

SENATE FINANCE COMMITTEE  
February 4, 2019  
9:01 a.m.

[9:01:48 AM](#)

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:01 a.m.

MEMBERS PRESENT

Senator Natasha von Imhof, Co-Chair  
Senator Bert Stedman, Co-Chair  
Senator Click Bishop  
Senator Peter Micciche  
Senator Donny Olson  
Senator Mike Shower  
Senator Bill Wielechowski  
Senator David Wilson

MEMBERS ABSENT

Senator Lyman Hoffman

ALSO PRESENT

Deven Mitchell, State Investment Officer, Department of Revenue; Senator Cathy Giessel.

SUMMARY

^STATE DEBT OVERVIEW and CREDIT RATINGS

[9:03:52 AM](#)

DEVEN MITCHELL, STATE INVESTMENT OFFICER, DEPARTMENT OF REVENUE, gave a brief history of his qualifications and experience. He discussed the presentation, "2019 Credit Review and State Debt Summary" (copy on file). He highlighted slide 2, "Debt Affordability Analysis":

Annual analysis required by AS 37.07.045 to be delivered by January 31

Discusses credit ratings current levels and history

Relies upon debt ratios limit of 5 percent for state debt and 8 percent when combined with municipal debt that the state supports

- With SB 26 change to revenue generation, and uncertainty about available revenue in future, reductions of 1 percent to debt ratio limits have been made

Identifies currently authorized, but unissued debt

Establishes refinancing parameters

Determines a long term debt capacity at current rating level

Discusses, but doesn't define a capacity for short term debt

Co-Chair Stedman wondered why SB 26 was of any significance.

Mr. Mitchell replied that SB 26 created the percent of market value (POMV) transfer from the Permanent Fund Earnings Reserve Account (ERA). He stated that for FY 19, it resulted in a significant increase in UGF revenue.

Mr. Mitchell discussed slide 3, "January 2018 Debt Affordability Analysis."

[9:09:57 AM](#)

Co-Chair Stedman asked about the two far right columns.

Mr. Mitchell replied that the percentage of UGF that was committed to the projected special payment on behalf of Public Employees' Retirement System (PERS) and Teachers Retirement System (TRS). The state determined in SB 26, that it was in the best interest of the system to limit employers contributions for TRS to 22 percent of payroll. The actuary went through an analysis of the funding levels and the expectations of payouts for participants that resulted in an actuarially calculated rate that should be paid to make up that balance over a finite timeframe.

Mr. Mitchell looked at slide 4, "January 2018 Debt Affordability Analysis."

Co-Chair Stedman wondered how the dividend calculation was handled in the 5.25 percent draw.

Mr. Mitchell only examined the UGF revenue. He did not look at expenses.

Senator Micciche noted the discussion of the reduction of one percent to debt ratio limits due to the increase in available revenue, and wondered who made that determination.

Mr. Mitchell replied that it was Department of Revenue (DOR).

Senator Micciche supported the conservative approach.

[9:15:00 AM](#)

Co-Chair von Imhof appreciated the examination of the POMV structured draw. She said that PERS and TRS was not considered "debt" but was a real debt to the state.

Senator Wielechowski queried the projected PFD, and the split between PFDs and fund transfers.

Co-Chair Stedman also requested the distortion that may be explicit, if the PFD was not accounted in any regard.

Mr. Mitchell replied that he did not make assumptions or projections about expenditures. He focused on the resources available to the state in the Revenue Sources Book.

Co-Chair Stedman wanted to follow the statutes, which dictated that the state pay the dividend.

Mr. Mitchell agreed to provide that information. He wondered whether that should be presented as percentage.

Co-Chair Stedman felt that the left-hand column could be used, and would change the percentages on the screen.

Mr. Mitchell agreed that it would look different.

Co-Chair Stedman stressed that the conversation should include the statutory obligation to pay a dividend.

[9:20:03 AM](#)

Mr. Mitchell completed discussion of slide 4.

Co-Chair Stedman wondered whether it included paying to dividend to meet the debt capacity.

Mr. Mitchell replied in the negative, and was a matter of what the money would be spent toward.

Co-Chair Stedman understood that Alberta was currently facing trillions of dollars in debt. He did not want Alaska to look like Alberta.

Co-Chair von Imhof stated that when looking at debt capacity, there was an examination of how much cash was available to cover the debt. She remarked that there should be a discussion about whether the state actually that cash flow had, because of the PFD required under statute.

Senator Shower remarked that budget would have a specific number.

Senator Micciche felt that the column needed to be changed for Alaska to be in line UGF forecast.

[9:25:19 AM](#)

Mr. Mitchell stated he felt it was a good discussion, because it was not his job to determine the size of the PFD.

Co-Chair Stedman announced that the PFD amount would not be zero, but probably less than \$3000.

Mr. Mitchell highlighted slide 5, "Debt Capacity":

Projected annual unrestricted revenue increase of approximately \$3.1 billion in FY 2019 vs FY 2018

Shift is primarily due to SB 26 and categorization of Permanent Fund earnings transfer as Unrestricted General Fund Revenue

Historically, PF earnings have been classified as restricted by custom rather than unrestricted, and these earnings may, in whole or part, revert to restricted

- Due to uncertainty of UGF in future years, reductions of 1 percent to debt ratio limits have been made

Projected ratios are below reduced ratio limits in both categories for the forecast period

Increased capacity of approximately \$1.5 to \$1.6 billion to total capacity of \$1.9-2.0 billion

For every \$100 million of recurring revenue that is added at this point we expect a current market increase in long term debt capacity of \$60-\$70 million

Co-Chair von Imhof assumed the converse was true.

Mr. Mitchell replied in the affirmative. He furthered that the debt load did not change, rather it was related to the volatile revenue.

Senator Micciche surmised that including the statutory requirement for the PFD, the \$3.2 billion may change the decision on the self-imposed cap.

Mr. Mitchell replied that it would, because so much uncertainty related to the PFD number.

[9:29:15 AM](#)

Mr. Mitchell addressed slide 7, "State of Alaska Credit Ratings and Recent History Agency Views":

FY 2010-2014 - high levels of unrestricted general fund revenue greatly exceed budgetary needs, growing reserve positions, pre-funding of budget items, large capital budgets, highest credit ratings with stable outlook. Upgraded to highest credit ratings.

FY 2015-2017 significantly diminished unrestricted general fund, use of pre-fundings, Statutory Budget Reserve and Constitutional Budget Reserve to balance budget, reductions to capital and operating budgets,

discontinuation of following statutory formula for determining Permanent Fund Dividends, consideration of various tax proposals, consideration of use of earnings of the Permanent Fund to pay for government, State downgraded four times followed by three additional downgrades in FY 2018.

FY 2018-2019 rating stabilization, shifting the state's credit analysis towards an endowment model rather than the state models that rely almost exclusively on annual tax and fee collection.

Mr. Mitchell highlighted slide 8, "Recent Financial Market/Credit Rating Challenges":

Investors False Perceptions on the State of Alaska:

Alaska's Economy Totally Reliant on Oil and is in Free Fall

- In 2016 the oil and gas sector represents about 13 percent of Alaska's GDP (\$6.75 billion of \$50.7 billion GDP) and represented approximately 4 percent of employment
- Oil and gas is the only industry in Alaska whose GDP is less in 2016 than in 2012 while other sectors have experienced moderate declines, stability or growth
- The State of Alaska does not currently rely on the broader economy for revenue as there is no broad based tax in Alaska
- The State benefits from the national and international economy through the investments of the Permanent Fund in securities of national and international firms

Reserves are Dwindling

- The reserve position of Alaska at 6/30/2017 is above the 6/30/2015 position
- Permanent Fund Earnings Reserve increased \$4.2 billion from FY 2016 to FY 2017
- Often discussed draws on reserves (SBR and CBRF) have been offset by deposits into the Earnings Reserve
- The Net Position of Alaska increased as a result of FY 2017 activity

- The Net Position of Alaska is projected to increase in each of the next nine years

The State Won't be Able to Balance its Budget.

- SB26 was passed
- Expenditures have been significantly reduced and may be reduced further
- In 2017 and 2018 the Governor and Legislature have ignored the statutory formula for determining the Permanent Fund Dividend and inflation proofing appropriations
- Just like the CBRF the Earnings Reserve of the Permanent Fund may be appropriated without statutory change
- Alaska's oil and gas tax credit structure has been changed
- Considering available revenues to the State, the budget has been in balance

[9:35:46 AM](#)

Co-Chair Stedman wondered how many other states owned their own subsurface and created the wealth to the state like Alaska.

Mr. Mitchell did not know.

Co-Chair Stedman stated that Alaska was the only state that was owned by the people. He stated that Alberta was similar to Alaska.

[9:37:12 AM](#)

Senator Bishop commented that

[9:37:58 AM](#)

Mr. Mitchell replied //

[9:38:09 AM](#)

Senator Micciche //

[9:38:51 AM](#)

Co-Chair Stedman //

[9:39:03 AM](#)

Mr. Mitchell //

[9:39:12 AM](#)

Mr. Mitchell addressed slide 9, "Alaska's Economy Has Been More Stable than U.S."

[9:40:53 AM](#)

Senator Shower //

[9:41:01 AM](#)

Mr. Mitchell //

[9:41:38 AM](#)

Mr. Mitchell highlighted slide 10, "Alaska's Economy is Diversified by Our Endowment":

- The Alaska Permanent Fund Provides Alaska Unparalleled Revenue Source Diversification
- As of March 31, 2018 Alaska's Permanent Fund endowment had an unaudited total fund balance of \$64.6 billion.

- o The State's Permanent Fund Revenue is generated from the national and world economies

- o The Permanent Fund does not rely on Alaska's economy for revenue generation - prohibited investment

- o The APFC Board independently directs investments and has established a 10-year total return projection of 6.50 percent

- o The Permanent Fund owns shares in more than 3,000 corporations around the world

- o Fixed Income holdings include both US and International securities

- o The Real Estate allocation provides inflation protection and enhanced diversification worldwide

- Investment income has tended to be countercyclical to oil, the source of the State's other largest revenue stream

[9:43:08 AM](#)

Mr. Mitchell looked at slide 11, "CBRF/SBR Balance and Credit Rating Timeline."

[9:44:01 AM](#)

Co-Chair von Imhof //

[9:45:32 AM](#)

Mr. Mitchell replied that the described scenario would most likely result in some form of report that would be negative in nature.

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Co-Chair von Imhof //

[9:47:49 AM](#)

Mr. Mitchell

[9:49:08 AM](#)

Co-Chair Stedman //

[9:49:12 AM](#)

Mr. Mitchell //

[9:49:52 AM](#)

Mr. Mitchell highlighted slide 12, "CBR/SBR and PR Earnings Reserve Balances Timeline."

[9:50:30 AM](#)

Co-Chair Stedman //

[9:50:44 AM](#)

Mr. Mitchell //

[9:51:48 AM](#)

Co-Chair Stedman //

[9:52:26 AM](#)

Mr. Mitchell agreed.

[9:52:31 AM](#)

Mr. Mitchell addressed slide 13, "State of Alaska Available Reserves Balance Timeline."

[9:52:50 AM](#)

Co-Chair von Imhof //

[9:54:03 AM](#)

Co-Chair Stedman //

[9:54:33 AM](#)

Mr. Mitchell //

[9:55:41 AM](#)

Co-Chair Stedman //

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Senator Micciche //

[9:56:29 AM](#)

Mr. Mitchell //

[9:57:10 AM](#)

Senator Micciche //

[9:57:30 AM](#)

Co-Chair Stedman //

[9:57:32 AM](#)

Co-Chair von Imhof //

[9:58:17 AM](#)

Mr. Mitchell agreed.

[9:58:22 AM](#)

Mr. Mitchell discussed slide 14, "State of Alaska Credit Ratings and Recent History Agency Views."

[9:59:25 AM](#)

Mr. Mitchell displayed slide 16, "State Debt Obligation Process":

- All Forms of State Debt are Authorized First by law
  - May be a one-time issuance amount or a not-to-exceed issuance limit in statute
  - General obligation bonds must then also be approved by a majority of voters
    - General obligation bonds are the only debt secured by full faith credit and taxing authority
- All State Debt must be structured and authorized by the State Bond Committee
  - Includes general obligation bonds, subject to appropriation issues, and state revenue bonds
- The State Bond Committee determines method and timing of debt issues to best utilize the state's credit and debt capacity while meeting the authorized projects cash flow needs
- The State has established other debt obligations
  - Reimbursement Programs
    - The School Debt Reimbursement Program or HB 528 reimbursement
  - Not currently authorized for new debt and periodically partially funded
  - Retirement Systems
    - Unfunded actuarially assumed liability (UAAL) for defined benefit employees is guaranteed by the Constitution
    - Annual payments on the UAAL of other employers is reflected as State debt in the CAFR
    - Some flexibility in how payments are made

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Mr. Mitchell addressed slide 17, "Total Debt in Alaska at June 30, 2018."

[10:04:00 AM](#)

Co-Chair Stedman //

[10:04:06 AM](#)

Mr. Mitchell continued with slide 17.

[10:08:05 AM](#)

Co-Chair von Imhof //

[10:08:21 AM](#)

Senator Bishop //

[10:08:33 AM](#)

Mr. Mitchell /

[10:08:58 AM](#)

Co-Chair Stedman //

[10:09:17 AM](#)

Mr. Mitchell /

[10:09:24 AM](#)

Co-Chair Stedman //

[10:09:40 AM](#)

Mr. Mitchell discussed slide 18, "Total Debt in Alaska at June 30, 2018."

[10:11:34 AM](#)

Senator Bishop //

[10:12:00 AM](#)

Mr. Mitchell //

[10:12:03 AM](#)

Senator Bishop //

[10:12:16 AM](#)

Co-Chair Stedman //

[10:12:35 AM](#)

Mr. Mitchell //

[10:14:10 AM](#)

Co-Chair Stedman //

[10:14:22 AM](#)

Co-Chair von Imhof //

[10:15:03 AM](#)

Co-Chair Stedman //

Mr. Mitchel //

[10:18:07 AM](#)

Senator Wielechowski //

[10:18:25 AM](#)

Co-Chair Stedman //

[10:18:38 AM](#)

Mr. Mitchell looked at slide 19, "State Debt Obligations Outstanding":

Annual Position as of June 30

- Balance outstanding peaked in 2016 at \$1,919.9 million
- Declining principal balances in every year (50 percent repaid by 2026)
- \$110 million of unissued general obligation bond authority

Senator Wielechowski wanted to correlate the numbers. He looked at page 17, which had total State Moral Obligation of \$1.897 billion. He wondered whether that correlated with the total on page 19.

Mr. Mitchell replied in the negative. He shared that the moral obligations were not paid by the general fund. He remarked that they were backstopped at the general fund.

[10:20:45 AM](#)

Senator Wielechowski asked for a correlation between pages 17 and 18.

Mr. Mitchell replied that the state debt would be included on the \$724 million, and the state supported debt of \$24.2 million would be included. He stated the remaining debts that would be included.

Co-Chair Stedman agreed for a table format of those numbers.

Senator Wielechowski wondered how much more debt the state could issue.

Mr. Mitchell replied that it was uncertain.

Mr. Mitchell addressed slide 20, "Current General Fund Annual Payment Obligation":

- GF Payment peaked in 2018 at \$225.2 million
- Declining payment in every year (50 percent of peak in 2029)
- PERS/TRS special funding payments grow every year
- PERS/TRS special funding is many times all other state commitments
- Existing Authorizations for \$300 million for Knik Arm Crossing, \$110 GO bonds, \$1.5 billion POB Corporation

[10:25:32 AM](#)

Co-Chair Stedman noted that there was a request for runs from the actuary to deal with the PERS/TRS obligation.

Mr. Mitchell looked at slide 21, "Existing State Short Term Debt Obligation Alternatives":

- Bond Anticipation Notes (AS 37.15.300-390)
  - May be used when long term debt is authorized by law
  - While short term, it is expected to be a precursor of long term debt
  - May be used to avoid negative carry in construction funds, better match long-lived projects and their financing, or as an additional budget management tool
  - Directly impacts long term debt affordability
- Revenue Anticipation Notes (AS 43.08.010)
  - May borrow money when it becomes necessary in order to meet appropriations for any fiscal year in anticipation of the collection of the revenues for that year
  - All notes and interest thereon shall be paid from revenue by the end of the fiscal year next succeeding the year in which the notes were issued
  - May be tax-exempt if a bona fide revenue deficit occurs during the fiscal year
    - Earnings of the Permanent Fund and other available fund earnings, will need to be included in determining if a revenue deficit occurs
  - The State has not used since the late 1960's

Mr. Mitchell discussed slide 23, "Authorized Bonding Authority."

[10:30:04 AM](#)

Co-Chair Stedman recalled that the initial issue to not have a timeframe, and felt that it should be timed out. Therefore, there was some concern about the amount of funds to issue without any legislative input. The legislature then took action He remarked that there was the issue of tax credits that were due by the state, and issuing bonds and then paying those bonds off. He remarked that there would be discussions about that issue.

Senator Wielechowski queried the impact of the state of the failure to pay those tax credit bonds once they are issued.

Co-Chair Stedman further requested the appropriator risk.

Mr. Mitchell noted that it would be categorized as a subject to appropriation obligation, similar to the certificate of participation program. He stated that there was a commitment to seek an appropriation every year, but

not required by law to make the appropriation. He stated that, in the instance of a failure to pay, there would be an expectation that the state's credit rating would diminish.

[10:35:28 AM](#)

Co-Chair Stedman understood the appropriation risk, related to the payments of the tax credit.

Mr. Mitchell stated that it was a fundamental risk of the investor.

Senator Wielechowski stressed that there was a statute in place, and the state had never not paid, and felt that it would not affect its credit rating.

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Mr. Mitchell stated that there would be a debt commitment made that should mirror the additional work that was currently authorized. He stated that over time the reality of oil price fluctuating would change what would be paid in future years.

Co-Chair Stedman stressed that there were various requests of information that he still hoped to examine the statutory requirement and what was actually paid.

#

ADJOURNMENT

[10:49:29 AM](#)

The meeting was adjourned at 10:49 a.m.