

HOUSE FINANCE COMMITTEE
March 4, 2019
1:34 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Tammie Wilson, Co-Chair
Representative Jennifer Johnston, Vice-Chair
Representative Dan Ortiz, Vice-Chair
Representative Ben Carpenter
Representative Andy Josephson
Representative Gary Knopp
Representative Bart LeBon
Representative Kelly Merrick
Representative Colleen Sullivan-Leonard
Representative Cathy Tilton

MEMBERS ABSENT

None

ALSO PRESENT

Bruce Tangeman, Commissioner, Department of Revenue; Alexei Painter, Analyst, Legislative Finance Division; Michael Partlow, Fiscal Analyst, Legislative Finance Division.

SUMMARY

CONSIDERATION OF GOVERNOR'S APPOINTEE: BRUCE TANGEMAN,
COMMISSIONER DESIGNEE, DEPARTMENT OF REVENUE

PRESENTATION - LEGISLATIVE FINANCE DIVISION: EDUCATION
FUNDING

Co-Chair Foster reviewed the meeting agenda. He handed the gavel to Co-Chair Wilson.

^CONSIDERATION OF GOVERNOR'S APPOINTEE: BRUCE TANGEMAN,
COMMISSIONER DESIGNEE, DEPARTMENT OF REVENUE

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Co-Chair Wilson invited Mr. Tangeman to the table.

BRUCE TANGEMAN, COMMISSIONER, DEPARTMENT OF REVENUE, introduced himself and thanked members of the committee for their time. He had lived in Alaska since 1991. He highlighted his diverse career in Alaska. He shared that he grew up in Indiana and recalled his high school graduating class of 1970. He detailed that he had earned his Eagle Scout award at the age of 14 or 15. He attended Indiana University and studied public finance and economics. He met his wife, Betty, in 1987 at university. He provided further detail about graduating from college and getting married. He worked as much as possible to get through school.

Commissioner Designee Tangeman shared that he worked for the Boy Scouts of America after college graduation. His wife had a degree in criminal justice and one in East Asian languages. He discussed his work background. He managed the airport parking lot when he moved to Juneau at the age of 22. He went into state service in 1996 working in accounting for the Department of Corrections (DOC). He became a budget analyst for DOC and for the Department of Health and Social Services (DHSS). He worked for the Legislative Finance Division (LFD) before moving to Anchorage to work for the Alaska Railroad as the corporate budget officer. He returned to the the private sector in 2008 and moved to Fairbanks. He provided detail about his position as chief executive officer for Doyon Utilities. The U.S. Army had been privatizing facilities across the country. He explained the desire of the Army for one company to own everything. His company became the third largest utility in the state owning 12 utilities. He spoke of the advantages of the size of the utility.

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Commissioner Designee Tangeman continued to share information about the utility company. He mentioned that they replaced the electrical system at 3 bases in the first 5 years of his tenure. He worked for the company for four years prior to going back to Anchorage. He worked as deputy commissioner for the Department of Revenue (DOR) after that

time. He provided detail about working on the Alaska Liquified Natural Gas (AKLNG) project and the TransCanada buyout. He hoped the issues they had worked on at the time would pay out dividends in the future.

Commissioner Designee Tangeman detailed that he had worked with the Alaska Gasline Development Corporation (AGDC), and in May 2014 he started with AGDC as a vice president of finance. He acquired a significant amount of experience working for Dan Fauske. He learned that the work was about finding a solution and being prepared with an idea on how to fix a problem prior to bringing it to a superior. He assisted in the hiring process for AGDC. He shared that his wife worked as a probation officer for 20 years. In 2016, he and his wife went on a four-month road trip. Following is trip he worked for former Senator Pete Kelly and the Senate Finance Committee. He highlighted his well-rounded background.

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Commissioner Designee Tangeman continued to address his work history. He stated it was too early to retire and was offered the position of commissioner of DOR. He looked forward to working in the position. He made himself available for questions.

Representative Sullivan-Leonard asked for Commissioner Designee Tangeman's view and mission for the department. She asked how he saw things going forward, especially in light of current challenges.

Commissioner Designee Tangeman detailed the department had 4 primary divisions including the Tax Division, the Treasury Division, the Permanent Fund Dividend Division, and the Child Support Division. He addressed the issue of constrained revenue. He thought it was a critical time for the state. Oil production was at 500,000 barrels per day. He spoke of the potential for further development of oil. The Constitutional Budget Reserve (CBR) currently had a balance below \$2 billion, which was a concern. He thought the percent of market value (POMV) approach in statute allowed the state to access a nice revenue stream. He believed the state and the department had many good building blocks in place, but stability on the revenue side would be a challenge in the future. Production was forecasted to be stable over the next 10 years, with a 5

percent decline over that period. He thought the revenue was as good as it could be presently. He added that 2 of the state's revenue streams appeared stable.

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Vice-Chair Ortiz referenced Commissioner Designee Tangeman's mention that he was not arriving to the position in an economic upswing. He asked if good times would be arriving soon or whether significant diversification was needed.

Commissioner Designee Tangeman replied that he viewed the environment as fairly stable and competitive. As the state went through a series of tax changes, the need for Alaska to compete became clear, which he believed had been done over the past 5 years. He thought the state had other revenue resources to get through the hard times. He asserted that a reduction in the budget was required to make ends-meet. The disparity between the available revenues versus the budget seen in the previous couple of years did not work. The state would have to tap additional revenues from the Permanent Fund Earnings Reserve Account (ERA). He did not see the need for any new taxes or revenues in the foreseeable future. He thought the need for additional taxes could be a decade away.

Vice-Chair Johnston believed she and Commissioner Designee Tangeman had first met when discussing landfill gas. She appreciated all of his work stabilizing oil and gas taxes and helping to develop structure with the Permanent Fund. She valued his comments on the importance of both. There were some bills that might come before the committee that would go beyond the structured draw of the ERA. She emphasized that there was an issue regarding the structured draw. She was relieved to hear the commissioner speaking in favor of it. She asked if Commissioner Designee Tangeman was on the board of Alaska Industrial Development and Export Authority (AIDEA). Commissioner Designee Tangeman answered in the affirmative.

Vice-Chair Johnston stated that the administration was looking at using AIDEA funds for the oil and gas credits and for the capital budget. She asked if the AIDEA Board had weighed in on the use of the funds and what AIDEA would be able to do without them.

Commissioner Designee Tangeman answered that the board was looking into the idea. The agency had over \$400 million in liquidity of which the administration was proposing to use just over half. He viewed the situation as a cash flow issue for the state. He thought if there was a large enough resource that could be used to pay down some of the state's debt, it was a reasonable approach. The bulk of the money would be used to pay the majority of the outstanding tax credits. He clarified that the money would not be used to pay the 3 larger oil companies. Rather, it would be used to pay off tax credits for investments that companies made under PPT, Alaska's Clear and Equitable Share (ACES), and SB 21. The tax credits were originally put into place to bring more companies to Alaska. In retrospect, he found that some companies had the balance sheet and experience to work in the state. He cited Hilcorp as an example. He reported that not all companies had money to invest or were in a position to do business in Alaska. The one-time use of AIDEA funds would be used to pay off the existing credits. The Alaska Industrial Development and Export Authority funds would not be an ongoing revenue stream. He spoke to the importance of paying down the state's debt and getting Alaska on a better footing with potential investors.

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Vice-Chair Johnston asked Commissioner Designee Tangeman if he believed the use of funds fit AIDEA's mission. Commissioner Designee Tangeman answered that the administration was not asking AIDEA to participate in the tax credit program. The administration was asking to use the resources AIDEA had to assist the state in paying down its debt. Going forward, he thought the plan for AIDEA would be a different discussion. He mentioned the Ambler Road project. He thought the use of funds helped the agency focus on its priorities.

Vice-Chair Johnston wondered if AIDEA would be more efficient with less money.

Co-Chair Wilson brought the discussion back to the confirmation.

Representative Josephson spoke in support of Commissioner Designee Tangeman's appointment. He was struck by the passivity of Commissioner Designee Tangeman's comments about revenue. He had used the phrase, "If revenues do

materialize." He discussed that the previous administration, which he broadly supported, wanted to steer the state's ship with the help of the legislature and had asked for direction. He referenced Commissioner Designee Tangeman's statement that he did not see the need for a tax in the next decade. He stressed that the public was incredibly alarmed by the cuts and was pleading for new revenue. He asked if there was a point, notwithstanding promises that had been made, that new revenue would need to be revisited.

Commissioner Designee Tangeman replied that the question of taxes was currently being debated. He noted that there had been 700 people at a recent town hall meeting, which was a record. He suggested the question was about whether the size of government was appropriate. If it was, he wondered how it would be funded. He noted there was a limited amount of savings including the Permanent Fund Dividend (PFD), the Earnings Reserve Account (ERA), and the Constitutional Budget Reserve (CBR). The Constitutional Budget Reserve was fairly depleted. He clarified that when he referred to revenues materialized; he was speaking about future potential production. The state had experienced a great run over the past few decades. Alaska had been the envy of many states, as it had no income or sales taxes. The problems the state was dealing with presently were tremendous. However, Alaska was still positioned better than most states. Using a percent of market value (POMV) structure to bring in a revenue stream had helped with the credit rating agencies and put Alaska on the right path. He thought the current discussion should be about what size government was needed. People were being forced to prioritize. The discussion was necessary, as the current model was not sustainable. He argued that the state could not extract enough revenue from the private sector to fund the delta it faced.

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Representative Josephson thought about members of the cabinet and the governor flying to the Lower 48 to attend conferences with 49 counterparts. He was curious what the conversations were like reporting that the state was scheduled by statute to give every Alaskan \$3,000 (which the state could not really afford), thousands of people were going to lose their jobs, and the state did not have a

broad-based tax. He asked how they explained the situation to other states.

Commissioner Designee Tangeman replied that he had not had discussions with his counterparts in the Lower 48 on the particular topic. He recalled some conversations when he worked at LFD in meetings with other states who did not offer Alaska the opportunity to participate because, in their minds, the state did not have any problems. Looking from the outside in, other states viewed Alaska as a state sitting on a balance of \$65 billion in the Permanent Fund. They wondered what the problem was. He was not going to weigh in on the dividend side. However, he felt strongly that the past size of government was unsustainable. He acknowledged that the proposed cuts were extreme, but the administration understood the legislature would weigh in on the cuts.

Representative Josephson was concerned that with the administration's plan, costs would be shifted to local governments. He thought the budget was being hoisted or pushed off. He believed the budget protected the state's interest as a political entity but was not a statewide solution favoring Alaskans. He asked the commissioner designee to comment. Commissioner Designee Tangeman answered that the issue might be better addressed by the Office of Management and Budget (OMB). He offered that it forced a discussion at both state and local levels. Not all communities had a sales tax or property taxes.

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Co-Chair Wilson reminded committee members they were interviewing Commissioner Designee Tangeman for the position of commissioner for DOR, not for governor.

Representative Carpenter asked in what ways Commissioner Designee Tangeman would work to improve the department and reduce its footprint.

Commissioner Designee Tangeman answered that the Treasury Division was a large part of DOR. He took a more conservative approach to investing in his own personal life. He suggested he would use the same approach with the department. He argued that the department had to be careful with its revenues. It was managing to a lower level because every dollar was critical. He mentioned that the Tax

Division was making tremendous progress as it worked through its audits. He spoke of reducing the time it took to complete them. He did not have an army of auditors to do the work - the division had experienced significant challenges performing audits under a different tax structure. He commended the auditors for their work to complete the last of the Alaska's Clear and Equitable Share (ACES) years. From 2014 through 2019, the state had essentially been under the same tax structure. Catching up with the audits gave the department the opportunity to look ahead instead of behind. He believed efficiencies would evolve. He mentioned that a new management system was in place. The department had not had to request any new positions and was fairly stable. He relayed that there might be a discussion about redeploying assets in work down the road.

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Commissioner Designee Tangeman addressed growth in the department and relayed that it had been stable throughout. Child Support Services had about 200 employees and had not asked for an increment. Treasury had also been fairly stable.

Representative LeBon believed Commissioner Designee Tangeman was very qualified and he supported his nomination. He thanked Vice-Chair Johnson for asking his questions related to AIDEA. He was concerned about the percent of market value (POMV) approach. In his banking world a realistic draw rate of 4.25 percent was the industry standard. His concern was about what effect it might have on the future value of the Permanent Fund. He asked the commissioner designee whether he had an opinion on the POMV draw rate.

Commissioner Designee Tangeman answered that over the past couple of years there had been substantial stress testing done. He recollected that the director of the Alaska Permanent Fund Corporation had appeared before the committee several times when the POMV was being discussed. The legislature settled on 5.25 percent for the first 3 years with a step-down to 5.0 percent. At the time the board and the director felt comfortable with the amount but was uncomfortable with anything above 5.25 percent. The expected returns were 6.55 percent. The state was approaching new territory because it would be using

earnings from the fund for government use. It put things in a different perspective as far as what the appropriate level was to grow the fund, to produce a dividend, and to provide revenue for government. The fact that the board and director were comfortable with 5 percent gave him the comfort he needed.

Co-Chair Wilson remarked on the Permanent Fund corpus.

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Vice-Chair Ortiz believed the committee agreed that revenues needed to match expenditures. He asked if Commissioner Designee Tangeman had done any analysis on the impact of further reductions in government spending versus a reduction in the PFD. He asked if there had been a study on the impact to the economy.

Commissioner Designee Tangeman had not personally evaluated the economics, but he had been a witness to several analysis over the past couple of years by various smart economists. There would be a presentation on Wednesday about the topic. He suggested that everyone was waiting to see what the impacts would be to the economy by infusing it with a \$3,000 dividend or taking money away from the economy. He thought that money would be infused through the dividend, or it would be extracted through a revenue measure like an income tax or a sales tax. Unfortunately, there would not be a definitive answer - there would be many two-handed economists. Personally, he had not done any economic modeling. He was concerned with the extraction of revenue from a small tax base. He did not believe it was possible to generate enough revenue to support the current size of government for a sustained period. He was concerned about what was sustainable. He stressed the need to be careful about the tax base and the private sector's reaction.

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Vice-Chair Ortiz noted his question had not pertained to additional revenue. He asked for clarification about what the commissioner meant regarding additional revenues. He wondered if he meant extracting additional revenue by potentially reducing the PFD amount. Commissioner Designee Tangeman replied "In a way." He thought the discussion would move in the direction of a reduced dividend amount in

both bodies of the legislature. The current administration believed that putting the money into Alaskans' hands to spend and reducing the budget was the appropriate course of action. He realized it would not be the end of the discussion. He viewed it as an injection of funds into the economy as opposed to a withdraw of money.

Representative Knopp supported his nomination. He asked if the Child Support Division had 200 employees. Commissioner Designee Tangeman replied in the affirmative.

Representative Knopp stated that in Commissioner Designee Tangeman's role he managed 4 divisions and several people. He asked if the commissioner would recommend changes to divisions such as the Child Support Services Division (CSSD) which had 200 employees and cost the state an average of about \$100,000 per employee. The total cost for salaries and benefits was about \$20 million per year. He asked the commissioner whether he would recommend changes if the division was not self-supporting. He wondered if the commissioner would look at his own department and programs for cuts. He also noted forecasting.

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Commissioner Designee Tangeman did not plan on making any changes to any of the department's divisions at present. The Child Support Services Division was the division he knew about the least. He spoke to the difficulty of the nature of CSSD jobs and positions. He noted that for every dollar the state contributed in general funds to the division, the federal government pitched in \$2, a two-thirds match. In terms of making changes or expectations from CSSD, he did not have an answer. He was aware there was a significant amount of turnover within the division.

Commissioner Designee Tangeman responded to Representative Knopp's comments regarding forecasters. The economic research group performed many duties. They took the lead on the Revenue Sources Book and produced several reports. There were about eight employees in that particular group. He was interested in exploring the reports that would be nice to have, the reports that have always been produced, and the reports that were required. He was not of the mindset that something had to continue being done just because it had always been done in the past. He was willing to take any criticism for making certain decisions and

thought all commissioners would have to start making some changes based on the state's fiscal reality.

Co-Chair Wilson asked if Commissioner Designee Tangeman would participate in the subcommittee process. Commissioner Designee Tangeman did not believe he would be participating. The administrative services directors would be leading the charge. The directors of each of his divisions would be available for questions. He believed the process would be more focused on projects and programs. He did not believe he would be participating unless instructed to do so.

Co-Chair Wilson hoped there would be an instruction for that to happen. She thought it would be very helpful. She thanked Commissioner Designee Tangeman.

Representative Josephson shared that the Bradner Report had conveyed that AIDEA did not object to the transfer of receipts.

Co-Chair Wilson reminded the committee that signing the report regarding the appointment of Commissioner Designee Bruce Tangeman in no way reflected an individual's approval or disapproval of the appointee. The committee's report accompanied the nominations which would be forwarded to the full legislature for confirmation or rejection. In accordance with AS 24.60.130 the House Finance Committee, having reviewed the qualifications for the commissioner of DOR, moved his name to the full legislature for confirmation. She handed the gavel back to Co-Chair Foster.

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^PRESENTATION - LEGISLATIVE FINANCE DIVISION: EDUCATION FUNDING

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Co-Chair Foster asked Mr. Painter if he would like to hold questions until the end.

ALEXEI PAINTER, ANALYST, LEGISLATIVE FINANCE DIVISION, replied he was happy to take questions during the 45-minute presentation. He addressed a PowerPoint presentation titled "Overview of K-12 Funding Formula," dated March 4, 2019 (copy on file). He began on slide 2 and addressed the FY 20 K-12 budget. He reported having been the legislative analyst for the Department of Education and Early Development (DEED) for the previous 4 years. Mr. Partlow was taking it over. He would be providing back-up.

Mr. Painter began by reporting the purpose of the presentation which was to provide an overview of how the K-12 education funding formula worked as well as how other funds flowed from the legislature to public schools in Alaska. The Legislative Finance Division (LFD) also published a white paper the previous fall entitled, "The Citizens Guide to K-12 in Alaska, " which was available on the division website. It attempted to walk through the formula in a way that members of the public and the legislature could understand.

Mr. Painter continued to slide 2, "FY 20 K-12 Budget":

- HB 287 (SLA 2018) appropriated FY19 and FY20 K-12 formula funding.
- The appropriation for FY20 will flow out automatically absent further action.
- The Governor's FY20 budget proposes repealing the FY20 appropriation for the Foundation Formula and replacing it with an appropriation for 76.87% of the statutory amount.
- In SB 142 and HB 287, the legislature also appropriated \$20 million outside the formula for FY19 and \$30 million for FY20.
- All of this funding has already been appropriated and cannot be vetoed or withheld by the Governor. Legislative action is necessary to alter or remove it.

Mr. Painter advanced to slide 3 outlining the organization of the Alaska School Districts. He read the slide:

Organization of Alaska School Districts

- School districts in Alaska do not have taxing power - they get funds from the federal, state, and municipal governments
- Alaska has 53 school districts
 - 34 in organized areas, with boundaries corresponding to that of local governments
 - 19 Regional Educational Attendance Areas (REAs) in the unorganized borough
 - Mt. Edgecumbe High School is run by the state and is not in a district

Mr. Painter turned to a pie chart on slide 4 showing FY 19 funding sources for school districts. He reported that school districts in Alaska received about \$2 million total in FY 19. In addition, the state provided another \$300 million of indirect funding for educational purposes. The largest source of funding for school districts was the foundation formula totaling \$1.2 billion. The funding came from a variety of sources including state, local, and federal dollars.

Mr. Painter moved to slide 5: "Foundation Formula - How It Works." He explained that both the foundation formula and the pupil transportation formula were not appropriated directly to the school districts. The money was deposited into the Public Education Fund and flowed out without further appropriation. The path he described was initially established in order to enable forward funding which the state had done for several years. He further explained that instead of putting money in the fund that would flow out the same year, the state put money in that would flow out the following year. The practice of forward funding ended in FY 15 and FY 16. There was no longer a balance in the Public Education Fund. Rather, the state would appropriate the amount necessary to fund the formula. The state did not necessarily need the Public Education Fund for its original purpose. The fund remained on the books and was used as a mechanism. The foundation formula monies for the department went into the Public Education Fund as designated in the language section of the budget.

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MICHAEL PARTLOW, FISCAL ANALYST, LEGISLATIVE FINANCE DIVISION, indicated that before he started talking about the mechanics, he wanted to bring up 2 points. He would be

talking about a fairly complex system made up of a significant amount of statutes, regulations, and mathematical calculations. For the purpose of the presentation he would be simplifying it down to the bare bones of the process to be able to more easily talk about concepts. He suggested that for further detail the department was a great resource. He also wanted to address the question of why there was a formula. He reported that previous legislatures had recognized a difference in funding costs for students depending on a variety of factors in Alaska such as location, the type of education, and the size of a school. The foundation formula was set up as a way to more fairly distribute money in Alaska for education in different communities.

Mr. Partlow moved to slide 7 and continued to discuss how the foundation formula worked. He suggested that when coming up with a formula a starting point was needed. The student count, students in Alaska by district, was based on an average daily membership (ADM). Once a student count was determined, the number would be put into a formula that had factors for 6 separate things that differed by district and helped the state to reach an adjusted average daily membership (AADM). Next, the ADM was multiplied by the base student allocation (BSA). The equation (the adjusted daily membership multiplied by the BSA) resulted in the basic need.

Mr. Partlow continued that the ADM was based on a student count that occurred in October every year. The count was based on the last 20 days of the month. A wider net was cast to capture not just 1 day in a year but several days. It helped to capture the full breadth of the student population in Alaska. He reported that the ADM had been calculated at least since FY 98 when the modern formula was established. The average student count in the state was around 130,000 students. He explained that in FY 20, it was projected to be about 128,000 students. Once the calculation was made, working with all of the districts to come up with a number, the 6 factors were applied to determine the AADM.

Mr. Partlow advanced to slide 8 and highlighted the first of the factors - school size. School size was included to recognize that there were economies of scale that came with having small schools or very large schools. The basic principle was that a classroom was needed, whether it was

filled with 30 students or 10 students, and a teacher was needed. He suggested there were fixed costs whether spreading the costs over 10 or 30 students. It provided an economy of scale. He continued that the second factor was the district cost factor. It was a multiplier that adjusted for the different costs across the state. Each district had its own multiplying factor. The base was Anchorage. The Anchorage area was the least expensive area in Alaska to provide education on a per-pupil basis. Each district, other than Anchorage, had a different calculation above 1. He would provide an example on the following slide.

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Representative Sullivan-Leonard mentioned the special needs factor and special education intensive student factor. She wondered why they were not combined into one factor.

Mr. Partlow replied that special needs covered students with reading disabilities to gifted and talented students. Whereas, special education intensive students needed extensive assistance in order for them to receive their education. The districts had dedicated staff and equipment. The special needs factor was a grant that went out to every school district. It was about 20 percent of additional funding. The added amount covered the basic needs of special needs students. The special education intensive student factor encompassed children in Alaska that had a significant amount of special needs. The factor tried to account for a certain population.

Representative Sullivan-Leonard asked if the state received additional revenues associated with each special needs students. Mr. Partlow answered in the affirmative.

Vice-Chair Johnston shared that the special education intensive student factor came into play about 7 to 8 years back when there was a number of students with medical needs coming into Alaska's urban areas. Numerous students were costing districts \$70,000 to \$80,000 per year. She asked if the 20 days in October were set out in statute. Mr. Painter replied in the affirmative.

Vice-Chair Johnston noted he had mentioned Anchorage being the base. She asked when the last cost study had been conducted. Mr. Painter replied that the cost study the state was currently using was conducted by the Institute of

Social and Economic Research (ISER) in 2005 and had not been updated since then. The original formula went into effect in 1998 and was adjusted by ISER.

Mr. Partlow continued addressing slide 8. The next factor was the career and technical education (CTE) factor. It was also a block grant, though for a smaller percentage than the special needs factor. After the previous factors were applied, the student count was multiplied by 1.015 equal to an increase of about 1.05 percent based on the student count above it. It covered vocational and technical education.

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Representative Knopp asked if districts received Technical Vocational Education Program (TVEP) funding for career and technical education. Mr. Painter replied that they did not receive direct funding, although there were grant programs administered by the department that were provided to certain districts.

Vice-Chair Ortiz asked about the career and technical education factor. He asked if schools had to provide technical education to receive the funding. Mr. Painter replied that districts had to offer some sort of career and technical education. However, he did not believe the statute specified a special course or a portion of another course. The statute also specified that the grant money could not be used for the administration portion, only for education. Some small districts might not offer a specialized class but could integrate it into another course.

Mr. Partlow continued with slide 8 addressing the special education intensive student factor. Each individual student was identified by the district, and the resulting number was multiplied by 13.

Mr. Partlow explained the final adjustment factor, the correspondence multiplier. At the very beginning of the process when doing student counts in school districts, the correspondence students were identified and removed from the process for a time. The step recognized that correspondence students were not physically located in the schools so that school size did not have an effect. The final step was to take the number of correspondence

students and apply the correspondence multiplier of 0.9. The multiplier took into account that providing education to a student who was not physically present could be less expensive for a school district.

Representative Josephson asked what kind of cash parents received for correspondence. Mr. Partlow responded that he did not know. It was likely specific to each district.

Vice-Chair Ortiz noted that his wife was a correspondence coordinator for the Ketchikan School District. He was aware that the amount varied depending on the sponsor of the correspondence program. He asked if his answer made sense. Representative Josephson responded affirmatively.

Mr. Partlow pointed to an example on how the foundation formula worked on slide 9. He used the Fairbanks North Star Borough as an example. The start of the process occurred with the student count in October taking an average over 20 days. The district had an average of about 13,290 students. The next step was to identify the number of correspondence students taking that number out of the process for a duration. About 291 students were identified in the Fairbanks North Star Borough. The following step was to apply the school size factor looking at the specific size of the school that each of the students in the Fairbanks North Star Borough were attending which equaled about 15,000. The next step was to apply the district cost factor. Each district in the state had a number associated with it. The Fairbanks North Star Borough's number was 1.07 which brought the calculation to about 16,000. Next was to apply the special needs factor of 1.20, which brought the student count up to about 19,500. Next was to apply the CTE factor of 1.015 bringing the number of students up to 19,700. The district identified 408 students with special education intensive needs. The special education intensive needs number was then multiplied by 13. The resulting number was 5,304 which was added to the total calculation. The last step was to add the correspondence students back in, multiplying the factor of 0.9 to 290 students bringing the correspondence count up to 261 students. It brought the total adjusted average daily membership for the Fairbanks North Star Borough to about 25,281.

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Mr. Painter turned to a bar chart on slide 10. The chart was an attempt to graphically show how the multipliers had changed over time. Each bar represented an average student in the state for each of the years. The layers showed the funding that each factor added. He pointed out that over time as the factors had been adjusted, the multipliers had increased. In FY 05, the average student count was about 1.6. In FY 19, it was about 2.1. The amount had changed primarily due to statutory changes. The cost factors currently being used came from 2005. Prior to that, the state had a different set of factors that were lower. The new factors were phased in over the course of several school years. He pointed to the green bars that had increased over time. The largest change was the special education intensive student factor. The multiplier had been 5, then 9, then 13 for the past several years. The state had seen quite an increase in funding aimed at special education intensive students. In addition, the CTE factor was created in FY 10 and was originally 1 percent then expanded to 1.5 percent. All of the changes meant that even if the BSA had been constant over the period, the funding would have increased. He thought much of the time when discussions occurred regarding education funding it was focused on the BSA. However, because of the changes in factors, the funding had changed substantially more than what the BSA indicated. He stressed that it was important to look at the totality of funding.

Representative Josephson noted that Mr. Painter mentioned the district cost factor had not changed for 15 years but the green bar had grown. He wondered why. Mr. Painter answered that the factors that were created in 2005 were phased in over a 5-year process. The last time it happened was in FY 09. The bar grew but had remained comparable since FY 09. He thought the composition of the location of students in the state had shifted.

Representative Merrick asked if the special education intensive needs students cost 13 times more than a traditional student. Mr. Painter replied that the amount had been set in statute. The special education intensive needs students were funded at a 13 percent difference, but the actual cost varied.

Mr. Painter continued to slide 11. He relayed that once the AADM was determined, it was multiplied by the BSA to get the basic need amount. In addition, there was a quality

schools grant which was relatively small. The basic need number was about \$1.5 billion currently and was paid for by three sources including the required local contribution, deductible impact aid, and state aid. He would address the first 2 amounts and where they came from. They were payers that came in before the state. The state picked up everything that was left.

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Vice-Chair Ortiz asked about slide 11. He requested more information about deductible impact aid. Mr. Painter replied that he would provide further detail in a subsequent slide. The amount was deductible from the state's contributions. The districts received the money, but the state deducted it from what it paid.

Mr. Painter turned to slide 12, which showed the BSA as it had changed since FY 05 in nominal dollars. Slide 13 showed the same chart in inflation-adjusted dollars. Much of the time when people focused on just the BSA, they would argue that funding had declined since FY 07 in real terms. However, because of the factor changes, it was not how the funding moved.

Mr. Painter continued to slide 14 which showed nominal funding since FY 00. The governor's budget for FY 20 was on the right side of the chart. He pointed out that the BSA had not changed since FY 17 in nominal dollars.

Mr. Painter moved to slide 15 which showed that if funding outside of the formula was included, the peak year of funding was FY 15 in inflation-adjusted dollars since 1998 when the state switched to the current formula.

Mr. Partlow advanced to slide 16 and addressed the required local contribution, which applied to 34 of the 53 school districts in Alaska. He relayed that Regional Educational Attendance Areas (REAAAs) did not pay because they could not levy taxes. He would discuss ways that they contributed. For most districts the required local contribution was the equivalent of 2.65 mills of real property value. It was capped at 45 percent. No school district in Alaska was contributing more than 45 percent towards education in their community. There were 4 communities (North Slope, Valdez, Skagway, and Bristol Bay) that hit the cap which was caused by high property values compared to low

population levels. The required local contributions by districts in the state in FY 19 was about \$255 million.

Representative Josephson asked if there could be a limit to local contributions so as to not differentiate areas of the state too widely. He spoke of a law case to avoid disparity statewide. Mr. Partlow agreed. He would address the issue in more detail in the coming slides. He would be discussing equalization and making sure there was not a substantial disparity between the best-funded and the least-funded school districts by AADM.

Mr. Partlow continued on slide 17 and addressed the deductible federal impact aid funding source. Districts received federal funding to compensate them for non-taxable federal property for facilities located in their districts. There were certain expenses incurred by having federal facilities in a community such as educating military children. School districts were not able to collect tax income from federal property. Therefore, the federal government had a program, Impact Aid, which was used to reimburse school districts. The State of Alaska, as a contributor towards basic need, was allowed by the federal government to deduct the funding that was going to districts from the portion that the State of Alaska would have to pay. They were able to deduct up to 90 percent of eligible impact aid from its share of the formula. REAAs were not able to levy taxes and did not contribute to the required local contribution in the same way as a municipality. One way that REAAs contributed was that the vast majority or all of their impact aid was eligible, up to 90 percent, to go to the state's portion. The state could deduct 90 percent from its contribution. In FY 19, the state deducted approximately \$98.7 million.

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Co-Chair Wilson used the Fairbanks North Star Borough as an example in which students were educated on [military] bases. She suggested that about two-thirds of the borough's property taxes went to schools. She wondered about the calculation and contribution of the bases and whether the amount of impact aid was equitable.

Mr. Painter replied that the federal impact aid was even paid to districts without a local tax. It was not necessarily based on the local tax rate, rather, it was

based on a federal formula. He did not know the specifics of the calculation. He explained that in organized areas far less than 90 percent was deducted. The amount deducted was based on a proportion of the district's local funding which was optional rather than required. The more a district contributed to education, the more it was able to keep. He further explained that the REAAs that did not contribute property taxes only kept 10 percent of the impact aid. In organized areas like Fairbanks, they had a multiplier that was far below 90 percent. The district kept the majority of impact aid for organized areas.

Co-Chair Wilson indicated that the borough was starting to tax some of the housing at Fort Wainwright. She wondered how the state's share would be impacted. Mr. Painter would have to follow up with an answer to her question.

Mr. Partlow moved to slide 18: "Federal Disparity Test." He suggested that in order to deduct federal impact aid as part of the state's obligation to meet basic need there was a federal disparity test. The test was used to ensure that the state's formula was equalized. The test made sure that the lowest funded school district in Alaska compared to the highest funded district in Alaska by AADM was not too far apart. He indicated that the calculation was fairly complicated. One of the things the federal government allowed the state to do was to exclude the top 5 percent and the bottom 5 percent of school districts. The exclusion prevented a super outlier for funding from making the state immediately fail the disparity test. The remaining 90 percent could not have a difference from top to bottom of more than 25 percent in order to be equalized. If the state failed the test, it could no longer deduct the impact aid. The money still went to the school districts, but the state could no longer deduct it towards its portion. In the example of Fairbanks, they would still receive their \$9.7 million in impact aid, but the state would have to pay an additional \$9.7 million. He continued that failing the disparity test would be very costly to the state in a single year. It would also be a multi-year process (2 to 3 years) to prove to the federal government that the state re-equalized its formula, and the cost to the state could be millions of additional dollars for funding to meet basic need.

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Mr. Painter addressed two pie charts on slide 19 pertaining to student count and state aid by district. The chart showed a comparison of the top 10 districts in terms of how much aid they received. The student count was reflected on the left pie chart. The right pie chart displayed state aid by district after the student count had been run through the formula and the federal and local sources had been deducted. The top 10 districts had 86 percent of the students and received 77 percent of the state funding. Districts like Anchorage, a relatively low-cost district, would receive less state funding. He noted that because Anchorage had relatively high property values, the city paid a relatively high share of the education contribution compared to other districts. The slide provided an idea of how the funding was distributed geographically throughout the state.

Mr. Partlow reviewed slide 20: "Pupil Transportation." In addition to the foundation formula funding that went out to districts, the state also supported districts in their pupil transportation costs. It was only provided to school districts that had a pupil transportation system. In Alaska there were 5 school districts that did not have one. Until FY 03 the funding was paid out by a grant program reimbursing school districts for their actual costs. In FY 04 the federal government calculated the FY 03 per pupil cost and multiplied that number by the non-correspondence student count for each district. He clarified that whether a child was getting to school by plane, sled, or other means, the districts were receiving the same amount of money through the program. Pupil transportation was adjusted for inflation periodically but not since FY 13.

Mr. Partlow highlighted funding outside the formula on slide 21. For multiple years the legislature had provided one-time funding for school districts outside of the formula. While not always, it typically flowed out according to the same formula - the ratio of funding that a school district received from the overall \$1.2 billion. They were also receiving the same ratio of funding outside of the formula in the given year. In FY 19 there was \$20 million appropriated outside the formula as well as another \$30 million for FY 20.

Mr. Partlow continued to slide 22: "Voluntary Local Contributions". He relayed that another source of funding for education in Alaska was the voluntary local

contribution. He had mentioned that there was a required community contribution, but there was also an additional level which a community could contribute. Typically, most school districts contributed slightly more than their required local contribution. The amount was limited to 23 percent of the prior year's basic need and was capped at the equivalent of 2 mills of real estate property value. He reported 6 districts currently funded additional amounts, 2 of which were very near the cap. He revisited the disparity test. In order for the state to pass a disparity test the funding between the highest-funded school district and the lowest-funded school district in Alaska had to be no more than 25 percent. It allowed for there to be a 23 percent difference between the 2 types of school districts. The funding cap was designed so the state would not fail the disparity test. He reported that districts budgeted around \$250 million in voluntary contributions in the current fiscal year. The amount included in-kind services which were services that the school district would have to incur if they did not receive funding from local entities or municipalities. Shared janitorial services or shared office space were 2 examples.

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Representative Sullivan-Leonard recalled Mr. Partlow reporting that 6 districts were currently providing local contributions at or near the cap. She suggested that 34 districts were using their property taxes to pay for school funding. She asked if the other districts were near the cap. She thought it would be helpful to see a graph that showed each district's level of contributions in reference to the cap. Mr. Partlow replied that he would follow up with the information in a graph. He indicated that it varied significantly by district.

Representative Sullivan-Leonard asked for the 6 districts referenced on slide 22. Mr. Painter replied, "Anchorage, Juneau, Skagway, North Slope, Yakutat, and perhaps Valdez. He would follow up with the list.

Co-Chair Wilson believed the last school was Skagway. She noted that the North Slope was slightly different. She asked Mr. Painter to explain how the North Slope cap was different from the rest of the state.

Mr. Painter replied that the difference had to do with the 2-mill cap. For school districts whose regular funding was based on basic need (because of hitting the 45 percent cap) the local effort cap was 2 mills based on property values. In the disparity test they were part of the top 5 percent that the state did not have to count. He continued that because they were not subject to the 25 percent disparity test limit, they could contribute a larger percentage. If their cap was limited to 23 percent of basic need and they were already contributing 45 percent of basic need, it would skew the formula.

Co-Chair Wilson understood that the North Slope had the oil business. She asked about Skagway. Mr. Painter replied that Skagway had a tourism industry that was proportional to the population in public schools - very large. About 1 million cruise ship passengers visited each year and there were about 400 year-round residents living in Skagway. Skagway's property value was very high.

Representative Merrick asked which schools were part of the top 5 and bottom 5 percent. Mr. Painter replied that the lists varied by year. Generally, the North Slope School District and Skagway School District were always on the list of the top 5 percent. He could follow up with a copy of the most recent disparity test from FY 17. He thought the FY 18 test would be finalized soon.

Vice-Chair Ortiz understood that if the legislature were to adopt the governor's suggested budget (which included a 23 percent reduction to the BSA) the cap would be lowered by 23 percent. He asked if he was accurate. Mr. Painter replied that the statute was ambiguous. Legislative Legal Services was working on a legal opinion that he would share with the committee. He noted that an opinion from Legislative Legal would not stop anyone from challenging it.

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Mr. Painter advanced to a bar chart on slide 23: "State and Local Education Funding, FY00-FY19 (Nominal Dollars)." He indicated that the chart was similar to a previous chart but included local funding. He highlighted that the local share had increased despite the required local contribution decreasing. He elaborated that it used to be 4 percent, but there was a hold harmless provision that became very

complicated. Eventually, it was changed to 2.65 mills. He noted that local funding had increased, and the overall picture was similar to what was presented before. He turned to slide 24 and reported that the peak year was still FY 15.

Mr. Painter continued to slide 25: "Indirect Funding to Districts." He had been talking about direct funding to districts. There was also a substantial amount of indirect funding to districts spent on things outside of the classroom. The largest amount was the state's contribution to the Teachers' Retirement System (TRS) and the Public Employees' Retirement System (PERS). The state paid a total of more than \$160 million on behalf of school districts because of the district contribution cap. The contribution for TRS was capped at 12.5 percent of the TRS payroll and for PERS it was 22 percent. The state paid for everything above the cap. Although the money was not going directly into the class room, if the state did not pay it, the districts would have to.

Representative Josephson asked which school district employees received Public Employees' Retirement System (PERS). Mr. Painter believed some administrative staff were paid through PERS. Similarly, there were state employees on TRS. The idea was for people who had employment in multiple sectors to be able to keep the same retirement system.

Vice-Chair Ortiz noted that any non-certified staff such as paraprofessionals, cooks, and custodians would fall under the PERS system.

Mr. Painter pointed to school debt reimbursement on the list of indirect funding. School debt reimbursement was about \$100 million per year. There was currently a 5-year moratorium on new debt. The program would return in 2021. The reimbursement ratio had shifted over the years. It was originally 80 or 90 percent depending on the project. It was decreased to 60 percent. In 2021, when the program returned, it would be either 40 or 50 percent. He explained how the program worked. Municipalities took out debt with a vote of the people, and the state agreed to pay a portion. It was required in statute that voters be told debt reimbursement was subject to appropriation. The state had not always paid the full share. He noted that there had been a veto of the appropriation a couple of years prior. There had also been some partial appropriations in the

past. The governor was proposing to eliminate the program and was not funding it in the budget for FY 20.

Mr. Painter spoke of another indirect funding source. He explained that organized areas with the power to tax could take out debt, whereas REAAs could not. The Rural Education Attendance Area fund was an alternate mechanism. In statute it was calculated as a percentage of school debt reimbursement. The amount was about \$40 million per year and went towards school construction and major maintenance projects across the state. The Department of Education and Early Childhood Development produced a priority list and funded projects on the list without further appropriation. The legislature did not select the projects, the department obligated the funds. The governor's budget did not make an appropriation to the fund, but the legislation abolishing the school debt reimbursement maintained the program in future years.

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Mr. Painter noted that the last couple of slides showed some broader statistics. Slide 26 showed the per pupil spending by state in FY 16, the most recent year in which the US Census Bureau had data. Looking only at state funding, Alaska ranked fourth in the country. Looking at total funding, Alaska ranked seventh. Looking at state and local funding, Alaska ranked eighth. Alaska's position changed depending on what was included in the ranking. He pointed out that relative to other states Alaska had a state-heavy system. On average, the state paid a larger portion than local communities. Alaska ranked fifth in the proportion of funding that came from the state. Much of the state's spending on education was driven by Alaska's split between state and local funding.

Representative Sullivan-Leonard commented that as she was looking at the slide, she understood how someone might notice a sense of disproportionate funding between local and state government. She suggested that it might be the reason the governor brought forward the issue of changing the structure. She wondered how much other oil rich states (e.g. Texas, Louisiana, South and North Dakota) paid for education compared to Alaska. Mr. Painter replied that the Texas education system was heavily funded at the local level. Aside from local property taxes, Texas had low

state-wide taxes. Local contributions for education in Louisiana and Wyoming were also high.

Representative Sullivan-Leonard clarified that he did not need to go state-by-state. She wanted to see a graph. She thought people would appreciate being able to see where Alaska stood in comparison to other states. It was difficult to measure Alaska against other states because of its oil wealth. However, Alaska could be compared to other resource rich states like Texas and Louisiana.

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Vice-Chair Ortiz asked whether Alaska's ranking had increased over time. Mr. Painter responded he had only done the comparison for two years. He reported that from FY 15 to FY 16 the state had not changed in its ranking. However, he was unfamiliar with the data from prior years. He offered to look into it further. Vice-Chair Ortiz indicated it was not necessary.

Representative Carpenter asked why Alaska had a higher federal portion than other states. Mr. Painter replied that it mostly had to do with impact aid. Alaska had a high military population compared to its total population, and it had a large amount of tribal land within the state. Both factors contributed to Alaska receiving a large amount of impact aid. Additionally, Alaska received a significant amount of federal funding for districts through the federal e-Rate program. He continued that because Alaska's internet was relatively expensive and slow the state received more e-Rate funding than the average state.

Representative Josephson wondered whether the budget would be short by \$250 million if the legislature were to pass a budget that made no reference to public school funding. Members would have to recommend or pass new revenue measures, or the appropriation could be subject to a veto. In other words, the amount that was funded in May of the prior year could not be vetoed, and the legislature would not have to take any further action for the FY 20 school year. He wondered what would happen if the budget omitted a discussion of education altogether.

Mr. Painter replied that there was no further action needed for the foundation formula and the pupil transportation formula, as they had already been appropriated in the

current year in order for the money to flow out. Other parts of the department were funded ahead of time.

Representative Josephson suggested that if the state were to operate off of the governor's budget, the budget would be short by \$200 million to \$300 million requiring additional revenue. He asked if he was correct.

Mr. Painter thought Representative Josephson was saying there would be a deficit essentially because it was counted. He confirmed that the legislature would need to find a funding source to cover the deficit. He suggested the money could be taken from the Constitutional Budget Reserve (CBR), additional revenues, or through budget cuts. The governor's budget did not include a funding source.

Representative LeBon stated that education funding was heading for a perfect storm of sorts. If Fairbanks experienced a \$30 million reduction in state funding for education and the borough had a revenue cap, the borough's ability to make up the reduction would be limited by several factors. He asked Mr. Painter what a community could do to make up for reduced state funding with a revenue cap and a disparity formula in place for education. He wondered how much money a borough could raise to offset a reduction in state funding for education.

Mr. Painter replied that it would depend on the interpretation of the change to the local contribution. If the interpretation was that the local contribution was also reduced, a borough's ability to make up the difference would be reduced. If the interpretation was that it was not reduced, the borough could increase its contribution. Representative LeBon asked about the timing of the ruling. Mr. Painter replied that a legal opinion had been requested.

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Mr. Painter concluded that there had been significant discussion in the current session about how much money was spent on instruction versus other expenses. The administration had reported that 54 percent had been spent on instruction which was shown in the pie chart on slide 27. He explained that the federal government had a slightly different chart of accounts than the state. They counted student activities as instruction that the state

did not count. According to the state's calculations, the two direct instruction categories would be 56 percent. He relayed that the state historically had a different method of calculating instruction. It used to have the 70/30 rule which meant that 70 percent of spending had to go to instruction. All of the items in blue were considered to be instructional expenditures based on the 70/30 rule. Much of the disagreement about how much went to instruction had to do with what counted as instruction. Depending on the definition of instruction the state might be spending between 56 to 76 percent. He was happy to answer any final questions.

Co-Chair Foster thanked the presenters. He reviewed the schedule for the following day.

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ADJOURNMENT

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The meeting was adjourned at 3:32 p.m.