

SENATE FINANCE COMMITTEE
January 24, 2020
9:04 a.m.

9:04:54 AM

CALL TO ORDER

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

MEMBERS PRESENT

Senator Natasha von Imhof, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Click Bishop
Senator Lyman Hoffman
Senator Donny Olson
Senator Bill Wielechowski
Senator David Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Deven Mitchell, Dept Manager, Treasury Division, Department of Revenue; Senator Gary Stevens; Senate President Cathy Giessel.

SUMMARY

PRESENTATION: STATUS UPDATE - STATE DEBT SUMMARY AND CREDIT

Co-Chair Stedman indicated there were mechanical issues with the presentation screen. They would attempt to do the presentation without the technology. He indicated Senator Stevens and Senate President Giessel were also present. He reviewed the agenda for the meeting. He turned the meeting over to Mr. Mitchell. He asked him to provide some background about himself to the committee.

^PRESENTATION: STATUS UPDATE - STATE DEBT SUMMARY AND CREDIT

9:07:14 AM

DEVEN MITCHELL, DEBT MANAGER, TREASURY DIVISION, DEPARTMENT OF REVENUE, introduced himself. He had been in his position since 1998 - initially in an acting capacity and ultimately designated as debt manager among other things. Since early 2000 he had been the debt manager for the State of Alaska. He was raised in Alaska, went to school in Arizona, and returned to Alaska to work for the state. He indicated the intent of the presentation was to review the state's debt. He would also talk about debt capacity and the rating agency process. The state had a rating from the three major rating agencies. He would discuss their view of the state. He began the PowerPoint presentation: "State Debt and General Obligations." He referred to slide 2 to review the state debt obligation process.

Mr. Mitchell reported that all state debt had to be authorized by the legislature. The authorization, in certain instances and for general obligation bonds, had to be ratified by the electorate. The State Bond Committee - comprised of a commissioner from the Department of Commerce, Community and Economic Development (DCCED), the Department of Administration (DOA), and the Department of Revenue (DOR) - issued all state debt. The state also had a couple of other obligations that were based on a statutory framework consisting of a school debt reimbursement program and the capital reimbursement program (otherwise known as the DOT Program). Both programs were supported by municipal general obligation debt. They were ultimately payable by local revenues if the state did not have money or transfer money to communities on an annual appropriation basis. The state had been unable to transfer funding multiple times, most recently in the current fiscal year. It was not fully funded for the first time in 1983. In the early 1990s it was also not fully funded for a series of years. More recently, it had been fully funded allowing for capital investment for school projects around the state.

Mr. Mitchell indicated the other major category of obligation was related to the retirement systems of the state; The Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS). In the early 2000s unfunded liabilities were recognized. Since that time, there had been a series of actions taken to limit future liabilities, as well as address the outstanding liability. The objective was to work towards a fully funded pension

system which currently had an amortization that would end in 2028.

9:11:12 AM

Mr. Mitchell pointed to slide 3 of the numbered presentation which contained a table that came from the State Debt Book, an annual publication of the Treasury Division of DOR that was required by statute. The table was categorized from the highest to the lowest commitment of credit. State general obligations were listed first, and the state currently had about \$670 million outstanding, a reduction of about \$54 million from the prior year. The state had a declining outstanding balance on an annual basis.

Mr. Mitchell explained that the second category on the list was state guaranteed debt comprised of the Veterans' Mortgage Program which had to be voted on by the electorate for bonds to be issued. The program was managed by Alaska Housing Finance Corporation (AHFC) and was supported by payments made by the mortgage holders. The Veterans' that obtained mortgages through the program had paid all of the debt service related to the bonds. It allowed for tax exemption to be utilized for purposes of funding the mortgages. They had lower rates than what would otherwise be available. He reported approximately \$106 million outstanding presently which equated to a \$60 million increase from the previous year.

Mr. Mitchell continued that state supported debt, debt where the state committed its credit to pay on a subject-to-appropriation basis (not constitutional debt), was a debt recognized by the market. He noted a certificate of participation for a facility in Anchorage which had an outstanding balance of \$22 million - a reduction of \$2 million from the prior year. He also pointed out lease revenue bonds comprised of Goose Creek Correctional Facility and the parking garage in Anchorage through AHFC that had an outstanding balance of \$193 million - a \$10 million reduction from the previous year.

Mr. Mitchell moved to the state supported municipal debt which included the school debt reimbursement program and the capital reimbursement program. He indicated that for purposes of the publication and because there was a lack of clarity on how the program might evolve into the future, he

assumed it would be fully funded. He relayed that \$704.8 million remained outstanding for the school debt reimbursement program which was a reduction of \$65 million from the prior year and \$22.5 outstanding for the other program reflecting a reduction of \$3.5 million from the previous year.

Mr. Mitchell continued to review slide 3. He addressed the Pension System Unfunded Actuarial Accrued Liability. The numbers on the chart reflected the June 30, 2018 valuation for PERS and TRS. The numbers did not necessarily reflect all of the state's liabilities because there were several PERS employers and the state's percentage of the TRS employer category was relatively small. The numbers totaled about \$6.6 billion or \$6.7 billion as of June 30, 2018 which was a reduction of about \$260 million from the prior year mostly related to some actuarial adjustments made due to assumptions about health care or other post-employee benefits. He understood that there was a preliminary June 30, 2019 valuation which was slightly smaller, about \$6.5 billion. Fortunately, the number was not growing like it had in the past.

Mr. Mitchell continued to state moral obligation debt, another statutory framework required to support the items listed and recognized by the market. The existence of a reserve fund was required in statute as well as certain reporting requirements. The market recognized the structure in statute as a moral obligation, even though it was not explicitly backed by the state's credit. However, it was implied that in the event of a failure of the underlying credit to be able to pay, the state would step in to replenish the reserve fund. If the state failed to do so, it would have a reduction made to its credit rating. The largest borrower in the category was the Alaska Municipal Bond Bank, which primarily provided loans to municipalities for local capital projects paid back with local revenues. He reported about \$1.1 billion outstanding in the program which was a reduction of about \$30 million from the prior year.

Mr. Mitchell reported that the Alaska Energy Authority borrowing was for Bradley Lake on the Kenai Peninsula and the Alaska Student Loan Program. Both have reductions of \$10 million and \$12 million.

Mr. Mitchell moved to state revenue debt. He explained that revenue debt was difficult because of the prohibition on dedicating revenues. In order to dedicate revenue a pre-existing revenue dedication prior to statehood or a federally mandated dedication requirement had to be in place. He reported the state had been able to borrow under the the Sportfish revenue bonds because sportfish licensure fees were dedicated to sport fish management by federal law. He also noted the international airport revenue bonds which were in place and had debt outstanding prior to statehood. He added that the sportfish revenue bonds had about \$13.9 million outstanding as of June 30, 2019, a \$3 million reduction from the prior year. The remainder of the bonds were payable on April 1, 2020. The last time he checked there was about \$11.7 million available for the payment the final payment or optional redemption. He anticipated both of the debts being fully paid in calendar year 2020. The surcharge that was implemented to provide for the repayment of the bonds would be sunsetting. The cost of a sport fishing license would either go down or be repurposed.

Mr. Mitchell continued that the state bond committee issued the international airport system debt. The Department of Transportation and Public Facilities (DOT) managed the system with airport directors and a controller at the system level. He was currently working with the airport system on refinancing some bonds that would become callable on October 1, 2020. He reported there would be about \$100 million in bonds. The department projected saving in the current market to be about \$10 million to \$14 million. The department would be moving towards making air travel and the system more efficient into the future. The airport system and some of the interaction that had gone on behind the scenes during the great depression or the recession of the United States where transfers through the system for cargo from Asia to the Continental U.S. Under duress, the department was able to work with airport management to diminish the landing fee requirement for the system relatively significantly for a period of years through the use of resources and debt restructuring. It allowed the airport to remain more competitive than it otherwise would and retained traffic that it could have lost. He noted there had been a good relationship with the airport system.

Co-Chair Stedman noted that the two slides were combined [slide 3 and slide 4].

9:20:28 AM

Senator Bishop asked if all of the Alaska Energy Authority bonds terminated at the same time. Mr. Mitchell responded that there were multiple series of bonds. He mentioned the most recent issue related to a modest increase in megawatts of power in the dam's capability to generate power. He believed the termination dates were staggered but would have to get back with the committee with specific dates.

Co-Chair Stedman asked Mr. Mitchell to get back to the committee with a response to all of the questions resulting from the current hearing.

Senator Olson highlighted the state supported municipal debt in the middle of the slide. He queried how the figures were impacted by the school debt service vetoed by the governor past the June 30, 2019 date.

Mr. Mitchell replied that the balances listed on the slide were outstanding balances. He clarified that the annual debt service was impacted by the veto. The annual debt service associated with the school debt reimbursement program was about \$100 million, \$50 million of which would be paid by local jurisdictions. The other capital project program reflected a 100 percent reduction. The annual debt service in FY 20 was about \$4 million to \$4.5 million. The amount would be paid by rate payers because of certain enterprise activity that was included in the program such as electrical generation projects and port and harbor projects. There were also some general obligations that would be paid by local revenues.

Senator Olson asked what would happen if the vetoes were over-ridden. Mr. Mitchell indicated it would not change the current numbers. However, the municipalities that had already paid a portion of their debt service, in essence, would receive a windfall because they were anticipating not receiving the 50 percent reimbursement.

Senator Olson clarified, "That's if the override is sustained." Mr. Mitchell responded, "That's correct."

Senator Wielechowski asked if the Treasury Division considered the oil tax credits to be a debt. Mr. Mitchell indicated the department considered them an obligation.

However, it was not something the division included in the current spreadsheet. He explained that the reason debt, but they were not reflected in the spreadsheet. The reason the division considered them an obligation was because they were included in the state's net position analysis. The document was a working document. Previously, the division did not include information on PERS or TRS liability. It would be something that was worth considering including in the summary.

Co-Chair Stedman asked a clarifying question about Senator Wielechowski's query. He commented that when things were settled, it would be a bond issue or, the state would payout cash. He wanted to make sure the committee understood the full position of the state.

Senator Wielechowski suggested that if the state were to win the lawsuit, it would be considered a debt. He inquired about the effects of the state's failure to pay. He wondered if the state's credit rating would be affected. Mr. Mitchell did not believe it would.

[9:25:56 AM](#)

Mr. Mitchell moved to slide 4 which was a continuation of the summary of the total debt in Alaska as of June 30, 2019. He spoke about the University of Alaska (UA) debt. He relayed that the UA debt was supported by revenues derived by the University. There was about \$287 million in a couple of categories and, there was a reduction of about \$13.5 million in the prior fiscal year.

Mr. Mitchell moved to the topic of state agency debt. He reported that they were obligations that were not back-stopped by the State of Alaska but were issued by entities that the State of Alaska created. The Northern Tobacco Securitization Corporation, a subsidiary of AHFC, was specifically created to place any liability further from the state because the bond issuance was supported by a sale - a portion of a settlement agreement that the state was a party to in exchange for a one-time payment. The Treasury Division did not want to expose the state to potential diminishment in the future by paying the debt service out of other resources in the event that the settlement agreement revenues were deficient. He would not expect the state to attempt to pay the debt in the event of a default unless there were other policy matters that warranted such

considerations. He reported a reduction of about \$40 million for state agency debt leaving \$440 million outstanding to-date.

Co-Chair Stedman noted there had been concern about the potential issuance of bonds that had already been approved by the legislature. He thought the dollar amount was in the billions. He would like an update on the issue. He recognized that some of the authorities such as the Alaska Railroad would never issue them for various reasons. He suggested it would be a good idea for the committee to be briefed. He thought the amount was staggering.

Mr. Mitchell clarified that the Alaska Railroad authorization was for a natural gas pipeline. There was the potential for them to access a tax exempt bond even though there was private activity. He asked if the Co-Chair was talking about any authorization that was currently outstanding, which would be a wider net. For example, pension obligation bonds were authorized up to \$1.5 billion and would be paid by the State of Alaska.

Co-Chair Stedman interjected that he would include the pension obligations and the railroad issue, as they were colossal and had no expiration. He thought there was an oversight on the part of the committee. He suggested expiration dates should be in place. Mr. Mitchell agreed with the Senator.

[9:30:41 AM](#)

Mr. Mitchell discussed slide 5 which showed the mature nature of the state's general obligation debt program. He highlighted the declining outstanding debt service each year. It declined an average of about \$40 million per year. The structure was viewed as very conservative and had the potential for significant additional borrowing power with the stability of revenue. He provided an example of having an outstanding balance of \$500 million in bonds. If the numbers were filled out to 2028 at the same level, the state would use about half of its potential capacity. He reported that when he talked to rating agencies and investors, he highlighted the strength of the state illuminating that the state had a net debt service of about \$78 million that would decline to about \$12 million per year during the same period.

Mr. Mitchell continued to slide 6 regarding the current general fund annual payment obligation. It reflected the full amount of debt. The two charts that were included were designed to show how relatively insignificant all of the state obligations were in comparison to the PERS/TRS liability. He pointed to the chart at the top of the page which showed the general fund paid debt service by category. The categories included state general obligation debt, state supported debt, and state supported municipal debt. The chart reflected the full amount of municipal debt and a timeframe from 2000 to final maturity. It was a historical and perspective chart. He highlighted that the largest category of debt service was school debt - on the reimbursement side rather than on the state side. The state was currently about \$100 million on each side; \$100 million of state supported debt and \$100 million of reimbursement. It would diminish gradually through 2038.

Mr. Mitchell continued to the chart on the bottom of slide 6. It was difficult to see where the \$200 million in 2020 existed. He indicated it was beneath the blue that extended out through 2040. The blue represented the PERS/TRS commitment to the state. If there was a way to consider addressing the PERS/TRS liability it would be beneficial to the state and the state's credit. It was universally noted that Alaska had a relatively large unfunded pension liability in relation to the state's population and the size of its economy.

[9:34:05 AM](#)

Senator von Imhof asked for clarification of Mr. Mitchell's use of the term, "relatively large" in reference to Alaska's population size. She noted periodicals that compared all 50 states regarding whether they were under water. Generally, Alaska was in the middle of the road. She asked if Mr. Mitchell viewed Alaska as being under water relative to all of the 50 states.

Mr. Mitchell replied that he had not studied all 50 state pension systems. However, he was aware that when rating agencies looked at Alaska's pension liability, they tended to use a lower discount rate. Instead of assuming Alaska was going to earn 7.38 percent, they assumed the state would earn something less as a conservative measure of their analysis. They also compared the liability, amortizing it in a way they viewed was appropriate. In some

instances, it was thought Alaska's amortization schedule was too long and that the state was not keeping up with the interest that was accrued in certain scenarios. He provided an example. He reiterated that relative to Alaska's population size and its economy, analysts tried to homogenize between states. Although Alaska had a sidebar of extraordinary wealth from oil generation and investment income, analysts tended not to incorporate it into their score cards. As a result, the state ended up with a mention in its credit reports that it was relatively less off because of pension liabilities.

Co-Chair Stedman commented that some members had concerns over the reduction of the annual contribution to the pension plan over the past few years. He suggested that some of the restating of schedules lead to the state's current situation. However, he thought virtually discounting the state's Permanent Fund was a huge oversight. Alaska was the only state with such a magnitude of wealth per capita. He argued that the state was not going broke any time soon and suggested that the public should not stay up too late worrying. The state was not going to skip out on its obligations because of its wealth accumulation.

Mr. Mitchell highlighted the note on slide 6 of other existing authorizations. He pointed to the final bullet showing \$300 million for the Knick Arm Crossing. The authorizations were limited to those obligations that the state would likely pay for from the general fund. The Knik Arm Crossing authorization was still on the books and was envisioned as a subordinate lien on toll collections of a project to build a bridge across the Knik Arm. It was anticipated that tolls would be insufficient to cover the debt of the project. Even though there would be a pledge, the state's commitment of an appropriation subject to approval would backstop the bonds. He indicated the legislature could fully anticipate paying the debt service from the general fund. He reported a remaining \$110 million authorization for general obligation bonds relating to the 2012 transportation act, a \$1.5 billion pension obligation bond authorization, and \$1 billion tax credit bonds authorization.

[9:39:38 AM](#)

Senator Wielechowski queried whether the authorizations affected the state's credit rating. Mr. Mitchell answered that it was noted from time-to-time. The rating analysts sometimes forgot if a specific authorization was not brought up. It was something that could influence the ratings discussion. However, it was not brought up day-to-day.

Co-Chair Stedman would wait to see what the list looked like when Mr. Mitchell got back to the committee. The committee might want to have a separate hearing on the matter. If it was of interest to the committee, he would put forth a recommendation to try to reign some of it in or at least put a window of termination in place.

Mr. Mitchell believed it would be a good thing to pursue because otherwise he would find himself crosswise with the legislature. He elaborated that when something was authorized it was assumed that it could take place. However, in many ways, if something was not done within 1-2 years of authorization, it would obligate the state to carry a financial commitment of funds to be paid out of the general fund. He suggested that perhaps it was something the legislature should have to reauthorize.

Co-Chair Stedman indicated the committee would look at the issue and talk to the commissioner of DOR to get his thoughts. He confirmed it was something to pay attention to.

Mr. Mitchell moved to slide 7 which discussed the existing state short-term debt obligation alternatives. He highlighted bond anticipation notes - debt authorized by the legislature and eligible for issuance. If the state did not want to issue long-term debt for management reasons, bond anticipation notes could be issued for a short-term. The state issued them in 2014, 2015, and 2016 for the 2012 transportation act, a management tool for financial reasons.

Mr. Mitchell reviewed revenue anticipation notes, a tool where statutes allowed the state to borrow money in years where there was a cash deficiency. He thought the subject dove-tailed into other discussions regarding the Constitutional Budget Reserve (CBR) and how it had been utilized historically. There was the potential of a financial benefit from using revenue anticipation notes. He

elaborated that the largest municipality in the state, Anchorage, issued a tax anticipation note annually even though it had enough money to pay for its fiscal year needs, it borrowed intra fiscal year because it could borrow tax exempt and could keep its money invested taxably, requiring a taxable rate. The difference between the two rates was extra revenue for municipalities to utilize. The difficulty in the state using revenue debt application notes was that all revenue had to be included - not revenue that the state categorized as revenue. If revenue was included from the Revenue Sources Book (money being saved or not categorized as being available) the state would not be viewed as having a deficit in the governor's proposed FY 21 budget. Therefore, the state would not be able to borrow on a tax exempt basis in the scenario. The state had not used revenue anticipation notes since the late 1960s.

[9:44:42 AM](#)

Senator Hoffman pointed out that Mr. Mitchell had mentioned the CBR account, which the state was obligated to repay each year. He asked if an amount was noted anywhere that the state was obligated to pay the CBR.

Mr. Mitchell indicated it was not noted because it was an obligation that the state was lending to itself. Although there was a constitutional framework for the CBR, there was an allowance within the framework that permitted the state to ignore it. The state had opted to disregard it which was the reason the state had not already repaid it.

Senator Hoffman asked for the amount. Mr. Mitchell responded that it was about \$10 billion.

Co-Chair Stedman remarked that there was no interest charge, as it was held within the state's accounts. The state borrowed from itself at no interest and with no timeline for repayment. He reported that at one time several years ago the state had paid the money back and accumulated a significant increased amount. At \$10 billion, he did not think any debt payments would be made anytime soon.

[9:46:34 AM](#)

Mr. Mitchell concluded the overview of the state's outstanding debt. He moved to the topic of state debt capacity beginning on slide 10. He noted another publication that his office generated annually, "The Debt Affordability Analysis." The publication was required in statute. He spoke of the difficulty in recent years of producing the publication because of the evolution that had been underway within the state as far as how revenues were categorized and what they were. He noted SB 26 [Legislation passed in 2018 establishing a percent of market value (POMV) draw] had a most impactful change. He suggested that even with SB 26 in place, the lack of structure around revenue made it difficult to determine how much money was available and how much was off the table.

Mr. Mitchell continued that in 2019, the division reduced some of the ratios used from 5 to 4 percent and 8 to 7 percent, to determine the state's potential debt capacity. In his view, even with the reductions it might overstate capacity without a downgrade in the state's current situation. The ratios churned out a capacity of about \$2.8 billion over the next 10 years, a huge number. However, straightaway the state had \$1 billion of authorization for a tax credit corporation structure as well as having \$100 million in authorized general obligations yet to be issued. The reduction brought the state down to about \$1.7 billion of theoretical capacity. However, it would be much easier if there were additional sideboards regarding how the state was moving into the future than were currently in place. He opined that it was a difficult task. He noted structure was good, and structure with flexibility was better. He continued that being able to betray that into the future was critical to forecasting what the state might be able to do in the future. He reported that the publication discussed a number of aspects related to capacity and was available on the Division of Treasury's website under debt management.

Co-Chair Stedman commented that when Alberta, Canada dealt with imploding oil prices and ran significant deficits, they borrowed money to fill the hole rather than reducing their operating budget. They were currently in a predicament that they might not get out of. He thought the state might have extra capacity, but there was a concern with piling on more debt.

Mr. Mitchell agreed that the debt made sense particularly in Alaska's construct with a large invested tax exempt fund. It allowed the state to borrow tax exempt against itself as long as the state had structure and it was borrowing for things it would have otherwise paid for. It was very difficult given the state's current make-up. He indicated it was part of a rational ongoing program that made financial sense to take advantage of debt to allow the state to retain resources. However, it should not be in addition to what the state would otherwise do.

[9:51:24 AM](#)

Mr. Mitchell continued to slide 10 which was a lookback at the past and described how the change from SB 26 changed ratios from the Fall 2017 forecast to the Fall 2019 forecast. He highlighted that the revenue expectation went from \$2 billion to \$2.8 billion to an expectation of \$5 billion to \$6 billion. The change was due to the inclusion of the POMV transfers from the Permanent Fund. If the POMV transfer was backed out, it would reduce capacity. He noted the blue charts on the slide. He pointed to 3.17 percent in 2020 with a cap of 5 percent to determine the incremental capacity to borrow. He also pointed to 6.4 percent in 2020 with a cap of 8 percent. Comparing the 2 amounts, the debt capacity was a much lower; \$622 million to \$1.2 billion in total. When the POMV transfer was backed out, it had a significant reduction in capacity. Arguably, authorized debt would fully utilize the capacity. He thought it highlighted the importance of having debt structure around how the POMV revenue would be available.

Mr. Mitchell pointed to the revenue forecast and budget outlook on slide 11. Historically, the state had used the slide because of the way the state categorized revenue. He commented that conservatism had been baked into the state's structure. In the 1990s the division would have approached a deficit by looking at how much to draw out of the CBR. For instance, if the deficit was \$200 million the state would have looked at how much was earned and the amount of deposits in the CBR. If the amount earned in the CBR was \$400 million and the deficit was \$200 million, there would have been a net draw of \$200 million, which did not include the Permanent Fund at the time. Today, the state had a rejiggering as a result of SB 26. Currently, certain revenues such as the POMV revenue from the Permanent Fund was included. However, it was not total revenue but

anticipated revenue by the Alaska Permanent Fund Corporation (APFC). The revenue sources book reported about \$1.3 billion that was expected to be earned in FY 21 and categorized as restricted.

Mr. Mitchell continued that under the structured draw scenario, it was available for appropriation. It was money coming in rather than going out. Although the division shared the revenue information, it was hidden in the Revenue Sources Book. In addition, there were deposits and earnings into the CBR and deposits into the Permanent Fund (some of which were constitutionally mandated and some of which were statutorily mandated). The combination would result in the state potentially saving more money than the state declared as a deficit in FY 21. He reiterated that the state credit to third parties was hidden in the publications and difficult to draw out at times.

Co-Chair Stedman asked Mr. Mitchell to use the term "less apparent" rather than hidden.

[9:56:38 AM](#)

Mr. Mitchell moved to slide 12 showing the January 2020 Debt Affordability Analysis inputs. Included was the general obligation debt service from FY 20 through FY 29. Lease purchase payments were also included as well as the capital leases, school debt reimbursements, capital project reimbursements, and the projected PERS/TRS payments. They flowed down into the lower chart that turned the percentages of UGF as characterized in the Revenue Sources Book. The state was below its targets for both the 4 percent and 7 percent caps. As far as including the pension fund obligations, it dwarfed the other debt commitments of the state. However, the percentage of revenues that might be paid for outstanding debt service and past pension fund liability was within the parameters of other states. The state was in a neutral or net category for payment percentages.

Co-Chair von Imhof suggested including a total on the far right. Mr. Mitchell agreed. Co-Chair von Imhof appreciated Mr. Mitchell's comment about the state being neutral or net. She thought it was nice to see how Alaska compared to other states.

Co-Chair Stedman indicated that the committee had consumed two-thirds of the time allotted for the meeting and had only reviewed 50 percent of the presentation. He wanted to finish up the meeting within 25 minutes. He invited the presenter to speed up his pace.

[9:59:08 AM](#)

Mr. Mitchell touched on slide 13 which he had already discussed. He would expand the list to include other obligations that were not necessarily created by the State of Alaska. Slide 14 showed the Alaska tax credit bond corporation history. It was created due to the 2016 scenario where the historical practice of paying most of the tax credits annually was no longer feasible. At the time, the state started paying based on the statutory formula. It was not anticipated by industry and resulted in duress. The corporate structure was derived with the state's and credit holder's interests in mind. In other words, there was a financial benefit to the state and to the credit holders. He elaborated that the payments that would be made would be discounted from the stated accrued value. He referenced the third bullet on the slide which noted that in the Fall 2019 Revenue Sources Book the \$739 million currently accrued would diminish to somewhere between \$583 million and \$660 million depending on the discount rate, given the numbers in the book at the time. The state benefited significantly, and capital relief was provided to industry. He hoped it would allow industry to do more in the state. The constitutionality was questioned for the corporation and was currently in the Supreme Court ripe for a decision.

Co-Chair Stedman commented that the committee had the information mentioned two days prior and would be watching the case. It might be that the budget would have to be modified before the end of session.

Mr. Mitchell reported that the department had done work to prepare for the potential of a positive ruling. If the ruling was passed the division would anticipate trying to issue bonds in the current year. The market would expect the legislature to revalidate the structure by having a debt service appropriation in FY 21, as it was a subject to appropriation commitment. Given some of the past disagreements between an administration and a legislature, he asserted it was important to have solidarity.

Mr. Mitchell turned to slide 15 showing the state security structure. He highlighted the agreement between DOR and the corporation. The agreement would result in the proceeds of the money that bond holders gave the corporation in exchange for their bonds. The bonds would be transferred to DOR to pay the determined amount for the outstanding credits in exchange for a contractual commitment to make annual payments to the corporations.

Co-Chair Stedman indicated the subject could be discussed at a later time when the appropriation was before the committee.

Mr. Mitchell continued to slide 17 showing the state's credit rating compared to other states. The state's credit rating had slid since 2014 and the decline of the price of oil. Some of the credit diminishment that the state incurred was a result of the difficulty in defining how the state would move forward. Presently, the state's ratings were strong: Aa3, AA, and AA-. Alaska was in the lower 20 percent rather than the top 20 percent of state credit ratings.

[10:03:53 AM](#)

Senator Wielechowski asked about the stability of ratings for states such as Illinois with a rating of Baa3, BBB-, and BBB. He noted Illinois was stable compared to Alaska and wondered why.

Mr. Mitchell explained that it was a designation the rating agencies used. The ratings had an implied probability of a ratings action in the future. Moody's assigned a negative outlook on Alaska not long before Fitch downgraded Alaska without putting it on any watch. It was a result of the difficulty the state had in getting a capital budget and an operating budget passed with a CBR agreement in place. He talked with analysts from Moody's and Standard and Poor's after the Fitch rating action was taken. He reported that both rating agencies were watching carefully. They were aware of the legislative session start date and of the governor's budget proposals for the coming fiscal year.

Mr. Mitchell continued to slide 18 regarding credit rating challenges. The slide was in response to an investor presentation he had attended in May 2018. He had not been

to another investor presentation since that time. He spoke to a group of investors about the state. He received feedback that people had misperceptions about the State of Alaska. They thought Alaska was running out of money, oil was the only source of revenue for the state, and it would never balance its budget. He provided a series of facts to offset the misperceptions. He had some success in dispelling the misperceptions, however, it was still difficult because of the use of mass media.

Mr. Mitchell moved to the rating agency challenges on slide 19. He spoke of the political paralysis of the legislature. He mentioned the 2 extended sessions in 2019 and the contentious issues taken up in the sessions. The sessions resulted in a diminished budget with some adjustments to the diminishments that were initially suggested. There was a near balanced budget even though there was some reliance on the CBR and the Statutory Budget Reserve (SBR). In his view, they were offset by projected deposits into the CBR. In essence, there was a net neutral budget that was agreed upon even though it was difficult. He furthered that the governor had some proposals that were viewed credit negative that were not all approved. The legislature also had some proposals that were viewed credit negative that were not all approved. The melding, in his view, was positive.

Mr. Mitchell continued that he was surprised when Fitch downgraded the state. He thought the basis for Fitch's downgrade had more to do with potential outcomes, rather than fact. He was discouraged by the downgrade. He noted the influence of the pension obligation bonds and the structural undesignated general fund imbalance. The state tried to offset the obligations by reporting it had other money. However, it was difficult to persuade the rating agencies. There was also concern with Alaska's revenue related to petroleum and potentially being outsized. He explained further that in order to reach 80 percent to 90 percent of UGF coming from oil revenue, Fitch went back to 2014 in its report. He opined that it was shoddy work on the part of Fitch to imply that Alaska was totally reliant on oil revenue from a 2014 revenue situation.

[10:10:54 AM](#)

Mr. Mitchell pointed to the credit rating challenges on slide 20 and noted the unrestricted surplus deficit. He

highlighted that the state was in deficit from 2013 forward continuing into 2020 and projected into 2021. He pointed to the far righthand column that showed the change in net position. He emphasized that the net position was only negative for a period of 2 years due to the strong structural make-up mandating that the state saved money. The state was saving more than its deficit.

Co-Chair Stedman asked Mr. Mitchell to restate his comment. Mr. Mitchell obliged. He explained that the category the state referred to as unrestricted general fund did not include all revenue, just some. Some revenue that was available for the legislature to expend was not included as unrestricted revenue. He continued that there were valid reasons why the funds were categorized as they were. He was not suggesting that the construction should be changed. He suggested that, although the state had an unrestricted general fund imbalance, in total the state had a surplus.

Co-Chair Stedman asked how the Earnings Reserve Account (ERA) and the POMV payout factored into the picture. Mr. Mitchell responded that the Permanent Fund impacted it hugely since it was such a significant category of revenue. He was not suggesting that the POMV structure should be amended, changed, or not followed. He suggested that the legislature should recognize that the Permanent Fund for the coming fiscal year was anticipating revenue that exceeded the draw by \$1.3 billion.

Co-Chair Stedman asked if Mr. Mitchell was talking about the current fiscal year, not the 5 year averaging of the POMV. Mr. Mitchell responded, "That's correct."

Co-Chair Stedman expounded that in looking at all revenue in the siloed year relative to the expenditures in the same year, the state would have a surplus under the methodology. Mr. Mitchell replied, "That's correct."

Senator Hoffman asked if the Permanent Fund ERA was taken into consideration when looking at the last column [Slide 20]. Mr. Mitchell responded that the chart did not show the fund balance. It showed the projected earnings or revenue.

[10:14:18 AM](#)

Mr. Mitchell moved to slide 21 and noted the difficulty of comparing Alaska to other states because of the Permanent Fund. No other state had a permanent fund like Alaska did or the size of its budget relative to population. The Permanent Fund was not reliant on Alaska's economy to generate revenue. Alaska was no longer like states such as California or New York that generated revenue from their economy. Alaska received revenue based on a world economy through the Permanent Fund - a unique situation among the states. He had broached the discussion with rating analysts.

Mr. Mitchell provided detail on the Alaska job economy turning to slide 22. While Alaska was in recession and had job losses over the last several years, the rest of the states had a strong resurgence in their economies and very low unemployment. Alaska's unemployment was much less volatile than other states. Looking historically at the number of years that the State of Alaska had added jobs, it ranked number 3 in stability. He argued that while Alaska's unemployment had not been a rosy picture in the past couple of years, it appeared to be better in 2019 without any large spike up or down. He did not think it was appropriate for the state to receive black marks for having the highest unemployment in the country. Alaska went from 7.2 percent to 8 percent when the rest of the country went from 10 percent to 4 percent.

[10:16:34 AM](#)

Mr. Mitchell continued to slide 23 which showed the CBR, SBR, and ERA balances on a timeline. He emphasized that while the CBR (the state's historical reserve fund) had been used for intra-fiscal year capital and funding for fiscal year expenditures, the ERA had significant growth during the same timeframe. He suggested that while the state did not want to spend it, it was still a reserve. The large drop in 2019 was the POMV draw in conjunction with the \$4 billion that was used for inflation-proofing. The money was still in the fund but no longer available for appropriation.

Co-Chair Stedman thought the Senate Finance Committee was interested in putting more money into the corpus of the Permanent Fund. He suggested the amount would be in excess of \$1 billion. He indicated the committee would have some future discussions on the subject. He thought the amount

would be a significant contribution to the protected portion of the fund. The committee would work with the administration to acquire support to ensure a transfer was signed into law.

Mr. Mitchell commented that from a policy perspective it would be an acceptable decision. He was aware that Fitch had conducted significant analytics on the ERA and the Permanent Fund. He thought Fitch was unrealistic on some of its analytics from his standpoint. He thought it was unrealistic to assume that the state would not make any changes if it experienced a series of bad years. He understood the concern about the ability of the ERA to sustain the state in the event of need in the period of multiple years over a negative cycle. He was not suggesting that legislators' policy decisions should not be to restrict money by transferring it to the principle. He was just relaying information.

Co-Chair Stedman did not think the legislature's policy direction would be to transfer so many funds from the ERA to the corpus that it would hinder the state's ability to pay dividends and operate. He thought the purpose of the transfer would be to inhibit the ability to liquidate the ERA - which would be an easy course of action.

[10:20:02 AM](#)

Senator Hoffman asked Mr. Mitchell, as the state's debt manager, how he would decide to put funds into the corpus versus paying off a portion of the state's unfunded PERS and TRS liability.

Mr. Mitchell responded that there would be an immediate positive effect from paying down the pension obligation fund. Shifting money to the principle of the Permanent Fund was a wise thing to do. He advised not overspending as a result of not restricting certain categories of money. However, in the short-term, it would have more of a negative impact because it would be viewed from the perspective of flexibility in the event of a negative experience in the future.

Co-Chair Stedman suggested that in the event of a catastrophic event, such as financial failure or an act of mother nature, the people of Alaska could allow access to the funding. He continued that there would have to be a

significant reason to access the funds, rather than a political whim.

Mr. Mitchell indicated he was finished with his presentation.

Co-Chair Stedman thanked Mr. Mitchell for his presentation. The committee would be inviting him back for additional information as the debt manager of the state. The committee would also be hearing from APFC, DOR, and other entities. He reviewed the agenda for the following Monday, January 27, 2020. He also reviewed other topics that would be heard throughout the following week.

#

ADJOURNMENT

10:24:37 AM

The meeting was adjourned at 10:24 a.m.