

SENATE FINANCE COMMITTEE

March 1, 2017

9:01 a.m.

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CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:01 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

Randall Hoffbeck, Commissioner, Department of Revenue;
Angela Rodell, Chief Executive Officer, Alaska Permanent
Fund Corporation.

SUMMARY

SB 70 APPROP. LIMIT/BUDGET PROCESS/PERM FUND

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

PRESENTATION: SB 70 OVERVIEW - RANDALL HOFFBECK,
COMMISSIONER, DEPARTMENT OF REVENUE

#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."

^PRESENTATION: SB 70 OVERVIEW - RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE

[9:02:16 AM](#)

RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, discussed the presentation, "SB 70 REVIEW" (copy on file). He informed that the presentation was the department's review of the bill in relationship to what it considered critical components that needed to be in any Permanent Fund restructure bill.

Commissioner Hoffbeck showed slide 2, "Part I - THE PERMANENT FUND'S ROLE IN A SOLUTION."

Commissioner Hoffbeck turned to slide 3, "USE OF PERMANENT FUND EARNINGS":

"This proposal, if approved, would amend the Constitution of the State of Alaska by ... establish[ing] a constitutional permanent fund into which at least 25 percent of all [mineral royalties] received by the State would be paid. The principal of the fund would be used only for income-producing investments permitted by law and the income from the fund would be deposited in the general fund of the State and be available to be appropriated for expenditure by the State unless otherwise provided by law."

Ballot Proposition No. 2
Permanent Fund from Non-Renewable Resource Revenue
Constitutional Amendment

Commissioner Hoffbeck thought there had been some disagreement as to what the Permanent Fund was originally established for. As evidenced by the ballot proposition language on the slide, the commissioner thought that it was the original intent of the fund to have the money available for appropriation for state expenditures.

Commissioner Hoffbeck displayed slide 4, "WHY USE PERMANENT FUND EARNINGS":

FY18 Budget \$4.3 billion
FY18 Budget Gap \$2.8 billion

Potential Tools to Close the Gap

Motor Fuels Tax Increase \$0.1
Broad Based Tax \$0.6
Oil Tax Credit Reform \$0.1
Max. Cuts Proposed (over 3 years) \$0.75
SB70 (net dividend) \$1.9

Commissioner Hoffbeck remarked on the governor's budget and the tools that had been proposed to close the fiscal gap. He highlighted the last two items on the slide, which were focused on in the bill.

Commissioner Hoffbeck showed slide 5, " Part II - STRUCTURE FOR USING THE PERMANENT FUND." He thought the Permanent Fund was a multi-billion-dollar solution, where other potential solutions were \$100 million solutions. He thought that it was not possible to solve the state's fiscal problem without using the Permanent Fund as one of the major components of any plan.

Senator Micciche referred to the Senate Majority's proposal of \$750 million in cuts over three years. He thought the commissioner had discussed the proposal as an aspect of the bill.

Commissioner Hoffbeck clarified that he had mistakenly spoke of the cuts as if they were contained in the bill. He continued that the cuts had been discussed as a companion to achieve the Senate's goal.

Commissioner Hoffbeck discussed slide 6, "STRUCTURE FOR USING THE PERMANENT FUND":

1. Rule-Based Framework (Saving, Spending, Dividend)
2. Stabilize the Budget
3. Protect the Dividend
4. Protect the Permanent Fund
5. Maximize the use of the Earnings Reserve

Commissioner Hoffbeck stated that over the previous two years, there were over 63 hearings on various Permanent

Fund restructuring bills. The governor, himself, and Office of Management and Budget (OMB) Director Pat Pitney had done over 500 meetings and presentations in the state, discussing fiscal plans and fiscal issues. He explicated that the administration had come up with five components of what was necessary for any restructuring of the Permanent Fund.

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Commissioner Hoffbeck turned to slide 7, "STRUCTURE FOR USING THE PERMANENT FUND":

A plan to use the fund should be ...

1. Rule-Based (Saving, Spending, Dividend)
 - Greatest threat to long term fund durability is unplanned withdrawals
 - Withdrawals need to occur under a set of statutory rules
 - Designed to protect the fund and guard against unsustainable uses
 - Ensure the ERA holds enough to bridge years of low earnings ("ERA durability")

Commissioner Hoffbeck commented that the proposed bill was not seen as a short-term fix, but rather was a long-term structural change in how the state would fund government.

Commissioner Hoffbeck reviewed slide 8, "STRUCTURE FOR USING THE PERMANENT FUND":

A plan to use the fund should be ...

2. Stabilizing:
 - Over the long term, economies that experience repeated ups and downs grow slower than stable economies.
 - Because commodity prices are volatile, economies dominated by a single commodity industry, like the petroleum industry, experience more (and more pronounced) cycles.
 - Permanent Fund Earnings can play a central role in reducing four decades of boom and bust budgeting cycles

Commissioner Hoffbeck expressed that the Permanent Fund could be used as a tool for stabilizing revenues, as well as a tool for stabilizing the size of government; so that the state could come out of the of boom and bust budgeting cycle.

Commissioner Hoffbeck showed slide 9, "STRUCTURE FOR USING THE PERMANENT FUND":

A plan to use the fund should...

3. Protect the Dividend

- Reflects the current and future economic realities of shrinking oil and gas tax revenue.
- Recognizes that too large a dividend limits available options for full fiscal solutions.
- Provides for a sustainable dividend for all generations of Alaskans.

Commissioner Hoffbeck had recognized how important the dividend was as part of the economic base of the state. He thought the size of the dividend needed to reflect the economic realities of the state budget. He explained that the larger the dividend, the more the deficit would have to be filled with other sources.

Commissioner Hoffbeck displayed slide 10, "STRUCTURE FOR USING THE PERMANENT FUND":

A plan to use the fund should...

4. Protect the Permanent Fund

- Meant to provide for funding state expenditures for all generations of Alaskans.
- Maintain or grow the real (inflation-adjusted) value of the permanent fund.
- Withdrawing too much is unsustainable and risks damaging the fund.

Commissioner Hoffbeck reiterated that the Permanent Fund was meant to be multi-generational, and needed to grow with inflation. Drawing too much from the fund was unstable and risked damaging the corpus of the fund.

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Commissioner Hoffbeck spoke to slide 11, "STRUCTURE FOR USING THE PERMANENT FUND":

A plan to use the fund should ...

5. Maximize the use of the Permanent Fund Earnings:

- As North Slope production declines, the fund's earnings will be increasingly important in eliminating the fiscal imbalance in order to sustain public services.
 - Similar to petroleum revenue, investment earnings can be highly variable.
 - Unlike petroleum, our financial reserves are a renewable resource.
- Withdrawing too little limits future options for full fiscal solutions.
- Other proposed new revenues and cuts could reduce the deficit by millions, the fund can sustainably contribute billions.

Commissioner Hoffbeck noted that there were several versions of bills that included some form of Permanent Fund restructuring. He emphasized the importance of using the tool of the Permanent Fund to its fullest potential. He pointed out that the state made substantially more on the earnings of the Permanent Fund than it made on oil and tax revenue.

Commissioner Hoffbeck showed slide 12, "Part III - SB 70 MODELING."

Commissioner Hoffbeck turned to slide 13, "MODEL SOPHISTICATION AND VETTING":

- Key aspects of the model
 - Probabilistic treatment of oil prices, oil production, investment returns
 - Focus on detail of how money flows between permanent fund, general fund, and dividends
 - Assumptions from objective sources
 - Monte Carlo simulations
- Vetted by McKinsey last year
 - Found no major mechanical errors, reasonable assumptions
 - Approved of Monte Carlo probabilistic method

- Suggested improvements, some of which the Department of Revenue (DOR) has incorporated (for example, probabilistic oil production, autocorrelation)

Commissioner Hoffbeck reviewed slide 14, "METHOD, INPUTS, AND ASSUMPTIONS":

- Permanent Fund Starting Value: \$54.9 billion
 - Realized portion of corpus: \$37.9 billion
 - Realized portion of earnings reserve account (ERA): \$9.7 billion
 - Unrealized earnings held by the fund: \$6.3 billion
 - Starting value based on
 - APFC forecast for end of fiscal year 2017 (FY17), without inflation proofing transfer for FY17
 - Because APFC accounts for October 2017 dividends in FY17, scenarios starting with \$1,000 per person dividends begin with a higher realized ERA balance of \$10.6 billion and a total fund balance of \$55.8 billion
- Investment Return: Callan Associates' 10-year forecast
 - Total return: 6.95% geometric, 12.32% standard deviation
 - Statutory return: 6.24% mean, 2.24% standard deviation
 - Inflation rate: 2.25%

Commissioner Hoffbeck emphasized that the investment return numbers used on the slide were from the Permanent Fund Corporation. He assured that the department attempted to use objective numbers wherever possible.

Commissioner Hoffbeck showed slide 15, "METHOD, INPUTS, AND ASSUMPTIONS":

- Petroleum Revenues:
 - Oil price: Probabilistic analysis of ANS oil prices using a PERT distribution from the fall 2016 price forecasting session
 - Production: Probabilistic analysis of ANS oil prices using a PERT distribution from the DNR provided Fall 2016 RSB

- CBR: \$4.4 billion beginning of year 2018 balance & a 2.25% rate of return

Commissioner Hoffbeck displayed slide 16, "BUDGET ASSUMPTIONS," which showed a line graph. The dotted line showed the baseline UGF revenues. The yellow line showed the effect of SB 70 with \$750 million in cuts. The blue dashed line portrayed SB 70, plus capital and debt service (the bill's appropriation cap plus capital and debt service). The green dashed line showed the extended 10-year OMB fiscal plan. He thought it was possible to see that the SB 70 appropriation cap was very similar to what OMB had forecasted for forward-looking budgets. He pointed out the delta that occurred with the \$750 million in cuts.

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Commissioner Hoffbeck spoke to slide 17, "SB 70 SCENARIOS MODELED":

- Deposits: 25% of royalties deposited into the permanent fund
- Draw Calculation
 - Maximum POMV:
 - For first 4 years, 5.25% of the average value of the fund in the first 5 of the last 6 years.
 - Beginning in FY22, 5% of the average value of the fund in the first 5 of the last 6 years.
 - Draw Limit: The maximum POMV amount is reduced by \$1 for every \$1 that UGF royalties and production taxes exceed \$1.2 billion.
- Dividend Calculation:
 - 25% of the maximum POMV calculation (before applying the draw limit).
 - Overwriting the above calculation, the dividends for CY2017, CY2018 and CY2019 are \$1,000 per person (the fund starting value accounts for the CY17 dividend).
- Inflation Proofing: Any ERA balance over 4 times the full POMV calculation (after the current year draw) is transferred to the corpus.

Commissioner Hoffbeck clarified that if the amount of the draw was reduced based on the draw limit, it would not reduce the size of the dividend.

Senator von Imhof referred to slide 16, and the blue line that represented SB 70 plus capital and debt service. She asked what assumptions were used for capital and debt service.

Commissioner Hoffbeck stated that the OMB numbers were used.

Senator von Imhof did not see growth in capital other than inflation.

Commissioner Hoffbeck answered in the affirmative.

Commissioner Hoffbeck discussed slide 18, "SB 70 SCENARIOS MODELED":

- SB70 with Full Fiscal Plan (full deficit closure, no additional draws)
 - The model assumes that the permanent fund framework is immune to any UGF deficit
 - This means that there are no unplanned withdrawals from the ERA
- SB70 with no other Measures (structural deficit remains requiring additional draws):
 - The model uses the \$4.1 billion appropriation limit in SB 70 plus OMB's capital budget and debt service payments as the budget assumption
 - Any deficit remaining after the planned withdrawal from the ERA is filled first from the CBR; after the CBR is depleted, budget deficits are filled by unplanned withdrawals from the ERA
- SB70 with 3 year \$750 million in cuts (\$300, \$250, \$200 million)
 - The model uses the \$4.1 billion appropriation limit in SB 70 plus OMB's capital budget and debt service payments as the budget assumption

- o Deficits are reduced by incremental spending reductions of \$300, \$250, \$200 million. Any deficit remaining after the planned withdrawal from the ERA is filled first from the CBR; after the CBR is depleted, budget deficits are filled by unplanned withdrawals from the ERA

Commissioner Hoffbeck turned to slide 19, "Part IV - DRAW DURABILITY." He noted that there had been discussion as to whether the 5.25 percent draw was too large. He thought it was important to look at the impact of 5 of the last 6 years of the draw calculation.

Commissioner Hoffbeck discussed slide 20, "POMV DRAW":

- 5.25% of the average fund value in the first 5 of the last 6 years
- Example: draw calculation for fiscal year 2018
End of FY
 - o Average fund value in the first 5 of the last 6 years = \$48.1 billion
 - o 5.25% of \$48.1 = \$2.5 billion
 - o Effective POMV: = 4.7% of 2017 value
- Aggressive, but sustainable ... if the draw limit is applied

Commissioner Hoffbeck directed attention to the table on the slide that showed the average fund value from 2012 to 2018. He pondered that while a 5.25 percent draw was aggressive, it was sustainable based on what experts had said. He thought that some people were more comfortable with a 4.25 percent draw. He noted that the actual real draw against the current value of the fund was about 4.7 percent.

Commissioner Hoffbeck showed slide 21, "THE EFFECTIVE POMV":

Based on historic fund values, these "snapshot" POMV calculations demonstrate that, 5.25 percent of the fund's average market value in the first 5 of the preceding 6 years is generally less than 5.25 percent of the fund's current value.

The slide also showed a bar graph that considered five-year increments of the effective POMV. He reviewed the hypothetical effective POMV in past years.

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Senator Micciche asked how the commissioner would feel about a 5.25 percent draw for the first five of the preceding 6 years, with a 5.25 percent cap. The cap would keep the draw from rising above 5.25 percent in heavy earning years of the fund.

Commissioner Hoffbeck stated that there were years in which the draw would be high, as well as years in which the draw would be substantially lower. He thought if a cap was applied, it may artificially constrain the amount that could be drawn in a given year; not recognizing the fact that there would be years that the 5.25 percent draw would be substantially lower than what the fund could actually achieve.

Senator Micciche asked, using the commissioner's logic to look at a 20-year horizon, if the draw averaged out and did not jeopardize the fund (even without a 5.25 percent cap).

Commissioner Hoffbeck answered in the affirmative, and stated that the department would show some modelling that considered a 24-year time span, that would show the draw was durable and sustainable at 5.25 percent.

Senator Micciche wondered if a 5.25 percent draw on a well-managed, well-diversified fund would remain safe over a long span of time that included historic lows and other such impacts that had been seen in the history of the Permanent Fund.

Commissioner Hoffbeck believed that the Permanent Fund was well-diversified, and had a projected 6.95 percent rate of return. He thought a 5.25 percent draw was achievable.

Co-Chair MacKinnon referred to Senator Micciche's comments and referenced a language change in the bill from a flat 5.25 percent draw to an "up to 5.25 percent" draw.

Co-Chair MacKinnon spoke to the importance of intelligibility. She wanted to clarify that she was

referring to a possible language change regarding the POMV draw.

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Senator von Imhof liked the "up to" rails around the draw. She thought if there were 2 or 3 or 4 years of decreasing market values, then the draw would look different. She noted that the numbers in the bill worked when the fund was rising at a relatively stable and predictable rate each year. She thought the math could become problematic if the fund had any kind of losses.

Commissioner Hoffbeck referred to Section 10 of the bill, and thought there was already "up to" language.

Co-Chair MacKinnon remarked that the language in the bill made the 5.25 percent a maximum draw.

Senator von Imhof thought that if a little less was drawn on an annual basis, there would be a little more in the ERA, and there would be a cushion in the case of a two or more year of loss in the fund. She thought a quarter of a percent could make a difference in years that earnings were low.

Commissioner Hoffbeck stated that "up to" language did not do any damage to the bill, as long as the maximum draw was left at 5.25 percent.

Vice-Chair Bishop thought the draw limit was helpful, as in high years of earnings the corpus of the ERA was increased.

Commissioner Hoffbeck stated that the draw limit was more tied to increasing oil prices than increasing returns, since the trigger was when oil prices reached a certain level. Increased earnings would increase the draw.

Senator Micciche thought that the draw limit served as an averaging mechanism. He thought the value of the limit was when oil prices were higher, it would diversify use of the investments.

Commissioner Hoffbeck agreed.

Commissioner Hoffbeck displayed slide 22, "DRAW LIMIT":

- Reduces the POMV draw by \$1 for every \$1 that UGF production taxes and royalties exceed \$1.2 billion.
- Does not apply to the portion of the POMV going to dividends.

Commissioner Hoffbeck spoke to slide 23, "UGF REVENUE WITH POMV & DRAW LIMIT," which showed a graph titled "UGF Revenue and Oil Price." He thought the graph showed how the draw from the ERA started to shut itself off as royalties and production taxes increased. Starting around \$75 per barrel (bbl) to \$80/bbl oil price, one could see a reduction in the draw from the ERA, and at an oil price of about \$110/bbl the draw was completely shut off. Without an ERA draw there would be uncapped revenues. He mentioned the appropriation cap in the bill.

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Commissioner Hoffbeck discussed slide 24, "SB70, FULL FISCAL PLAN," which showed a bar graph entitled 'Median UGF Revenue and Budget.' He pointed out the blue bar which represented status quo revenue (from existing taxes and fees and oil), while the yellow showed planned Permanent Fund withdrawals, and the green bars showed the difference between the OMB budget and the revenues from the other two sources. He stated that gap would need to be filled from other sources, even after the Permanent Fund was in play.

Co-Chair MacKinnon asked if Commissioner Hoffbeck was referring to other sources to deal with the deficit such as cuts, or other revenues beyond the Permanent Fund.

Commissioner Hoffbeck answered in the affirmative.

Senator Micciche asked about slide 23, and asked at what oil price point did the draw from the ERA begin to decline.

Commissioner Hoffbeck estimated that the draw began to decline around the \$80/bbl price point. He offered to provide the actual number at a later time.

Senator Micciche referred to slide 24, and asked if the curve on the graph represented the actual Consumer Price Index (CPI) trend.

Commissioner Hoffbeck explained that for the OMB budget, the curve was the CPI for agency-type operations, and then actual increases that were forecast for the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the state on-behalf payments.

Commissioner Hoffbeck showed slide 25, "Part V - DIVIDEND DURABILITY."

Commissioner Hoffbeck reviewed slide 26, "DIVIDEND FORMULA":

- \$1,000 per person for the first 3 years, then
- 25% of the POMV draw (expected to be about \$1,000 per person into the future)

Commissioner Hoffbeck showed slide 27, "SB70, FULL FISCAL PLAN," which showed a graph. He drew attention to the line between the yellow and blue portions of the bars, which showed the distribution of the various results that occurred in the probabilistic modelling. The lines above and below the blue and yellow bars represented the extent of other results that occurred within thousands of runs of the modelling. He noted that the line between the colors showed a \$1000 Permanent Fund Dividend (PFD), which grew to \$1600 in 2041 under the bill plan. The buying power of the dividend would remain through the life of the 24-year forecast.

Commissioner Hoffbeck displayed slide 28, "Part VI - INFLATION PROOFING / FUND DURABILITY."

Commissioner Hoffbeck spoke to slide 29, "INFLATION PROOFING TRANSFERS

- AS 37.13.145(c) currently provides for annual inflation proofing transfers from the ERA to corpus
- The ERA needs a sufficient balance to be able to meet the draw each year ("ERA durability" concern)
- Bill provides that the ERA balance over 4 times the maximum draw (after current year draw) is transferred to corpus instead
- This "4 times" rule is designed to grow the corpus in pace with inflation over time

Commissioner Hoffbeck noted that he had modelled to see if the transfers worked over the life of the fund to build up the corpus and meet the inflation-proofing requirement.

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Commissioner Hoffbeck discussed slide 30, "SB70, FULL FISCAL PLAN," which showed a graph that depicted the life of the fund over the span of the forecast. He drew attention to the line between the yellow and blue bars, which indicated what the total fund value was through the life of the forecast. He noted that the FY 41 median value was \$112 billion, which was \$66 billion real dollars after accounting for inflation. He observed that the fund grew greater than the rate of inflation over the period of the forecast. He noted that there was no risk of ERA failure.

Senator Micciche asked to go back to slide 24, and asked if SB 70 provided for inflation and escalation.

Commissioner Hoffbeck stated that the plan itself allowed for the fund to grow with inflation, and also allowed for budget growth with inflation. It also allowed for inflation under the appropriations cap.

Senator Micciche referred to an article that had suggested the bill was a flat-funded plan. He wanted it understood that the numbers showed the rise in the value of the fund, and the value of the POMV with a balanced budget by 2024. He wanted to see the assumptions that created the green bars. He admitted that if there was a long-term trend of low oil prices, the state would likely have to supplement with other revenue. He wanted to understand the assumptions that had been used in the presentation.

Commissioner Hoffbeck agreed to work with the Legislative Legal Department. He thought it was how that inflation was dealt with in the budget component of the bill that created a difference.

Co-Chair Hoffman referred to slide 30, and thought many people were concerned about the health of the fund itself. He asked if under SB 70, under the median case scenario, the fund would reach approximately \$100 billion by 2037.

Commissioner Hoffbeck answered in the affirmative.

Commissioner Hoffbeck showed to slide 31, "Part VIII - FISCAL PLAN IMPACT."

Commissioner Hoffbeck reviewed slide 32, "SB 70 MODELING COMPARISON: FUND SIZE," which showed a graph entitled, 'Nominal Fund Value.' The graph looked at SB 70 with \$750 million in cuts, and at SB 70 with a revenue package to fill the gap. The comparison would show the relative difference and why it was important to do more than just pass a Permanent Fund bill to solve the fiscal situation. The dotted line showed the revenues available under the status quo, and the blue dashed line was SB 70 by itself. He thought the bill by itself would result in unplanned cuts once the CBR was depleted. He suggested that with SB 70 alone and no other fiscal measures, there was a 45 percent failure rate. Considering SB 70 with a revenue package would ensure a durable and lasting fund. He thought there was still work to do even after passing a Permanent Fund bill.

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Senator Micciche assumed that Commissioner Hoffbeck had gone with the past curve of production decline in order to get to the point on the graphs. He agreed that the further out the projections went, the more difficult it was.

Commissioner Hoffbeck stated that the presentation used the fall forecast from the Department of Revenue. He referred to a presentation by Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue. The department did not look at new fields more than five years out. He stated that there were several fields that were likely to occur, that were just outside the five-year window and were not included in the forecast numbers being presented.

Commissioner Hoffbeck showed slide 33, "SB 70 MODELING COMPARISON: DIVIDEND," which a graph titled "Nominal Dividend Per Person (Median)." The graph showed the PFD per person under status quo and under SB 70 in various combinations. Although the status quo maintained dividends at a higher rate for a period of time, by 2024 or 2025 there was a precipitous drop off and no dividends once the ERA was depleted. Under the other plans, there was not a substantial difference in the size of the PFD until 2027 or

2028, when additional draws would be made against the ERA. Cuts or revenues as a solution were relatively inconsequential for the size of future dividends.

Commissioner Hoffbeck displayed slide 34, "SB 70 MODELING COMPARISON: UGF REVENUE," which showed a graph entitled "Funds Available for Services." He noted that the graph showed the status quo line that represented using whatever monies were available, and the ERA once the CBR was depleted. The other three lines started to diverge in about 2027, when there were additional draws against the ERA.

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Commissioner Hoffbeck read slide 35, "Part VIII - CONCLUSION."

Commissioner Hoffbeck discussed slide 36, "CONCLUSION," which showed a table considering the five rules measured against the bill and other measures. He noted that the status quo largely did not meet any of the criteria being examined. He noted that SB 70 alone would meet criteria for a period of time, until the ERA was depleted, and the plan had some of the same issues the Status Quo plan had. He continued that SB 70 with a revenue plan under a revenue plan would meet all the criteria, get a partial stabilization of the income. He discussed the appropriations limit after \$750 million in cuts. He commented that there would still be some pressure to try and fill the void under the cap.

Senator Micciche thought to maximize ERA use, that the scenario on the table under SB 70 was missing text. He thought an overlay chart that showed oil prices would be helpful. He recognized that the assumptions were based on the fall forecast, which was necessary. He mused that a substantive increase in oil price (\$5 or \$6) would paint a different picture. Conversely a long-term decline in the same amount would paint a very negative picture. He asked if the commissioner could provide a range on the chart, and reiterated that line 5 under the "SB 70 Alone" column on the chart was overstated. He explained that the committee was trying to make the best decision that covered the fiscal gap. He suggested that different verbiage could be used with the understanding the oil price fluctuations would dramatically impact fiscal outcomes.

Commissioner Hoffbeck thought Senator Micciche had made a fair criticism, and thought there could be more explanation on the slide. He referred back to slide 30, where it could be observed that there was a broad range of the total fund value, which took into account probabilistic modelling on oil production as well as price. He offered to provide numbers associated with the chart.

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Co-Chair Hoffman referred to line 3 on slide 36, which addressed protection of the PFD. The chart alleged that that the dividend was at risk when the ERA was depleted under the status quo scenario. He asked to look back to slide 27, which showed the dividend rising to above \$1500 in about 21 years. He asked how the slide rectified with the comments on slide 36.

Commissioner Hoffbeck explained that slide 27 assumed there was some package that filled the void and that there were no draws against the ERA. He had slides that modelled what would happen to the dividend without filling the void, and the slides showed a declining dividend.

Co-Chair Hoffman asked what year the decline occurred.

Commissioner Hoffbeck specified that the decline started in 2027 or 2028, when the ERA was tapped.

Co-Chair Hoffman asked for a dollar amount of how much the dividend would decline.

Commissioner Hoffbeck offered to provide the information at a later date.

Co-Chair Hoffman thought the margin of error of decline could be questionable. He thought people would be concerned with slide 33, which showed that in there was no dividend in other years. He thought the Senate was trying to show that it was trying to protect the dividend. He asserted that SB 70 captured the dividend at the \$1000 amount, and protected the dividend into the foreseeable future. He referenced slide 33, and emphasized that if action was not taken the dividend would be eliminated.

Co-Chair Hoffman thought the general public needed to understand that the dividend was very important. There were

many variations of plans, but SB 70 protected the dividend. He referred to an LFD model that showed the fund itself increased every year. He thought that although there were many variables, LFD estimated that the plan that the Senate proposed protected the fund itself and extended it 250 years. It also protected the dividend.

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Commissioner Hoffbeck wanted to get together with LFD in order to mitigate confusion with the way the numbers had been modelled. He thought that there was a difference in the way inflation had been treated in the various models. Under the model on slide 33, in 2041 the real value of the dividend would be about \$1200. He reiterated that he would reconcile numbers with LFD to work with only one set of numbers.

Co-Chair Hoffman stated he was trying to make the point that if nothing was done, there was a \$3 billion deficit. He questioned the remaining options if the CBR was depleted. He thought the state had the luxury of a \$4 billion buffer, but recognized that four years previously, there had been a \$17 billion buffer.

Senator Micciche referred to slide 33, and cautioned that the graph modelled an assumption of decline, and looked at oil prices 12 years in the future. He acknowledged that there would be changes in the future that would require adjustments. He discussed the possibility for a broad-based revenue solution to adjust to possible deficits. He thought if there was a 10 percent increase in the price of oil the modelling would look much better. He pointed out the difference between SB 70 alone and SB 70 with cuts or a full fiscal plan were things that were difficult to predict.

Commissioner Hoffbeck agreed. He stated that the graphs were a best estimate, which he recognized was within a range.

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Senator Dunleavy referred to slide 33, and the dotted line that showed the dividend decreasing and then disappearing. He asked if the calculation was a mathematical assumption

that the legislature would be driven to take more out of the ERA.

Commissioner Hoffbeck stated that the graph was based on the assumption that once the CBR was depleted, the next step would be to start using the monies that were available for appropriation in the ERA.

Senator Dunleavy stated that he had received calls on the matter, and thought it was important to note that it was assumed that the legislature would go into the fund to draw more to cover the deficits.

Senator von Imhof thought that slide 33 showed that the status quo of spending remained. She thought it was obvious that if people would rather have a dividend, the tradeoff was less money in government services.

Commissioner Hoffbeck agreed.

Co-Chair MacKinnon thought the challenge, from the Senate perspective, was advancing cuts to the budget that would pass both bodies.

Vice-Chair Bishop referred to the production curve starting in the 1980s. He emphasized that it was necessary to deal in absolutes as much as possible. He thought SB 70 was a good plan to put the state on sustainable footing. He referred to the state's dependence upon oil. He thought it was important to insulate the state with other forms of revenue.

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Commissioner Hoffbeck turned to slide 37, "CONCLUSION," which addressed how much SB 70 resolved the fiscal issue. The status quo and SB 70 scenarios both started with a \$4.3 billion proposed governor's budget. Under the status quo there would be about \$1.6 billion in revenues, and under SB 70 there would be about \$1.7 billion in revenues because some royalties were moved into revenues for new oil. He looked at differences in the planned ERA draws under the two plans. He compared the \$2.8 billion deficit under the status quo to a \$700 million deficit under SB 70. He noted the substantial closure of the fiscal gap through SB 70 as reflected on the table.

Commissioner Hoffbeck reviewed slide 38, "SB 70":

- Provides a Rule-Based Framework for use of the Permanent Fund earnings Reserve
- Stabilizes the budget related to Oil and Gas Revenues and Permanent Fund Earnings and limits spending on all revenues
- Protects the Dividend
- Protects the inflation adjusted value of the Permanent Fund
- Maximizes the use of the earnings reserve

Co-Chair MacKinnon asked if the administration supported SB 70.

Commissioner Hoffbeck stated that the administration supported the bill.

Co-Chair MacKinnon informed that the committee would be happy to consider any specific feedback on inflation-proofing that he might have.

[10:04:07 AM](#)

AT EASE

[10:10:53 AM](#)

RECONVENED

Co-Chair MacKinnon noted that the executive director of the Permanent Fund Corporation was available to answer questions and discuss the effects of the bill on the fund.

ANGELA RODELL, CHIEF EXECUTIVE OFFICER, ALASKA PERMANENT FUND CORPORATION, introduced herself.

Co-Chair MacKinnon asked if Ms. Rodell had a statement of review for SB 70 for the committee's consideration.

Ms. Rodell wanted to make a couple of observations based on the previous testimony. She thought it was important to point out that the bill had the intent to review the effect of the 5.25 percent draw on the ERA after three years. The review would coincide with the stepping down of the draw rate to 5 percent. She thought it would be important to review the effects at the three-year mark and reflect on how the mechanics of the bill were working.

Ms. Rodell continued her remarks, and considered that the bill recognized the importance of inflation-proofing the corpus of the fund to grow for future generations. She observed that there was not a reconciliation to whatever actual inflation might be. There was a provision that anything in excess of four times the draw may be appropriated into the corpus. She thought inflation could actually be very different than what the provision calculated.

[10:13:23 AM](#)

Co-Chair Hoffman relayed that there had been discussion about the 5.25 percent payout. The dialogue had concerned whether the amount protected the corpus of the fund. He wondered if the corporation had concerns about the draw level at 5.25 percent or the rolling average.

Ms. Rodell relayed that the Alaska Permanent Fund Corporation (APFC) did not have concerns about the 5.25 percent draw and the step-down to 5 percent, which she thought were reasonable numbers. She thought the average of looking at 5 out of the last 6 years provided certainty for managing the investment portfolio, and was a key piece of the provision.

Senator von Imhof referred to Ms. Rodell's comments on inflation-proofing. She recognized inflation-proofing as an important mechanism to include in a plan, but thought there were many ways to accomplish the task. She proposed that the calculation that existed in statute was good, but was not the only option. She thought the current calculation was arguably more appropriate to use while the fund was growing and while it was in its early years. She thought at the fund's current size, there were other ways to inflation proof; including through the earnings mix, investments, and how the draw was done.

Ms. Rodell agreed with Senator von Imhof, and thought if there was only one fund, inflation-proofing would be a lot easier. She discussed the challenge of the fact that the fund was made up of two very different accounts: a savings account (the corpus), and a checking account (the ERA). She specified that the ERA had about \$10.5 billion of the \$57 billion fund total. She emphasized that there was a very real legal distinction between the savings (which could not

be spent), and maintaining the investment power of the fund; and the ERA. She reminded that the legal structure around the ERA had always given the legislature the ability to appropriate the balance in the ERA in its entirety with a simple majority vote. She thought that the ERA had been treated as a sacred cow that was not to be touched.

Ms. Rodell suggested that as the legislature was planning to use the ERA in a different way than it had in the past, it was important to recognize that it had the right and authority to spend it all in entirety if necessary. She stated that inflation-proofing was important because it was the method through which funds went to the non-spendable part of the Permanent Fund. Inflation-proofing protected investments in the corpus of the fund, and maintained the investment power of the corpus.

[10:18:52 AM](#)

Co-Chair MacKinnon referenced Senator von Imhof's comments about the fund changing over time. In the fund's infancy, it had been heavily invested in stocks and bonds; and currently there were unrealized gains sitting in the corpus of the fund, and in real estate. She asked if Senator von Imhof had been referring to other inflation-proofing that had been happening with fixed assets.

Ms. Rodell answered in the affirmative, as long as the gains remained unrealized. She thought it was challenging to realize the gains. She used the example of selling real estate assets to illustrate a lack of inflation proofing when the original asset went back in the corpus and any earnings went to the ERA.

Co-Chair MacKinnon asked if there was something that could be inserted into a bill that would provide fixed asset compensation to retain additional funds in the corpus. She did not want the APFC to hold its assets and not create interest earnings for dividends. She asked if Ms. Rodell could identify language that would help with inflation-proofing for fixed assets.

[10:21:35 AM](#)

Ms. Rodell appreciated the discussion. She reminded that the constitution was very clear in dictating that income went to the General Fund (GF), and the ERA was available

for appropriation. She thought the cleanest way was to appropriate back to the corpus, as the legislature had done since 1982. She recognized that there was a mechanism for appropriating money back in to the corpus in SB 70 that was based on a different formula than had been used in the past. She wanted to observe that the formula being proposed did not recognized inflation itself, but rather recognized that at some point there could be excess funds to put back in the corpus and help recover inflation differentials that happened over the years.

Co-Chair MacKinnon asked if there was a formal process that could be inserted into the bill, or was there language in existence to provide the corporation and board of directors comfort. She discussed a possible minimum balance to set for the ERA to ensure that the account remained healthy at all times.

Ms. Rodell answered affirmatively, and stated that she could look at what might constitute a healthy balance in the ERA, so that if there was language added about inflation proofing, the ERA would not be drawn below the desired level.

[10:24:43 AM](#)

Senator von Imhof stated that traditionally a fund did not usually have an earnings reserve fund and a corpus. Normally managers managed the investment mix of a fund and made sure there was liquidity available for the annual draw. She asked if a more traditional model made sense, and if Ms. Rodell envisioned moving the fund in that direction.

Ms. Rodell informed that the APFC Board of Trustees had put forward a resolution in 2004, and it had not been rescinded. The resolution had advocated for a constitutional amendment which would change the investment language. The resolution would roll the ERA into the corpus of the fund, leaving one fund of which an annual draw amount would come off on a POMV to the GF. The resolution pertained to changing the draw calculation, and was done before Generally Accepted Accounting Principles changed in 1997 with regard to income. In 2005, the board removed the legislative list of investments, and was allowed to have a broad diversification of the investments. She stated that it would be great to move towards a more traditional fund, and it was supported by the Board of Trustees.

Senator von Imhof thought that the change would accomplish two functions and allow inflation-proofing to be more robust, and capture more than the current calculation. Additionally, the resolution would give the APFC more flexibility to manage the assets in the highest and best use of asset mix with the market. She thought the traditional method was more lucrative.

[10:27:27 AM](#)

Co-Chair Hoffman discussed the four-time rule, which already addressed the fact that the corpus of the fund could grow by inflation. He referred to slide 30, which showed that the corpus of the Permanent Fund would grow in value over the course of 20 years to a balance of \$100 billion. He wondered if Ms. Rodell agreed with the projection.

Ms. Rodell thought it was possible, but thought it was important to note that the projection was based on the assumption of a full fiscal plan so the fund was allowed to grow because the ERA was not being drawn upon.

Senator Micciche thought all would agree that the legislature had not always been disciplined on spending in high revenue years. He thought the legislature had been disciplined on protecting the Permanent Fund corpus. He asked for information on how much was re-deposited over the statutory and constitutional requirements since the birth of the fund. He thought that when the state got back into high revenue years, he would support into over-inflation-proofing. He thought the plan was far above the statutory inflation-proofing.

Ms. Rodell offered to provide the information on the excess royalty that was done by statute.

[10:30:28 AM](#)

AT EASE

[10:31:34 AM](#)

RECONVENED

Co-Chair MacKinnon conveyed that the APFC had presented to the committee previously, and the presentation was available for reference. ["Alaska Permanent Fund - 2017"]

presented to the Senate Finance Committee 2/21/17 (copy on file).]

Ms. Rodell looked at slide 15 of the previous presentation, "Statutory Net Income," and observed that \$29.1 billion had been saved in addition to regular royalties, in the form of excess appropriations when the legislature chose to sweep the balance of the ERA into the corpus. Additionally, there had been times when the legislature considered it was prudent to appropriate additional monies into the corpus. She calculated that there was \$16 billion was roughly the inflation calculation, and there had been in excess of \$3 billion over that amount. She agreed to provide Senator Micciche more detailed information about his question.

Senator Micciche recognized that the legislature had been on a savings spree in the past, in there had discipline in protecting the fund and over-inflation-proofing the fund. He envisioned a fully sustainable draw from the Permanent Fund that would eliminate the need in perpetuity for broad-based taxes. He thought the bill protected the fund. He hoped to return to the days where it was possible to deposit more than was required into the fund.

[10:34:37 AM](#)

Senator Olson discussed a significant loss to the Permanent Fund 10 to 12 years previously because of a lack of timing of a fund transfer. He asked if SB 70 or any other legislation would protect the fund from another significant loss because of an untimely transfer.

Ms. Rodell thought Senator Olson was referring to a transfer made during the creation of a sub-account in the CBR when monies were transferred in. Unfortunately, equities had been purchased at a high price point and took time to recover, but there was an immediate loss. She recognized the Permanent Fund and the investments of the CBR required a balance of short-term needs and the recognition of one-year inside market volatility and the expectation for using the money. Limiting the amount of the draw would provide some protection, but there could be events that could not be foreseen. The APFC tried to minimize such events by creating a diversified portfolio so as to not get overexposed; which resulted in not getting as much when markets were high, but not losing as much when markets dropped.

Ms. Rodell continued her remarks, pointing out that in current statute, APFC was asked to invest the ERA in a similar manner to the corpus of the fund. The statute had been interpreted over the years that APFC would pro-rate each investment. Every security and asset owned by the fund was owned partially by the ERA and partially by the corpus of the account. She explained that when it changed was when the fund started to realize gains and reinvest. She reiterated the importance of the three-year look-back in the bill, because if things were happening in the market where the fund was unable to grow as expected, draws were larger, and the ERA was shrinking faster than anticipated; it might necessitate a different asset allocation than the corpus.

Senator Olson asked if APFC had the statutory authority to do what Ms. Rodell described.

Ms. Rodell answered in the affirmative.

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

Co-Chair MacKinnon discussed the agenda for the following day, and informed that SB 14 would be removed from the agenda.

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ADJOURNMENT

[10:39:22 AM](#)

The meeting was adjourned at 10:39 a.m.