

HOUSE FINANCE COMMITTEE
January 27, 2020
1:35 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:31 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Jennifer Johnston, Co-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
Representative Adam Wool

MEMBERS ABSENT

None

ALSO PRESENT

Deven Mitchell, Debt Manager, Treasury Division, Department of Revenue.

PRESENT VIA TELECONFERENCE

None

SUMMARY

STATUS UPDATE - STATE DEBT SUMMARY AND CREDIT BY DEPARTMENT OF REVENUE

Co-Chair Foster reviewed the agenda for the day and invited Mr. Mitchell to the table.

^STATUS UPDATE - STATE DEBT SUMMARY AND CREDIT BY DEPARTMENT OF REVENUE

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DEVEN MITCHELL, DEBT MANAGER, TREASURY DIVISION, DEPARTMENT OF REVENUE, introduced the PowerPoint presentation: "2019 Credit Review and State Debt Summary" (copy on file). He was asked to give a presentation on outstanding state debt, the credit rating process, and debt capacity.

Mr. Mitchell began with slide 2: "State Debt Obligation Process" noting that all state debt had to be authorized by law, whether it was general obligation debt or municipal debt. There were some categories of debt such as general obligation debt (a full faith credit pledge by the state) that had to be ratified by state voters. There were a couple of other categories of obligations that the division historically reported on including the school bond debt reimbursement program and another capital reimbursement program in which the State of Alaska reimbursed municipalities for debt issued by local jurisdictions for qualified projects and programs. The largest of the two categories was the school bond debt reimbursement program - in existence since 1970. The other category the division started reporting on more recently, due to the rising unfunded liability, was the Public Employees Retirement System (PERS) and the Teachers Retirement System (TRS). It was one of the largest categories of obligations the state had to-date.

Co-Chair Johnston asked where Mr. Mitchell would insert revenue anticipation notes or tax anticipation notes. Mr. Mitchell responded that he would be covering the information later in the presentation. He noted they fell into the short-term category of borrowing. Revenue anticipation notes were allowed by statute and a form of constitutional debt. They were short-term obligations that were allowed to provide for intra-fiscal year funding in instances of cash deficiencies.

Representative LeBon brought up general obligation bonds needing voter approval. He drew attention to the bullet point regarding a state bond committee. He asked if Alaska had a hard ceiling maximum that could be originated through a bond sale for whatever purpose approved by voters.

Mr. Mitchell responded that currently there was not a hard ceiling in the state's governance structure. However, there were limits from a market perspective. If someone urged the state to borrow \$1 trillion, it would not be possible in the market place. He suggested there was a balance. He indicated the state bond committee was the body that authorized the issuance of all State of Alaska debt. In the case that the State of Alaska would be at the top of the prospectus or the offering document, the state bond committee (comprised of the commissioners of the Department of Revenue, the Department of Community and Economic Development, and the Department of Administration) would authorize a resolution to allow the issuance of debt.

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Representative LeBon wondered if there was a level of review and approval that might change the outcome of a community voting in favor of a school bond indebtedness. Mr. Mitchell replied that the issue would be a market limitation rather than a hard cap. A hard cap was not in statute. In Alaska's case, it had some of the largest per-capita debt outstanding even though the state had relatively modest debt because of the state's oil wealth and its relatively small population.

Mr. Mitchell turned to slide 3: "Total Debt in Alaska at June 30, 2019 (\$millions)." He indicated there were a couple of publications his office put out each year per statute. The first was the Alaska Public Debt Book, from which the table on the slide came from, and a debt affordability analysis. Between the two publications, the debt book described all of the outstanding obligations within the State of Alaska - whether state obligations or municipality obligations. The debt affordability analysis included a discussion of the state's potential debt affordability.

Mr. Mitchell noted the table continued on slide 4. He explained that the table was categorized by the state's strongest credit pledge to its weakest credit pledge. General obligation bonds came first in the amount of \$670 million outstanding. He elaborated that in the category of debt there was a reduction of approximately \$50 million from the previous year. The state had one remaining authorization to issue general obligation bonds related to

the 2012 Transportation Act in the amount of \$110 million. The funds would be issued as project cash flow dictated.

Mr. Mitchell reported that next category was state guaranteed debt which was issued by H (AHFC) for the Veterans' Mortgage Program. The program required a state back-stop in the bonds to be eligible for tax exemption. In the 70s' there was an amendment to the state's constitution to allow the bonds to be issued tax exempt. The tax exemption benefit was to be passed through to Veterans that were going to participate in the program to facilitate a lower interest rate for them. He noted the term "tax exemption" was something heard frequently when talking about municipal bonds. It meant that the investors that purchased the bonds would not have to pay income tax on the related investment income. As a result, they were willing to accept a lower yield on the securities than they would if they had to pay tax.

Mr. Mitchell continued to the next category of debt - debt supported by the state's general fund on a subject-to-appropriation basis. It was a lesser credit pledge than general obligation bonds required. It did not require a vote of state residents. Rather, it was approved by a legislative action in combination with administrative support. The first subcategory was certificates of participation issued directly by the State of Alaska. The only outstanding certificate was for a residential housing facility at the Alaska Native Medical Center in Anchorage. The lease revenue bonds were ones in which the state partnered with sub entities. He reported that AHFC was a partner in the parking garage in Anchorage. The Atwood Building was formerly funded through the same debt category. The state was also paying down debt, \$14 million between two authorizations in the prior year, for the Goose Creek Correctional Facility in the Mat-Su area.

Mr. Mitchell reviewed state supported municipal debt. The category included the School Debt Reimbursement Program and state reimbursement capital projects debt that came about as a result of HB 528 [legislation passed in 2002] and encompassed a variety of harbor and energy projects. The table listed the full statutorily allowed reimbursement amounts. They had not been trimmed based on some of the recent reductions in the current fiscal year or in a couple of prior fiscal years. Both of them decreased in the last fiscal year. He indicated the school debt reimbursement was

down \$65 million and \$3.5 million in the other program primarily due to the moratorium on the School Debt Reimbursement Program that had been in place since 2014.

Mr. Mitchell moved to the next category: The Pension System Unfunded Actuarial Accrued Liability (UAAL). The Public Employees' Retirement System (PERS) debt was \$5.1 billion and the debt for the Teachers' Retirement System (TRS) was \$1.5 billion. The increase for PERS was about \$50 million and, TRS had a decrease of \$310 million. The changes resulted from actuarial adjustments made to the actuarial analysis of health care which benefited the system. He reported a downward shift in the assumed rate of return from 8 percent to 7.38 percent. If the state were to assume it was going to earn less on the prefunded pension funds, it would have to pay more in the future to make up the difference. If the state earned 7.38 percent on the prefunded amount instead of 8 percent, it would create an additional burden for future payments to pay off the unfunded liability. However, it was considered more conservative, in line with many other pension funds, and viewed favorably from a credit rating perspective.

Mr. Mitchell moved to state moral obligation debt largely comprised of the Alaska Municipal Bond Bank Program. The program used the state commitment to borrow money and lent it to municipal entities. It saved money for borrowing that would otherwise occur at a local level. For example, instead of paying 5 percent for a loan, an entity would pay 4.5 percent. The debt for the Alaska Energy Authority (AEA) of \$74.7 million was related to Bradley Lake. The Alaska Student Loan Corporation had a diminished issuance since some federal laws changed related to the origination of student loans. The amount all declined in the prior fiscal year - \$30 million for the Alaska Municipal Bond Bank, \$10 million for AEA loans, and \$12 million for the Alaska student Loan Corporation.

Representative LeBon reported that the Alaska Industrial Development and Export Authority (AIDEA) went to the bond market to raise capital for projects in Alaska. He asked if the state's moral obligation fell under the sale of a bonded debt by AIDEA.

Mr. Mitchell answered that it depended. He explained that a moral obligation was created with a statutory construct that required a reserve fund securing bonds to have cash

placed in it at closing. There was also an annual reporting requirement on the sufficiency of the reserve to meet the intended security for bond holders to the legislature and the governor. It implied that if there was a deficiency the legislature would act to solve it and appropriate money. The Alaska Energy Authority did not carry most of its programs. He was only aware of one program for the Interior Gas Utility in which there was an allowance for \$150 million of moral obligation bonds to be issued. He indicated that AIDEA was a conduit facilitating access to the market rather than tying its assets to secure investors. If there was a deficiency, the state would be obligated to come in and appropriate money to the reserve fund.

Representative LeBon asked if the backing provided by the state helped to lower the cost of the bond. Mr. Mitchell replied in the affirmative.

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Representative Josephson asked what had been the largest amount of state general obligation bond debt historically. Mr. Mitchell responded that the figure was in the debt book. He thought it was about \$2.1 billion. The state was below the peak for the 1980s. He further explained that as oil revenues were coming online there were a number of general obligation bond issued that were layered on with shorter amortizations (10 years) because of how the Prudhoe curve was perceived.

Representative Josephson asked about the amortization on what was outstanding. He wondered what the state was paying in annual debt service. Mr. Mitchell responded that presently the state was paying around \$75 million per year in annual debt service. The amount declined every year. He relayed that the state had \$110 million to issue which would moderate the decline slightly.

Representative Josephson commented that relative to the PERS/TRS liability the number seemed lower than he recalled. The amount was \$11 billion and the state paid \$3 billion. He thought the amortization was going to increase the amount because the state's payments were low. He thought \$6.6 billion was low and asked Mr. Mitchell to comment.

Mr. Mitchell replied that there had been some improvement partially due to strong financial performance in the market. Some of the improvement was because of shifts in actuarial inputs. There had been some extension of the amortization of the unfunded liability. Also, there had been healthcare adjustments that had resulted in improvements to the funding level and to the amounts the state was obligated to pay. He recalled when the state was looking at over \$1 billion per year due to the amortization being level dollars meaning level amortization. Presently, the state had a percentage of payroll which resulted in less being paid upfront and more paid in the future. It had been concerning because at one point the state was looking at going from \$200 million to \$800 million. More recently the figure had moderated to about \$300 million to \$450 million in the final year of the amortization in 2038. There had definitely been improvement in the retirement systems.

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Mr. Mitchell addressed the final category on the slide for state revenue debt - sportfish revenue bonds. They were supported by a pledge of the sportfish fund and paid by a surcharge on sport fish licenses sold in the state. The amount was about \$13.9 million which was approximately \$3 million less than the previous year. He reported that the remaining bonds would be payable or optionally redeemable on April 1, 2020. Based on the balance in the debt service account and the annual collections on the surcharge, he anticipated that the state would optionally redeem those bonds in the current fiscal year and pay them off.

Mr. Mitchell reviewed another State of Alaska revenue bond, the international airports revenue bond. He relayed that the constitution in Alaska had strong prohibitions on dedicating revenue. However, there were certain exceptions - if they were required by federal law or if there was a dedication prior to statehood. He indicated it was typically where he saw dedicated revenue issues. He suggested that there was the possibility of a constitutional amendment to allow dedication post statehood. The sportfish bonds were allowed because they were required to be dedicated by federal law. The airport system was dedicated, as it existed and had debt outstanding prior to statehood.

Representative Wool understood the licensing fees went towards paying down the bond. He asked what the \$13.9 million figure was for. Mr. Mitchell responded that it was part of a \$60 million bond issued for sport fish hatcheries in the state including the Anchorage and Fairbanks hatcheries. The amount did not turn out to be enough which resulted in the state appropriating additional monies for the Anchorage hatchery. He also reported the use of some surcharge revenues supporting a hatchery in Petersburg.

Representative Wool referred to the state's general obligation bonds. He noted the outstanding principle of \$1.1 billion and the interest and maturity of \$540 million. He asked if the interest figure reflected the history of the bond. He wondered how large of a bond the interest applied to. Mr. Mitchell thought Representative Wool was talking about the state moral obligation debt and the Alaska Municipal Bond Bank Authority. On June 30, 2019 the bond bank's outstanding principle was \$1.111 billion and had an amortization over future years as long as 30 years. During the 30-year life span, absent refinancing, the state would pay \$530 million in interest.

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Mr. Mitchell turned to slide 4: "Total Debt in Alaska at June 30, 2019 (\$millions)(Con't)." He discussed the debt related to the University of Alaska. The University of Alaska sold revenue bonds secured by University revenue collections. As of June 30, 2019, the University revenue bond debt was \$271.3 million outstanding which was a decrease of about \$12 million in the prior year. The University also had some smaller categories of lease commitments and installment contracts that had declining balances and outstanding principles. The University had a total decline of \$13.4 million.

Mr. Mitchell moved to state agency debt which was not secured by the state's credit pledge like many of the first three categories of debt. Revenue debt was not secured by a state pledge either. Some argued there was a close linkage between the University and the state that could result in support but was not a requirement of the bonds or implied in any way to potential investors in the securities. The state agency debt that was issued by public corporations in

the next category were similarly not secured by any credit support from the state.

Mr. Mitchell continued that the AHFC Bond Bank and the Northern Tobacco Securitization Corporation (a subsidiary of AHFC) had a total of \$40 million of bonds outstanding which reflected a reduction of about \$40 million from the prior year. He explained that in some instances, like the tobacco settlement bonds, they were specifically pushed as far as possible from the state because of the nature of the risk associated with the settlement agreement itself. The state was party to a master settlement agreement with tobacco producers that had some risk of not paying in the future. He indicated that by selling portions of the settlement agreement to the tobacco corporation who then securitized it and sold the revenue stream to investors, it allowed the state to provide for some capital projects and take the risk. In some people's view, it took the reliance on tobacco revenue off the state's balance sheet.

Representative LeBon referred to the subcategory of commercial paper. He asked for Mr. Mitchell to provide the story behind commercial paper. He thought the interest to maturity category on the slide did not apply. Mr. Mitchell responded that it was an AHFC program. He was unfamiliar with it. He believed AHFC used it as the linkage into their longer-term collateralization programs which were in the next category. They bought mortgages using their commercial paper program which was a short-term borrowing program. They would then payoff the commercial paper program as they issued the collateralized bond issues.

Representative LeBon hesitated asking the question because in an upcoming subcommittee hearing AHFC would be presenting. He would direct his question to the corporation.

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Representative Josephson asked if Mr. Mitchell stated he anticipated the debt burden for the University of Alaska to be \$13.4 million less in FY 21 than in FY 20. Mr. Mitchell clarified that the amount was only the declining principle balance outstanding. The University had not been issuing additional debt in the past year. Rather, it had a payout of a portion of its outstanding principle balance. The University had not had an improvement in cash flow.

Co-Chair Johnston asked if the University had been able to refinance its debt. Mr. Mitchell indicated that the University was moving in the direction of refinancing in the coming year. The University's credit rating had been significantly reduced over the previous calendar year and was experiencing some challenges. He explained that he was the debt manager for the State of Alaska and worked for the Alaska municipal Bond Bank as the executive director. One of the things the bond bank had done at one point was to work with the University on the cogeneration facility (the new coal-fired facility) located at the University of Alaska Fairbanks campus. He suggested there could be an allowance provided for the University to take advantage of the bond bank program in a broader way that would enhance savings to the University. It would increase the credit rate at which their debt rate would be sold because the bond bank currently had a higher credit rating than the University. It would also decrease the interest rate the University would pay on refinanced debt potentially providing savings.

Mr. Mitchell continued to the next category of state agency collateralized or insured debt. He reiterated the debt was not secured by the State of Alaska. He spoke of a group of home mortgages being placed together and the cash flow being collateralized and used to borrow money from a bond issuance. He noted that the largest category of borrowing was AHFC in the state agency collateralized or insured section both for their mortgage program and state capital project bonds. He indicated AIDEA was also in the category with their revolving fund bonds and power revenue bonds which were related to the Snettisham Hydro project South of Juneau. He reported an increase of about \$73 million in the category of debt: State Agency Collateralized or Insured Debt. He relayed that AHFC was filling its mission and providing a housing financing market.

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Vice-Chair Ortiz asked if Mr. Mitchell had stated that the categories were listed in a prioritized fashion on the slide in terms of what would be paid off first. Mr. Mitchell clarified he meant from a state perspective. Some of the bonds could have AAA ratings on their collateralization program. They could have a higher credit rating than the State of Alaska. He relayed that it was not

based on how secure the bond issues were. Rather, it was based on how much the state had committed to their repayment.

Vice-Chair Ortiz wondered what category would apply if the state were to look to a bonding program for the capital budget.

Mr. Mitchell replied that there was a variety of ways to fund capital projects. The most transparent or highest level of commitment was through general obligation bonds. He continued that state supported debt would typically fund a specific capital project if there were certificates of participation, lease revenue bonds or, other public corporation debt under the category. He noted a couple of examples. He elaborated that it would apply to a targeted capital project that might not lend itself to a statewide election. He also mentioned the use of public corporations to provide for capital projects such as under the AHFC Program. The program originally stemmed from AHFC having a strong portfolio of loans and being able to provide a substantial annual payment to the state. A portion of the payment was made into a capital budget in the form of the state capital project bond program. He noted that the student loan corporation did something similar in the past. The Northern Tobacco Securitization Corporation provided for state capital projects - an innovative way of generating revenue for capital projects at a time when money was tight. He suggested there were a variety of ways to fund capital projects depending on the goals of the projects and what the projects might be within the program.

Co-Chair Johnston asked to return to the University and the opportunity in the current year to refinance some of its bonds. She wondered if it was the first year due to the maturity of the bonds for refinancing. Mr. Mitchell explained that bonds were typically issued with 10-year calls at which time they could be refinanced. The state used to be able to do advanced re-funding but could no longer do them with the tax reform act. Presently, the state had to wait until bonds were callable to refinance them for savings.

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Representative Josephson mentioned the 2012 transportation act and wondered whether a residual amount could be bonded.

He asked if it would have to be related to transportation or would have to have approval from the state bond committee. He wondered if it would be a matter of the legislature, by a simple majority, stating it wanted to fund capital projects with the \$100 million.

Mr. Mitchell replied that there was proposed legislation for general obligations that did not provide flexibility. Instead, it had a list of specific municipal capital projects with defined dollar amounts that could not be shifted between projects. He explained that for Department of Transportation and Facilities Maintenance (DOT) capital projects there were specific amounts but an allowance for reappropriation within the list of projects. If there was a DOT project that was on the list that otherwise needed funding and another project that did not, the monies could be shifted. The state bond committee would have to approve all bonds. Representative Josephson commented, "That's a complication."

Representative LeBon pointed to the term, "Collateralized home mortgage revenue bonds and mortgage revenue bonds" under AHFC. He asked if AHFC packaged bonds and sold them on the market as a mortgage back security. Mr. Mitchell deferred to AHFC.

Mr. Mitchell continued to slide 5: "General Obligation bonds Current Financings" which was intended to graphically show the amortization of outstanding principal of general obligation bonds into the future. It was reflective of a mature program in which the state had had bonds outstanding since 2003. The issuance in 2003 had an authorization in 2008, 2010, and 2012 that layered on bonds. As the bonds were issued, they were issued in a relatively level 20-year series. As a result, the state had declining debt service and a declining outstanding principle balance moving forward through time. He reported a net debt service of \$77.8 million in FY 20 and declining to \$12.2 million in FY 28. As the bonds were issued, they were issued in a level series and, there was a declining balance moving through time. He had already talked about remaining authority.

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Mr. Mitchell discussed slide 6: "Current General Fund Annual Payment Obligation," which showed the magnitude of

the pension obligation debt relative to other state debt. The top chart showed the State of Alaska general fund debt service. He noted the peek in the current fiscal year to over \$200 million in annual debt service. It assumed that the state paid the full amount of the school debt reimbursement program rather than 50 percent (seen in light blue on the top). The state-supported debt included Good Creek, the residential housing facility, and state general obligation debt. He reiterated the maturity of the debt and the declining debt service payments year-over-year moving through time.

Mr. Mitchell continued to explain slide 6. He pointed to the lower chart showing the PERS/TRS payment commitment layered on top of the other state payments. Other state payments could no longer be easily seen. The blue took over the chart and represented the level of difference between the state's regular debt program and the pension fund liability payment issue. The slide also noted other existing authorizations including \$300 million for the Knik Arm Crossing. It was envisioned that the state would take a subordinate lean position on toll revenue and have a state-supported structure that would be used to pay a debt service for some period of time until the bridge had had traffic to pay the primary debt as well as the subordinate lean debt. There was \$110 million in general obligations debt, \$1.5 billion in pension obligation bonds that could be authorized by the pension obligation bond corporation, and the \$1 billion tax credit certificate bond corporation authorization that was currently being considered by the Supreme Court. He explained that there was a constitutional challenge to the construct under consideration. The outcome of the challenge was expected shortly.

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Mr. Mitchell detailed slide 7: "Existing State Short Term Debt Obligation Alternatives." The slide highlighted a couple of categories in which the state could borrow short-term bond anticipation notes which were simply a way of managing a long-term debt portfolio. He furthered that the state used them relatively recently when it had difficulty nailing down project cash flow. Instead of borrowing long, paying higher interest rates, and placing money in an escrow fund that earned less than the borrowing rate, an entity could borrow short earning about the same as the borrowing rate. They could borrow a lesser borrowing

amount, re-enter the market while ramping up a program, then take it out in long-term debt. He relayed that the state sold bond anticipation notes in 2013, 2014, and 2015.

Mr. Mitchell discussed revenue anticipation notes towards the bottom of the slide. He reported that if the state were to sell revenue anticipation notes, they would most likely be taxable. In order to avoid the notes being taxable the state would have to have less resources available to it than it did including the Permanent Fund (PF) Earnings Reserve Account (ERA). It could still be a tool that could be used if there was an intra fiscal year cash deficiency. For example, if the state had a \$200 million cash shortfall in the fiscal year, it could borrow the funds and pay them off at the end of the year with revenue that flowed in. Repayment could be structured for the subsequent fiscal year but would be a taxable security diminishing the benefit to the state. There would not be a taxable tax-exempt gain that was often seen with some regular issuers of short-term securities.

Mr. Mitchell moved to the next portion of his presentation, state debt capacity. He turned to slide 9: "Debt Affordability Analysis." The division produced an annual publication per statute that included a discussion on ratings, debt levels, histories, and projections. It relied on a ratio of current debt service including state-supported and directly paid state debt service to unrestricted fund revenue. In 2019, the state had a significant change in what was considered unrestricted general fund revenue in the Revenue Sources Book based on SB 26 passing. As a result, at the time the division diminished the ratios from 5 to 4 and 8 to 7. The division tried to become more conservative in projecting potential capacity. The following slide would highlight the issue. He reported that it ballooned up with the inclusion of \$3 billion revenue on a \$2 billion base. It made capacity seem so great that it was, in his view, somewhat unrealistic until there was a greater understanding of what was actually available on an ongoing basis for the state.

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Mr. Mitchell advanced to slide 11: "January 2018 and 2020 Debt Affordability Analysis" which showed the Fall 2017 revenue forecast numbers at the top and the Fall 2019 revenue forecast numbers at the bottom. The chart

referenced \$2.0632 billion for 2020 under the Fall 2017 revenue forecast and \$5.0494 billion for 2020 under the Fall 2019 revenue forecast. The change was due to the transfer under the percent of market value (POMV) payment from the ERA to the PF. He directed attention to the top of the chart which showed that under the Fall 2017 forecast the state was over its metric of 5 percent in 2018 and 2019. In 2020 the percentage was about 5 percent. The forecast reflected a theoretic capacity in the out years. He explained that the state used a method of determining capacity that was used by a wide variety of other states. Alaska used it because of its small population, small economy, and relatively large revenue base. It made more sense than some other management tools. He explained that if Alaska had a tenth of a percent of capacity in 2020 the state would assume that the state went to 5 percent for each of the years that had some differential. It churned out a capacity of \$200 million to \$300 million range in 2017 or 2018 based on the 2017 fall forecast.

Mr. Mitchell pointed to the ratio of 1.99 percent, in the lower portion of the slide highlighted in blue, which dropped to 1.31. The state had capacity in the first year of the forecast through the last year of the forecast. It ended up generating significantly more capacity from a forecast perspective. The amount generated was \$2.8 billion. He suggested that if the transfer from the ERA that would have been used for the statutory formula for the dividend, there would be a significant reduction in capacity. He relayed that from a debt capacity projection perspective, the concern was that it was unclear what number should be used. It was a caution the division had whenever there was discussion regarding capacity. The change of backing out the dividend dropped capacity to \$622 million to \$1.2 billion.

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Co-Chair Foster asked Mr. Mitchell to use the pointer on the computer.

Mr. Mitchell pointed to the area he was referring to. He continued that if the assumption was that the full amount of the transfer from the ERA through the POMV was available for payment of debt service and the Permanent Fund Dividend (PFD) projection was backed out, it increased the ratios to certain numbers [Mr. Mitchell did not indicate verbally

which column he was referring to] which diminished the projected debt capacity by about \$1.5 billion. It had a significant impact on what would be reasonable for the state to consider given the metrics it set for itself. He relayed that if there were further sideboards, definitions, or structures to how the transfer from the ERA would be used, it would make it easier to use the 5 percent and 8 percent caps. Caps could also be discussed if revenue volatility diminished. He explained that part of why the caps were set at the levels they were was because, historically, the state relied on petroleum revenues for 80 percent to 90 percent of unrestricted general fund revenue - the revenue appropriated and spent. Historically, the volatility in the revenue had been extraordinary. Volatility meant that the state had to be more conservative when projecting capacity in the future. If the volatility was diminished through a new revenue generation paradigm with some money coming from investments of the PF that would allow it to be more aggressive on capacity.

Mr. Mitchell continued to discuss the slide. He reported that the capacity the division arrived at in the debt analysis for the current year was \$2.8 billion. There was already about \$1.1 billion claimed on that capacity. There was up to \$1 billion for the tax credit certificate bond corporation if the state were to prevail in its litigation. There was also \$110 million needed for general obligation bonds. As a result of both obligations there would be a theoretical capacity of \$1.2 billion remaining.

Representative Josephson asked Mr. Mitchell what he meant by a theoretical debt capacity of \$1.2 billion. Mr. Mitchell explained that the state's credit rating had been under duress since the price of oil went down in 2014. The state had the highest credit rating: AAA, AAA, and AAA. The state's credit rating had been downgraded 9 times since 2014. He did not believe the state could authorize and issue \$1.2 billion in additional debt without a change in the current structure in establishing available revenues and how the state would move into the future. It made capacity and the ability to issue less.

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Representative Josephson suggested that to the extent it was used for capital construction without producing its own taxation, it primed the pump and fueled the economy.

However, it did not help the state's treasury. Mr. Mitchell agreed. He indicated the state was penalized for having a small economy and for being perceived as highly reliant on the oil sector for activity. The goal for those individuals moving to the state was for the economy to be strong and to be able enjoy a high quality of life. However, it cost the state money.

Mr. Mitchell turned to slide 12: "Revenue Forecast & Budget Outlook." The slide showed how the state classified revenue. Historically, the state would declare there was a fiscal gap (insufficient revenue to cover expenditures) and that a draw on reserves would be necessary to balance the budget. He relayed that the division had done the same analysis in the early 2000s' and found that in the 1990s there were several difficult funding years in which there were recurring draws on the constitutional budget reserve (CBR). At the same time there were large deposits to the CBR. The large deposits, because of the CBR's construct, were not counted as revenue available for spending. The money was constitutionally restricted having to be deposited into the CBR.

Mr. Mitchell continued to explain that once the funds were in the CBR, the money could be spent with a three-quarter vote of the legislature. The money was supposed to be repaid, but the repayment was just a line item in the coffer. Interest was not charged and there was no hammer requiring the funding to be repaid if the legislature took appropriate action each year. He highlighted the section of the flow chart under state revenue. He explained that in other states restricted revenue was federally or constitutionally restricted and unavailable for general government. The State of Alaska was classifying the funding as restricted and saving it over several years. Alaska had an incredibly conservative construct for how funds flowed into the state, which, he thought, undersold the strength of the state. He suggested it made the state more cautious than it might have been in some of the good years Alaska experienced.

Mr. Mitchell relayed that in looking at the Revenue Sources Book produced by the Tax Division, there was unrestricted general fund revenue available including a POMV transfer from the PF. In looking at the PF projections for FY 21 there was about \$1.35 billion of revenue projected in earnings for FY 21 and categorized as restricted. In

addition, there was about \$30 million of earnings in the CBR and a projection of \$75 million for a tax settlement being deposited into the CBR. Adding up the items in conjunction with some of the constitutionally mandated deposits into the PF, it exceeded the state's deficit. He explained that when he talked to potential investors of the state or people who were assigning a credit rating to the state, he tried to highlight some of its nuances.

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Co-Chair Johnston asked if Mr. Mitchell had ever looked at other states that had funds that had a threshold similar to Alaska's and how their ratings were affected.

Mr. Mitchell responded there were no other states with a sovereign wealth fund similar to Alaska's. There were states like Texas that had a higher education fund that was used to guarantee municipal debt for educational capital projects. He was aware that Wyoming and North Dakota had significant reserves. He suggested that on Thursday the commissioner would provide additional information about comparisons of sovereign wealth funds in other states. He was not suggesting that something greater than the established POMV should be drawn from the PF ERA.

Co-Chair Johnston realized Alaska had a large fund balance. She argued it was the counter argument to the appropriation language.

Mr. Mitchell addressed the inputs and outputs on slide 12: "January 2020 Debt Affordability Analysis." The slide reflected debt service payments from FY 20 through FY 29 for the different categories including general obligations, lease purchases, capital leases, and the school debt reimbursement program. The slide assumed 100 percent payment based on the program framework. It reflected the state-expected PERS/TRS payments which were nowhere near the \$1.1 billion payments that were discussed in the past. He mentioned some escalation, but not nearly as significant as they would have been in the out years. Using the Fall 2019 Revenue Sources Book, the undesignated general fund (UGF) revenue in FY 20 was \$5 billion growing to \$6 billion by FY 29. The percentages at the 4 percent cap were 1.99 percent in FY 20 to 1.31 percent in FY 29. The output from the model generated a debt capacity of about \$2.8 million. He pointed to the percentage of UGF revenue committed to

state supported debt. He reported that PERS/TRS was \$9.96 in FY 20 and dropped to 7.71 percent by FY 29. He indicated he had not come up with a way of incorporating the PERS/TRS liability into the model. However, he looked at other states and the percentages they had for the combination of debt and past service liabilities with their retirement systems. He found that Alaska fell in the middle.

Mr. Mitchell turned to slide 13: "Authorized Bonding Authority." He indicated he had already covered the items in an earlier slide.

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Mr. Mitchell continued to slide 14: "Alaska Tax Credit Bond Corporation History." He reported that the corporation formed in legislation was due to the shift in funding for the tax credit program. The oil and gas credit program was formed to incentivize certain activity in Alaska. He detailed that companies could do work and the State of Alaska would reimburse them for a portion of the work if they adhered to certain guidelines. There had been a general practice of paying the credits as they came in. However, in 2015 when revenue diminished, the practice ended. The state reverted to a statutory formula amount which caught many by surprise, as it was a change in operating practice.

Mr. Mitchell continued that currently the Fall 2019 Revenue Sources Book reflected an oil change. The industry had \$739 million of accrued credits. He explained that the way in which corporations were set up, the amount would be discounted based on the cash flows which were the basis for the Revenue Sources Book. For instance, if a company was going to get paid in the fifth year, they would receive 5 years of discounting on future cash flow. The discount was either 4.5 percent (the state's cost of capital of about 3 percent plus 1.5 percent) or the highest discount rate the statute allowed which was 10 percent. The input along with the Revenue Sources Book projections generated a current day cash value of \$583 million to \$660 million on \$739 million of accrued credits.

Mr. Mitchell continued to discuss slide 14. He indicated that the Department of Natural Resources (DNR) would determine how the discount rate would be established. He also pointed out opting for the discounted rate financially

benefited the state and the oil companies. The state would pay a discounted value for credits in exchange for the oil companies accepting a lower payment in the present rather than waiting for a full payment. He suggested it was a win-win scenario. However, the option was yet to be determined because the court system's current consideration of a related case. If there was a favorable ruling, it would take significant work to determine which credit holders were interested and to apply the discounted rate to the credits to determine their value.

Mr. Mitchell turned to slide 15: "Alaska Tax Credit Financing - State Security Structure." He thought the slide showed a simplification of a more complex state security structure. The idea was that the Alaska Tax credit Certificate Bond Corporation would borrow money from bond holders in exchange for a pledge of all revenues that the corporation received. The only revenues the state would receive would be based on an agreement with the Department of Revenue (DOR) in which it would provide proceeds in the form of cash to DOR in exchange for that commitment to pay on a subject-to-appropriation basis. The cash would be used to pay off credit holders. The concept was allowed in statute. The legislature passed associated legislation in 2009 which was signed by the governor.

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Representative Josephson referred to slide 14. He mentioned the "028 fund" that captured revenue that then paid tax credits. He reported Alaska having a perfect score during other tax regimes and the state paying whatever it was presented for tax credits. He continued that when times became difficult, the state decided to pay only what was required by law - a certain percentage. Following the decision there was an interpretation that it was only a percent of severance taxes the state received. Presently, the legislature was not appropriating anything. He asked if he was accurate.

Mr. Mitchell reported that there was not an appropriation in the current fiscal year. He thought it was due to an expectation that litigation would be resolved and the corporation would be able to provide an alternative for credit holders to be paid.

Representative Josephson commented that when Governor Walker vetoed \$200 million that was owed, people were outraged. Following, the goal post moved and became something else at which time the halls of the capital building were filled with creditors asking about their revenue. He commented that they were no longer in the halls of Juneau. He believed the changes were not good for the state's credit rating. He asked Mr. Mitchell to comment.

Mr. Mitchell thought it was an indicator of stress. The state had gone through the difficulty of providing funding for credit holders. In some instances, the credit holders had banks that were relying on the credits for the repayment of their loans. He confirmed that there was an awareness of the difficulty. However, there had not been a direct reference to it in a rating agency report as a cause for negative credit action.

Co-Chair Johnston acknowledged an impact on the state but argued that people in the private business sector were also impacted.

Mr. Mitchell advanced to the section addressing the state debt rating. He began with slide 17: "State of Alaska and Other 49 States' Ratings." He reported that the state's current credit ratings were Aa3 which was the same as Aa3(Negative) from Moody's, Aa(Stable) from Standard and Poor's, and Aa-(Stable) from Fitch Ratings. He was not concerned with the Aa-. However, Fitch Ratings downgraded the state in the fall without ever shifting from "stable."

Co-Chair Johnston asked about the asterisks next to certain states. Mr. Mitchell responded that the states with the asterisks next to them did not receive ratings from all three rating agencies. He noted that "NR" meant, "not rated." For example, Arizona was not rated by Fitch Ratings.

Co-Chair Johnston clarified she was looking at Indiana and Iowa. Mr. Mitchell corrected himself. He was not sure about the asterisks.

Co-Chair Johnston noted that Alaska was the only state that had a Moody's rating of Aa3. She thought Alaska had a story of instability, but with a large amount of assets. Mr. Mitchell commented that there were 8 states that had

ratings equal to or lesser than Alaska's rating. States were relatively highly rated.

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Representative Sullivan-Leonard agreed with Mr. Mitchell that she did not take much stock in the credit ratings. She asked Mr. Mitchell to review some of the challenges the state had faced regarding the state's current recession. She wondered what Alaskans could look forward to as opposed to the negative behaviors on which the rating agencies were basing their judgement.

Mr. Mitchell thought the next few slides would address her questions. He believed that Alaska, generally, did not fit into the scorecards used by rating analysts. He expounded that Alaska had a small population. One of Moody's metrics was the gross domestic product (GDP). If the state's GDP was about \$75 billion, a state would fall in the AAA category. If it was below \$50 billion, a state would fall under the single A category. He did not think it was a true barometer of an entity based on size. He continued that when confronted with issues about diminishing GDP he rebutted that every sector but oil and gas increased in GDP in the timeframe. The information was based on a Department of Labor and Workforce Development Corporation (DOL) analysis on GDP.

Mr. Mitchell thought when people looked at Alaska, they tended to overemphasize the oil and gas sector. He had tried to position the state in different ways to highlight that it had growth in net position, even when it had a declared fiscal gap. Alaska had a very conservative governance structure and a very conservative debt practice. The state had an endowment that generated annual revenue not reliant on its economy. He suggested that if it was added to the state's economy, or a factor for GDP of the PF, Alaska would likely be in the AAA metric. However, the rating agencies did not have the means. They could overrate certain things such as the state's reserve position. However, within the agencies' construct of their attempt to have a homogenized analysis for every state, it was a continuous struggle to try to get appreciation for the strengths of the state that did not occur in the same way as other states.

Co-Chair Johnston offered, "Illinois?" Mr. Mitchell did not think Illinois was a very highly rated state. He suggested New York might be a better comparison.

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Mr. Mitchell turned to slide 18: "Recent Financial Market/Credit Rating Challenges." The slide was in the prior year's presentation and was created in direct response to his attending to an investor presentation and talking to a group of investors about the state's credit. It was based on the feedback the state received from the underwriting and investment community that Alaska's economy was totally reliant on oil and was in freefall. One of his responses was the GDP slide where every sector but oil increased. He noted reserves were dwindling. He regretted highlighting the use of the CBR fund and the diminishment of the fund balance. However, while there was a different threshold for the use of the CBR, the earnings reserve account was growing. From a net-net perspective the State of Alaska was in about the same position as when it started in terms of available reserves. Reserves were not dwindling to the extent being publicized. The state would not be able to balance its budget.

Mr. Mitchell disagreed with the perception that the state did not have the intestinal fortitude or the ability to make the hard decisions to balance the budget. He argued that while last year's budget took several sessions, and everyone was a little unhappy with the budget, the draw between the CBR and the statutory budget reserve (SBR) was not really a draw considering the current year's revenue that went into the fund. Fitch Ratings did not agree with his perspective and downgraded the state's credit rating after the end of the second special session.

Mr. Mitchell advanced to slide 19: "Rating Agency Challenges in 2019/2020" which listed some of the reasons for the state's credit rating downgrade. The list included political paralysis, the deterioration in the advancement of financial policies, and recurring historical concerns. In his view, the report was written based on feeling rather than analytics. As a result, Fitch Ratings reached some negative conclusions assuming that the state would continue on its current path. He believed other rating agencies started basing their decisions on feelings rather than fact

as well. He did not think the state was in a position that warranted an additional ratings action.

Mr. Mitchell highlighted the items under recurring historical concerns. The first was that the state had a comparatively large net pension liability. Even though the state's pension liability situation had improved, there was a percentage of GDP on a per capita basis. He explained that because Alaska had a small population, the percentage was comparatively large. Another concern was an ongoing structural UGF imbalance and reliance on one-time financial resources. He elaborated that in Alaska's political process UGF was discussed to a great extent. The discussions about the state having budget shortfalls appeared in the press frequently and was the topic people remembered reading about Alaska. The state reporting that there was not really an imbalance, considering all of its revenues, fell on deaf ears. In other words, the UGF imbalance was the focus - it did not matter that the state had an increase in its net position.

Mr. Mitchell indicated Alaska's narrow economy was another historical concern. It was relatively small and outside the proportion of operating revenues related to petroleum development. In Fitch Ratings' report, the 2014 UGF percentage was used which was over 80 percent for petroleum revenue. The last year the percentage reached that level was 2014. He suggested there was a new paradigm in the works, yet Fitch Ratings was using the same tired historical concern as a basis for a ratings action.

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Representative Wool asked if the credit rating agencies considered the use of the ERA and unplanned draws. Mr. Mitchell responded that the agencies definitely looked at the use of the CBR and considered how the state might move forward from a flexibility standpoint. He thought the rating agencies recognized that the options were the same as Representative Wool suggested. The budget could be cut or new revenue could be generated through a broad-based tax, an oil tax, other options, or a diminished PFD. Increasing the size of the draw from the Era was not a strong or long-lasting option, as there would be negative impacts. The rating agencies would not view unplanned draws in a positive light. He believed there was a cynicism to the approach of rating analysts.

Co-Chair Johnston recalled in 2008 or 2009 the Municipality of Anchorage was doing a short-term paper. At the time there were no credit ratings because the system had blown up. Some of the credit ratings did not exist the following day. She suggested there was a reason for trying to re-establish themselves.

Representative Knopp referred to slide 18 which Mr. Mitchell had indicated was from the prior year. He commented that when Mr. Mitchell was trying to defend Alaska's position with the credit rating agencies, he was certain it was not helpful that the media advertised a \$1.5 billion deficit in the state's proposed budget. He also noted the political instability related to the three-quarter vote for use of CBR funds. He asked if they were items that created challenges for Mr. Mitchell to defend Alaska's position with the rating agencies. Mr. Mitchell confirmed that external entities were concerned with the issues Representative Knopp had mentioned in terms of how the state would manage.

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Mr. Mitchell indicated the next slides were used by the department to address some of the concerns he noted. He continued to slide 20: "Recent Financial Market/Credit Rating Challenges" which highlighted some of the strengths the state had that were not always apparent. He drew attention to the middle of the slide that showed the unrestricted surplus deficit, general purpose UGF revenue, and reoccurring and discretionary general fund expenditures. He noted that some of the figures were red from FY 13 through FY 18 and would include FY 19 and FY 20. He pointed to the final column that reflected the change in net position. Although Alaska's UGF fiscal balance had been in the red for 6 steady years, the state had only had 2 years being out of balance in terms of growth or a decrease in net position. Carrying the figures forward in FY 19 and FY 20 the numbers would be positive again. The slide highlighted that analysts needed to be looking at all aspects of the budget.

Mr. Mitchell turned to slide 21: "Revenue Forecast & Budget Outlook" which addressed the PF. He explained when he developed the slide, he was suggesting the state should be rated similar to an endowed university rather than a state.

The state did not directly generate revenue from the economy for general state expenditures other than from oil and gas activity. There were other taxes on the economy at the state level, but they were generally cycled back into their respective activities. The Permanent Fund was not reliant on the state's economy to be successful, rather it was diversified in the world economy. He thought the PF's type of diversity should be rewarded and recognized.

Mr. Mitchell elaborated that the PF's principle was not always mentioned in rating analysts' reports because they were focused on the portion of the earnings reserve which could be spent. The principle had the inherent strength of revenue generation different than talking about rainy day reserves. The principle portion was not intended to be spent; it was intended to be in place permanently. He had tried to move the discussions with the rating agencies towards acknowledging the diversity of revenue stream and the diminishment in volatility of revenue stream as well. The slide was generated after the POMV was implemented as a result of the passage of SB 26 [Legislation passed in 2018 creating a POMV].

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Mr. Mitchell moved to slide 22 which demonstrated that Alaska's economy was not in as bad of shape as the rating agencies claimed. In recent years, rating agency reports noted that Alaska had the highest unemployment rate in the country which was true. However, at the same time, Alaska's unemployment rate had only moved 1 percent or 2 percent while the nation's unemployment rate was at 10 percent. Alaska went from being rated as one of the best to one of the worst states for unemployment even though its rate had not moved significantly, whereas, the rest of the country's had. Alaska's economy was slow but steady in terms of growth and was ranked third in the nation. He mentioned that home prices had not dropped which would otherwise indicate economic distress. He continued that historically, rating analysts did not consider the PF because they did not believe any of it could be spent on anything other than the dividend. He wondered why a rating would be assigned based on Alaska's economy if the state did not rely on it for the payment of its bills.

Mr. Mitchell moved to the graph on slide 25: "CBRF/SBRF and PF Earnings Reserve Balances - Timeline." The slide was a

depiction of the demise of the use of the CBR fund and the coincidental growth of the PF ERA. He noted the \$14 billion balance in 2013 in the CBR fund which grew to almost \$18 billion and currently had a balance of less than \$2 billion. During the same period, the ERA went from \$2 billion to more than \$18 billion. He pointed out the drastic movement in the current fiscal year with a shift of \$4 billion to the principle for inflation proofing. At the same time there was \$360 million in revenue that went into the PF principle from royalty revenue. The combined revenues provided a stable and available reserve which he thought implied credit strength. He was available for questions.

Representative Josephson commented on the final slide. He thought that with the amount of money placed in the principle in the prior year it would have supported a better credit rating. He suggested it was a sign of confidence. The legislature was not compelled to place additional monies in the principle of the PF, but thought it was a good idea. He wondered if Mr. Mitchell made the same argument.

Mr. Mitchell agreed that the deposit was good in the long-term. In the short-term, an extra deposit diminished flexibility which was not good for the state's credit rating. Fitch Ratings had completed some Monti Carlo simulation work on the ERA and had come up with some scenarios where some percentage of the time in 2028 the ERA would be depleted, meaning it would have a zero balance. The simulation did not account for the possibility that the state would change course.

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Representative Sullivan-Leonard commented that as of November, the balance of the PF was \$68 billion. Currently the balance was at \$67.7 billion. She thought the corporation was doing well and had fulfilled its mandate.

Representative LeBon asked to return to slide 15. He noted the chart reflected the credits for oil companies to look for more production. He indicated that not all of the credits had been paid. There was currently a challenge in the Supreme Court to allow the state to go to the bond market to sell debt to pay for its tax credits. He wondered if the bond market would view Alaska as a worthy creditor

since the state would be selling bonds to pay for credits in default of payment. He also wondered if the market would look at Alaska's PF and its earnings as an assurance that the state would pay its obligations.

Mr. Mitchell indicated that the structure was state supported which meant that the debt service on the bonds would be subject to annual appropriation. It was recognized by the market as a statutory framework allowing the state to commit credit. He conveyed that in 2021 there would have to be an appropriation to sell the securities to provide investor confidence. If there was an event of a failed appropriation, the state's credit rating would suffer. It would create an inability for the state to access capital markets for a period of time. He thought it was a matter of the level of commitment the state made and whether it went beyond that level of commitment. At the end of the day, people had faith that the state would appropriate money based on its' past actions.

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Representative Wool thought Mr. Mitchell had stated Alaska's unemployment rate had stayed constant which was a good thing. Another comment Mr. Mitchell had made was that Alaska was reliant on oil and, oil was in a freefall. He thought it was accurate to say that currently Alaska was reliant on the world economy and the returns on the PF - essentially Alaska's number-one industry. He asked if rating agencies were concerned about the future of the world economy looking out 10 years to 20 years.

Mr. Mitchell replied that rating agencies had initiated a process of looking at the future. He reported that Fitch Ratings had done the most work by creating the Monte Carlo simulations of various markets that would result in increases or decreases in revenue generation. The simulations also considered potential POMV transfers from the ERA and whether the balance of the ERA would be sufficient to make payments in the future. He remarked that there was definitely a shift towards the concept. However, it was difficult to turn a large ship. He suggested that with ratings, it was easy to go down but difficult to go up. It might take many years to increase the state's credit rating. He suggested that if some of the current disagreements could be resolved, it would allow managers to report a plan to the rating agencies for the future. He

suggested rating analysts were currently watching the legislature. He believed if there were two or three special sessions at the end of the regular session, rating agencies would take additional actions.

Representative Wool mentioned that the committee had heard from the Office of Management and Budget who referenced the formula-driven budget items. He asked if the rating agencies would be more comfortable if the legislature were to adjust some of the formulas affecting the budget. Mr. Mitchell replied that it would be beneficial if the state could declare a balanced budget.

Co-Chair Foster reviewed the agenda for the following day.

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ADJOURNMENT

The meeting was adjourned at 3:22 p.m.