminded that the body was constitutionally obligated to pass an operating budget. He remarked on the state's dwindling savings, and noted that the legislature had reduced the budget substantially from an \$8 billion budget to just over \$4 billion. There was still a deficit of over \$3 billion. He recounted that the legislature had struggled the previous year in coming up with components to address the deficit.

Co-Chair Hoffman pointed out that the previous year the Senate had passed SB 128 [legislation pertaining to the earnings of the Permanent Fund], but was unsuccessful in getting any major legislation to pass both bodies. He commented that there were one year's worth of reserves in the Constitutional Budget Reserve (CBR), and it was more critical than ever that the legislature try to address the fiscal concerns of the state. He shared that the Senate had come up with additional reductions, including the 5-4-3 plan, to cut \$750 million over the course of the next 3 years. He thought that SB 70 was a critical component of the Senate's plan. He referred to a spending limit within the bill, as well as structural changes to the Permanent Fund Dividend (PFD) Program. He thought that the restructuring would give the people of the Alaska some assurance that the dividend would be protected in the future. He referenced comments from the governor that suggested that without structural changes the dividend could be in jeopardy. He believed the people of Alaska deserved a PFD.

Co-Chair Hoffman continued discussing the PFD and thought it had averaged about \$1000 over the course of the last 20 years. He recalled the first dividend was \$1000, which he thought was a fair amount to target. He thought the bill was a beginning point. He felt that the bill was crucial to any fiscal plan that came forward from the legislature.

9:10:37 AM

Co-Chair MacKinnon expressed that she would like to walk through the bill.

LAURA CRAMER, STAFF, REPRESENTATIVE ANNA MACKINNON, discussed the Sectional Analysis for SB 70 (copy on file). She noted that many of the provisions in the bill were similar to SB 128, which the committee passed during the previous session. She related that she would highlight which sections of SB 70 were similar to the previous legislation.

9:11:30 AM

Ms. Cramer read from the Sectional Analysis:

\*Section 1: Legislative intent that the legislature reevaluate the use of the earnings of the Permanent Fund in three years

\*Section 2: Removes the reference to the current statutory appropriation limit

\*Section 3: Statutory Appropriation limit:

- Unrestricted General Fund appropriations may not exceed \$4.1 billion
- Adjusts for inflation using known inflation data
- Inflation adjustment is based on the Consumer Price Index for Anchorage prepared by the United States Bureau of Labor Statistics

Appropriation Limit excludes appropriations:

- To the Alaska Permanent Fund;
- For Permanent Fund Dividend payments;
- For payment of Debt obligations of the state (e.g. - General Obligation Bonds and Certificates of Participation);
- and for Capital projects

\*Section 4: Under the responsibilities of the governor, adds language requiring the governor to submit a report with the release of the December 15th proposed budget, a calculation of the statutory appropriation limit and how the budget falls within the limit

Ms. Cramer noted that language in Section 1 was identical to language from SB 128.

[9:13:16 AM](#)

Ms. Cramer continued to address the sectional analysis:

\*Section 5: Dedicated deposits of royalties to the Permanent Fund are reduced from the current 25/50 split on old/new leases to the constitutional minimum of 25%

\*Section 6: Requires the Alaska Permanent Fund Corporation to determine the net income of the earnings reserve account excluding the unrealized gains or losses. Deletes the existing language for determining income available for distribution from the fund "...21 percent of the net income...for the last 5 fiscal years..."

\*Section 7: (b) Defines the Percent of Market Value payout as five and one-quarter percent of the average year-end market value of the Permanent Fund and Earnings Reserve Account for the first five of the most recently completed six fiscal years. The payout may not exceed the year-end balance of the earnings reserve account for the fiscal year just ended. Excludes the Amerada Hess funds from this calculation

(c) Reserves 25% of the POMV payout for dividends. The remaining 75% of the payout is subject to a dollar for dollar reduction as oil and gas revenue rises above \$1.2 billion. The reduction takes place if (1) exceeds (2):

(1) Total amount of non-dedicated royalties - oil and gas production taxes, mineral lease rentals, royalties, royalty sale proceeds, net profit shares, and federal mineral revenue sharing payments and bonuses that are deposited into the general fund in the current fiscal years

(2) \$1,200,000,000 revenue limit

Ms. Cramer continued to discuss the sectional analysis:

\*Section 8: Changes the Percent of Market Value payout from five and one-quarter percent to five percent (effective date found in section 20, July 1, 2021)

\*Section 9: The Amerada Hess funds which are deposited into the capital income fund are not available for distribution under the POMV calculation

\*Section 10: AS 37.13.145 is the Disposition of Income of the Permanent Fund statute  
Subsection (e) allows for appropriation from the ERA to the general fund subject to the provisions outlined in Section 7  
Subsection (f) provides an inflation proofing mechanism whereby any amount in the ERA over 4 times the POMV payout (less the payout just made) may be appropriated to the Permanent Fund Principal

\*Section 11: Allows for appropriation from the ERA to the Dividend fund 25% of the amount calculated for the POMV (Dividends are comprised of 25% of the 5.25% POMV)

Ms. Cramer pointed out that language from Section 9 had also been in SB 128.

[9:16:29 AM](#)

Ms. Cramer continued to discuss the sectional analysis, noting that Section 12 was also language from the SB 128:

Section 12: Mental Health Trust Fund may not be included in the computation of income available for distribution under the POMV

\*Section 13: Clarifies that the amount to the dividend fund is the amount appropriated (not transferred)

\*Section 14: The amount of each Permanent Fund Dividend for fiscal years 2018, 2019, and 2020 shall be \$1,000

\*Section 15: Conforms to Sec. 11, which moves money to the Dividend Fund by appropriation

\*Section 16: Once the money is in the Dividend Fund, the Department of Revenue shall annually pay dividends without further appropriation

\*Section 17: Repeals current statutory appropriation limit language and the current dividend calculation

\*Section 18: Repeals Section 14 - \$1,000 dividend for three years on June 30, 2021

\*Section 19: Transition language giving the Commissioner of Revenue and the Alaska Permanent Fund Corporation the authority to adopt regulations, policies, and procedures to implement this Act

\*Section 20: Previous section takes effect immediately

\*Section 21: Effective date for Section 8 - changes the Percent of Market Value payout from five and one-quarter percent to five percent, July 1, 2021

\*Section 22: Effective date of July 1, 2017

Co-Chair Hoffman asked if the committee had received an opinion as to whether the bill met the single-subject rule.

Ms. Cramer relayed that typically there was a memo at the time a bill was drafted, and she had not received one with SB 70.

[9:20:17 AM](#)

ROB CARPENTER, FISCAL ANALYST, LEGISLATIVE FINANCE, discussed the document "LFD Fiscal Model," which showed five graphs and a data table (copy on file). He pointed out the graph in the upper left quadrant, which depicted Unrestricted General Fund (UGF) revenue and UGF budget under the bill scenario. The blue bars denoted existing UGF revenue, and the green bars denoted the Percent of Market Value (POMV) payout. The orange bars depicted usage of the Constitutional Budget Reserve (CBR) to balance the budget. He informed that the bottom axis showed fiscal years from FY 16 to FY 26. The model showed that by FY 26, the budget was virtually balanced. The table on the bottom left of the sheet showed the numbers reflected by the graph. The graph showed that a \$58 million deficit would remain in FY 26. He noted that the margin of error on the projections was

significant, but thought the graph represented a balanced budget.

Mr. Carpenter drew attention to the 2nd graph on the left-hand side, which depicted the health of the budget reserves under the bill scenario. He pointed out the orange bars, which represented the CBR, and the green bars that represented the Permanent Fund Earnings Reserve Account (ERA). The graph entitled 'Dividend Check' on the upper right of the model depicted the status quo dividend with a red line; and the dividend under the model of SB 70 was represented by a purple line.

Mr. Carpenter directed attention to the middle graph on the right-hand side of the document, "Permanent Fund," which showed the health of the fund under the model compared to the status quo. The fund maintained its real value over the time span, and ended in FY 26 at 102 percent of real value. He noted that the PFD payout (represented on the table below the graph) started at 5.75 percent and dropped to 5.25 percent and then 5 percent. The plan provided an effective payout of 4.56 percent starting in FY 18 because of the 5-year average.

Mr. Carpenter spoke to the graph on the lower right, "Payout for Dividends and General Fund," which was a depiction of the amount to be paid or transferred into the General Fund (GF) and the amount transferred into the dividend fund. Approximately \$1.8 billion would be transferred in FY 18, rising to \$2 billion, with almost \$2.3 billion transferred to the GF by FY 26.

[9:23:36 AM](#)

Senator Dunleavy asked if the model assumed budget cuts had taken place.

Mr. Carpenter noted that the model reflected no cuts.

Senator Dunleavy asked if the model showed a \$180 million capital budget.

Mr. Carpenter answered in the affirmative.

Senator Dunleavy directed attention to the bottom right graph entitled "Payout for Dividends and General Fund." He

asked if the government take was greater, or if it changed in relationship to the dividend after FY 23.

Mr. Carpenter stated that the payout amounts were shown on a table directly below the graph, and observed that the payouts went from \$1.8 billion to \$2.1 billion in FY 23. He stated that theoretically as the market value of the fund grew, the payout for government and the dividend would grow with it.

Senator von Imhof reflected that part of SB 70 had a spending cap starting at \$4.1 billion UGF. She asked if the total budget included designated funds or only UGF.

Mr. Carpenter explained that the model showed the UGF budget and revenue picture, to which the spending limit would apply.

Senator von Imhof thought the dotted line on the graph should start at about \$4.1 billion initially.

Mr. Carpenter answered in the affirmative, and noted that the dotted line on the graph depicted roughly \$4.3 billion, and the appropriation limit excluded appropriations for state debt (general obligation bonds, etc).

[9:26:14 AM](#)

Co-Chair Hoffman asked if the appropriation limit also excluded the capital budget of \$180 million.

Mr. Carpenter answered in the affirmative.

Co-Chair Hoffman asked if the inflation factor was calculated as a constant 2.25 percent.

Mr. Carpenter stated that the graphs modelled 2.25 percent inflation.

Co-Chair Hoffman asked if Mr. Carpenter could explain the CBR earnings shown at 2.89 percent.

Mr. Carpenter explained that the Department of Revenue currently estimated that 2.89 percent was the assumed rate of return for the CBR.

Co-Chair Hoffman asked about the rate of return over the previous ten years.

Mr. Carpenter did not have an exact figure, but suggested that the rate of return had been considerably low given the lower balance in the CBR, which had led to conservative investments.

Senator Micciche noted that the committee tried to apply pressure (while still managing liquidity) and to more aggressively invest the CBR earnings so that they were more similar to the PFD. He was glad the model was relatively conservative with the CBR earnings, but felt that a substantial amount of potential earnings had been given up. He hoped that if the legislation moved forward that the subject would be more carefully evaluated. He understood that there would be a greater demand for liquidity, but he thought any greater earnings to the CBR would make the model look better. Any increase in the price of oil or any additional budget cuts would also make the model look better. He understood that the model was predicated on assumptions and the understanding of the fall forecast.

Mr. Carpenter agreed.

Senator Olson asked if deferred maintenance was considered under the modelling or was part of the \$180 million capital budget.

Mr. Carpenter stated that the \$180 million was higher than the current capital budget, and considered the amount needed to match federal funds. He acknowledged that there was some amount built in for deferred maintenance in the out years, but it was not a significant amount given the considerable backlog. He thought there could be pressure to have a capital budget larger than \$180 million, but LFD had to assume a number for modelling purposes.

[9:30:12 AM](#)

Senator Dunleavy referred to Section 5 of the bill, and asked how the split of dedicated deposits of royalties was determined.

Mr. Carpenter noted that Section 5 would change the dedicated royalty of the Permanent Fund back to the constitutionally required minimum. Currently, the royalty

to the fund was based on the minimum plus any fields from 1979; and was averaging approximately 30 percent. The bill would reduce the royalty to 25 percent required by the constitution, in order to provide more money to the GF.

Senator Dunleavy asked about Section 7, and wondered why the 5.25 percent POMV was chosen.

Co-Chair MacKinnon communicated that the same POMV amount had been in SB 128 the previous year.

Ms. Cramer stated that the committee had run variable numbers through the model that Mr. Carpenter had presented, and the 5.25 percent was chosen with recognition of the many years of deficit spending and use of the state's reserves. More funds were needed to help with the fiscal challenges of the state at the outset, and the rate was set at 5.25 for three years. The amount was a policy call made by the body.

Senator Micciche referenced modelling that was done when considering SB 128 the previous year; and the 5.25 percent had not "failed the test" when considered by the committee. He asked if the amount would drop down to 5 percent after three years.

Ms. Cramer answered in the affirmative. She reiterated Mr. Carpenter's assertion that the effective payout was not 5.25 percent, but rather an average of approximately 4.5 percent for the next 9 years.

Co-Chair MacKinnon asked if the effective payout was based on a five-year average.

Ms. Cramer answered in the affirmative.

Co-Chair Hoffman noted that the two areas of great concern were debt service, and contributions to the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS). He asked how the items were treated in the model, and if there was a forecasted payment schedule.

Mr. Carpenter answered in the affirmative, and specified that there was forecasted state assistance, retirement, and debt service built in to the operating budget as projected by the actuaries.

[9:34:05 AM](#)

Senator Dunleavy asked about Section 11, and wondered why the appropriation to fund the dividend was chosen to be 25 percent of the POMV, rather than a greater amount.

Ms. Cramer explained that the amount was a policy decision. She noted that there had been discussion of 33 percent and 50 percent in other bills.

Senator Dunleavy asked for an explanation of an appropriation versus a transfer as listed in Section 13 of the bill.

Mr. Carpenter stated that the intent of Section 13 was to signify that there would be an appropriation to the Dividend Fund, and there were no further appropriations required.

Co-Chair MacKinnon recalled that the governor had vetoed the previous year's dividend, and asked if the language in Section 13 would affect his ability to veto future dividends.

Mr. Carpenter answered in the negative.

Senator Dunleavy asked if the governor could still veto a dividend.

Mr. Carpenter answered in the affirmative.

Senator Micciche thought it would be interesting to have a retrospective white paper that explicated the objectives for choosing the numbers associated with the Permanent Fund, such as the amount of dedicated deposits of royalties. He thought he had broad-based knowledge of the formation of the fund and the ensuing dividend program that came after, but thought it would be enlightening for the public and members to have the additional information.

Co-Chair MacKinnon believed that many did not know that the legislature had contributed billions of dollars in excess of its constitutional responsibility to make sure that the fund was healthy.

[9:38:01 AM](#)

Senator Dunleavy asked about the spending cap, and wondered how to prevent the shifting of operating dollars to capital.

Co-Chair MacKinnon stressed that preventing the shift of funds was the legislature's responsibility. In the past, operating funds had been called "one-time items" and moved to the capital budget. She referred to past actions of Senator Bert Stedman; who had extensive knowledge of finance, and had adjusted the books so that the fund shifting would not occur. She thought it was important for the legislature to hold itself accountable in making sure that capital items were in the capital budget, and operating items (recurring expenses) were in the operating budget. As chair of the capital budget, she had identified items in the current capital budget that she believed belonged in the operating budget. She affirmed that the committee would realign the proposed capital budget so that the policies and transactions stayed in the correct place.

Senator Dunleavy requested the LFD Fiscal Model to be calculated after considering \$300 million in cuts.

Co-Chair MacKinnon asked about the presumption for current spending used to calculate the model. She thought it had taken a reduction into account, although not the entire \$300 million referenced by Senator Dunleavy.

Mr. Carpenter stated that the \$4.3 billion depicted on the model was reflective of the current spending level. If the exclusions under the appropriation limit were assumed (primarily the amount going to debt service), then the total would be approximately \$4.08 billion.

Co-Chair MacKinnon asked Mr. Carpenter to prepare the document as requested, accounting for the goal of \$300 million in reductions.

Senator von Imhof wanted to discuss the Anchorage Consumer Price Index (CPI) as the inflation index. She thought using a 5-year average of the POMV helped to reduce variability over time. She shared a concern about variability in the Anchorage CPI. She wondered if LFD had given thought to doing a five-year retrospective look at the CPI in Anchorage. She understood that there was a CPI recorded for Anchorage but not for Alaska as a whole. She thought a

five-year retrospective would provide a smoother number over time.

Mr. Carpenter did not believe there had been discussion of averaging of the CPI, but thought it was a reasonable consideration. He concurred that inflation had some volatility, although not as extreme as market returns.

[9:42:26 AM](#)

Senator Micciche asked if Mr. Carpenter could provide the committee with a 20-year chart of the Anchorage CPI to provide more understanding of the possible fluctuation. He thought using the Anchorage CPI also provided cost control, more so than an Alaska-wide index.

Mr. Carpenter thought Senator Micciche had made a fair assessment. He stated that there was a more conservative growth rate in the appropriation limit by using the Anchorage CPI rather than an index of all of Alaska.

Ms. Cramer added that as Senator von Imhof had stated, the United States Bureau of Labor Statistics only provided a CPI calculation for Anchorage rather than statewide. She addressed Senator Dunleavy's question pertaining to controlling operating expenses and not shifting them to the capital budget. She pointed out that on page 2, line 19 of the bill there was a fairly strict definition of "capital project." She thought the definition did not preclude the shifting of appropriations, but the definition was specific to activities such as construction, repair, structural improvement, land acquisition; with a \$10,000 threshold.

Vice-Chair Bishop referred to the downturn of the price oil in the 1980's, and recalled that the state had grown at a rate of 1 percent over about 20 years. He thought the plan was close to optimal, but might need small changes. He referred to deferred maintenance, and emphasized that it was necessary for the legislature work with the administration to get on a schedule. He feared that if a schedule was not accomplished, the state would never get out of a cycle of peaks and valleys with UGF funds.

[9:46:05 AM](#)

Senator Dunleavy asked about the timeline of the bill, and when Co-Chair MacKinnon expected to take action on the bill.

Co-Chair MacKinnon did not have an expectation as to a timeline for the bill, and stated that the committee was waiting on the Senate State Affairs Committee to send the other options.

Senator Micciche referred to Vice-Chair Bishop's comments, and thought everyone could agree that the state was in emergency management mode the past several years; and there had been no opportunity to spend funds on deferred maintenance. He agreed that deferred maintenance was a debt burden that would continue to grow until there was a plan in place. He thought that the bill dealt with the majority of the fiscal gap and balanced the budget over time. He thought increased revenue would allow for comprehensive planning. He thought that if the price of oil went even lower it would necessitate further cuts and possibly broad-based taxes. He hoped that the plan would stabilize the economy and bring the state out of a recession. He spoke to the investment environment in the state and the importance of a plan.

[9:49:12 AM](#)

Senator von Imhof recounted that the Anchorage School had done an analysis and evaluated each of its buildings to prioritize and create a scheduled maintenance and replacement plan. She thought a statewide comprehensive evaluation would be challenging but positive. She pondered a reasonable prioritization and evaluation system that made sense to plan over time.

Senator Olson asked how the implementation of the state income tax would affect the model, at the rate being discussed in the other body.

Mr. Carpenter stated that implementation of an income tax would be reflected in a surplus in the upper left quadrant on the model, and would be observable in about FY 23.

Senator Dunleavy thought the state needed a maintenance schedule as discussed by Senator von Imhof, to include reevaluation of assets and priority setting. He thought a

selling or abandoning of assets was also important to consider.

Senator Dunleavy referred to Senator Olson's question about income tax, and asked if anything in the bill would prevent the spending of the proceeds from such a tax.

Mr. Carpenter relayed that an income tax would be considered UGF, and the appropriation limit could be exceeded with a simple majority vote.

[9:53:30 AM](#)

Senator Dunleavy asked if the price of oil would reduce the draw on the permanent fund and factor into the use of an income tax.

Ms. Cramer answered in the affirmative. The revenue limit applied to the POMV draw, and oil and gas revenue above the amount.

Co-Chair MacKinnon discussed a possible amendment to lower the revenue limit.

Senator Dunleavy considered that any tax revenue could be included in the scenario.

Senator Micciche thought that the primary focus should be on the health of the corpus of the Permanent Fund. He agreed with Senator Dunleavy in that if there was a dramatic improvement in the price of oil, increased spending could occur. He thought it was necessary to be absolutely mindful of future additional revenues. He reminded that the bill was merely adjusting an existing statutory spending limit, and the plan was for a constitutional limit in the future once right growth was engaged. He thought there were assets in the state that were kept on the books. He reiterated that the legislature would have to exercise discipline to ensure that the state did not return to a model of excess spending.

[9:57:15 AM](#)

Co-Chair MacKinnon understood that departments had lists of its facilities as well as the schedule in place for maintenance.

Ms. Cramer relayed that she had communicated with the Office of Management and Budget (OMB) two weeks previously, and found that it had a running list of deferred maintenance with prioritization criteria. She furthered that OMB had a presentation ready and available to show the committee. She affirmed that there were deferred maintenance plans within individual departments directed by the governor's office.

Co-Chair MacKinnon recognized departmental staff in attendance.

Co-Chair MacKinnon thought all the elements of the bill were extremely important to Alaskans. She stated that the committee had tried to expeditiously produce the bill. She commented that each section was an opportunity to "turn a knob" in public policy, such as the setting of the POMV draw. She referred to a recent constituent meeting at which someone asked about the POMV draw, which was a flat percentage rate of the total value of the Permanent Fund. The rate could be used in a calculation that would provide dividends and a revenue stream for state government.

[10:00:18 AM](#)

Co-Chair MacKinnon noted that each section of the bill was an opportunity to do things differently. She remarked that the bill was in draft form, and was subject to change. She hoped to move a piece of legislation out of the committee as quickly as possible. She asserted the national credit rating agencies were watching the state. She noted that the state's unfunded pension liability exceeded \$6 billion. She pointed out that nationally pension programs and private programs were reducing assumptions on returns. She thought the state was structurally imbalanced. She agreed with other proposals that included reductions. She emphasized the collaborative process of working within the legislature to solve fiscal problems. She expressed optimism that the committee members would bring diverse people's views to the table. She noted that the state had the highest unemployment rate, by over 2 percent, and was now in recession.

Co-Chair MacKinnon discussed the agenda for the following day.

#

ADJOURNMENT  
10:04:31 AM

The meeting was adjourned at 10:04 a.m.