

SENATE FINANCE COMMITTEE
January 17, 2018
9:04 a.m.

[9:04:07 AM](#)

CALL TO ORDER

Co-Chair Hoffman called the Senate Finance Committee meeting to order at 9:04 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

None

ALSO PRESENT

Pat Pitney, Director, Office of Management and Budget, Office of the Governor; Brian Fechter, Policy Analyst, Office of Management and Budget.

SUMMARY

^PRESENTATION: STATE OF ALASKA - FY2019 BUDGET OVERVIEW

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Co-Chair Hoffman remarked that the state continued to face financial problems such as a large deficit. He referenced fiscal plans such as SB 26 [legislation relating to the Permanent Fund and the Earnings Reserve Account] and hoped the legislature could come to a resolution and help the state move forward. He was optimistic that that the legislature could work with the administration and finish the work of the people.

PAT PITNEY, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF THE GOVERNOR, looked forward to addressing some of the issues around the fiscal plan.

BRIAN FECHTER, POLICY ANALYST, OFFICE OF MANAGEMENT AND BUDGET, addressed the presentation "State of Alaska FY2019 Budget Overview" (copy on file).

Mr. Fechter addressed slide 2, "Key Budget Items":

Safer Alaska

Public Safety Investments - \$34.0 million; 18 positions

- \$2.9 million for enhanced trooper and prosecutor presence in rural Alaska
- \$18.0 million for substance abuse treatment grants
- \$10.4 million for Corrections prison operations
- \$0.2 million for statewide drug prosecutor
- \$0.6 million for support positions to free trooper time
- \$0.5 million public defender support
- \$1.0 million Anchorage prosecutor/investigator positions

Medicaid

- Medicaid fully funded

Health Care

- \$1.0 million for continued work towards health care authority (\$0.75 million) and stakeholder process for broader Alaska health care reform strategies (\$0.25 million)

Mr. Fechter asserted that the governor's proposed budget made significant investments in public safety. The budget also fully funded Medicaid. He reminded that in FY 18 the Medicaid program was underfunded by about \$100 million. There was an increment of \$127 million in the budget for Medicaid, with the \$27 million representing organic growth in the program.

[9:08:11 AM](#)

Mr. Fechter showed slide 3, "Key Budget Items":

Stronger Alaska

Oil and Gas Exploration Credits

- Debt refinancing
- Statutory calculation would pay credits off in FY2025
- Small producers offered the opportunity to receive payment today at a discount
 - Discount starts at 10%, reduced for additional future royalty interest
- Discount covers state's financing costs (budget neutral)

Alaska Liquefied Natural Gas Pipeline

- Signed 5-party agreement
 - For the first time, interested buyers are coming to the table
 - Natural gas is available to Alaskans, first and foremost
 - Over 12,000 jobs and \$2.0 billion in annual economic activity
 - Future revenue stream to the state
- Budget only includes authority to accept third party investor funds but no additional state funds requested

Mr. Fechter informed that the budget included a proposal to finance the state's oil and gas tax credit liability. He reminded that the state had just over \$700 million in outstanding oil and gas tax credits.

Co-Chair Hoffman asked about the state's total tax credit obligation for FY 19.

Ms. Pitney anticipated (under the formula that was traditionally used) the liability would be \$209 million based on the price of oil.

Co-Chair Hoffman asked how the governor planned to meet the obligation.

Ms. Pitney informed that through the financing proposal, the state would have a \$27 million debt payment in the current year, roughly \$30 million debt payment the next two years, and over \$100 million debt payment for the remainder of a ten-year debt service.

Co-Chair Hoffman asked about the form of obligation for the debt service.

Ms. Pitney stated that the obligation would be a subject-to-appropriation bond financing, structured similarly to the approval provided for pension obligation bonds in 2008. She stated that an associated piece of legislation would be read across in the near future.

Co-Chair Hoffman had not seen the bill read across the previous day.

Ms. Pitney anticipated the bill to be read across in a week's time.

Senator Micciche wondered if the proposed 10 percent was an administration fee or comparative to the cost of the bonds to the state.

Ms. Pitney explained that the administration was looking for a net neutral on a net present value basis, and the 10 percent covered the cost of financing. There were ways in which the administration was contemplating (in the bill) that would allow small explorers to take a smaller discount. She qualified that the administration wanted a net neutral for the state and for the explorers to have capital in hand.

[9:11:49 AM](#)

Senator Micciche asked if the discount to the explorers brought the state to a break-even status.

Ms. Pitney answered in the affirmative.

Mr. Fechter continued to discuss slide 3:

Alaska Liquefied Natural Gas Pipeline

- Signed 5-party agreement
 - For the first time, interested buyers are coming to the table
 - Natural gas is available to Alaskans, first and foremost
 - Over 12,000 jobs and \$2.0 billion in annual economic activity
 - Future revenue stream to the state

- Budget only includes authority to accept third party investor funds but no additional state funds requested

Vice-Chair Bishop commented on the last bullet on the slide. He wanted to know if there was any state liability associated with accepting third party investor funds.

Co-Chair Hoffman referenced a bullet point on the slide and was interested in making natural gas available to Alaskans first. He asked for the Office of Management and Budget (OMB) to provide further written detail of how provision of gas would be accomplished.

Mr. Fechter spoke to slide 4, "Key Budget Items":

Base Capital Budget

The Governor's FY2019 capital budget prioritizes annual federal match programs, housing, energy, maintenance, and information technology.

	UGF	Total
Federal Match & Leverage	\$ 103.4	\$ 1,108.6
Housing	\$ 15.0	\$ 30.3
Energy	\$ 1.3	\$ 34.2
Maintenance	\$ 16.3	\$ 24.5
Information Technology	\$ 14.0	\$ 87.6
Total	\$ 150.1	\$ 1,285.2

Table in Millions

Mr. Fechter thought committee members would be familiar with many of the appropriations in the base capital budget represented on the slide. He was excited that the budget proposed to use excess Power Cost Equalization (PCE) fund earnings to support community and energy projects. Legislation was passed in 2016 to allow excess earnings of the fund (when available) to be directed towards energy programs.

Co-Chair Hoffman thanked Co-Chair MacKinnon for targeting the fund to include energy projects for the people of Alaska.

[9:14:55 AM](#)

Mr. Fechter discussed slide 5, "Key Budget Items":

Stronger Alaska

Alaska Economic Recovery Act

- \$800.0 million over 3 years (\$280.0 million in FY2019)
- \$1.4 billion in economic impact with federal, local, and private funds
- Housing, state and school deferred maintenance, and energy projects
 - Many smaller projects to ensure work is started today, not after years of environmental studies
 - School maintenance impacts 60+ communities, both rural and urban
 - Does not grow government, takes care of current liabilities
- Funded by a 1.5% wage tax, capped at 2 times the PFD amount
 - Receipts designated for high-value capital projects
 - Sunsets in 2.5 years
- Creating jobs and getting the economy working is priority #1. Reassess in 2022

Mr. Fechter detailed that the Alaska Economic Recovery Act was contingent upon passage of the wage tax. He characterized the proposed act as a departure from past thinking. The administration thought it was important to solve the fiscal gap but thought the most important thing was job creation and getting the economy working again. He emphasized that within the package described on the slide, there were many small projects rather than a handful of larger projects.

Ms. Pitney discussed the plan described on slide 5, and relayed that the administration considered it a short-term measure that would put people back to work.

Mr. Fechter turned to slide 6, "Key Budget Items," which showed a table titled "Alaska Economic Recovery Act." He noted that the administration proposed to reenact the geobond projects that the governor had paused in FY 16. He summarized that \$800 million of state investment from proceeds of the proposed wage tax would leverage \$1.4 billion of federal and local support funds.

Ms. Pitney relayed that the Legislative Finance Division (LFD) had pointed out a discrepancy between the first phase of the proposed act and the first year's estimated revenue. The first phase of investment was dependent upon a tax that would produce \$800 million; the cash flow on capital projects was such that there would be enough revenue at the time the commitments on the projects were due. The administration viewed the plan as "a spend and revenue neutral" that was set aside from the normal operating and capital budgets.

Co-Chair Hoffman stated that the plan still spent \$120 million, which he considered deficit spending.

Ms. Pitney stated that the administration viewed the plan as a three-year fiscal package on both the revenue and expenditure side.

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Co-Chair MacKinnon heard the presentation reference re-starting projects that had been put on hold, and the expenditure of bond proceeds. She asked about the Knik Arm Crossing project.

Ms. Pitney affirmed that there was a plan for expenditure of bond proceeds. She stated that the Knik Arm Crossing was not viewed as a road project, and the proposal referenced the road between Anchorage and Palmer.

Co-Chair MacKinnon asked about the Juneau Road Access Project.

Ms. Pitney stated that the Juneau Access Road Project was not included. The Juneau road project was not in the geo-bond package and had a "no-build" recommendation. The general funds (GF) appropriated for the Juneau road were in two separate appropriations through action done the previous year. One appropriation was still directed to the Juneau Road Access Project, and another was directed to transportation projects in Upper Lynn Canal.

Co-Chair MacKinnon did not know of suspension of the projects. She asked Ms. Pitney to relay the progress that had been made on the deferred maintenance plan.

Ms. Pitney recalled the previous year the administration had provided an overview of \$1.8 billion in deferred maintenance. The legislature appropriated \$20 million the previous year, and the administration had prioritized and distributed the funds to agencies for the highest-need projects. The administration had an inventory and was working on centralizing facilities maintenance to get more from the existing resources. She offered to provide the inventory list and prioritization that guided state deferred maintenance investments.

[9:22:00 AM](#)

Senator Micciche referenced an inventory of state properties on the deferred maintenance list that had been requested by the legislature two years previously. There had been consideration of the some of the properties possibly being surplussed. He asked about the status of the consideration by the Department of Transportation and Public Facilities (DOT).

Ms. Pitney stated that consideration of properties for surplus was an ongoing project. There were no major facilities that had been determined as valuable to surplus. There had been minor facilities and parcels that had been decided upon. She agreed to provide further details at a later time.

Senator Olson asked what kind of priority list would be used to examine the list of projects for K-12 major maintenance.

Ms. Pitney explained that major maintenance statute had a very solid set of criteria, and there was a process that happened every fall. On the most recent list there was \$172 million in projects that were prioritized. The priority list was available on the OMB website as well as the Department of Education and Early Development (DEED) website.

Senator Olson asked if the administration would follow the priorities of DEED.

Ms. Pitney stated that it was the intent of the appropriation to follow the priorities of DEED.

Senator Olson asked if the funds listed on the slide were the only funds in the budget for major maintenance for DEED.

Ms. Pitney answered in the affirmative.

[9:24:16 AM](#)

Senator von Imhof asked what factors were used in listing and prioritizing projects. She referenced properties that were municipally owned, state owned, and federally owned; and referenced a lack of cooperation. She considered deployment of labor and resources to small communities (for maintenance) and wondered how the state could collaborate. She referenced the Denali Commission, which had looked at dual expenses and ways to reduce redundancy. She wondered if there were creative ways to look at leasing back some of the state's assets. She referenced Senator Micciche's remarks and considered selling smaller assets to allow for multi-use in the community. She used the hypothetical scenario of a Native corporation utilizing a state asset, while the state also used the asset if there was extra capacity. Under a shared usage the state could share maintenance costs.

Co-Chair MacKinnon discussed deferred maintenance. She asked Ms. Pitney if she believed remodeling and furniture constituted deferred maintenance.

Ms. Pitney considered that remodeling was a part of deferred maintenance, and furniture could be a necessary component to make a space usable.

Co-Chair MacKinnon was not sure that remodeling and furniture was the highest and best use of limited state funds in the current budget climate. She asked if Ms. Pitney was personally watching departments expenditures specifically related to spending funds on safety rather than remodels.

Ms. Pitney was happy to provide further detail prioritization of the \$20 million appropriated the previous year. She referenced a remodel project on the 8th floor of the State Office Building in Juneau. She listed the new roof project for the geological building. She thought the vast majority of expenditures would be for building systems. She stated that the administration's capital

budget coordinator had worked with every department and considered each agencies list of priorities. She detailed that there were five criteria that were considered, one of which was timely execution of the project. The administration had chosen projects that were more urgent and readier to execute.

[9:29:53 AM](#)

Co-Chair MacKinnon referred to the replacement roof for the Geological Center and wondered if she had referenced the building located in Anchorage that was purchased two years previously.

Ms. Pitney stated that the Geological Center was the building in Anchorage Co-Chair MacKinnon was referring to. The roof was a known issue at the time purchase.

Co-Chair MacKinnon did not recall being advised of a forthcoming roof replacement for the facility. She recalled that the Geological Center had been moved from the Chugiak/Eagle River community.

Senator Micciche wondered what kind of comprehensive supply chain logistics that the state might consider and wondered about efficiencies. He had not seen any relevant initiatives. He wondered if DOT would be presenting to the committee.

Co-Chair Hoffman thought have the four major cost drivers (including DOT) should come before the committee like the previous year. He thought it was important that members had an understanding of the major cost drivers in the state.

Senator Stevens asked about the total for deferred maintenance for the University of Alaska (UA).

Ms. Pitney stated that UA had a deferred maintenance inventory of roughly \$1 billion. She encouraged members to have a specific discussion on UA deffered maintenance, and what it was doing on a yearly basis to address maintenance issues. She stated that UA's ongoing plan was at \$50 million annually while endeavoring to keep the backlog from growing.

Senator Stevens asked if Ms. Pitney thought the amount listed on slide 6 for UA deferred maintenance was adequate.

Ms. Pitney considered that the funds were adequate. She discussed the pace of spending and logistics involved in addressing deferred maintenance.

[9:33:59 AM](#)

Mr. Fechter referenced slide 7, "Cost Avoidance - Efficiency":

Smarter Alaska

Office of Information Technology

The purpose of this centralization is to deliver lower cost information technology services by leveraging the purchasing power of the state as a single organization.

Shared Services

The Shared Services initiative resulted in a ten percent savings to back-office administrative functions during its first year. An additional ten percent savings will be realized in fiscal year 2019.

Facilities Consolidation

The new Facilities Services division strives to place the right maintenance employee at the right facility at the right time to better care for state facilities and realize savings.

Mr. Fechter discussed three centralization initiatives detailed on the slide, and pointed out savings displayed in a table on the slide. He detailed that DOT was leading the Facilities Consolidation.

Ms. Pitney spoke to the Internet Technology (IT) consolidation. The administration was looking at the Office of Information Technology (OIT) department to help drive cost savings in the capital technology upgrades. She expected that through IT upgrade project coordination, the state could save 10 percent on the projects.

[9:36:40 AM](#)

Senator von Imhof asked what kind of efficiency savings might be seen at the end of the FY 18 fiscal year.

Ms. Pitney offered to supply the numbers at a later time. She detailed that the Shared Services Initiative expected a

10 percent savings. There were other departmental efficiencies, and she would provide additional detail at a later time.

Senator von Imhof knew that changes took effect slower. She thought the state would theoretically see the benefits of efficiencies in the current year.

Ms. Pitney stated that savings were built-in, based on shared services moving forward.

Senator Micciche asked if the state had employed any outside consultants to assist with the Smarter Alaska Initiative.

Ms. Pitney affirmed that there had been a consultant hired for shared services, that had been very valuable in the process. There had been several consultants engaged to look at functions within Department of Health and Social Services. She thought there was a balance to strike with bringing in outside entities. She recalled that another outside advisor had been brought in to consider appropriations.

[9:40:15 AM](#)

Co-Chair MacKinnon asked for a progress report on the savings that had been planned for the FY 18 budget. She thought there were sometimes issues with ideas based on what had been done in other states.

Mr. Fechter presented slide 8, "Cost Drivers - Health Care," which showed a table listing health care costs funded directly and indirectly in state budget. He pointed out that there was a total of \$1.4 billion in state funds were directed towards healthcare. The largest portion of the total was Medicaid, with \$705 million. Other significant costs came from employee health care. He thought the support to school districts and local governments could be seen as a subsidy of what each paid for employees.

Co-Chair Hoffman commented on the total of \$1.4 billion and stated that there was interest in the area since it was such a large cost driver.

Co-Chair MacKinnon asked about the \$705 million for Medicaid.

Ms. Pitney informed that the total was comprised of \$690 million of GF, as well as Designated General Funds (DGF) and other funds. The total was an expectation for FY 19.

Co-Chair MacKinnon wondered if there would be a supplemental request for the Medicaid budget, and whether funds had been adequately placed in the FY 19 budget.

Ms. Pitney stated that the administration strongly believed it had accounted for the total cost of Medicaid. She acknowledged that there would be additional enrollment and had accounted for additional enrollment. The administration would do everything it could to maintain costs within the quoted funding total for FY 19.

Co-Chair MacKinnon asked about the amount of the supplemental request for Medicaid for FY 18.

Ms. Pitney specified that there was a \$100 million supplemental request for FY 18, which did not count the Children's Health Insurance Program (CHIP) reauthorization. When FY 17 was finished, there was \$75 million more than the budget that was authorized in FY 18.

Co-Chair Hoffman asked about chip reauthorization and wondered if it was a federal reauthorization.

Ms. Pitney answered in the affirmative. She stated that the difference was funding at a 50 percent federal match versus 68 percent.

Co-Chair Hoffman asked if there was any expectation as to whether the chip would be reauthorized.

Ms. Pitney thought it was uncertain whether the reauthorization would pass.

Co-Chair Hoffman asked about the state's options if CHIP was not reauthorized.

Ms. Pitney stated that short-term options would be to provide the formula match. In the long term, it would be necessary to change Medicaid statute.

[9:45:57 AM](#)

Ms. Pitney stated that CHIP was a federally funded children's health program that was partially matched by the state.

Senator Stevens asked for a breakdown of healthcare costs for inmate/juvenile justice health. He asked if the administration projected that inmate healthcare costs would decrease in the future.

Ms. Pitney did not anticipate inmate healthcare being reduced in the future. The administration was doing everything it could to constrain inmate health. More use of electronic monitoring and half way houses would result in lower costs, but there was a balance with public safety. She agreed to provide further detail on the breakdown of inmate/juvenile justice healthcare. She estimated that inmate health cost close to \$40 million.

Senator von Imhof referred to the \$100 million supplemental request for FY 18 and asked about the Xerox computer system and Medicaid eligibility processing. She referred to past challenges with technology and administrative functions. She wondered if the supplemental request would cover the costs associated with the challenges she referenced.

Ms. Pitney stated that the \$100 million supplemental was for provider payments, and additional costs were not anticipated for FY 18. She continued that some of the technology upgrades were in the FY 19 capital budget, and included some Department of Health and Social Services systems related to Medicaid.

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Vice-Chair Bishop asked Mr. Fechter to elaborate on his reference to cost savings.

Mr. Fechter stated that the administration had identified savings in the retiree healthcare system and would speak further on the matter later in the presentation. He mentioned a \$1 million investment in working towards other efficiencies.

Co-Chair MacKinnon referenced the \$100 million supplemental request, and technology improvements for Medicaid that

would be in the capital budget. She asked if the system had been certified by the federal government.

Ms. Pitney believed that the certification arrived in December 2017. The system upgrade would require some support from DHSS.

Co-Chair MacKinnon thought that the committee would be having an informational session on Medicaid. She understood that the state system had not been certified, and mentioned on-screen advertisements for the health and human services offered by the state.

Co-Chair Hoffman thought it had been well over a year that the administration had claimed the state would have certification for the Medicaid system. He thought further updates were needed and wanted a more detailed report of how long certification might take.

Ms. Pitney agreed to provide further details.

[9:53:34 AM](#)

Senator Micciche noted that roughly one-third of state spending was on healthcare, half of which was on the Medicaid program. He asked how the administration planned to cap healthcare spending. He spoke about the graph on slide 9 and expressed concern about increasing spending on healthcare. He emphasized a need for a cap on healthcare spending.

Ms. Pitney stated that the administration placed a high priority on the health of Alaskans. She thought the economic recession had exacerbated Medicaid enrollment, and stated that half of enrollment had been associated with traditional Medicaid. She recalled that during the Medicaid reform process, many state costs for healthcare were shifted to federal spending. The state's expenditure for Medicaid was the same as it was in FY 15 while serving over 75,000 more people. She reminded that healthcare was the only sector of the economy that was growing jobs in the state, due to increased federal funding. She stated that the previous year the state changed provider reimbursement from 130 percent of Medicare down to 115 percent in the effort to drive costs down. She stated that Alaskan's access to healthcare was an important priority of the administration.

[9:56:59 AM](#)

Senator Micciche thought there had been unintended consequences to Medicaid expansion, and that there had been incorrect assumptions relating to the expansion population. He thought access to healthcare was important. He was concerned that the end result was not reduced cost to the state.

Co-Chair MacKinnon wanted all Alaskans to have access to healthcare. She referenced a budget reduction for adult day-care the previous year and thought people had relocated to Alaska for the services the state provided. She thought the health industry was growing because the state was paying 60 percent of the cost. She recounted that \$1.2 billion in federal funds had supported 30,000 Medicaid recipients the previous year, which had been matched with GF. She thought the state budget had been propping up most of the budget of the growing healthcare industry. She wondered how long the trend could continue.

Ms. Pitney commented that the administration was well aware of cost increases and was looking to constrain costs.

[10:00:26 AM](#)

Ms. Pitney discussed slide 11, "Cost Avoidance - Efficiency," which showed a table titled "Potential Health Care Budget Cost Avoidance Projections." The slide was part of the administration's ten-year plan, under which it planned to maintain healthcare costs at inflation-only levels. She discussed the trend in healthcare increase, and identified target savings to constrain healthcare growth as shown on the slide. She mentioned the implementation of (EGWP) the Employer Group Waiver Program (EGWP), which would provide \$25.5 million of cost avoidance in the next year, and \$50 million of savings in the following two years.

Ms. Pitney continued to discuss slide 11. She anticipated moving forward with savings in the Health Care Authority. She reiterated that the recession had contributed to Medicaid enrollment, and anticipated that as the economy improved there would be declining enrollment. She noted that not all areas of expected savings were listed on the slide. She informed that the administration had formed a

group of larger stakeholders (that included private sector and legislative participants) that was looking at how to address healthcare costs in the state. The governor's office was working towards the same end at the federal level.

Co-Chair Hoffman asked how comfortable the administration was at keeping the future costs at inflation-level or lower.

Ms. Pitney believed it was imperative for the state in the long-term to keep costs at inflation-level or lower. If the state could keep the costs with inflation, the state would still remain one of the high-cost areas in the nation. She did not think the state had a choice in the matter.

Senator Olson asked about EGWP.

Ms. Pitney detailed that the EGWP was an employer group that included almost every retirement system, and would start January 1, 2019, the system included a process by which Medicare would pay for prescriptions that the state's retiree program paid for.

Senator Olson asked how the state could anticipate future costs. He wondered about the program's success in other states.

Ms. Pitney stated that the figures were from the recent Health Care Authority Feasibility Study; and was based on experiences in other states and the volume of pharmaceuticals in Alaska's program.

[10:05:39 AM](#)

Mr. Fechter turned to slide 12, "Cost Avoidance - Efficiency":

State government employment below 2002 levels

- There were 3,000 fewer state government employees in November 2017 than the same month in 2014, the year state government employment peaked.
- State government employment is at its lowest level in 16 years, since 2002. Over this period, Alaska's population has grown 15%

Mr. Fechter drew attention to a table depicting state government employment from 2001 to 2017. He qualified that the data reflected "live bodies" rather than position control numbers (PCNs).

Mr. Fechter referenced slide 13, "Budget Summary." The slide showed a table. He noted that there was significant under-funding of certain programs in the FY 18 budget, and the slide included supplementals in comparison. There was a difference of approximately \$60 million, largely due to public safety investment and continued growth in Medicaid.

Co-Chair Hoffman stated that the presentation including the supplementals was a deviation from all prior administrations. He asked Mr. Fechter to provide the committee with a traditional comparison not including supplemental budgets in order to provide more transparency. He thought the presentation did not give a good comparison to prior years' spending.

Ms. Pitney explained that showing the difference from the FY 18 Management Plan was traditional reporting and was reflected on the bottom line of the table on slide 13. She furthered that the bolded line above contained supplementals, included due to the known underfunded items from the previous year.

Co-Chair Hoffman stated that prior presentations by OMB had not included supplemental budgets in the comparison. He thought it looked as though the deficit was smaller than it was in reality. He reiterated that the slide was a deviation from prior presentations by the administration.

[10:08:55 AM](#)

Mr. Fechter presented slide 14, "Budget Summary,":

- Provide the legislature with the tools necessary to pass a timely budget
- Agency budgets fully funded with existing revenue, ERA draw and SBR
- Certain statewide items CBR-funded (school debt/REAA, retirement, exploration credits)

- While inconvenient, late passage will not disrupt schools or government services

Mr. Fechter continued discussing slide 14, which also showed a table. He noted that the budget was structured differently than past budgets. He drew attention to the column entitled "FY 2019 Capacity Budget," which showed the day-to-day operations of state government. The capacity budget funded on existing revenue, a draw from the Permanent Fund Earnings Reserve Account (ERA), and if necessary a backfill from the Statutory Budget Reserve (SBR). He stated that the reason the budget was presented as such, was to give the legislature the tools it needed in order to pass a timely budget. The budget reflected in the first column was available through a simple majority vote and would ensure that day-to-day operations of the government could continue.

Mr. Fechter continued addressing the budget summary table on slide 14. He pointed out that the second column, "FY 2019 CBR Items" included items that were inconvenient if the state was waiting on protracted budget negotiations but would not stop day to day government services.

Co-Chair Hoffman referred to a meeting the previous summer with Department of Revenue Commissioner Sheldon Fisher. He felt it was portrayed that the Constitutional Budget Reserve (CBR) should have a larger balance to accommodate future emergencies. He had gleaned that the state would try and preserve the CBR. He wondered what had changed from the meeting to the present time. He thought it was a small number in comparison to the rest of the budget, but the implications of needing a three-quarters vote from the legislature could cause further spending.

Ms. Pitney opined that in a perfect world there should be \$5 million in the CBR or in the SBR. The state remained a highly volatile revenue state, and even with the Permanent Fund Protection Act (PFPA). There was estimated to be \$2.3 billion in the CBR at the end of 2018. She stated that it would be prudent to maintain a balance of \$2 billion in the CBR. She thought it was more important to never draw unsustainably from the ERA. The administration believed that a trade-off would be to draw a sustainable amount from the ERA. She stated that a later slide would address a ten-year plan, which would come close to restoring the CBR to a \$2 billion level.

Co-Chair Hoffman did not think it would be possible to achieve a three-quarters vote from the other body in order to access the CBR.

10:13:00 AM

Senator Micciche asked to return to slide 13. He commented on the immensity of the problem that Co-Chair Hoffman had referenced. He thought that the slide skipped over the fact of the increase in spending in the supplemental budget. He supported the Co-Chair Hoffman's request that the budget information be presented in the way it had been in years past. He thought it was important to highlight the problem of supplemental expenditures.

Senator von Imhof referenced slide 14 and thought by decoupling agency funding with other state expenses such as debt service and retirement; she thought there was a trade-off between accounting and political influence. She considered that the proposed budget would work better with a viable spending cap in place to prevent "budget creep." She thought the slide was insufficient until there were other parameters in place.

Vice-Chair Bishop asked about a federal supplemental budget.

Ms. Pitney specified that the funds were in Medicaid, and in FY 17 there was an open-ended federal supplemental. In FY 18, the funds knowingly not included, and the GF budget for Medicaid was knowingly underfunded in FY 18. The FY 18 supplemental was different than prior years, as in prior years there was underfunding that was not known. She reiterated that the previous year, there was underfunding that was clearly known at the end of the legislative session.

10:16:51 AM

Co-Chair MacKinnon asked if the underfunding of Medicaid was due to the fact that the Medicaid system had not yet been certified.

Ms. Pitney answered in the negative and stated that there was a piece of budget language in 2017 that allowed for the receipt of all federal funds without a specific number. The

administration had considered it more transparent to receive a set amount of funds rather than open receipt authority.

Senator Olson looked at slide 14 and referenced the first column. He asked why the Regional Education Attendance Area (REAA) school construction budget of almost \$40 million was in the column under CBR items, when it was considered unlikely that a passing vote would be achieved. He noted that other school projects were in the capacity budget columns.

Ms. Pitney stated that there were no other school projects in the capital budget. The \$87 million for listed on the slide for debt service was for urban school debt reimbursement. The formula tied the REAA school funding to school debt. She pondered what items would not stop day-to-day business, which would allow for a capacity budget with a simple majority vote. She stated that the administration had to move \$400 million and had moved items into the CBR category that were payment driven, rather than day-to-day operationally driven.

Senator Olson mentioned the short construction season in his district and pondered the viability of building in the current year if there was a delay from a required CBR vote.

Ms. Pitney recalled the previous year that the operating budget and capital budget were extended. She acknowledged that the current budgets could follow a similar protracted timeline and affirmed that the administration considered the project important.

Co-Chair Hoffman commented on the "super extended" timeline of budget passage the previous year hoped that the legislature would pass the current year's budget in a much more professional manner.

[10:20:40 AM](#)

Ms. Pitney stated that the following 3 slides and graphs were for reference. The slides detailed relative increases to the budget, decreases to the budget, fund changes, mental health, one-time items, and statewide non-agency related changes. She stated that the slides were a tool for the committee to use and would make it easier to see what had moved in the budget.

Ms. Pitney spoke to slide 17, "Budget Detail," and spoke to the "Community and Energy Support" supplemental item on the table. She referenced Mr. Fechter's reference to the PCE program and available earnings for community assistance and energy projects. The administration made the budget decision to capitalize the Community Assistance Fund in FY 18, therefore the payout in FY 19 was a full \$30 million to communities. If the fund had been capitalized in FY 19, there would only be a \$20 million payout to communities in FY 19.

Ms. Pitney spoke to the \$14 million that was deposited into the Renewable Energy Account, which was made effective the last day of FY 18 and available for use in FY 19 for projects that would show up in the capital budget.

Co-Chair Hoffman reiterated that the presentation deviated from prior practices. It was normal for the administration to include a separate appropriation for supplementals, and not include the supplemental requests in the operating budget. He asked about the logic behind the change to a practice that had existed for decades.

Ms. Pitney stated that in the time she had been director of the Office of Management and Budget, the office had tried to include every supplemental that was known before the budget was submitted each year on December 15. She stated that if the practice was a departure from previous administrations, she was not aware of it.

Co-Chair Hoffman asked if Ms. Pitney was suggesting that there would be additional supplemental requests coming forward from the administration.

Ms. Pitney stated that it was possible that there would be additional supplemental requests that came forward before the mandated deadline. She believed any such request would be very minor.

Co-Chair Hoffman mused at the possibility of a negative supplemental.

[10:24:12 AM](#)

Senator Micciche reminded that he was chair of the Senate Finance Budget Subcommittee for the Department of Health

and Social Services. He recalled that the previous year there was an anticipated \$30 million budget shortfall. He wondered how to avoid the problem of budget shortfalls and subsequent supplemental requests in the future.

Ms. Pitney recalled that the FY 18 budget proposed by the administration for Medicaid was \$580 million, and it had anticipated a \$65 million increase. The administration had taken action to reduce costs and anticipated bringing in the increase at just over \$32 million. Subsequently, the Medicaid budget was lowered from \$580 to \$565. The increase in Medicaid enrollment was a contributing factor in the budget increase, and the FY 17 year-end numbers were higher than anticipated. The administration felt that the \$100 million budget item (listed on slide 1) fully funded Medicaid. The administration did not want to be in the supplemental cycle in the future.

Senator Micciche thought that the budget process felt like a game. He was concerned that there was a growing supplemental problem. He alleged that when Medicaid was expanded, it was done with incorrect assumptions. He was very concerned about uncontrolled spending and the cost of Medicaid expansion in the future.

Co-Chair Hoffman concurred with Senator Micciche's remarks and opined that the legislature agonized over reductions to the budget but did not spend much time or scrutiny on the supplemental budget. He thought there should be a more concerted effort by the administration to operate within the confines of the budget.

[10:28:42 AM](#)

Senator von Imhof appreciated the budget presentation including the supplemental. She referenced slide 17. She discussed spending on Medicaid expansion, and wondered what the state could expect for UGF spending as federal funds decreased. She asked if the administration had done an analysis on the topic to look in the near future.

Ms. Pitney stated that Medicaid expansion accounted for less than \$20 million of the \$705 million spent. The state cost for Medicaid expansion was less than \$20 million, and the program was federally funded at 93 percent to 94 percent. The federally funded portion would go down to 90 percent. She thought that if the federal government made a

drastic change and did not fund 90 percent, there would be a serious policy question for the state to consider. She detailed that the cost driver was enrollment increases in the traditional Medicaid program, largely children and single parent families. She added that the administration would provide a projection of decreased federal funding that Senator von Imhof had inquired about.

[10:31:29 AM](#)

Vice-Chair Bishop asked about Ms. Pitney's reference of an increase in children on Medicaid and questioned the effect of losing high-paying jobs in the state. He spoke of a movement at the federal level to allow for insurance to be sold across state lines, ostensibly to lower costs. He hoped that the change would come to pass.

Mr. Fechter discussed slide 18, "Deficit Reconciliation," which showed an OMB to LFD deficit reconciliation. He was sure that members had seen the reports from LFD with a calculated deficit of around \$671 million. He detailed that OMB had calculated the deficit at \$477 million; with the biggest difference being the economic recovery plan and \$120 million gap in cash flow. The measure was meant to be contingent upon and funded by the new wage tax; therefore, deficit neutral over a three-year period. He noted that LFD had denied savings from the EGWP Provisions, because they were not yet approved by the Retirement Management Board. Notwithstanding the two items, there were a couple of small adjustments to dividend figures that OMB had not had; and the calculated deficit for FY 19 would be near to \$525 million.

Co-Chair Hoffman asked if the deficit as shown on the slide excluded the obligation to outstanding tax credit liability, which was a substantial number.

[10:34:20 AM](#)

Mr. Fechter turned to slide 19, "Budget Reconciliation to Fall Estimates." He explained that the previous fall LFD and OMB came forward with an analysis which included items that were likely to drive up the FY 19 budget. The slide was a reconciliation of what was known the previous fall and the governor's budget that was put forward. He pointed out an increase in the projection for Medicaid, largely because it was estimated that payment levels would remain

flat with FY 17 while not factoring in growth for FY 18 and FY 19. There were smaller differences in inmate health and debt service. He noted that the largest difference reflected on the table was the debt financing concept for exploration credits. He recalled that one of the co-chairs had stated that if the state paid the statutory amount of tax credits owed, there would be a \$118 million increase to the budget rather than a \$30 million decrease as proposed.

Mr. Fechter continued speaking to slide 19 and pointed out additional funds used from the Public School Trust Fund, which would require legislation to be passed in order to achieve the savings. He mentioned the EGWP provision, and some adjustments to fiscal notes. The governor's budget restored the Senior Benefits Program, which would also require legislation. He added that the economic recovery plan allowed for a leaner capital budget.

Co-Chair Hoffman asked when the administration would change course if the plan did not proceed as expected. He thought it was a lofty idea. He mentioned other ideas such as Vice-Chair Bishop's similar concept with a different funding source.

[10:37:17 AM](#)

Senator Stevens asked for discussion about the estimated increase for the Alaska Marine Highway System (AMHS).

Mr. Fechter explained that the FY 18 budget had funded the AMHS with a one-time balanced draw-down. Instead of being subsidized partially by UGF, and partially running off receipts; it was identified that there was sufficient balance to draw the system down to a certain point. Subsequently, \$44 million in the budget was shifted from GF to Marine Highway Funds. The move was a one-time strategy.

Co-Chair MacKinnon asked for more discussion on the Marine Highway Fund. She recalled another way that had been proposed to fill the fund.

Ms. Pitney recounted that as part of the legislative budget process the governor's budget proposal had funded AMHS in the traditional manner. There were two components: in FY 17; a supplemental was put forward to capitalize the Marine Highway Fund, and FY 19 put more burden on the fund. The supplemental (due to last-minute negotiations) had not come

through and left AMHS funding short. There was a letter that had been sent to the co-chairs over the summer regarding the problem. The capitalization had been a one-time strategy that pushed the funding to DGF.

Senator Micciche asked about the most reliable source of obtaining a list of various accounts and funds where state dollars were sequestered. He thought that it might be time to evaluate and reprioritize such funds.

Ms. Pitney stated that the administration had provided such a list in the fall and agreed to provide it again. She considered that it would be prudent to provide the information in conjunction with LFD so there was more awareness.

[10:42:03 AM](#)

Mr. Fechter referenced slide 20, "Transparency Report,":

The Alaska Budget Transparency Report corrects for budget strategies to show a more accurate trend:

- Reclassification of unrestricted revenues to designated or other
- Other general fund offsets
- Retroactive budget items (i.e. multi-year supplemental appropriations)
- Supplemental items
- Reappropriations

Budget Transparency Proposed Next Steps

- Work with Legislative Budget and Audit Committee to codify reporting rules

Mr. Fechter stated that OMB wanted to work with the Legislative Budget and Audit Division in order to create some reporting rules to more clearly show changes from year to year. There were a number of budget strategies that artificially deflated GF spending and made it challenging for the public to understand the movements of the budget.

Mr. Fechter spoke to slide 21, "Budget Trend (Transparent Budget) ":

Agency operating budgets increased by less than one percent from FY2018 after accounting for supplementals:

- Investment in public safety of \$34.0 million
- Higher than anticipated prison population
- Increased formula costs of \$27.2 million for Medicaid

Statewide Items (Debt, Retirement, Credits, etc.) declined 12.6 percent driven by:

- Medicare Part-D Employer Group Waiver Plan (\$25.5 million in savings)
- Exploration Credit Financing (more in a later slide)

Total Operating and Capital reduced by 3.1%

Including the Dividend, total budget is down 1.7% or \$93.1 million

- 30 percent compromise dividend proposed (7.7% above 2018 levels), estimated at \$1,216/Alaskan. Growing to above \$1,500 in 10-years

Co-Chair MacKinnon asked if Mr. Fechter was referring to GF spending, or all-in spending including federal funds and other designated receipts.

Ms. Pitney stated that the slide showed what GF spending would be in a very stable environment. The slide did not include federal funds.

Co-Chair MacKinnon thought the slide could use more information to inform what funds were used. She referenced conversations with constituents to explain the rationale of increasingly using federal funds. She discussed using federal funds to the highest benefit of the people of Alaska while the funds were available. She discussed the state's diminished economy. She thought the budget was trending upward due to accessing more federal funds than in the past.

Co-Chair Hoffman referred to the transparency report and noted that the committee would hear an independent view from LFD the following day. He thought the report from LFD might differ from that of OMB.

[10:45:49 AM](#)

Mr. Fechter spoke to slide 24, "Expenditure Reductions to Date," which showed a table/graph that broke down the transparency report by agency. He drew attention to a wide range of reductions, noting that many departments had taken reductions greater than 5 percent, with many in the 20 to 40 percent range. He noted that there was an asterisk next to the Department of Commerce, Community and Economic Development; which denoted that the reduction was due to the transition of the tourism and seafood marketing function to the industry and away from GF.

Mr. Fechter discussed slide 25, "Budget Reform":

"We need to get to the point where the largest employer in the state is not sending a pink slip to all of its employees every year....they are not buying houses, cars, etc..."

Southeast Banker

Ms. Pitney clarified that the author of the quote on slide 25 came from a banker in Southeast Alaska.

Senator Micciche referenced slide 22. He referred to former Senator Ted Stevens, who was fondly known as "Uncle Ted," and had brought in a maximum amount of federal funds to the state. He thought it was important that Alaskans knew that the legislature was focused on federal spending increases as the state worked on UGF reductions. He wished for a second slide that captured information on federal spending increases.

[10:48:12 AM](#)

Mr. Fechter turned to slide 26, "Budget Reform":

Defining the Problem - Consequences of an untimely budget

- Employees and teachers receive layoff notices (reduced morale, increases costly turnover)
- Ferries cannot publish their schedule (foregone revenue)
- Agency staff focusing on government shutdown, not service to Alaskans

Budget Reform Legislation

- If the Governor fails to submit the budget by December 15th
 - Forgo salary and per diem
- If a budget is not passed by legislative day 91:
 - Legislative salaries withheld, per diem forfeited
- Shift to biennial budgeting
 - During the first session of each 2 year cycle, 2 budgets are passed
 - During the second session, a supplemental true-up is passed
 - More time to tackle policy issues
 - Avoid lengthy budget negotiations each year

Mr. Fechter discussed the budget reform legislation as proposed on slide 26. He noted that the State of California had enacted a similar piece of legislation; and since passage there had only been one year in which the budget was passed late.

Co-Chair MacKinnon asked how many years the administration had missed the budget submission deadline of December 15th.

Ms. Pitney relayed that there had been a budget submitted by the Walker Administration every December 15 each year. She detailed that the first year of the administration, the December 15 budget was a non-endorsed budget, but had been submitted by the deadline.

Co-Chair MacKinnon recalled a year when the administration had not submitted the budget in a timely manner and commented that the budget had been unbalanced and based on legislation that had to pass. She thought it was open for interpretation as to whether the administration had submitted a budget on time. She appreciated the desire for transparency and commented on the challenging fiscal climate. She thought the general public was very dissatisfied with the fighting that was going on in the legislature in the nation's capital. She thought it was extremely important that the powers in the constitution were upheld.

Co-Chair MacKinnon continued her remarks. She referenced political maneuvers. She was uncomfortable with the governor's proposal to penalize himself and legislators for

the lack of timely budget passage. She discussed her personal circumstances. She did not think that the current per diem rate for legislators was set at the right level. She discussed the tough decisions that state government was faced with during a fiscal downturn, and diminished state savings. She suggested that the governor's proposal could infringe on the constitution the powers of the legislature. She commented that legislators lost money by leaving higher-paying jobs to work in the legislature. She found the proposal alarming.

[10:54:07 AM](#)

Senator Micciche echoed the sentiments of Co-Chair MacKinnon. He thought there should be a penalty that would incentivize legislators working better together. He referenced the challenge of the legislative process and found the governor's proposal offensive. He referred to past budget negotiations and suggested that the administration had caused delays. He thought the administration should act as part of the team. He thought the governor's proposal was unconstitutional.

[10:56:04 AM](#)

Co-Chair Hoffman asked to return to slide 24. He wanted to highlight the work the committee had done in streamlining government and reducing expenses. He thought the committee had done so with public support. He thought that well over 50 percent of belt-tightening measures had been initiated by the committee amidst much criticism. He spoke to right-sizing government and thought the committee had done a better job than its counterparts. He restated that it was important for the government to work together for the state. He thought the per diem issue was something that the legislature should decide rather than the executive branch. He agreed with previous comments.

Co-Chair Hoffman continued his comments. He emphasized the importance of moving forward in a positive manner. He commented on the difficulty of making reductions and generating new revenue. He spoke to the legislative process and hoped that progress could be accomplished. He referenced Co-Chair MacKinnon's comments about expending state savings.

[10:59:13 AM](#)

Mr. Fechter stated that the final slides would address anticipated revenues for FY 19.

Mr. Fechter referenced slide 27, "Revenue for Operating and Base Capital":

Existing revenue expectation: \$2.0 billion
Compromise Permanent Fund Protection Act: (30% dividend): \$2.0 billion
Other revenues: \$40 million
CBR/SBR: \$477.4 million, Adjusted to \$525 million per recon

- Narrowing the gap reduces uncertainty
- Alaska Economic Recovery Act to addresses the recession
- Reassessment needed when temporary tax expires
 - Savings anticipated to be depleted in FY2025
 - Reassess in FY2022 given current oil price/production levels, success of efficiencies, market returns, etc.

Mr. Fechter mentioned the Motor Fuels Tax, and a variety of other bills associated with additional revenues proposed by various legislators.

Mr. Fechter looked at slide 28, "Revenue Sensitivity," which showed a table. He noted that the current budget balance point was at \$90 per barrel (bbl) price of oil, but that once a fiscal plan was enacted the curve would be shifted downwards. He discussed different fiscal plans as listed on the slide. As of January 9, 2017; the price of oil was \$69.02/bbl. He thought it was important to note that the state's tax system worked on the average North Slope per-barrel oil price for the year.

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Co-Chair MacKinnon pointed out that most of the money that the state spent went back to local communities. She thought it was not entirely accurate to claim that there was \$2.1 billion for government. She used the example of education, which received over \$1 billion, while the state education department was very small. She referred to an interim meeting with Ms. Pitney in which she had provided figures describing how funds were used in communities. She

referenced the Glenn Highway, which was very expensive to maintain. She asked Ms. Pitney to speak to how much of the state government budget was sent to communities.

Ms. Pitney stated that over 50 percent of state-funded dollars went to communities via payments for dividends, school districts, retirement on-behalf payments for local governments, school debt reimbursement. Such payments went directly out to communities. She stated that she would utilize a slide from the presentation Co-Chair MacKinnon had referred to in order to provide further detail.

[11:04:27 AM](#)

Mr. Fechter thought it was important to note that slide 28 did not include SB 26 revenue limits. At \$70/bbl the Permanent Fund Protection Act dictated that the draw should be reduced by \$500 million as oil and gas royalty and production tax increased. He thought it was a challenge to balance the need to have sufficient funding in the CBR against the need to preserve the balance of the Permanent Fund for future generations.

Mr. Fechter presented slide 29, "Ten Year Strategy," which showed a table entitled "FY2019-FY2028 Budget Projection (\$millions)." The table showed around a \$500 million deficit in FY 19. Presuming the CBR and SBR balance was above \$1 billion, there would be a \$300 million fiscal gap given the current forecast. The gap represented a reassessment point that had been discussed earlier in the presentation. If reductions were higher than anticipated, or oil price and production increased beyond expectation, it was very likely that the gap could increase. He thought it was equally likely that the gap could increase.

[11:06:12 AM](#)

Mr. Fechter showed slide 30, "Diversifying Revenues," which showed a bar graph. He pointed out that historically 85 percent of the state's budget had been covered by oil and gas revenue, with 15 percent from non-oil and gas revenue. At current oil price and production levels, only 30 percent of the state's budget could be funded by oil and gas revenue. There was 50 percent unfunded portion of the budget to be filled by savings. The administration endeavored to generate additional revenue by directing Permanent Fund earnings towards the budget for government

services and communities; which would still leave a 13 percent savings gap in the near term. He discussed possible future developments such as the Alaska Liquid Natural Gas Project and Alaska National Wildlife Refuge, it would be possible to close the gap.

Mr. Fechter showed slide 31, "Diversifying Revenues," which mirrored the previous slide but for the addition of the Permanent Fund Dividend.

Co-Chair Hoffman asked about assistance to communities and asked if the governor's proposed budget had \$30 million appropriated for community assistance. He stated that without the appropriation, FY 20's payout could only be a \$20 million payout.

Ms. Pitney stated that until there was a sustainable fiscal plan, the administration felt (as it had the previous year) it was not prudent to use GF for community assistance.

Co-Chair Hoffman thought the same was true for any program and wondered why the administration had singled out a program that benefitted virtually every citizen in the state.

Ms. Pitney stated that the \$20 million payout in 2020 was to protect the smallest communities. She thought it was difficult to share funds with the lack of revenues the state was experiencing. The administration was pleased that the PCE fund had excess funds. If there were excess funds, the administration would consider a supplemental in FY 19.

Co-Chair Hoffman recalled that the committee had sought to reduce the community assistance payout from \$60 million to \$30 in order to protect the program. He thought it was unfair to put the burden on the program. He wanted the public to know if it was not the desire of the committee. He did not support further reduction to community assistance. He thought there were many services and programs funded by the ERA, and thought it was a choice of the administration to cut community assistance.

[11:10:55 AM](#)

Co-Chair Hoffman reiterated the need for collaboration. He spoke to the need to get the people's business done in as cordial a manner as possible.

Senator Micciche thanked Ms. Pitney for her presence. He acknowledged her difficult position.

Co-Chair Hoffman discussed the schedule for the week.

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ADJOURNMENT

11:12:33 AM

The meeting was adjourned at 11:12 a.m.