

HOUSE FINANCE COMMITTEE
INTERIM
October 2, 2020
10:06 a.m.

[Note: meeting took place in the Anchorage LIO and was recorded from Juneau.]

10:06:17 AM

CALL TO ORDER

Co-Chair Johnston called the House Finance Committee meeting to order at 10:06 a.m.

MEMBERS PRESENT

Representative Jennifer Johnston, Co-Chair
Representative Dan Ortiz, Vice-Chair (Via Teleconference)
Representative Ben Carpenter (Via Teleconference)
VACANT
Representative Andy Josephson
Representative Bart LeBon (Via Teleconference)
Representative Kelly Merrick
Representative Cathy Tilton (Via Teleconference)
Representative Adam Wool (Via Teleconference)

MEMBERS ABSENT

Representative Neal Foster, Co-Chair
Representative Colleen Sullivan-Leonard

PRESENT VIA TELECONFERENCE

Bill Milks, Assistant Attorney General, Department of Law; Lucinda Mahoney, Commissioner, Department of Revenue; Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue; Deven Mitchell, Executive Director, Alaska Municipal Bond Bank Authority, Department of Revenue; Alexei Painter, Director, Legislative Finance Division; Representative Bryce Edgmon; Representative Harriet Drummond; Senator Elvi Gray-Jackson; Representative Sharon Jackson; Representative Delena Johnson; Representative Geran Tarr.

SUMMARY

PRESENTATION: SUPREME COURT DECISION ON OIL & GAS TAX
CREDIT BONDING: DEPARTMENT OF LAW

PRESENTATION: REVENUE PROJECTIONS: DEPARTMENT OF REVENUE

PRESENTATION: FY 21 AND FY 22 FISCAL OUTLOOK: LEGISLATIVE
FINANCE DIVISION

Co-Chair Johnston recognized House Speaker Bryce Edgmon and Representative Harriet Drummond online. She reviewed the meeting agenda.

^PRESENTATION: SUPREME COURT DECISION ON OIL & GAS TAX
CREDIT BONDING: DEPARTMENT OF LAW

10:08:05 AM

Co-Chair Johnston recognized the presence of Senator Elvi Gray-Jackson, Representative Sharon Jackson, and Representative Geran Tarr on the line.

10:08:31 AM

BILL MILKS, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF LAW (via teleconference), introduced himself. He indicated he would provide a short update on the Alaska Supreme Court decision *Forrer v. State of Alaska*, issued on September 4, 2020. He explained that the case was in response to HB 331, legislation introduced by former Governor Bill Walker and passed by the legislature in 2018. He detailed that the legislation sought to address outstanding oil and gas tax credits that had accumulated. The legislation proposed a financing structure where a state corporation would be created, the corporation would issue bonds, and the proceeds would be used to pay off outstanding oil and gas tax credits. He added that the debt service for the bonds would be subject to legislative appropriation. He elaborated that the debt service would be paid by legislative appropriation, but there was no binding requirement for the legislature to appropriate the funds.

Mr. Milks provided more general background information on the issue. He detailed that the legislation concerned the oil and gas tax credit program that began in the first part of the 2000s. He elaborated that in 2003 and 2006 a program had been established that allowed tax credits to be used to reduce production tax. Alternatively, a producer could sell

the credits to another producer to allow the purchaser to reduce its tax liability or the credits could be submitted to the Department of Revenue (DOR) for purchase of the tax credits, subject to legislative appropriation. He explained that it had all been part of a concept to try to encourage production and spur job growth.

Mr. Milks relayed that when oil prices had plunged in 2014, the appropriations to pay for the tax credits had been reduced for the first time in a veto by former Governor Walker. The legislature had eventually phased out the program in 2017, but there had still been outstanding oil and gas tax credits. When the governor had proposed HB 331 in 2018 and the legislature had passed the legislation, there had been outstanding tax credits of approximately \$800 million with around \$200 million more that could be requested. The bill included a process to try to refinance the tax credits through the issuance of bonds with the debt service to be paid out over a decade.

Mr. Milks reported that there had quickly been a legal challenge to the legislation by Mr. Forrer alleging that the specific type of debt was not permitted under Alaska's constitution. The superior court had found the bonds were constitutional and had dismissed the lawsuit. The court's decision was based on the fact that the full faith and credit of the state were not being pledged. He explained that an appeal had been filed and the Alaska Supreme Court reversed the superior court decision on September 4. The supreme court reached the conclusion that the specific bonds violated the Alaska Constitution's provision on contracting state debt.

[10:13:08 AM](#)

Mr. Milks provided a couple of take-a-ways on the court's decision. He explained that the court had been faced with a kind of bond where a corporation would issue the bonds, but the corporation had no independent revenues to pay the debt service. The debt service would be subject to legislative appropriation. He informed the committee that the court's decision marked a guiding line on the ability to issue bonds. The decision did not affect the state's ability, which was clear under the Alaska Constitution, to issue general obligation bonds. He explained that general obligation bonds were first approved by the legislature, followed by voters for purposes of things like capital

improvements and veterans' loans. Additionally, the court's decision did not impact the ability of the state or state entities to issue revenue bonds with a dedicated revenue stream. He summarized that the court had ruled that bonds could not be issued for the payment of the oil and gas tax credits under the HB 331 structure.

Mr. Milks reported that the Department of Law (DOL) had filed a limited petition to the court for a rehearing because it was seeking the court to clarify that the case was about a specific type of bond that had no revenue stream and required legislative appropriation. The state sought clarification that the court ruling did not apply to revenue bonds with dedicated revenue streams. He detailed that the petition had been filed on September 28 and the department was waiting for the court clarification.

[10:16:00 AM](#)

Representative LeBon broached the topic of moving forward. He asked whether DOL had looked into a repayment method that may be tied to an escrow approach. For example, he asked whether the legislature should authorize a draw from the Permanent Fund Earnings Reserve Account (ERA) and set aside for future bond debt repayments an amount that allowed for a ten-year repayment. He explained that the method would mean the legislature would be guaranteeing bond debt repayment from a funding source outside the General Fund. He elaborated that it would mean setting aside one-tenth of 1 percent of the value of the \$65 billion Permanent Fund for future commitments. He detailed that about \$750 million would then be available and would reassure bond holders there was a commitment to repay the bonds.

Representative LeBon explained it would not create a problem as far as a general obligation - it would be a revenue stream connected to the ERA for example. He asked if it would be a violation of SB 26 [Permanent Fund legislation passed in 2018] and the 5 percent draw [from the ERA]. He argued that the bond repayment would not necessarily be funded from the ERA. He expounded that it would be a commitment that if the legislature chose not to use general funding in the future, it could fall back on a draw from the ERA. He asked if Mr. Milks had an opinion on the approach.

Mr. Milks responded that he could not offer an opinion at present. He explained that due to the complex financing structure, he would have to confer with DOR and pencil it out.

Representative LeBon thanked Mr. Milks for his reply and noted he had not expected there to be an answer. He remarked that the state was currently in technical default. He asked how the state's credit rating would be impacted if it failed to pay its tax credit obligations.

Co-Chair Johnston suggested that the question might be more appropriate for the upcoming presenters.

Representative LeBon responded that he respected the notion. He wondered whether DOL had an opinion.

Mr. Milks indicated DOL did not have an opinion. He believed the question would be better addressed to DOR.

Co-Chair Johnston thanked Mr. Milks for his testimony.

^PRESENTATION: REVENUE PROJECTIONS: DEPARTMENT OF REVENUE

10:20:19 AM

LUCINDA MAHONEY, COMMISSIONER, DEPARTMENT OF REVENUE (via teleconference), introduced the combined PowerPoint presentation: "Update on Tax Credits and Revenue Projections" (copy on file). She outlined the department's intent to provide a fiscal update and a follow up to Mr. Milks' discussion of the tax credit certificates. The presentation included historical purchase amounts and an update on the remaining tax credit certificate amounts and the statutory payoff rate. She referenced questions asked by the committee earlier in the meeting about how the state would move forward with the debt. She spoke to the importance of understanding the information because it would drive policy discussions and conversations about resolutions for the future. Additionally, the department would discuss its current revenue outlook that would include some of the changes DOR had made to its 2020 spring forecast.

Commissioner Mahoney relayed that the presentation included a few economic indicators regarding the overall fiscal health of the state's economy and would use it to launch

into a discussion on the 2021 and 2022 revenue outlook. Lastly, the presenters would provide comments on the uncertainties of the state's revenue stream. She relayed that DOR thought about the aforementioned topics on a daily basis and the areas that would drive policy decisions in all three levels of government in the near future. Specifically, the uncertainty around the path of the virus and how it impacted the global and local economies would be critical to the discussion.

Commissioner Mahoney highlighted the global economy's impact on the price of oil and Alaska's revenues and investment portfolios. She shared that due to supply shortages on the West Coast, inventories in Valdez had been filling up and DOR had been notified the previous day that Alyeska would begin a proration of 25 percent of production beginning Saturday at noon through October 6. She stated the situation illustrated how things taking place at a global level were significantly impacting Alaska. Additionally, the department would speak about mitigating investment volatility risk. She stated that the percent of market value (POMV) was the state's largest revenue source. The department would share how it managed through the largest investment portfolio, the Permanent Fund.

[10:23:47 AM](#)

Commissioner Mahoney continued to review an outline of the presentation. The department would also discuss the preliminary analytics it performed to assess the potential revenue impacts if Ballot Measure 1 were to pass [in the upcoming November general election]. She emphasized that the data represented estimates. The ultimate interpretation of the ballot measure would only be determined post-enactment. The goal was to provide the public and legislature with estimates and information in order to make informed decisions. The discussion during the current meeting would be based on the frequently asked questions from the public hearing process held the previous week.

[10:25:01 AM](#)

DAN STICKEL, CHIEF ECONOMIST, ECONOMIC RESEARCH GROUP, TAX DIVISION, DEPARTMENT OF REVENUE (via teleconference), shared that he would begin with a couple of slides on tax credits followed by the revenue outlook and areas of uncertainty in the forecast. He began with slide 2 titled

"Tax Credit Certificates Historical Purchases." The slide showed a graph with a history of the tax credit certificate purchases made each year since the purchases began in FY 07. Since FY 07, \$3.65 billion had been spent by the state on credit certificate purchases. Prior to FY 16, the full amount of eligible tax credits had been purchased each year. In FY 16 and FY 17, changes to the credit laws set in place sunset provisions for new credits. He reported that the ability to earn new credits had been phased out. He elaborated that as state budget issues intensified, FY 16 was the first year that less than the full outstanding amount was purchased; it had been the case every year since FY 16. He relayed that FY 20 was the first year there was no appropriation for the purchase of tax credit certificates.

[10:26:31 AM](#)

Mr. Stickel moved to slide 3 titled "Tax Credit Certificates for Purchase Status." The slide contained a chart projecting how the outstanding tax credits would be paid off over time if the statutory appropriation were made each year beginning in FY 22. He noted the information was based on the 2020 spring forecast. He explained that DOR calculated the statutory appropriation based on either 10 or 15 percent of estimated production tax levied before subtracting any tax credits. He expounded that when the oil price was less than \$60 per barrel, which was the case for the next several years, the multiplier was 15 percent of the production tax before credit amount. The department estimated there was \$738 million in outstanding credit certificates at the end of FY 21 and \$5 million more becoming available for purchase in FY 22, for a total balance of \$743 million. The chart assumed that no statutory appropriation would be made for FY 21, which would have been \$36 million per the spring forecast. The chart assumed a \$40 million statutory appropriation in FY 22. The appropriation was projected to increase over time based on improving oil prices. Under the scenario presented on the slide, most of the credits would be paid off by FY 32, with the last \$4 million purchased in FY 33.

[10:28:08 AM](#)

Representative Josephson referred to Mr. Stickel's statement that the state would have paid \$36 million in FY 21. He asked for the bond amortization rate had the

court had ruled in a different direction. He was trying to determine the difference between a successful and an unsuccessful HB 331.

Mr. Stickel replied that he would have to follow up with the information.

[10:29:16 AM](#)

DEVEN MITCHELL, EXECUTIVE DIRECTOR, ALASKA MUNICIPAL BOND BANK AUTHORITY, DEPARTMENT OF REVENUE (via teleconference), answered that he did not have the figures on hand.

Representative Josephson considered the situation solely through the lens of the state's treasury. He asked if it was possibly a good thing that HB 331 had been rejected by the Alaska Supreme Court.

Commissioner Mahoney answered that she could not speculate. The department was focused on trying to evaluate the impact of the ruling and manage its way through.

Co-Chair Johnston indicated Representative Delena Johnson had joined the meeting.

[10:30:26 AM](#)

Representative Wool looked at the chart on slide 2 showing the state purchase of tax credit certificates by fiscal year. He observed that the laws had been changed to eliminate cashable credits in FY 17, but there were still purchases in FY 17 through FY 19. He asked for clarity on the word "purchase." He knew there had been cashable credits the state had paid out to oil companies. He thought the law had been changed so that going forward the credits were simply a reduction in taxes received and not necessarily purchases. He remarked that it appeared the state purchased zero tax credits purchased in FY 20. He asked if the state was continuing to incur tax liability going forward. Alternatively, he wondered if new liability stopped when the legislature passed a bill eliminating cashable credits.

Mr. Stickel responded that DOR was using the term "credits for state purchase," while "cashable credits" was a more colloquial term. The terms both referred to the tax credits available for the state to write a check to a company to

purchase. He detailed there had been legislation in 2016 and 2017 that made changes to the tax credit program; the bills implemented a gradual sunset on the ability to earn new credits for state purchase. He elaborated that the provisions had taken effect over several years, meaning the state had been incurring some additional credit obligations over the past several years. The ability to earn new credits had been entirely phased out. The department's spring forecast assumed there would be \$5 million in additional credits that would become available for purchase in FY 22. At that point, there would be no additional credits available for purchase. The \$743 million balance the department was forecasting to be available in FY 22 should be the final balance.

[10:33:35 AM](#)

Representative Wool referred to the repayment schedule beginning in 2022 and ramping up to 2032 based on oil prices and a 15 percent statutory minimum (slide 3). He asked how the projection compared to a scenario where HB 331 had not been overturned. He knew a deal had been struck with oil companies where they would take a reduced payment. He wondered if the state's total liability would be about the same due to the fees on the bond. He wondered if the overall cost in both scenarios was about the same for the state.

Mr. Stickel answered that the net cost to the state would be the same or less. He deferred to a colleague for more detail.

Mr. Mitchell confirmed that there was an impact on the deal that may have been struck in the past as the price of oil fluctuated in the future. He explained that if the price of oil went up, the expected payments under the formula went up in a similar fashion and the deal the state struck would be more beneficial to the state than expected. Conversely, if the price of oil went down, the deal would be worse for the state than expected. The expectation under the legislation [HB 331] was that bonds would be sold at a discount to the expected payments under the projections of the day and it would be necessary to wait to see what the future held in terms of the actual results.

Representative LeBon was trying to determine a path forward. He highlighted the existing situation where the

state could not sell bonds to immediately pay back the total obligation to the tax credit holders and the potential for payments to be stretched out over a ten-year basis (as shown on slide 3). He asked how to reassure tax credit holders and banks that repayment would happen, that the state had committed to repay, and that it had set aside, through an escrow method on the ERA, the money to pay the installments should there not be the will of the legislature to fund the repayment from the General Fund at some time in the future. He asked if doing so would be a sign of good faith toward the credit holders and banks to indicate that they could count on being paid. He did not know if the concept made complete sense. He explained that he was trying to find a path forward.

Commissioner Mahoney responded that the department was evaluating all of the possible options to determine a step forward. She assured the committee that the issue was a top priority. She invited Mr. Mitchell to comment on the potential view of the investors, banks, and credit ratings.

Mr. Mitchell informed the committee that the nonpayment of the tax credits in the current fiscal year did not have an immediate reaction from the credit rating agencies. The commitment that the state had made was salient to fill. There were other examples of similar experience in recent history that were cumulatively a death by a thousand cuts that reflected negatively on a state's ability to stand behind its commitments. He shared that the lobby wall of the ratings agency Moody's displayed the saying "man's faith in fellow man." He relayed that the saying captured the basis of debt - the belief that people would stand behind their word. He explained that when that belief was lost, it was reflected in the credit rating.

[10:39:54 AM](#)

Representative LeBon asked whether the bond could be sold to pay tax credits immediately if the legislature was able to attach repayment to the ERA in the manner he had previously described. He explained that the revenue stream would be committed through the ERA and should the legislature fail to meet the annual debt service through the General Fund it could fall back on state savings. He asked if the approach would be valid.

Mr. Mitchell replied that he believed there would be a number of structuring issues that would be difficult to overcome for purposes of issuing a bond under the scenario presented by Representative LeBon. He explained there were prohibitions on the dedication of state revenue. He contemplated the scenario where the legislature was looking at appropriating the entire amount due under the tax credit program to an escrow that would be irrevocably pledged to the repayment of the obligations over time. He relayed that it was a complex question that would require thought about the limitations resulting from the recent supreme court decision and how something might be structured. He would not characterize the idea as impossible but believed there would be some challenges.

[10:41:39 AM](#)

Representative LeBon believed the situation may have reached the point where it was necessary to think outside the box if the state was in a position where paying the tax credits was in question. He stressed that default by the state would send a very bad message to the capital markets and future bond issues by the state and municipalities. He underscored that the state did not want to have to damage control that message.

Representative Josephson referred to slide 3. He believed Mr. Stickel had stated that paying the credits at the statutory level would have required a payment of \$36 million [in FY 21]. He knew that HB 331 had backloaded the main obligation to paydown the bonds. He recognized that the conversations were vital and important, yet when considering the \$2.3 billion deficit with a full dividend, the amount appeared much smaller.

Mr. Stickel responded that the \$36 million was the statutory appropriation for FY 21 under the spring revenue forecast. He referenced the current payoff schedule on slide 3 and highlighted that the spring forecast had a lower price point and production tax revenue calculation than the previous forecast. He clarified that the payoff schedule under the spring forecast included a smaller payment and a longer time horizon.

[10:44:34 AM](#)

Mr. Stickel addressed the revenue outlook on slide 4. The slide included world changes that had occurred since the spring forecast. He detailed that the spring forecast had been released in early April during a time of tremendous and unprecedented uncertainty in the world. He reported that despite all of the change, the outlook for unrestricted revenue had not changed significantly. He shared that investment revenue was currently the most important revenue source - markets had recovered faster than expected from the March lows. On the federal revenue side, the CARES Act had been passed right before the spring forecast had been released and was not included in the forecast. He elaborated that between the state, municipalities, and other entities, there had been about \$5.6 billion in federal aid to Alaska. A significant portion of the federal funding would be state revenue to be reflected in FY 20 and FY 21. He noted that the federal funding was considered restricted revenue in the forecast.

Mr. Stickel continued to address the revenue outlook on slide 4. He discussed that oil prices had plunged in April, immediately after DOR had released its forecast. He reported that oil prices had gone negative for one day on April 20, but they had headed back up and were now slightly above the spring forecast level. Oil production was curtailed in April through June, first due to Trans-Alaska Pipeline System (TAPS) prorations caused by concerns about oil storage capacity and then due to low prices where ConocoPhillips had chosen to reduce production at Kuparuk and Alpine because of unacceptable pricing levels. The curtailments had ended, but DOR was still waiting for drilling to come back at Prudhoe and Kuparuk in particular. He reported that it had been a rough year for tourism and many other industries, which was largely baked into the spring revenue forecast. He noted that the federal CARES Act had made some changes to corporate income tax that would reduce revenue slightly over the next couple of years.

[10:46:55 AM](#)

Mr. Stickel turned to slide 5: "Fall Forecast Process." The slide provided a high level overview of the fall forecast process, which was just getting underway. He noted that FY 20 data was still preliminary and would be finalized later in the month. The department was in the process of updating its forecast models and assumptions and it would

be working through them over the next couple of months. The fall forecast and Revenue Sources Book would be released in early to mid-December, which would be the next official update to the revenue forecast and would form the basis for the governor's budget proposal.

Mr. Stickel reviewed the key economic indicators for Alaska on slide 6. He noted that while DOR focused substantially on state revenue, it was important to look at how the overall state economy was doing. He reported that state gross domestic product (GDP) was down slightly in the first quarter after gains in seven straight quarters. The second quarter GDP had been released earlier in the day and was down 33.8 percent for Alaska, which was slightly more than the national decline of 31.4 percent. The declines were at a record level and COVID-19 had a major impact on the goods and services produced in the national economy and Alaska.

Mr. Stickel shared that slide 6 included the unemployment rate because it was a widely followed economic indicator; however, he noted the figure was slightly misleading at present. He explained that the unemployment rate calculation was an estimate of the share of people in the labor force who are out of work and actively looking for work. He expounded that some COVID related issues had complicated the unemployment rate calculation, including the enhanced unemployment benefits as well as difficulty conducting the survey that helped to inform the calculation. He informed the committee that currently the best read on the unemployment situation likely came from looking at jobs numbers and claims for unemployment insurance benefits. He pointed out that unemployment insurance claims were still nearly 7 times higher than one year earlier and despite the unemployment rate, employment in the state was actually down by 37,000 people or 10.5 percent compared to one year earlier.

Mr. Stickel reported that wages and salaries were down 6 percent from one year earlier and showed an impact of COVID-19. He relayed that bankruptcies and foreclosures were less than the prior year, likely due to various government programs providing temporary aid and limiting foreclosures. He noted that COVID's full impact had not yet been seen in the bankruptcy and foreclosure category. He concluded slide 6 by reporting that housing starts were down slightly from 2019. He remarked that a big question was what the last three indicators looked like throughout

the fall with federal support and limitations on foreclosures and bankruptcies tapering off. He explained that without further federal stimulus, it was possible the indicators could begin to look very bad and Alaskans could be looking to the state for help.

[10:50:14 AM](#)

Mr. Stickel discussed the current revenue outlook and oil price forecast update on slide 7. He detailed that the next set of slides showed how FY 20 ended up relative to the spring forecast and an updated view on FY 21 and 22. He noted that two years of history had been included for comparative purposes. The FY 20 average Alaska North Slope (ANS) oil price was \$52.12, which was slightly ahead of the spring forecast of \$51.55. Oil prices had plunged in April and on April 20, ANS prices were assessed at a negative value for the first time ever. Slide 7 showed a revised oil price outlook for FY 21 and FY 22 based on futures market prices from the end of the previous week. The projected FY 21 price was \$42.97 compared to the \$37 spring forecast. The projected FY 22 price was \$45.91 compared to the \$41 spring forecast. He reported that overall, the department was seeing some possible support for oil prices; global oil demand had rebounded faster than supply and April lows. He elaborated that inventories were being drawn down. He stated that while they were still above historical averages, absent a second wave of COVID, there was some stability.

[10:51:58 AM](#)

Mr. Stickel reviewed the oil production forecast update on slide 8. The slide included a chart comparing the ANS average daily oil production to the spring forecast. He reported that FY 20 production came in at 472,000 barrels per day compared to the spring forecast of 486,000 barrels per day. The production curtailments in April through June caused production to drop below the forecast. He relayed that the drilling of new wells was on pause in Prudhoe Bay and Kuparuk, which impacted oil production. The revised outlook was based on a low oil price scenario prepared by the Department of Natural Resources in April. The information also included actual production so far in FY 21. The revised outlook for FY 21 was 468,000 barrels per day compared to 487,000 barrels per day included in the

spring forecast. The revised outlook for FY 22 was 448,000 barrels per day compared to the spring forecast of 458,000.

Mr. Stickel relayed that DOR was actively revising the production outlook for the fall forecast. He shared that the department had begun meeting with companies earlier in the week to understand how their plans had changed since the spring.

[10:53:13 AM](#)

Mr. Stickel provided an updated unrestricted revenue forecast (not including the POMV from the Permanent Fund) on slide 9. He relayed that FY 20 revenue was still preliminary and could come in slightly higher or lower than the forecast when the reconciliations were complete. He reported that it currently looked like the state had received \$1.6 billion of unrestricted revenue, which was in line with the spring forecast. He explained that the rebound in oil price in May and June roughly offset the impacts of lower production. The department's revised outlook was based on the revised price and production numbers, in addition to other revenue changes. He shared that both FY 21 and FY 22 were looking to be right in line with the spring forecast, as the slightly higher price offset slightly lower production and other impacts.

Mr. Stickel elaborated that for FY 21 and FY 22, DOR was expecting \$1.2 billion and \$1.3 billion of unrestricted revenue, respectively. The slide contained good and bad news - while the outlook had not worsened, the projected revenue was historically low, and the state's fiscal situation remained extremely challenging.

[10:54:36 AM](#)

Representative Wool surmised that Mr. Stickel was saying the forecast was almost as predicted because oil prices were slightly higher, and production was slightly lower than expected. He asked if it was fair to say that price was more volatile, so if price were to dip down, production was harder to rebound, especially in the short-term. He asked if the reduced production was based on low demand as a result of COVID. He wondered if the low demand was expected to continue even if COVID was remedied. He remarked on more people working from home and fewer people flying for business travel.

Mr. Stickel replied that he believed the concern about oil demand was legitimate. Demand had rebounded faster than supply on a global level; however, demand was still not back to its pre-COVID level. There was some question about when and if demand globally would return to those levels. Speaking specifically to Alaska's production, he explained that the revised outlook was based on a low oil price scenario that DNR prepared in April and May. The scenario was based on the presumption that production would be paused. He reported that drilling was still on pause at major fields. He suggested paying attention to the announcements coming out of major fields including Prudhoe and Kuparuk where production had been paused in order to learn how oil production may compare to the outlook.

[10:57:05 AM](#)

Mr. Stickel turned to slide 10: "POMV Revenue Forecast Update." The slide included a chart showing the POMV transfer from the Permanent Fund, which was currently the state's largest source of unrestricted revenue by far. He detailed that the POMV draw was available for dividends and government spending; the split was up to the legislature to determine. He elaborated that the POMV was a fairly stable revenue source, based on the Permanent Fund's average ending market values of the first five of the last six fiscal years. The FY 20 draw was \$2.9 billion, and the FY 21 draw was \$3.1 billion. The FY 22 draw was estimated at just under \$3.1 billion. He detailed that the FY 22 draw was \$21 million higher than projected in the spring forecast, which was due to a better than expected investment recovery at the end of FY 20 (the final year that went into the FY 22 POMV calculation).

[10:58:25 AM](#)

Mr. Stickel covered the areas of uncertainty impacting the revenue outlook in the fall forecast on slide 11. He indicated there was always uncertainty with commodity prices and production, but there were additional hurdles to deal with in the current year.

Representative LeBon asked if it were safe to predict there would not be a need for a supplemental budget appropriation when the 32nd legislature met in January 2021.

Commissioner Mahoney responded that it was too difficult for DOR to predict an answer at present.

[10:59:55 AM](#)

Representative Josephson referred to slide 10. He believed Mr. Stickel's testimony that the POMV draw was stable was the best news. He stated that the Alaska Permanent Fund Corporation (APFC) reported an ERA balance of \$10.3 billion. The corporation anticipated that the legislature would spend \$3 billion of the balance. The corporation also reported that \$1.7 billion could not be realized. He suggested that if the legislature were to pay the retroactive dividends of \$4.6 billion it would leave an ERA balance of \$1 billion. He wondered if the earnings were sufficient to get back up to the \$3 billion sustainable draw shown on slide 10.

Commissioner Mahoney answered that it was difficult to speculate. She offered to run the analytics to reevaluate the balances before responding in writing.

Representative Josephson accepted the offer and thanked Commissioner Mahoney.

[11:01:31 AM](#)

Mr. Stickel reviewed the uncertainties around COVID-19 on slide 12. He stated that the uncertainty around the pandemic and potential and current recovery impacted all of the state's major revenue sources in some way. He relayed that the potential for investment volatility was a major concern as it was the state's primary source of unrestricted revenue. He reported that federal stimulus funding through the CARES Act and other programs totaled \$5.6 billion thus far. He elaborated that the federal funds had helped put a floor under many parts of the economy, but it was unclear whether the support would be extended and what would happen when the funding ceased. Petroleum revenue had been impacted by low prices and demand destruction and a resurgence in COVID cases could cause demand to fall again. He noted that the low prices threatened the economics of new projects.

Mr. Stickel addressed uncertainty on the non-petroleum side on slide 12. He noted that the revenue sources were

impacted in several ways. He explained that the tourism season had been lost, for the cruise industry in particular. The department was anticipating a slow return to normal. He detailed that it currently looked like there could be a half-capacity season in the summer of 2021; however, the possibility was speculative. He highlighted that COVID had impacted many of the state's basic industries such as mining and fishing. He explained that impacts to the basic industries were an extra challenge because they threatened state revenue and directly impacted communities and their economies.

Mr. Stickel reported that corporate income tax had been impacted in two ways. First, corporate income tax was based on profits and there was significant uncertainty about what the taxes would look like for the calendar year 2020. Second, the CARES Act made a change to the corporate income tax that allowed companies to carry back any losses for the 2018, 2019, and 2020 tax years, up to five years back. He explained that Alaska statutes were tied to the federal law and the department estimated that the carry back provision would have an impact of up to \$200 million across FY 21 and FY 22. He added that the estimate was uncertain because what 2021 would look like was not yet known.

[11:04:14 AM](#)

Co-Chair Johnston noted Mr. Stickel had mentioned the federal CARES Act funding on slides 11 and 12. She stated that the last time Alaska had a similar amount of federal funding injected into its economy was during the Exxon Valdez oil spill. He asked if anyone had taken a look back to see if any adjustment had been made because there were very few ways to get the secondary and tertiary revenues from the federal funding unless it impacted the state's corporate tax. She remarked that it could impact sales or property taxes at a local level. She asked if DOR had looked back to see what impact there had been on the bottom line during the Exxon Valdez oil spill in order to determine what the effect may be during the current year.

Mr. Stickel replied that it was not something DOR had looked at directly, but he thought it was an excellent suggestion. He remarked that one of the interesting things about the current federal funding was it was largely replacing what would have been in the private economy. The federal stimulus had replaced wages and salaries lost

through the unemployment benefits and to replace economic activities such as the lost tourism season.

Co-Chair Johnston considered what effect the situation had on the state's bottom line.

[11:06:22 AM](#)

Mr. Stickel discussed investment volatility on slide 13. He stated that as witnessed in the current year, investments could be extremely volatile. He pointed out that in March, the stock market had lost over one-third of its value in a single month; however, markets had rallied back to all time highs since then. For example, the anticipated return for large cap stocks was expected to range from a 10.7 percent loss to a 24.7 percent gain about two-thirds of the time, which was too broad of a range to base a budget on, especially when the other major revenue source was based on oil price. One way to reduce the volatility was through diversification. For example, in FY 21, the Permanent Fund had an expected return of a 0.2 percent loss in the low case and a 13.9 percent return in the high case. He explained it was a smaller range of uncertainty through diversification. He noted that for comparison, the Permanent Fund had a 2 percent positive return in FY 20.

Mr. Stickel shared that investment volatility was further reduced for the POMV draw through its calculation method. He explained that the draw was based on an average fund value of the first five of the last six fiscal years. He elaborated that even with the range of possible FY 21 returns with volatility reduced through diversification, the range of returns did not impact the POMV calculation until FY 23 and then the potential range on the FY 23 draw was about \$50 million.

[11:08:21 AM](#)

Co-Chair Johnston asked for verification that the current year had closed out at a 2 percent return.

Mr. Stickel replied affirmatively. He confirmed that the FY 20 net return for the Permanent Fund was 2 percent.

Co-Chair Johnston asked for verification that the target return for the Permanent Fund was 7 percent over the five-year lookback.

Mr. Stickel replied that the 7 percent was the expected return baseline assumption from Callan Associates that went into the Permanent Fund calculation.

Mr. Stickel continued to the last area of uncertainty on slide 14: "Ballot Measure 1." He relayed that the information on slide 14 was taken from an FAQ document DOR had prepared in conjunction with the public hearing conducted by the lieutenant governor the previous week. The department had used one potential interpretation of the ballot measure for its modeling, based on how the sponsor had described the initiative. He clarified that the interpretation was subject to change. He detailed that Ballot Measure 1 provisions would apply to the Prudhoe Bay, Kuparuk, and Colville River units. He detailed that the minimum tax would be increased to at least 10 percent of gross value; all per barrel credits, carried forward losses, and other offsets would be prohibited; and there would be an additional net profits tax that would take effect at higher oil prices.

Mr. Stickel elaborated that the ballot measure would increase state revenue and decrease producer profit. The department had not yet attempted to evaluate the net impacts of the revenue increase compared to changes in oil production and the economy; however, some companies were delaying decisions pending the outcome of the election.

[11:11:00 AM](#)

Mr. Stickel reviewed slide 15: "Ballot Measure 1: Production Tax Revenue." The slide showed estimated production tax revenue for FY 22 under current law and Ballot Measure 1 at several different oil prices. The analysis was based on the spring forecast assumptions, assuming no changes in oil production and company investments as a result of the tax change. He explained that the revenue impact depended on the oil price. At an oil price of \$35 per barrel, Ballot Measure 1 was expected to bring in \$224 million in incremental revenue, which was a 215 percent increase in production taxes. At an oil price of \$75 per barrel, Ballot Measure 1 was estimated to bring in just over \$1 billion of incremental revenue, which represented a 223 percent increase in production taxes. He asked members to keep in mind the estimates did not factor in any potential changes to oil production or investment.

[11:11:58 AM](#)

Mr. Stickel discussed the government and producer take under Ballot Measure 1 on slide 16. The slide showed an estimate of how oil production profits would be shared between the different stakeholders at different prices. The analysis was based on the spring forecast assumptions for FY 22. He noted that the analysis looked at the three units [Prudhoe Bay, Kuparuk, and Colville River] that would be impacted by the ballot measure. He explained that the government and producer take calculations looked at the profit leftover after accounting for transportation costs and lease expenditures and the share of that profit that went to the state, federal government, and producers. At \$35 per barrel, under current law, the state's revenue was higher than the profit per barrel. He detailed that the state's take was greater than 100 percent and the producers' take was negative. Under the example, costs for the impacted fields amounted to about \$30 per barrel, leaving a profit of approximately \$5 per barrel. He noted that the state took slightly more than that amount.

Mr. Stickel continued to address slide 16. He detailed that under Ballot Measure 1 at an oil price of \$35 per barrel, the government take increased to 140 percent and the producer take was even more in the negative. At higher prices under Ballot Measure 1 the producers' share went positive. At a price of \$45 per barrel the total government take was 70 percent with 30 percent going to producers. At an oil price of \$75 per barrel, the total government take was 62 percent with 38 percent going to producers. He reiterated his earlier statement that the estimates did not factor in any potential changes to oil production investment.

[11:13:37 AM](#)

Representative Josephson looked at the information on slide 16 and could not tell what the producer take was under SB 21 [oil tax legislation passed in 2013] at oil prices other than \$35 per barrel. He observed that the department had a position about the total government take and the

producer take, but he did not have much to go off of for a comparison.

Mr. Stickel replied that he could follow up with the information. He reported that at under current law the producer take would be 39 percent at a price of \$45 per barrel, 49 percent at \$55 per barrel, 52 percent at \$65 per barrel, and 50 percent at \$75 per barrel. He noted there was a significant difference between the two laws.

Representative Josephson highlighted Mr. Stickel's comment that it was not possible to predict how producers would respond if Ballot Measure 1 were to pass. He reasoned there were many variables on the producers' plates, including price, that were not entirely in the producers' control.

Mr. Stickel agreed; however, DOR had not attempted to predict what the producers' response would be.

[11:15:46 AM](#)

Vice-Chair Ortiz asked how the producer take under SB 21 compared to the producers' locations in other states. He asked if the producer take under SB 21 was generally higher or lower than in other tax regimes.

Mr. Stickel responded that there had been some third party studies comparing the current tax system under SB 21 to other tax regimes. He was happy to direct committee members to some of the studies. It was his understanding that Alaska was competitive with other tax regimes under the current law.

Co-Chair Johnston asked the federal take at an oil price of \$45 per barrel.

Mr. Stickel responded that slide 16 showed the federal corporate income tax at the current marginal tax rate of 21 percent. The reason it was not shown in the \$35 barrel price range was because there was no profit to the company to be taxed at that price.

Co-Chair Johnston thanked the presenters for their presentation.

^PRESENTATION: FY 21 AND FY 22 FISCAL OUTLOOK: LEGISLATIVE FINANCE DIVISION

11:18:18 AM

ALEXEI PAINTER, DIRECTOR, LEGISLATIVE FINANCE DIVISION (via teleconference), introduced a PowerPoint presentation titled "FY21/FY22 Fiscal Update: House Finance Committee," dated October 2, 2020 (copy on file). He shared his intent to discuss the outlook for FY 21 and FY 22, but noted it was necessary to first look at FY 20, which had just been completed. He relayed that actual expenditures and revenue would not be finalized until the release of the Comprehensive Annual Financial Report (CAFR); therefore, all FY 20 numbers were currently in draft form.

Mr. Painter shared that the Legislative Finance Division (LFD) was frequently asked about the prospects for the Constitutional Budget Reserve (CBR) balance going forward. Unfortunately, it was not possible to rely on extrapolating from the cash balance of the CBR any longer for a couple of reasons. First, over the past few years increasing direct appropriations had been made from the CBR for the previous year's capital budget and for a portion of the current year's operating budget. He explained that looking at cash did not capture the fact that appropriations for capital projects could be drawn out over several years. Second, as the CBR balance had diminished, the amount of cash in the general fund at the end of the fiscal year that belonged to the CBR was becoming a more important factor in the balance. He elaborated that it was a variable number that was not known until the CAFR was published later in the year.

Mr. Painter reported there was currently about \$1 billion in cash in the CBR. He expected the final number at the end of the current fiscal year would be lower than that; however, it would likely be a bit higher than the balance in the LFD fiscal summary, which was just under \$600 million. He stated that looking ahead, it was likely the reasonable range that could be expected.

11:20:28 AM

Co-Chair Johnston asked for verification that the CAFR did not include the supplemental under revenues and expenditures.

Mr. Painter clarified that the CAFR included supplementals spent in the given fiscal year. He elaborated that the report included all state expenditures in a fiscal year, regardless of when they were appropriated.

[11:21:14 AM](#)

Representative Josephson congratulated Mr. Painter on his new job. He assumed part of the reason the balance was higher was because the April 7th vetoes left over \$200 million in the CBR.

Mr. Painter replied that the \$586.9 million in the fiscal summary projection included the vetoes. The primary reason the balance was looking to be a bit higher than the projection was due to lapsed funding. For example, there had been a mild fire season; therefore, some of the fire supplemental lapsed to the General Fund. Additionally, deposits to the CBR appeared to be slightly higher than the forecast. He shared that it looked like the state may be a little better off than had been anticipated - the amount would be known once the numbers were finalized.

[11:22:19 AM](#)

Co-Chair Johnston indicated that it was her understanding in the spring that approximately \$550 million was available from the CBR to be used as the cash resource for the budget. She asked for the accuracy of her statement.

Mr. Painter responded that it depended on the year. He elaborated that at the end of FY 19, the General Fund ended at a fairly high balance. He explained that there had been about \$500 million that belonged to the CBR that was in the General Fund at the end of FY 19 for cash flow. He reported that FY 20 had ended with a much lower level of cash and it was possible the CBR would owe the General Fund when the numbers were finalized. He confirmed that about \$500 million was used for cashflow, but how it ended up at the end of a fiscal year was highly variable. There had been large swings from year to year based on cash management needs. He clarified that \$500 million was an average, but it had been higher and lower in different years.

[11:23:40 AM](#)

Representative Josephson suggested the state was in a red or danger zone. He recalled the Treasury Division saying they did not like a balance anywhere near the number projected for the CBR.

Mr. Painter responded that in the past several years the legislature had drawn from the CBR before going to the POMV draw, which allowed APFC to maximize investment earnings. He explained that if there was no CBR and the POMV draw took place first, it would cost the state investment revenue. He stated that the situation was not unmanageable, but it was costly because the Permanent Fund earned 7 percent per year and the CBR was in much shorter term investments. The situation would result in losing out on higher return investments because it would be necessary to use the POMV draw earlier in the year.

[11:25:05 AM](#)

Representative LeBon asked Mr. Painter if he had a prediction for what the 32nd legislature may face in January with regard to a potential supplemental budgetary need. He discussed that a couple of years back the legislature needed to deal with the economic fallout from an extreme fire season and the Anchorage earthquake. He asked if Mr. Painter had any prediction about what the legislature may be facing in January due to COVID-19 and other issues.

Mr. Painter replied that there were several areas LFD had identified that may have supplemental needs. He relayed that the following few slides would address some of the potential supplemental issues. He noted it was very difficult to put a number on some of them at present.

[11:26:12 AM](#)

Mr. Painter began addressing some of the potential supplemental needs on slide 3 titled "FY 21 Incomplete Capital Budget." He explained that in the past few years the typical capital budget had been limited mostly to federal matching funds; the majority of that funding had been included in the FY 21 operating budget as the legislature tried to get out of session quickly. Additional RPLs [Revised Program Legislative] had been approved in August that had added some of the missing capital projects;

however, a fairly large chunk of the capital budget remained outstanding.

Mr. Painter relayed that when comparing the governor's capital budget submission with what the legislature had passed, LFD had identified about \$150 million in projects that had not yet been funded. He noted that about \$33 million of the total was undesignated general funds (UGF). He elaborated that some of the outstanding funding may be a result of policy decisions to not fund things the governor requested, but some of the things were normal big ticket items that were included every year such as deferred maintenance and Alaska Energy Authority projects like the Bulk Fuel Program. Many agencies had very little of their capital budget funded such as the Department of Fish and Game and the Department of Natural Resources.

Mr. Painter reported that skipping payment for some of the items for a year meant likely missing the 2021 construction season for deferred maintenance. He elaborated that if funding were not appropriated for items until April or May it would be very difficult to get the funds spent quickly. For many of the projects, the earlier it could be appropriated the better. He highlighted that the first deadline had already been missed because the federal fiscal year had ended earlier in the week. He relayed that precisely how much the state had lost because of the missed deadline was not yet known. He continued that more detail may be available by the start of session. He stated that not appropriating funding to some of the items likely cost the state some federal revenue.

Co-Chair Johnston remarked that there had been quite a bit of discussion about the topic the past spring. The legislature had learned from the federal delegation that there were lapsed funds from other states that Alaska could potentially take advantage of. She cautioned that other states were in as bad or worse shape than Alaska and she hoped it did not mean the matching funds would not be available.

Mr. Painter replied that it was a good point. He explained that the situation would vary by grant and it was currently unclear how much the state lost because the federal matching funds were not in place. As the administration went through its budget process, he expected there to be more information on the topic by the time session began.

11:29:48 AM

Mr. Painter moved to slide 4: "FY 21 Emerging Budget Issues." He stated that some agencies had lost significant revenue due to COVID-19 and may need some supplemental appropriations. The most prominent being the Alaska Marine Highway System (AMHS). He detailed that the department had estimated about \$45 million of lost revenue between FY 20 and FY 21 and had responded with a drastically reduced schedule; however, AMHS may still need additional funding in order to get through the year and pay for the required vessel overhauls. There were other agencies reliant on fees or designated taxes such as the Department of Fish and Game (DFG) and the Department of Environmental Conservation (DEC) to a lesser extent. He elaborated that some of those agencies may have shortfalls and whether they could make the shortfalls up out of carryforward or other things would be clearer at the start of session.

Mr. Painter continued to review emerging budget issues on slide 4. Another large potential supplemental item had to do with school enrollment decreases in many districts. He noted there had been numerous news articles about the situation. He explained that the October student count would make the scope of the issue much clearer (the count had begun on Monday and would go for four weeks) within the next couple of months. He believed that once the numbers were available it would be much easier to see exactly how much enrollment was down in different districts and what sort of fiscal impact it would have. For the first nine months of the year, districts received payments from the state based on the student count from the previous year - only the last quarter of payments depended on the new student count. He explained that no matter how the student count came out, districts would receive a solid revenue stream until April and any revenue declines would start to be felt at that time.

Mr. Painter highlighted that there was a statutory hold harmless provision for reduced enrollment. He clarified that a district with a 5 percent enrollment reduction got to keep 75 percent of the enrollment difference between the prior and current years. He stated that while some of the news reports about enrollment being down 10 percent were alarming, it would trigger the hold harmless provision and districts would keep 75 percent of the difference between

the two years' funding. He recognized that the funding loss was not insignificant; however, it may not be as severe as doing the straight line math [without factoring in the hold harmless provision]. He discussed that there may be districts that lose just under 5 percent that were actually worse off than the district losing exactly 5 percent. He noted there may be some equity issues that the legislature may want to address. He reiterated that once the student count was available it would be much clearer which districts fell under the hold harmless category, which districts did not, and what the budgetary impact would be.

Representative Wool stated his understanding that if school enrollment were down in October - it was currently down by more than 5 percent in his district - the previous year's numbers would be used for the first three-quarters of the year. He reasoned that the following year would use the current year's numbers. He asked if it meant districts would take a cut in funding for the following year based on the attendance in the current year.

Mr. Painter explained that districts' early payments would be reduced and the true up payments in the last quarter of the fiscal year would get districts to their total amount. He noted that it may cause some cash flow issues for districts if their enrollment rebounded next year and they were receiving reduced payments throughout the first three quarters of the year.

Representative Wool stated his understanding that districts would be made whole at the end of the year to make up for the first three-quarters of the year that were low as a result of being based on the current year's [enrollment] numbers. Additionally, he understood that if enrollment dropped by greater than 5 percent there was a mechanism for districts to receive 75 percent of the difference between the two years, meaning that the situation was not as bad as it may look. He asked if the University of Alaska, as an entity that would see a significant decrease in funding due to COVID-19, was included in the category with AMHS, DFG, and other agencies.

Mr. Painter confirmed that the University had communicated that it had seen significant tuition decreases. Although the latest numbers were a little less than the original projections, the University was seeing a significant loss.

11:36:03 AM

Vice-Chair Ortiz understood there would be more information once the October school count had been completed. He was trying to determine how much funding may be needed for a supplemental or increase in funding in FY 22 to make districts whole. He noted that slide 4 showed AMHS being down by \$45 million; however, the school district portion of the slide only showed enrollment percentages, which was hard to equate to potential actual dollars.

Mr. Painter replied that it was very difficult to identify a number because it was not yet known which districts would trigger the hold harmless provision. He explained that if numerous districts came in with a 4.5 percent enrollment decline it would be a very different situation than having numerous districts with a 5 percent decline, which would trigger the hold harmless provision. He clarified that because of that threshold it was very difficult to project the scale until the student count was available. In regard to AMHS, because of the schedule reductions and secured CARES Act funding, the supplemental need would not be the full \$45 million. He relayed that the number would be significantly less, and the department would come out with its proposal in the governor's budget. He did not want to speculate on the amount at present.

Representative Carpenter asked if current law allowed school districts to submit enrollment numbers based on the previous year. If not, he wondered whether it would require a change in statute to do so.

Mr. Painter responded that the department did not have that flexibility under current law. The department was required to distribute funding according to the statutory formula. He remarked that the legislature could try to come up with some complicated language to accomplish the same thing; however, a statutory change would be much cleaner. He added that a statutory change would be highly preferable to trying to backfill with an appropriation.

11:39:36 AM

Mr. Painter turned to slide 5 and continued to review emerging budget issues. He reported that a significant portion of the CARES Act funding flowing through the state was currently unspent. Particularly, some local governments

had been slow to receive and spend their funding. The state Small Business Grant Program had a slow start, but if all of the current applications were approved the funding would be exhausted. He noted that the slide did not show the portion of funding going through the Department of Health and Social Services (DHSS) budget for use in other state agencies. He explained that the funding had largely been allocated, but it had not all been spent. He noted there were only several more months to spend the funding.

Mr. Painter reported that it was not yet known what would happen if there was money remaining at the end of the year. There had been some expectation earlier on that the federal government may extend the deadline or change some of the rules; however, it was unclear what would happen if there was money left over from any of the allocations. There had been speculation that the funding could be used to shore up the balance in the Unemployment Trust Fund. He stated it could happen but there were questions about whether the administration could take the action without the legislature.

Mr. Painter continued to review emerging budget issues on slide 5. He relayed that the Election Fund would need a minor supplemental appropriation to the Division of Elections early in the 2021 calendar year. The RPL process had enabled the state to get federal funding into the Election Fund to be used for the November election; however, the RPL process could not be used to get money out of the election fund. He explained that the division was spending more from the fund than it would be able to do under the current appropriation and would need a supplemental to continue operating throughout the full year.

Mr. Painter shared the good news that the state had a mild fire season. Funds had lapsed in FY 20 and there was about \$11 million remaining for the second half of the fiscal year. Depending on the forecast for next year's fire season, there could be a small supplemental or none at all, which was a large difference from the previous year.

Mr. Painter cautioned that when the CBR vote had been included in HB 205 [FY 21 operating budget bill], there had been no headroom or space for future supplementals without taking another three-quarters vote. He explained that any future appropriation bills that spent from the General Fund

beyond the level in HB 205 would require another CBR vote. He elaborated that in past years there had been some amount that could be used without another CBR vote, but that was not an option in the current year.

[11:43:23 AM](#)

Representative Josephson referenced election funding and CARES Act dollars. He recalled that the administration had declined some of the CARES Act funding that it could have accepted, presumably during the April/May timeframe that would have helped with COVID impacts on elections. He asked if Mr. Painter recalled the situation.

Mr. Painter replied that he would follow up on the question.

[11:44:06 AM](#)

Representative Wool addressed the unspent CARES Act funding. He believed local governments were required to spend the funding on certain things directly related to COVID and many communities did not have the direct expenses. He wondered if other states had similar issues and whether the deadline could be extended, or restrictions could be loosened. He knew that some of the issue was federal and the answers were not known. He remarked that the Municipality of Anchorage had meetings with the federal government over buying a building. He knew that when the funding had been given to communities, they did not all have direct expenses that could be attributed to COVID. He wondered about the solution and wanted to keep as much of the funding in Alaska as possible. He cited past discussion about returning the unspent funds to the state to be reappropriated elsewhere in Alaska. Alternatively, he wondered if new legislation was required to override the RPLs.

Mr. Painter replied that the RPL statute allowed for appropriations to be increased; there was no provision to allow appropriations to be decreased through the RPL process. He was unsure how the situation would play out if the funding were to be redistributed. There were some places in the budget, such as unemployment, where there was open-ended federal receipt authority. He stated it was possible the administration could merely shift the funding, but he recommended talking to Legislative Legal Services

about the concept. He did not want to speculate on what could and could not be done through the RPL process as there were some conflicting opinions. In terms of what other states had experienced, some states had substantial unspent money and others had been able to spend the funding quickly. He explained that the funding had a floor of \$1.25 billion that hit every state from Wyoming to Kansas in population. He detailed that Alaska had received the same amount of funding some of the states with populations far exceeding its own. Consequently, those states had much higher needs and had been able to spend the funds quickly. He believed it had been harder for some other states to spend the funding. He reported there was a lot of variation in states' ability to spend the funding. He had last heard there was some interest at the federal level of extending the deadline; however, he could not speculate on what Congress would do.

Representative Wool had heard other states were in a similar position. He remarked that the flat amount given to many states helped explain the situation.

[11:47:49 AM](#)

Mr. Painter moved to slide 6: "FY 22 Budget Outlook." He explained that to look at the coming year, LFD was adopting the Congressional Budget Office's methodology where they consider current law and current policy as potential baselines. He explained that on the federal level sometimes there was a little less distinction, but in Alaska there could be a large distinction because of its lack of dedicated funds. The current law outlook assumed the state would fully fund statutory obligations such as the statutory Permanent Fund Dividend (PFD) calculation, school debt reimbursement, the Regional Educational Attendance Area (REAA) fund, community assistance, and the oil tax credits of \$40 million for FY 22. He reported that the statutory PFD was projected at about \$2 billion or approximately \$3,100 per recipient in FY 22. The other statewide items that were not funded in FY 21 but were still on the books statutorily, added up to about \$174 million UGF in FY 22. He noted it was a rough projection because the newer school debt projections and a couple of other things that may vary, were not yet known.

Mr. Painter highlighted that the current policy outlook assumed that FY 22 would match up with FY 21 with a

dividend of roughly \$1,000 and no funding for school debt reimbursement, the REAA fund, community assistance (beyond the amount coming from the Power Cost Equalization (PCE) Fund), or oil tax credits. He explained that both baselines assumed flat agency operations in FY 22, which given natural increases in the budget each year, may necessitate some cuts to get there. He elaborated that both baselines used the revenue forecast DOR had presented earlier in the meeting.

[11:50:17 AM](#)

Representative LeBon noted Mr. Painter had mentioned school bond debt to communities, REAA, and community assistance. He asked for the actual number projected for the items for FY 22.

Mr. Painter directed attention to the appendix on slide 11 showing FY 22 scenarios for statewide items. He reported that LFD estimated the UGF portion of school bond debt reimbursement at \$82.6 million, which assumed about \$15 million would come from the school fund that was funded with tobacco tax revenue. The REAA fund deposit was projected at approximately \$34 million, which was a percentage of school debt reimbursement. He explained that a portion of PCE Fund earnings could be used for the Community Assistance Program, which was about \$12 million based on the calculation. The remaining amount to reach \$30 million deposit was about \$17.6 million. He expounded that a higher deposit for community assistance was possible because statute specified depositing \$30 million or the amount needed to reach a \$90 million fund balance. Oil tax credits would be \$40 million based on DOR's numbers provided earlier in the meeting.

Representative LeBon discussed that the state was helping a variety of school districts around the state with their bonded debt reimbursement. He asked Mr. Painter to repeat the number for the next fiscal year.

Mr. Painter replied that the number was about \$82.6 million UGF; however, it was an old projection from the spring. He relayed that an updated projection was not yet available. He elaborated that LFD's figures assumed \$15 million would come from the tobacco tax revenue. The total number was just under \$100 million.

11:53:09 AM

Mr. Painter previewed the FY 22 budget under current law in a table on slide 7. The revenue figures on the first line for agency operations had been presented earlier in the meeting by DOR. The baseline assumption was that agency operations would be flat at \$3.9 billion. The statewide items would increase because some of the items were unfunded in FY 21. The capital budget was estimated at \$150 million, which reflected an average over the past six years rather than the incomplete capital budget of about \$120 million in FY 21. The table included a placeholder of \$50 million for supplemental appropriations. He noted the number may be conservative, but they did not want to go overboard on the figure given the absence of any headroom in the current fiscal year. The result was an FY 22 deficit of just over \$2.4 billion. The number reflected about 36 percent of the total budget. He detailed that if the dividend was removed from the equation it was just over half of the non-dividend budget. Without further revenue or major budget reductions, the baseline assumption going forward was a deficit that equaled about half of the state's budget (excluding the dividend).

Representative Wool surmised that Mr. Painter was saying that the deficit of \$2.4 billion (with the dividend excluded) would be about half of the budget. He observed that if the dividend were removed, the budget would decrease substantially. He elaborated that \$2 billion would be removed from the PFD line [on slide 7] and the deficit would be roughly \$0.4 billion. He thought if the dividend was removed from one end it should be removed from the other.

Mr. Painter clarified that under the governor's budget the dividend was paid, but the amount was excluded from the governor's fiscal summary. He relayed that if a statutory PFD were paid out, the deficit would be equal to about half of the other expenditures. He confirmed that without a dividend the deficit would be about \$400 million.

Representative Wool stated his understanding that Mr. Painter was explaining a scenario where the dividend was taken out of the budget but was included as a \$2.4 billion expenditure in another category outside of the budget. Under the scenario, the \$2.4 billion would be half of the budget.

Mr. Painter agreed; it was how the governor's fiscal summary had portrayed the dividend over the past couple years.

Representative Wool observed that it was "more of a bookkeeping thing."

Mr. Painter added that he had included the information [on slide 7] to give an idea of the scope of the problem. He stated it was difficult to see what the deficit number meant in scale. He elaborated that putting in 36 percent of the total budget or half of the non-dividend budget provided a sense of scale of the deficit.

[11:56:58 AM](#)

Mr. Painter addressed an FY 22 budget preview under current policy on slide 8. He highlighted that the data on the slide was identical to the previous slide with the exception of statewide items that dropped to \$456.2 million [from \$630.2 million on slide 7] and the PFD that dropped to \$680 million [from \$2.024 billion on slide 7]. The table assumed that items not funded in FY 21 continued to not be funded in FY 22. The reduction to the dividend line would result in a PFD of approximately \$1,000 per recipient. The table on slide 8 showed a deficit of \$900 million, which still exceeded the remaining CBR balance.

[11:57:36 AM](#)

Mr. Painter reviewed the projected fund balances available in FY 22 on slide 9. He detailed that going into FY 22, the CBR balance was projected at around \$600 million or so. The ERA was expected to have a balance of approximately \$11.7 billion, which did not include unrealized gains. He explained that gains had to be realized before they were spendable. He noted that there had been various numbers mentioned when the ERA balance was discussed. He clarified that the slide showed the amount projected to be available on the first day of FY 22 prior to a POMV draw and any earnings coming in; the number reflected the starting point. He noted that sometimes people took out the POMV draw but did not count the earnings, which resulted in different numbers. The number on slide 9 reflected the number shown in the history and projections sheet produced by APFC.

Representative LeBon referenced the \$587 million balance in the CBR shown near the top of slide 9. He asked if the FY 22 balance accounted for an untouchable working capital cushion of \$1 billion, which he deemed to be the floor of a working capital amount for the state.

Mr. Painter replied in the negative. He clarified that the working capital was available for appropriation. He elaborated that if the CBR was fully expended down to zero there were other cash options that were more costly (e.g. the ERA). He reported that after FY 22 there would not be anything available in the CBR beyond the amount used for cashflow. He explained that the amount could be drawn, but it would result in having to turn to higher earning savings accounts or other accounts in order to meet the cashflow need. The state had already passed the point where \$1 billion could be kept in the CBR because the balance was already below that amount.

Co-Chair Johnston asked if the projected ERA balance of \$11.7 billion included unrealized gains.

Mr. Painter replied that the figure did not include unrealized gains. He expounded that \$11.7 billion reflected the spendable cash level projected to be in the ERA on June 30 of the current fiscal year.

[12:01:02 PM](#)

Representative Josephson stated that the [ERA] number currently used by APFC was \$10.3 billion or \$10.5 billion. He asked if Mr. Painter was projecting earnings of \$1.2 billion over the following nine months.

Mr. Painter responded that \$11.7 billion was the number APFC was projecting to be available at the end of the current fiscal year with the remaining earnings. He explained that the realized earnings thus far had slightly outpaced the forecast.

[12:02:07 PM](#)

Mr. Painter identified the last item on slide 9 as the balance in funds the administration listed as sweepable. He knew there were some legislators who disagreed with some of the funds included in the list. He explained that because

the administration was responsible for the sweep, the items it included were the default; however, the legislature could contest the action. The balance was approximately \$1.5 billion with the vast majority held in the PCE Fund and Higher Education Fund (funds that had not been considered sweepable until the past couple of years). He noted there was very little remaining in other funds. The available funds in addition to the CBR were not quite sufficient to balance the FY 22 budget under the current loss scenario. Absent action by the legislature to reduce the budget or add new revenue, LFD expected that other sources would be necessary.

12:03:18 PM

Representative LeBon referenced the appendix on slide 11 that referenced school bond debt reimbursement of \$82.6 million and the REAA Fund deposit of \$33 million. He asked for Mr. Painter to address how the two items were interconnected.

Mr. Painter replied that there was a complex REAA calculation in statute that linked the student count in REAAs versus organized areas and giving a percentage of the bond debt reimbursement accrued in organized areas into the REAA Fund to be used by the department to fund school construction and maintenance in the unorganized boroughs. He emphasized that over the past few years when there had been vetoes or reductions to school debt reimbursement, there had also generally been a corresponding reduction to the REAA Fund deposit because they were linked in statute.

Mr. Painter explained that the consent decree that created the REAA Fund found that the school construction was a state responsibility regardless of what happened elsewhere because the areas did not have the ability to raise their own funds through bonding. He elaborated that even if school bond debt reimbursement were zeroed out going forward, the state would be out of compliance with the order if it also zeroed out the REAA Fund going forward. He characterized continuing to reduce the REAA Fund deposit as legally risky regardless of what the state wanted to do with school bond debt reimbursement despite the statutory linkage between the two items.

Representative Josephson considered the question of sweepable funds. He referenced Mr. Forrer's success in

stopping a broader interpretation of the state's authority to bond. He shared that he had recently spent about five hours reading *Hickel v. Cowper*. He had been struck by the hearings that occurred on the Senate side in July 2019 about the differences of opinion between the administration and LFD about what was sweepable. He mentioned the *Forrer* case because he believed there could be litigation if the PCE Fund was swept. He explained that the PCE Fund was part of the Alaska Energy Authority and it was unclear in *Hickel v. Cowper* what the court would make of the action. He concluded that the legislature should not assume that the funds were available for expenditure without some pushback.

Mr. Painter responded that the sweepable funds statute passed in the 1990s was found unconstitutional in *Hickel v. Cowper*; therefore, there was no statutory guidance to follow. He believed that how the Alaska Supreme Court would rule on the case was ambiguous. He stated it could be argued that the current sweepable list was not large enough and because ERA funding was used for the general government, it should also be considered sweepable. He stated it had not been tested and it was unclear how the courts would rule. He continued that it was possible to speculate on how the courts might rule, but there was significant uncertainty about what was sweepable because the supreme court had invalidated the statutes and no replacement had been made.

[12:08:11 PM](#)

Representative Merrick asked for the average rate of return on the PCE Fund.

Mr. Painter answered that the last projection he had seen was 6.2 percent going forward. He had not looked to see if there was an updated projection. He stated that generally the funds managed by DOR returned at a fairly similar rate to the Permanent Fund over the long-term. He believed the Higher Education Fund return was also projected at 6.2 percent.

Co-Chair Johnston believed the actual return for both [the PCE Fund and the Higher Education Fund] had been very similar to the Permanent Fund in the current year at 2 percent.

Representative LeBon looked at the \$40 million for oil and gas tax credits line item on slide 11. He asked for verification that the \$40 million was the minimum payment required in FY 22 related to the state's total obligation of approximately \$743 million.

Mr. Painter replied affirmatively. He elaborated that the amount reflected the statutory calculation for the deposit. The obligation was subject to appropriation and the legislature could opt to deposit more or less.

Co-Chair Johnston thanked the testifiers and members for their participation.

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ADJOURNMENT

12:10:19 PM

The meeting was adjourned at 12:10 p.m.