

HOUSE FINANCE COMMITTEE
March 2, 2021
1:33 p.m.

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CALL TO ORDER

Co-Chair Merrick called the House Finance Committee meeting to order at 1:33 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Kelly Merrick, Co-Chair
Representative Dan Ortiz, Vice-Chair
Representative Ben Carpenter
Representative Bryce Edgmon - Via Teleconference
Representative DeLena Johnson
Representative Andy Josephson
Representative Bart LeBon
Representative Sara Rasmussen - Via Teleconference
Representative Steve Thompson
Representative Adam Wool

MEMBERS ABSENT

None

ALSO PRESENT

Deven Mitchell, Executive Director, Alaska Municipal Bond Bank Authority, Department of Revenue; Pam Leary, Director, Treasury Division, Department of Revenue.

PRESENT VIA TELECONFERENCE

Lucinda Mahoney, Commissioner, Department of Revenue; Mike Barnhill, Deputy Commissioner, Department of Revenue.

SUMMARY

CONSIDERATION OF GOVERNOR'S APPOINTEES: COMMISSIONER LUCINDA MAHONEY, DEPT. OF REVENUE

PRESENTATION: SAVINGS ACCOUNT AND STATE DEBT AND INVESTMENT FUNDS BY DEPARTMENT OF REVENUE UPDATE ON THE STATE'S CASH RESERVE FUNDS AND STATE CASH FLOWS DISCUSSION: DEPARTMENT OF REVENUE

Co-Chair Merrick reviewed the agenda for the afternoon.

^CONSIDERATION OF GOVERNOR'S APPOINTEES: COMMISSIONER LUCINDA MAHONEY, DEPT. OF REVENUE

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LUCINDA MAHONEY, COMMISSIONER, DEPARTMENT OF REVENUE (via teleconference), explained that she was appointed to the commissioner position for the Department of Revenue (DOR) in February 2020. She had participated in a previous confirmation hearing with the House Finance Committee remotely and was pleased to be before the committee in person. In her comments she would provide a brief overview of her education and her work history. She would also share a few of the accomplishments that her team at DOR had achieved over the prior year. At the end of her remarks, she would be open to questions.

Commissioner Designee Mahoney had a bachelor's degree in business administration with a concentration in finance from the University of Texas. She also had an MBA from the University of Alaska Anchorage and a couple of certifications. She was a certified valuation analyst which enabled her to conduct business evaluations for mergers and acquisitions. She also studied at Wharton School at the University of Pennsylvania and received a certificate in portfolio analysis. As a self-directed learner she continued to study based on where she worked.

Commissioner Mahoney moved to the topic of her employment history. She worked in Alaska for more than 35 years in both the private and public sectors. She began her career in the oil industry where she spent the majority of time working for Atlantic Richfield Company (ARCO). She worked there for 14 years in the areas of finance, accounting, budgeting, reporting, and information technology (IT). At one time she was appointed as the onsite Prudhoe Business Manager as well as the onsite Kuparuk Business Manager where she was able to learn about the detailed operations of the fields. Additionally, she did much of the cash flow forecasting for the company.

Commissioner Mahoney continued that she was recruited to join KPMG, a big 4 global audit and advisory services firm. Her title was "Director of Advisory Services." Her goal was to grow and manage the consulting practice for all industries in Alaska including Native village corporations, Alaska regional corporations, publicly traded companies, and municipalities. She also did a project for the State of Alaska. She provided entities with advice related to process improvements, business valuations, litigation support, forensic investigations, internal controls, and benchmarking projects. The position was very valuable to her, as it opened her eyes to the many businesses in Alaska. She highlighted that while working in the oil industry she realized her view had been insular. She appreciated the insights she gained while working at KPMG.

Commissioner Mahoney moved on the Arctic Slope Regional Corporation where she was the director of shared services managing the back office operations for the various subsidiaries. Specifically, she was in charge of accounting, IT, human resources (HR), procurement, facilities management, and insurance and risk. After leaving the Arctic Slope Regional Corporation, she started her own financial consulting company. In her management company she provided many of the same services she had referenced to many of the same companies she had worked with as an employee and at KPMG.

Commissioner Mahoney received a call from Mayor Dan Sullivan who asked her to become the chief financial officer (CFO) of the Municipality of Anchorage. She was initially hesitant because she did not have public sector experience but was convinced to give the job a try. She was responsible for the management of treasury, property assessment, public finance, debt, procurement, the controller's department (accounting), IT, cash management, and the 49th State Angel Fund. She started out in the position in 2009 and was there until 2014. A few of her accomplishments while at the Municipality of Anchorage related to achieving an AAA credit rating. Everyone in the organization worked together to attain the incredible achievement. Additionally, she established the 49th State Angel Fund which was funded by the Obama Jobs Care Act from 2010. She explained that the 49th State Angel Fund helped the start-up of small businesses. After she left the municipality, she returned to her financial consulting

firm, Value Solutions. She had her own companies and invested in other small companies.

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Commissioner Mahoney was a family focused mom. She thought of herself as a working mom. She and her husband had six children and provided a home to five additional kids in a foster-like environment. She continued to support them as they were launching into their careers.

Commissioner Mahoney relayed that when she was first contacted about her current job as the commissioner designee of DOR, she was concerned about the potential conflicts associated with her husband's law practice. As a result, an ethics screen was established by the chief of staff and the Department of Law that prevented her involvement with any potential conflicts. It had been in place for over a year and was working well. She would continue to avoid conflicts at all times.

Commissioner Mahoney felt fortunate to be a part of her team. Her team members were professional, knowledgeable, and generous with their time. She wanted to share some of the group's many accomplishments in the past year. First, the team established an investment advisory committee as the result of a legislative audit relating to a matter that occurred prior to her arrival at DOR. She explained that the commissioner of the Department of Transportation and Public Facilities (DOT) had fiduciary oversight over the general government funds which were about \$7 billion. It was a significant amount of money for one person to oversee.

Commissioner Mahoney reported that the funds were managed and invested by the Treasury Division. However, the department had set up some additional external oversight in governance control over some of the funds. Her team established an external committee of professional investment advisors to help provide guidance and insights. The committee met quarterly and had already met twice since it was established. The meeting notes would be posted online and anyone who was interested could read what the committee was discussing.

Commissioner Mahoney continued that her team had also made regulation modifications including one that had had a

profound effect on Alaska's communities. It had to do with online charitable gaming that was implemented as a result of Covid. It enabled charities to be able to continue to raise funds for their organizations while most communities had been shut down.

Commissioner Mahoney relayed another accomplishment by her team. They updated the department's strategy document in a collaborative manner involving division managers. As a result, each division had specific goals, objectives, and initiatives. The department monitored the results and had established performance metrics and benchmarks allowing the department to identify where help was needed and where things were going well.

Commissioner Mahoney noted that although DOR was a small department in terms of the scheme of the state, she managed the department closely. Mr. Fletcher, who managed the department, could operate in an environment of thrift. She was available for questions.

Representative LeBon thanked Commissioner Mahoney for her presentation. He wondered what she noticed about the department that stood out to her upon her arrival. Commissioner Mahoney thought it related to the quality and caliber of the staff who were in the department when she arrived. She felt very fortunate to have the leaders who knew their divisions well. They knew the issues and what needed to be addressed.

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Representative Rasmussen asked about the plan for gaming. She wanted additional information. Commissioner Mahoney responded that the department issued a request for proposal (RFP) the scope of which was to hire a consultant to evaluate gaming in Alaska. She had been talking with various experts throughout the United States. They advised that there would be one shot to do it correctly from the beginning. She asked the consultant to do a comprehensive socio-economic evaluation of gaming in Alaska. They would study trends in other states comparing them to Alaska and determine whether the trends would be effective in the state. For example, the department would look at the number of casinos that might benefit the state and the amount of revenue that could be generated.

Commissioner Mahoney continued that another example would be the type of games that would be appropriate depending on the goals of the initiative. The initiative was to diversify and create a new industry creating new jobs and potentially new infrastructure in the state. The consultant would also enable a real discussion with stakeholders about how gaming would affect them. She would talk to the charitable gaming industry to try to help them understand the direction of the governor. They would also assist in the development of draft legislation as well as regulation.

Representative Rasmussen thanked the commissioner for her response. She was excited about the opportunity to bring in additional revenues especially with the drop in the state's oil revenue. She appreciated DOR's initiative, as it was important for Alaska to expand its industries. She did not believe the state would be another Las Vegas, but it was an opportunity to compliment the state's already strong tourism industry in typical years. She thanked Ms. Mahoney for stepping up to serve. She was an accomplished Alaskan woman. She was honored to have her as the state's acting commissioner for DOR.

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Representative Josephson noted the commissioner mentioned regulatory changes to the state's current charitable gaming. He asked if the changes were designed to lay the groundwork for the governor's interest in expanding to more sophisticated gaming. Commissioner Mahoney replied that she had misspoken. The department had not changed the regulation, rather they adopted online charitable gaming through the disaster declaration.

Representative Josephson had a question about the governor's initiative. He asked if she was pursuing it at his direction. Commissioner Mahoney responded, "That is correct."

Representative Josephson asked if there were other revenue measures the department was considering outside of gaming. Starting next fiscal year, the governor intended to have \$1.3 billion in new revenue, and he did not know what that was. He wondered if she could share anything. Commissioner Mahoney answered that as the commissioner she would do everything she could to work collaboratively with the legislature to forge a path forward. She opined that the

state was in a pivotable position fiscally, and that action needed to be taken soon. It would be up to policy makers to determine a timeline.

Commissioner Mahoney thought the issue needed to be addressed in a phased approach. First, it was important to recognize that the state was currently in a recession with high unemployment. The governor's goal was to stabilize the economy. The governor proposed \$350 million in bonds and the additional stimulus from the Permanent Fund (PF) earnings reserve account (ERA). Once the economy was stabilized, the state would need to look at all potential revenue sources. She indicated the governor believed that there was a structural imbalance. As a result, he submitted a bill for structural changes. There were 3 constitutional changes relating to the establishment of a spending cap, enshrining the dividend in the constitution, and requiring a vote of the people for any new broad-based tax. The state would be positioned to discuss specific revenue sources once the legislation passed and was implemented.

Commissioner Mahoney noted that in the previous summer she had done a presentation to Common Wealth North. In that presentation the topic was potential new revenue sources. She was happy to supply the information to members. It identified revenue sources, different taxes, and dollar amounts for the taxes.

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Representative Josephson replied that he would appreciate the information. He noted that one of the governor's proposals, along with a 50/50 split in the percent of market value (POMV), was to constitutionalize the POMV so that the overdrafts planned in FY 21 and FY 22 did not happen again. He wondered about the overdrafts and the voters rejecting his proposal. He wondered what the legislature would do. Commissioner Mahoney responded that the state would be in a difficult situation. She indicated the governor had presented options to address the state's structural imbalance.

Vice-Chair Ortiz thanked the commissioner for her presentation. He thought the problem with the governor's suggestion of asking for voter approval was that the process did not resolve FY 22 and FY 23 because of the timeline. He asked the commissioner to respond.

Commissioner Mahoney recognized the timeline of the governor's proposal did not work well. However, the governor was not supportive of any new tax without the vote of the people. The state would be spending down the ERA with any deficit balances in the future.

Vice-Chair Ortiz asked if the commissioner was recommending an overdraw of the ERA. Commissioner Mahoney responded that she was not recommending an overdraw of the ERA. However, she thought it might be the only choice.

Representative Wool asked in a typical year what the State of Alaska brought in from gambling revenues. Commissioner Mahoney asked if the representative was asking about revenues from charitable gaming.

Representative Wool indicated he was not asking about charitable gaming, as most of those monies went to non-profits. It was his understanding that the state got some money but not much. Commissioner Mahoney confirmed that charitable gaming brought in very few dollars. Representative Wool clarified he was asking about cruise ship gambling. Commissioner Mahoney did not have the number with her.

Representative Wool thought the state received about \$5 million to \$6 million per year in gambling revenues from cruise ship gambling in Alaskan waters. Commissioner Mahoney responded, "Okay."

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Representative Wool returned to the subject of additional revenue. He wondered if gambling would be put to the vote of the people. Commissioner Mahoney understood that the intent was for new broad-based taxes to be put before voters. Representative Wool wondered if gambling would qualify. Commissioner Mahoney responded that it was unlikely.

Representative Wool relayed the governor proposed \$1.2 billion in revenue in 2023. He also noted he had heard in a presentation earlier in the day by the Legislative Finance Division that if the legislature wanted money for 2023, revenue measures would have to be implemented immediately. There were things that would have to occur before the

legislature could act. The timeline would be approximately 2 years. He suggested that DOR would likely have to start ramping. He did not think it was a sound idea to have to wait for a constitutional amendment to be put to a vote and put into place.

Commissioner Mahoney responded that the governor was not comfortable implementing a new tax in the current recession. He was open to discussions on the matter in the future.

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Representative Carpenter had a longer-term question about how the commissioner was advising the governor on additional revenues. There were two types of state revenue: oil-based revenue and non-oil revenue. In all of the charts he had seen, non-oil revenue was a small slice of the state's revenue. Oil had been Alaska's revenue bread and butter. He wondered where the commissioner saw the opportunity to grow Alaska's economy outside of the oil industry.

Commissioner Mahoney replied that the topic was discussed when her team was developing the 49th State Angel Fund. The group's goal was to start funding some of the smaller start-up companies hoping that at least one would hit a homerun. Some of the things she learned in the process had to do with challenges such as manufacturing, distribution, and logistics. The price of goods in Alaska made things more difficult. However, Alaska had the best cargo airport with several flights in and out. She saw potential in the areas of manufacturing and technology. She believed in Thomas Friedman's book, "The World is Flat," which indicates that technology companies could be successful anywhere. She saw it as an area Alaska could grow the economy.

Representative Carpenter referenced the government's budget in the current year and believed it would have to be a partnership between the legislature and the governor. He did not see any recommendations or asks for growth in the areas she mentioned. He asked the commissioner what other advice she had provided the governor to fortify private sector growth. He wondered if the governor was going to explore options other than gambling.

Commissioner Mahoney noted that the governor had been speaking extensively about resource development. The goal was to try to leverage all of the wonderful natural resources Alaska had opening up Alaska for business in that area. The department had internally formed a resource development group that consisted of some of the resource-focused departments. They were working together to expand the state's business.

Representative Carpenter asked the commissioner what she thought was one of the largest challenges the state faced that state government could help with in growing resource development. He was focused on non-oil revenue. Commissioner Mahoney opined that the state's largest challenge was federal overreach. The administration was working diligently with the federal delegation to try to get Alaska's voice heard at the federal level. The goal was for Alaska was to be able to develop its own resources and to become independent.

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Representative Edgmon thanked the commissioner for her presentation. He appreciated her comments about her family which spoke volumes about her character. He also appreciated her candidness about the state's revenue situation. He suggested that there was no plan currently before the legislature. He also did not believe the administration had a real fiscal plan to bridge the fiscal gap going forward. He had made some direct comments to the Office of Management and Budget (OMB) a couple of days prior that were similar. He did not see another way of moving forward without overdrawing the ERA unless the legislature massively cut the budget. He looked back to the governor's State-of-the-State address when he talked about the gaming industry being able to provide hundreds of high-paying jobs in Alaska. He argued there was an extensive lead time before implementation and many policy implications the legislature would have to consider.

Representative Edgmon continued that of all of the governors he had seen in office since his time at the legislature had been repeating the mantra about resource development. However, Alaska remained a one-trick pony in terms of resource development. In reality, the state was now a two-trick pony including oil and investment revenues because of the earnings from the PF. According to the

governor's proposal, the earnings accounted for 72 percent of of the state's revenue in his proposed FY 22 budget. He felt compelled to point out that there was no other proposal to move forward except for overdrawing the PF.

Representative Edgmon thought her agency would be central to the development of any new revenue measures in terms of analysis, advocacy, and taking a lead in the internal discussions. He asked if there had been any conceptual discussions within the current administration to fill the proposed \$1.2 billion gap. He did not think gaming would come close to filling the gap. He wondered if internal discussions had ensued about additional taxes or other new revenue measures. He asked her to share any important points.

Commissioner Mahoney responded that the department had been evaluating different revenue sources internally including different taxes. However, the governor was not willing to introduce them because the state was currently in a recession.

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Representative Edgmon suggested the legislature would have to wait for elections to take place in November 2022 before the Dunleavy Administration would come forward with any proposals to address the vexing issue the state faced. He wondered if he was accurate. Commissioner Mahoney indicated that the governor had stated on social media that he was adamant that any new taxes would require the vote of Alaskans.

Representative Edgmon commented that the legislature was not doing its job without looking at a comprehensive picture. He wondered, if a member of the legislature put something forward, whether her agency would provide the analysis that it had provided in the past during the Walker administration and prior. He suggested DOR was the "quarter-back" of analysis helping by providing the legislature some direction. He asked if her agency would be willing to participate. Commissioner Mahoney responded in the affirmative. The agency would be able to provide the fiscal impacts of any revenue proposals offered by the legislature.

Representative Rasmussen reported that she had done some research about gaming across the nation. She found that gaming contributed over \$260 billion to the economy and over \$40 billion in tax revenues to local governments. The industry also currently supported almost 2 million jobs across the country. She thought gaming would have a major economic impact on Alaska if the legislature took the governor's proposal seriously. She asked about the commissioner's contribution to improving the Municipality of Anchorage's fiscal situation. She thought Commissioner Mahoney had done a remarkable job of turning around the municipality's credit rating and overall financial outlook.

Commissioner Mahoney replied that at the Municipality of Anchorage, she established some fiscal guidelines. She had 7 or 8 key points that she used to guide the fiscal management of the city. She indicated the guidelines mostly related to how the city managed expenses and debt. For example, the city would not issue bonds in a manner where the amount issued for annual debt service would not enable the municipality to be flat throughout the period. In other words, the city's annual debt payment would not increase. The municipality would refinance where possible to take advantage of lower interest rates. Devin Mitchell would be speaking to the committee about refinancing opportunities. The most important thing that occurred while she was at the municipality was that she worked with the political body establishing discipline which the city adhered to. It was an effective strategy. There were 11 politicians at the municipality. Whereas there were 60 politicians within the legislature. Her team put aside politics and did what was best for the city.

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Representative LeBon remarked that the conversation had touched on the governor's willingness to overdraw the ERA to send out the stimulus checks in the spring. He asked for her philosophy around public purpose endowments such as the Alaska Permanent Fund Corporation (APFC) and holding to the POMV approach to a public endowment.

Commissioner Mahoney responded that the best practices for an endowment was to set and follow the rules of the fund. It was proven that over time and sticking to the rules, the fund earned the best returns. She reported that the governor was aware of the rules. However, she believed that

with Covid, the state was in an anomaly situation. It was the reason the governor was proposing to overdraw the ERA.

Representative LeBon had heard in other presentations that overdrawing the ERA would impact future revenues and the 5 percent draw which would amount to millions of dollars going forward. He asked if the current need outweighed the future benefit to children and grandchildren for the dollars that would be forever lost.

Commissioner Mahoney commented that the representative posed a good question. She thought it was something for policy makers to evaluate by looking at and determining the needs of their communities. She had learned over time that there was a tension between the beneficiaries versus the investors of the fund. She elaborated that the beneficiaries wanted their benefit whereas the investors wanted to protect the fund for the long term. She thought the state was currently experiencing that tension.

Representative LeBon thought that in the current case, the investors and the beneficiaries were one and the same - the people of Alaska and future generations. The long-term beneficiaries were children and grandchildren. He believed that protecting their interest was an obligation of every legislator.

Representative Josephson relayed that the sense he got from the commissioner's testimony was that if the legislature were to pass a tax measure, the governor would veto it because the state was in a recession. However, the governor would support a constitutional resolution to voters seeking permission to institute some sort of revenue measure. He assumed that if it was the governor's resolution, he would campaign for it. He wondered if the governor would support a measure that was placed in the ballot.

Commissioner Mahoney responded that the governor believed that any new broad-based tax needed to be presented to Alaskans for a vote of support. She had not had a conversation to ascertain whether he would support a new tax. However, the governor wanted to have assurance that the citizens supported a new tax.

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Representative Thompson was concerned about what might be created. He opined that no one would vote to tax themselves. He also suggested that the people who would vote against a tax measure were the same people who wanted the largest dividend possible. He surmised that waiting 1.5 years to put the issue on the ballot and having it voted down would make for real trouble. He asked if the commissioner agreed. Commissioner Mahoney asked Representative Thompson to repeat his question.

Representative Thompson thought it would be a formula for disaster for people to vote no on any taxes yet vote in favor of a larger dividend. He asked the commissioner if his hypothetical scenario sounded like a disaster.

Commissioner Mahoney suggested the state needed to educate Alaskans about its fiscal condition. Alaskans needed to understand that large dividends combined with deficit spending placed the state in a difficult long-term situation.

Vice-Chair Ortiz understood that currently the times were unique. The governor had a point that if there was ever a time in which a statutory dividend was needed, the time was now based on the current economic situation caused by Covid-19. He asked whether additional federal stimulus monies would be sufficient to supplant the need for a large Permanent Fund Dividend (PFD) and an overdraw from the ERA.

Commissioner Mahoney offered that she could have a conversation with the governor, particularly if the checks were close to \$1400 (the amount she had been hearing). It could potentially help minimize the draw. The state would have to see what came out of congress. It was definitely a consideration. Ultimately it would be the governor's decision.

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Representative Johnson commented that the prior year had been unprecedented and unusual at times. Alaska oil revenue had been hit hard last year at one point and decoupled from the Brent crude price. Much of Alaska's analysis of oil was made based on the Brent crude price. She asked the commissioner to comment on why the state's price of oil separated from the Brent crude price and how it impacted the state's revenue. Although oil prices had gone back up

to \$60 per barrel, she wonder what the revenue forecast looked like and about stability. She noted a COVID revenue relief package making its way through the U.S. Congress. She asked if the commissioner thought Alaska would be receiving relief funds and wondered how they could be used.

Commissioner Mahoney deferred to Dan Stickel to address the representative's question about Brent crude and why Alaska separated from it. Mr. Stickel would be presenting on the following Wednesday and could address the question at that time. She asked for clarification on the representative's third question.

Representative Johnson noted that Alaska's oil prices had bounced back up to \$60 per barrel. She asked how the department was using the factors of Covid in its projections and analysis.

Commissioner Mahoney responded that regarding oil prices, they had increased since it did its fall forecast, which was great news for the state. She watched the Brent futures market every day. In the previous week, the outlook had been in the mid-sixties per barrel. In the current week, the price had dropped to around \$61 per barrel. She was watching the Organization of the Petroleum Exporting Countries (OPEC), and the department would be having a meeting on the following Thursday. She reported that there was the potential for an increase in supply which could potentially cause a decrease in price. The items would be considered when the department released the spring forecast in the middle of March.

Commissioner Mahoney addressed COVID and how Alaska's revenues were affected. She replied that for FY 21 and FY 22 the amount of negative impact was about \$570 million. There was a report that came out by the federal government showing that in the U.S. Alaska was hit the hardest of any of the states. Alaska saw a 43 percent drop in revenues. She responded to the representative's questions about federal stimulus monies. She was hopeful that some of the funding could be used for revenue replacement to assist Alaska in getting through the currently difficult times.

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Representative Wool was glad the commissioner brought up the percentage drop. He understood that there had been

significant federal stimulus money. There was also talk about additional stimulus money from the state. Since Covid, individuals making over \$75,000 received \$1200 and an additional check for \$600. Their children received checks for \$500 and, there was a second round of checks for \$600. He suggested the total was \$1800. There was also talk of an additional \$1400 stimulus check which would bring the total amount of stimulus checks to \$3200 per person. The amount was close to the amount of a full PFD. The governor also wanted an additional \$2000 to go out to each Alaskan to alleviate the current recession. He asked how long the current recession had been - the one the state was currently in.

Commissioner Mahoney responded that in terms of evaluating, for example, the gross domestic product (GDP), the department saw it hit Alaska in the second quarter of FY 20. She asked if his second question had to do with how long the recession would last.

Representative Wool believed the state had been in a recession since before 2020. He asked the commissioner how long it would last. He also wondered how the state would get out of a recession besides handing out checks for \$2000.

Commissioner Mahoney thought Representative Wool asked a really good question. She indicated the department would be evaluating the issue and presenting it in the spring forecast. The department would be making assumptions as to when the state would be coming out of the recession. She was initially optimistic about the cruise lines and tourists coming to Alaska in the coming summer. She clarified that with Canada shutting down its borders, it would negatively impact the state's revenues. The governor was working with Canada and Canadian officials to try to get it reopened which would help Alaska's revenues. She had no idea how long the recession would last. She indicated folks needed to start spending. Much of the money that was being provided was being placed in bank accounts. She indicated that the Wall Street Journal reported that people were putting money in their bank accounts rather than spending it.

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Representative Wool noted that at the beginning of the pandemic when the first round of checks went out (\$1200 per individual and \$500 per child) people were spending the money because many of them were out of work. Much of the second round of funding was put into bank accounts. He also noted that many Alaskans did not lose their jobs and, therefore, did not spend their stimulus checks. He thought that people needing money right away would spend it immediately. He reported that the federal government targeted income levels unlike the state.

Representative Wool opined that it was irresponsible to wait on imposing any revenue measures until the state was out of a recession. He criticized the department and the governor for not working on new revenue measures at present. He commented that by asking the people of Alaska to vote on a constitutional amendment, they were becoming the policy makers rather than the legislature. The legislature would not have a say and would have to wait for a decision to be made by Alaskans. Legislators were the people spending their time in committee meetings, looking at data, crunching numbers, and hopefully making good decisions. He thought having to wait for a vote of the people was irresponsible, and he did not want to be irresponsible. He hoped that elected leaders and others would take the state's deficit problem seriously. He noted there was a time lag between when the legislature passed a law and when it took effect. He hoped the administration and DOR would play a large part in solving the fiscal crisis.

Representative Wool reported that 10 years prior in 2010 oil revenue was about \$10 billion. In 2020 or 2021, the revenue was \$1 billion or one-tenth of what it was in 2010. He suggested the state would be waiting a long time if it continued to rely only on oil to save it from its fiscal crisis.

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Co-Chair Merrick OPENED public testimony.

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Co-Chair Merrick CLOSED public testimony.

Co-Chair Foster indicated the House Finance Committee had reviewed the qualifications of the governor's appointee and recommended that Lucinda Mahoney's name be forwarded to the joint session for consideration as the commissioner for DOR. The recommendation did not reflect an intention by any member to vote for or against her during any further session for the purpose of confirmation.

There being NO OBJECTION, it was so ordered.

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AT EASE

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RECONVENED

Co-Chair Foster brought the meeting back to order and indicated the committee would hear a presentation then recess until 7:00 p.m. to hear the second presentation.

^PRESENTATION: SAVINGS ACCOUNT AND STATE DEBT AND INVESTMENT FUNDS BY DEPARTMENT OF REVENUE

[2:46:24 PM](#)

DEVEN MITCHELL, EXECUTIVE DIRECTOR, ALASKA MUNICIPAL BOND BANK AUTHORITY, DEPARTMENT OF REVENUE, introduced himself and indicated he also served as the executive director of the Alaska Municipal Bond Bank, a public corporation of the State of Alaska. He introduced the PowerPoint presentation: "March 2021 Credit Review and State Debt Summary" which had three sections including credit ratings, outstanding state debt, and state debt capacity. He would run through the section in an abbreviated manner to stay within the timeframe.

Mr. Mitchell began with slide 2: "State of Alaska and Other 49 States' Rating." The three primary rating agencies were listed including Moody's, Standard and Poor's, and Fitch. He reported the state's credit rating had suffered over the course of the last 5 years. Coinciding with the reduction in the price of oil beginning in late 2014, the state's credit was put under additional scrutiny with the rating agencies as revenues decreased and the state had struggled with how to adjust to a lower level of income. As a result, the state had gone from the state having the highest rating possible to one of the states in the lower quartile of

ratings. Alaska had been downgraded ten times. The state was currently on a negative outlook with all three of the rating agencies which implied that there was some percentage of additional negative action on the credit rating. He had been told generally that if there was not some favorable action taken in the current legislative session towards lessening the fiscal gap, the state should expect it would suffer additional negative credit action.

Mr. Mitchell moved to slide 3: "Rating Challenges in 2021." The slide showed a summary of some of the discussions that he generally had with ratings analysts in the current challenging environment. There had been the political challenge of reaching resolve on adjusting to the new revenue paradigm that the state had been living in since 2014. The issue of using the constitutional budget reserve (CBR) compared to other alternatives and foregoing making difficult decisions had been a blessing and a curse simultaneously. It was a blessing in that the state had the flexibility and a curse because the state's savings was dwindling. He thought the obvious question had to do with the gridlock over how to adjust the PF, generate new revenues, or a combination of the two.

Mr. Mitchell continued to financial policies. The one bright spot in rating agency conversations over the previous couple of years had been the POMV shift that occurred in 2018. The adjustment created a split between the dividend program and money used for state government that allowed for the state to have a period of time where its ratings were stable. However, the exacerbation of the price environment of oil and the continued reliance on and the depletion of the CBR had resulted in a return to a negative outlook.

Mr. Mitchell noted the rating agency concerns, regardless of whether the state believed them to be true, was the state's comparatively large net pension liability, a narrow economy, and the perception that the state's economy and operating revenues were reliant on petroleum development. He argued that the state's dependence on oil was historically true, but much less true at present.

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Mr. Mitchell continued to the summary of the most pressing credit rating challenge the state had on slide 4. He

highlighted the column in red reflecting the unrestricted surplus/deficit. A deficit was showing in every year from FY 13 thru FY 21. He pointed to the second column reflecting the general purpose unrestricted general fund (UGF) revenue. There was a large increase in FY 19 due to the POMV shift which contributed \$2.7 billion towards UGF revenue. Even with the large influx of revenue there was a large use of \$1 billion for dividends and \$1.7 billion for government with a deficit remaining.

Mr. Mitchell indicated that another thing the chart teased out was the change in net position reflected in the final column on the slide. Even though the state had had a UGF deficit each year, the state had only experienced a reduction in net positions in two of the years. He explained that it was due to the state's historical practice which continued presently of saving money in good and bad times. Although the state declared having a deficit, there was revenue coming in that went into reserves.

Mr. Mitchell shifted to the topic of outstanding state debt. He turned to slide 6: "State Debt Obligation Process." He reported that all state debt was approved by law. There was no authority of the state to issue securities or encumber any debt without authority established in statute. It might be a one-time issuance such as a General Obligation (GO) Bond or a lease purchase agreement. It could also be a "not to exceed" amount authorization that might revolve as in a public corporation like the housing corporation or the bond bank.

Mr. Mitchell continued that GO Bonds had the requirement that they be approved by the majority of voters because they carried the highest pledge available including the imposition of taxes and the use of any available reserves. Constitutionally, people on his side of the table would agree that available reserves included the use of the PF - even the principle which was protected by the constitution. He further explained that the PF principle would be available for the repayment of the state's GO Bonds in the instance of a failed payment. The court could compel a payment to occur.

Mr. Mitchell explained that all state debt must be structured and authorized by the state bond committee which was comprised of the commissioners of revenue, commerce,

and administration. The method and timing of various authorized issuances determined by the state bond committee in consultation with staff, himself, and others within DOR. The state had established other debt obligations. He highlighted the School Debt Reimbursement Program which allowed local jurisdictions to issue GO bonds for school projects and participated in the repayment of those obligations. The state had not always paid on that commitment. In the current year, the state did not have an appropriation for the reimbursement of local jurisdictions. There was a greater flexibility at the state level and a greater risk at the local level from using such a construct.

Mr. Mitchell relayed that the state paid both its contribution as an employer and a contribution on behalf of all of the employers to retain a percentage of payroll for Public Employees' Retirement System (PERS) that did not exceed 22 percent and Teacher's retirement System (TRS) that did not exceed 12.56 percent. It resulted in a large annual payment that the state made on behalf of the various PERS and TRS employers.

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Mr. Mitchell advanced to slide 7: "Total Debt in Alaska on June 30, 2020." The slide came directly from the Alaska Public Debt Book, a publication by DOR's debt management section. The debts were prioritized as listed on the table from the highest to the lowest commitment. The first row was the state's GO Bonds. The outstanding balance as of June 30, 2020, was \$620 million. The state issued \$84.5 million in additional bonds shortly after closing in August. Currently the state probably had about \$680 million in GO Bonds outstanding because it amortized about \$30 million to \$40 million in principle per year.

Mr. Mitchell continued down the list on slide 7 to state guaranteed debt which included the Veteran's Mortgage Program, bonds of the Alaska Housing Finance Corporation. There was state supported debt which was direct issue support. It included certificates of participation and lease revenue bonds. There was only one of each that were presently outstanding. There was state supported municipal debt which he had mentioned previously - the School Debt Reimbursement Program. There was also a much smaller capital project program. Next on the list was the pension

system unfunded actuarial accrued liability which was \$4.8 billion for PERS and \$1.4 billion for TRS which was significantly larger than any of the prior obligations of the state.

Mr. Mitchell continued that there was also state moral obligation debt which totaled \$1.3 billion. In terms of this section, the state did not pay debt service but provided a form of credit support to allow lower costs to be incurred by the entities that issued the debt. State revenue debt appeared at the bottom of the slide which included sportfish revenue bonds and international airport system revenue bonds. He explained that the sportfish bonds were optionally redeemed, the final \$1.8 million in July 2020. There was about \$333 million of airport system bonds outstanding.

Mr. Mitchell continued to review Alaska's total debt in Alaska as of June 30, 2020, on slide 8. The state had limited opportunities to issue revenue bonds because of the constitution's prohibition on dedicating revenues. They had to be a revenue dedicated prior to statehood, dedicated under the constitution, or dedicated by federal law. The University of Alaska had about \$270 million of revenue bonds outstanding. State agency debt included commitments that were paid for by the various agencies that issued them including the Alaska Housing Finance Corporation (AHFC), the Alaska Municipal Bond Bank, the Alaska Railroad, and the Northern Tobacco Securitization Corporation. There was also state agency collateralized or insured debt which included things like collateralized mortgages of AHFC and the Alaska Industrial Development and Export Authority (AIDEA) power revenue bonds. It also included the state capital project bonds of AHFC, a proposal the legislature would be discussing in the current year for paying capital projects. He reported that the total state agency debt equaled approximately \$12.5 billion.

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Mr. Mitchell advanced to the summary of the current state paid obligations on slide 9. He pointed to the charts on the right-hand side which showed that the school bond debt reimbursement was the largest component of state general fund paid obligations. The state's GO Bonds were followed by state supported debt which included certificates of participation and lease revenue bonds. He reported that for

2020 the school debt reimbursement program and the other reimbursement program was not funded bringing the state down to the \$100 million mark for annual debt service. The point of the bottom chart was to show the magnitude of the PERS and TRS liabilities. The same information on the top chart was incorporated into the bottom chart which was difficult to see because of the size of the PERS and TRS liabilities. They were payments on behalf of PERS and TRS employers to keep their contribution rates lower.

Mr. Mitchell continued to slide 10 to discuss the UGF budget impact. He pointed out that GO Bonds carried the full faith and credit of the state and required legislative and voter approval. For purposes of the governor's proposed GO Bonds of \$350 million would be issued at the earliest in September of 2021 if there was a special election in July in which voters approved issuance. He anticipated there would be a debt service payment in FY 22, an interest expense payment. The state would have annual debt service if the state issued all of the bonds of approximately \$22.4 million. It was likely the state would issue something less than all of the bonds because the projects had to utilize the proceeds within 2 years of the issue date - unlikely, based on the nature of projects. At the bottom of the slide there was a summary of potential payments for AHFC's capital project bonds, approximately \$6.9 million per year in debt service.

Mr. Mitchell continued to slide 11 which showed a summary of short term borrowing potential for the State of Alaska presently. The state had bond anticipation note authority through AS 37.15.300-390. He explained that the structure was such that when the state had GO Bonds authorized, the state could issue 1-year notes to stay on the short end of the yield curve and have lower interest rates while project cash flows solidified. They were used to maintain flexibility while the state stayed within the confines of the Internal Revenue Service code to maintain tax exemption on the bonds. The other short term borrowing potential was revenue anticipation notes which would be difficult to issue in Alaska on a tax exempt basis. There was some potential that it could still be taxable but only for an intra-fiscal year revenue shortfall. He elaborated that where there were deficiencies in cash flow during the year but the receipt of revenues was anticipated prior to the end of the fiscal year, money could be borrowed to make up for the shortfall. The state had not used the option

since the 1960s. It was a little cumbersome because the state had to anticipate what it would need in advance. Volatility in oil price or other revenues made it difficult to accurately predict 6 months, 9 months, or longer.

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Mr. Mitchell moved to slide 13: "Debt Affordability Analysis." He reported that statute required an analysis be provided by January 31st of each year. The analysis discussed credit ratings, current debt levels, and history and projections. He tried to provide a summary of where the State of Alaska was and had been from a debt perspective. The department's actual calculation for determining capacity was relatively simplistic. He used a percentage of unrestricted general fund revenue as a target. He indicated 4 percent was used for direct state paid debt, and 7 percent was used when debt was combined with other obligations paid by the state. He noted that in 2019 the percentages were reduced from 5 percent and 8 percent due to the uncertainty about how revenue would be available in future years. The state declared in long-term debt capacity at the current rating level in the publication and did not include certain state agency obligations or revenue bonds. He would run through the calculation in an upcoming slide.

Mr. Mitchell turned to slide 14 which provided a summary of the authorized bonding authority of the state. Currently, the state did not have a significant amount of bonding authority. The last series of GO Bonds was sold in August from the 2012 Transportation Act. There was currently no remaining outstanding authority. There was the outstanding obligations he had already summarized in Table 1.1. The other state general fund paid structures that had been authorized had been challenged and found unconstitutional. There were a couple of public corporation structures that were no longer potential issuers of state paid debt.

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Mr. Mitchell reported slide 15 showed the analysis on debt affordability he had recently referred to. He pointed to the top portion of the page that showed various payments made between 2021 and 2030. There could be some slight adjustments, as the numbers were from June 30, 2020. He relayed that for FY 21 the GO Bond debt service was \$79.1 million; the lease purchase was \$2.9 million; the

capital lease (the Goose Creek Correctional Facility) was \$19.5 million; the school debt reimbursement was \$92.7; the capital projects reimbursement was \$3.6 million; and the PERS/TRS contribution on behalf of employers was \$338.6 million. He noted the magnitude of the PERS/TRS contributions relative to the other commitments of the state.

Mr. Mitchell highlighted the chart at the bottom of the slide which showed the projected debt capacity. He indicated for FY 21 the projected general fund revenues in the Fall Revenue Sources Book was \$4.3 billion. He reported that 4 percent totaled \$173.3 million, the state's maximum allowed annual debt service for direct paid state debt. He relayed that 7 percent of the projected revenues equaled \$303.2 million which was the maximum allowed state direct paid debt plus other obligations. The currently outstanding GO debt service was subject to appropriation. The difference between \$101.5 million and \$173.3 million was \$71.8 million which generated a capacity. If the state was to issue bonds in the present day, it would be supported by \$70 million. The state might be able to issue \$1 billion to \$1.2 billion in bonds. It created a theoretical capacity.

Mr. Mitchell reported that in one of the following years the state would have a slight reduction to available capacity. The calculation generated a total theoretical capacity of \$1.7 billion. However, because of the uncertainty of the POMV transfer revenues as to whether or not they really were UGF or whether they should be characterized some other way because of the need to fund a PFD program, the state reduced the \$1.7 billion down to \$1 billion. In the current year, the 10-year capacity of the State of Alaska was \$1 billion. The final point on the page was the impact on the PERS/TRS state payments. He indicated that when the payments were added the percentage of UGF revenue that the state anticipated spending in FY 21 on just the fixed payments was 12.22 percent which gradually declined with the currently outstanding obligations to 8.99 percent. He suggested it was a significant commitment from just outstanding debt in PERS/TRS payments.

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Mr. Mitchell had already discussed the content of slide 16. There was no authorized but outstanding state debt. The court decision eliminated some of the existing structures.

He moved to slide 17 to discuss the Alaska Tax Credit Certificate Bond Corporation (ATCCBC) which was the focus of the constitutional challenge lawsuit. On September 4, 2020, the Supreme Court ruled that it was, in fact, unconstitutional. The court reaffirmed the state's ability to issue lease revenue bonds which would allow the state to finance discreet projects such as buildings using the structure if the legislature decided to do so. The idea of the state entering into a contract that would provide a public corporation a revenue stream it could securitize and provide a lump sum to the state for some special purpose, had been taken off the table. As a result, it eliminated the ability for Alaska Pension Obligation Bond Corporation to issue bonds.

Mr. Mitchell continued that the final two slides showed the difference between a subject-to-appropriation debt structure and a moral obligation debt structure. The primary difference was that the appropriations to pay debt service in the state supported debt structure came from the state directly. If the State of Alaska was going to appropriate, it would be a commitment that went into the future but was subject to an annual appropriation.

Mr. Mitchell moved to the final slide, slide 19, which showed the moral obligation structure. The state's commitment was such that if a reserve was deficient, the state would consider replenishing it. He pointed to the upper right portion of the slide to the municipal bonds box which actually paid the debt service. The debt service was paid by a third party source. The state was just providing credit support to obtain a lower rate to save Alaskans money. He concluded his presentation.

Co-Chair Foster asked Mr. Mitchell to summarize his entire presentation into just a few sentences. For example, the state had fiscal difficulties presently and was on the higher end of debt. As a result, credit agencies had downgraded the state over the prior few years and could expect more if the trajectory did not change. He asked Mr. Mitchell to provide a summary in his own words.

Mr. Mitchell might characterize things slightly differently. He reported that when he talked to folks outside of the State of Alaska including investors and credit rating agency analysts, he explained that the state was in a very awkward place. Alaska had gone from being

rich, not having any taxes in place, saving money, paying for everything out of oil revenues, and giving money away to its residents to oil revenue not being the wealth generator it once was. Alaska was arguing about how much money to give its residents while other states were debating how much to tax people. He suggested it was a matter of living within the state's means - having a balanced budget where revenues equaled expenditures.

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Representative LeBon thanked Mr. Mitchell for his presentation. He referred to slide 17 and revenue bonds for the Knik Arm Bridge which was determined to be illegal. He wondered if the legislature should propose a revenue bond package to voters for a project, whether a bridge or power-generating dam on the Susitna River, that would generate revenue to pay back the revenue bond holders. He wondered if it would require voter approval for such a plan to be legal.

Mr. Mitchell responded that there could not be a revenue bond issued by the State of Alaska because it was not allowed by the constitution, even with a vote of the people. The state would have to have a vote of the people to amend the constitution to allow specific revenue to be dedicated. As in a revenue bond structure, the investor expected an irrevocable pledge of revenue. It was not subject to appropriation or the vagaries of any legislative body. It was 100 percent pledged to the investor every year and with other caveats in consideration. He suggested that for the Knik Arm Bridge the state might consider a public corporation. He explained that a public corporation could issue revenue bonds where there was real revenue from third-party sources.

Mr. Mitchell continued that both projects lent themselves to the idea that the Knik Arm project would be a toll bridge and the Susitna Dam Project would generate electricity that could be sold to the grid to pay for debt services. The difficulty with the Knik Arm Crossing was that the total revenue would be deficient for the total financing needs of the project. He formulated the structure where the state would pay the debt service. The state would take a subordinate pledge of revenue from toll collections and would anticipate paying debt service out of the general fund on a subject-to-appropriation basis. The investor

would not be reliant on the total subordination, it would be the state's willingness to appropriate revenue. It would be a structure close enough to the ATCCBC that he believed a legal authority to sell the bonds would be difficult to obtain.

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Representative LeBon liked Mr. Mitchell's response. He noted that the governor had a proposed GO Bond package of \$350 million with an annual debt service of about \$23 million. He referred to slide 15. He wondered if the state could afford such a debt service.

Mr. Mitchell responded that it would fit. He clarified that the debt affordability analysis was subjective. He wished it was more analytical and a definitive outcome was possible. He suggested that it was well within the metrics the state had established. An additional \$25 million of debt service would not influence any outcomes the state would expect for its credit rating. However, the state was on negative outlook with all three rating agencies. There was a high probability the state would be downgraded regardless of the GO Bond proposition.

Representative LeBon suggested if the state's credit rating was downgraded again and, it moved forward with the GO Bond, the state's interest rates would go up and the debt service would go up accordingly.

Mr. Mitchell agreed that when the state's credit rating deteriorated, the perceived risk would increase along with the rate. The silver lining was that rates were extremely compressed which meant that the credit spreads between credit ratings were very narrow at present. He also noted that because the State of Alaska only had \$620 million of bonds outstanding, there was a significant amount of investor demand because of portfolio diversification issues. It was difficult to find the bonds, as there were only 50 states and they were not around. Even though the credit was lower, it was a general obligation credit. Investors could do their own credit work to see the state having a difficult time and why in order to make their own informed decision about investing. It was easier than if selling a revenue pledge of the same caliber. He confirmed that there would be an increased cost but not to the extent

expected in a different interest rate environment or for a different credit.

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Representative Josephson thought he heard Mr. Mitchell state that in theory, the state's debt capacity could withstand \$1 billion of GO Bonds. The governor was proposing \$350 million. He asked if he was correct. Mr. Mitchell responded in the positive.

Representative Josephson thought Mr. Mitchell had stated that \$350 million of projects qualified but would have to be completed within 2 years. Earlier the legislative finance director indicated that the que was \$1 billion. He thought there might be qualifying projects that could be completed in 2 years since the que was so long. He asked Mr. Mitchell to respond.

Mr. Mitchell replied that the state just funded \$110 million of the 2012 Transportation Act funding. There was still money from the 2008 Transportation Act. The 2010 Education Act funding was not fully expended until about 9 years after the original authorization. He continued that the final proceeds from the 2003 act was not fully spent until 12 years after the original authorization. It had been his experience that project lives were longer than anticipated. He was a bit pessimistic based on past experience.

Representative Josephson asked Mr. Mitchell to explain the 2-year stipulation. Mr. Mitchell responded that the state also staggered issuance for the other issues other than the 2003 issuance. He had been directed to issue all of the bonds at once. There was an affirmation that the money would be spent in the allowed timeframe. He continued that was the reason the state recently sold the last series of the 2012 act. The tax code required that 15 percent of the money be spent in the first year, 82 percent in the second year, and the remaining balance by the end of the third year. He was using 2 years because that was where his comfort zone was as far as making projections. He expected that if an agency or a recipient of proceeds indicated they could spend money within 2 years, it could be relied upon.

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Representative Edgmon referred to Mr. Mitchell's initial comments that unless favorable actions were taken in the current session, the state would likely be downgraded in its credit rating. He asked him to elaborate. Mr. Mitchell responded that the credit agencies posted different warning signals about negative outlooks. It was a soft negative implication. It did not necessarily mean the state would be downgraded but signaled a heightened level of concern. A credit watch would indicate a high probability of being downgraded within 90 days. In the state's instance, credit rating analysts had discussed the state's difficulty in transitioning to the lower revenue generation levels. The use of one-time reserves had led to the near depletion of the state's normal reserves. Without the state taking any actions to change the trend, it was likely they would adjust their rating which was the basis of his comment.

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Representative Edgmon thought Mr. Mitchell had summed things up when Mr. Mitchell responded to Co-Chair Foster's question. He thought Mr. Mitchell had been eluding to the fact that unless the state took remedial action, its credit rating would be downgraded.

Representative Wool suggested that the lack of favorable action would lower the state's credit rating. He wondered if an overdraw of the ERA would lower the state's credit rating.

Mr. Mitchell responded that the credit rating agencies were well aware of the state's use of the Permanent Fund and the POMV structure. They had analytics revolving around endowments. There had already been some criticism of the percentage level of 5.25 percent and 5 percent of a POMV draw being too high. He thought a failure to follow the POMV draw amounts would garner the rating agencies' attention and concurred it would not be viewed favorably.

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Representative Wool appreciated Mr. Mitchell's diplomatic response. He mentioned the importance of following the rules relating to sovereign wealth funds. He mentioned the lawsuit related to oil tax credits. He had heard about the suspension of any bond bank projects due to the lawsuit. He

asked for clarification around discrete and non-discrete projects.

Mr. Mitchell clarified that two different things were occurring. The bond bank program was not what he was referring to certificates of participation for the State of Alaska or at least revenue bonds that the State of Alaska participated with another entity such as a corporation or municipality that issued bonds. They were essentially a conduit only pledging the state's lease payments in their debt issuance - the revenue pledge. The bond bank had some legal concerns because there were similar statutes in the tax credit certificate corporation structure to the bond bank. There was a moral obligation in the tax credit statutes that the court explored in their decision. The state's counsel was concerned that it could have negative implications for the bond bank.

Mr. Mitchell continued that the state went through something similar to an appeal, a petition for rehearing with the Supreme Court, asking for clarification that they did not mean to imply that other credits were impaired by the decision. The state was awaiting the outcome. He noted that 2.5 weeks ago the state received a response from the court that they were not going to consider the petition and the state could go back to the bond counsel to revisit the issue. The bond bank was, in fact, no longer in a suspense mode. Instead, the bank was actively moving forward on restarting a refinancing transaction for savings he had been working on when the lawsuit was issued on September 4th.

Co-Chair Foster thanked Mr. Mitchell for his portion of the meeting. The committee would recess until 7:00 p.m.

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Co-Chair Foster indicated the committee would be hearing from DOR.

^UPDATE ON THE STATE'S CASH RESERVE FUNDS AND STATE CASH FLOWS DISCUSSION: DEPARTMENT OF REVENUE

[7:03:08 PM](#)

PAM LEARY, DIRECTOR, TREASURY DIVISION, DEPARTMENT OF REVENUE, introduced the PowerPoint presentation: "Update on the State's Cash Reserve Funds and Discussion of State Cash Flows." She began with slide 2 that provided the agenda for the presentation. There were three topics. First, she would provide an update of the state's savings and investment funds. She would then discuss state cash flow followed by revenue volatility management.

Ms. Leary moved to slide 4: "FY 22 Days that Alaska could run on Total Balances (Cash Reserve and Other Funds)." The chart was provided in the prior year with updated changes. It was called the countdown clock. It showed the number of days that Alaska could run on total balances. It provided context in terms of the state's assets not necessarily in how they should be used. Starting with the CBR, the estimated balance at the beginning of FY 22 was \$900 million and would provide 76 days of coverage of the proposed operating budget for FY 22 of \$4.3 billion. The coverage amounted to about 2.5 months. Other funds the state could turn to if the CBR fund was exhausted included the Power Cost Equalization (PCE) Fund, the Alaska Higher Education Investment Fund, and other smaller designated funds. By adding the other funds to the CBR the state would have about \$2.8 billion which would provide 238 days of coverage or about 8 months. By adding the account balance of the ERA at the beginning of FY 22 less the potential for \$2 billion in dividends the state would have about \$12.7 billion which would cover a \$4.3 billion budget for 1078 days or about 3 years. Her figures assumed no new revenues.

Ms. Leary turned to slide 5 that showed a graphic by Pew Charitable Trust on the number of days that each state could run on total balances in FY 19. The slide was the impetus for the department to look at what the state had available. She reported that even with large draws Alaska was only second to Wyoming in FY 19 in terms of days of expenses in the funds. The number of days for Alaska was 170. The median for all 50 states went up from 40 days in FY 18 to 49.7 days in FY 19. It was an interesting depiction of state reserves.

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Ms. Leary continued to the cash reserve comparisons of Alaska to other states on slide 6. The National Association of State Budget Officers (NASBO) supplied the comparison. It showed how much coverage savings reserve funds provided as a percentage of budget expenditures. The survey reported that the percentage increased since 2008 when the median balance was 4.8 percent of coverage to an expected high of 8.4 percent for FY 21 prior to the pandemic. There was an increase of coverage and reserve balances. The table in the middle showed that about a third of the states had a reserve that covered 10 percent or more of their expenditures. He noted that Alaska's CBR balance currently represented about 22 percent of the FY 22 budget.

Ms. Leary advanced to slide 7 that showed another group of statistics that looked at cash reserves and things to consider. She pointed to the box at the top of the page showing the number of days of general funds spending in reserves that each of the states listed in the left column showed. The farthest column to the right showed what the balance of Alaska's reserve account would be if Alaska was using other state's balance rules. In other words, if Alaska used North Dakota's rule of capping at 9.5 percent for general fund appropriations, it would mean that Alaska would have a reserve of about \$500 million. They ranged from 2 percent to 20 percent of general fund expenditures. However, the NASBO data indicated it should reflect the risk of volatility of the revenue stream. According to Pew Charitable Trust, three factors were most important in setting targets or reserve accounts. First, it was important to know the purpose of the fund whether it was to satisfy cash flow needs, to fill a revenue shortfall, or some combination between the two. Also important in determining the reserve size was to look at the state's volatility of its tax revenue or other revenue. Also, like an insurance policy, it was important to determine what level of coverage the state was comfortable with in its reserve accounts. The most important aspect of the slide was considering what was available and what made sense for Alaska as a state. In any of the studies there was no one-size-fits-all approach. Each state had a different set of circumstances. It was a challenge to decide what figure was the right amount of reserves, but each state should do so for themselves.

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Ms. Leary continued that reserve balances had been the topic of discussion for the previous few years within DOR. Different models had been identified to estimate reserve balances. The state had been using its reserve balance for a number of different purposes to fill cash flow and fill the budget deficit. She suggested that until there was some clarity regarding how the reserve was to be used, it would be difficult to estimate the balance amount presently. She asked if members had questions.

Vice-Chair Ortiz referred to slide 4. He was looking at the potential funds the state could access if needed during difficult times including the PCE Fund. He wondered how the state determined which accounts with balances were available to use when necessary.

Ms. Leary replied that the funds that were listed were also sweepable. They were funds that would be placed into the CBR. Other funds the Treasury managed were trust or endowment related funds that had specific purposes that might not be able to be used for the particular purpose being discussed. The funds listed on the slide were the most accessible if the state had to borrow from them. They were also the funds that would naturally be part of a sweep provision.

Co-Chair Foster indicated that there was a full committee in attendance.

Representative Wool saw where 170 days was reflected on the map on slide 5. However, he could not see the same number of days on slide 4.

Ms. Leary responded that Representative Wool was correct for two reasons. First, slide 4 had FY 22 balances whereas the map showed FY 19. Also, slide 5 was a study from the Pew Charitable Foundation. It was an assessment where they pulled the data themselves. They had a very narrow view of the information they pulled. They took the general fund and the CBR and deemed them total funds that could be used for expenses. She wanted to broaden the amount. The funds on slide 4 were the funds being discussed. She wanted to provide context to see what was in the funds. She could certainly change the slides. The purpose was to show what the state had and long it would take for the state to run down its assets.

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Representative LeBon referred to slide 4. He recalled in prior discussions regarding the state's working capital position that at one point it was determined that \$1.5 billion in the CBR was a minimum standard. Presently, the CBR balance was a little less than \$1 billion with the potential for a portion of the amount to be used. He asked if the administration had a recommendation of a minimum cash reserve balance should have at all times.

Ms. Leary replied that in terms of a reserve, there was no official recommendation presently. The last time there was a suggested reserve balance was in FY 00 and was about \$2 billion. There were fluctuations such that the reserve went very high, and there was no need to have a reserve discussion. She explained that when it went lower, a discussion ensued. The reserve balance had been about \$2 billion but really depended on how the reserves would be used. There had been calculations that her division had done as well as what the economic research group had calculated. The Government Finance Officers Association (GFOA) ideology used 10 percent or any of the other states listed on slide 7. The reserve amount could be anywhere between \$400 million to \$600 million. Without knowing how the fund would be used, it was difficult to set a reserve balance. So far, the state had used the reserves for both cash flow purposes and to fill structural deficits. If the state ceased using the funds for structural deficits and only used them for cash flow, the division could come up with a target figure.

Representative LeBon viewed the analysis on slide 4 as though the ERA was untouchable. He argued that the ERA was the fund for the future. It was what generated the income for future budgets. He opined that the emergency funds were the other funds that were mentioned including the CBR, PCE, and the Higher Education Investment Funds. He thought the funds that were available totaled about \$2.8 billion and were really the state's main reserves.

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Representative Josephson suggested that in the circumstance where the state incurred a cash problem, the legislature had to tap the CBR rather than the ERA. For emergent draws, the legislature had to draw from the CBR, not the ERA. Ms.

Leary clarified that his question was whether the CBR was filling the cash flow imbalance or the structural deficit. She asked if was correct about his question.

Representative Josephson was talking about the headroom the legislature passed as part of a three-quarter vote. The headroom allowed government to draw more from the CBR during the interim of the legislative session. The state would not draw more from the ERA.

Ms. Leary indicated Representative Josephson was correct. She elaborated that in the past few years the state had transferred money from the CBR first when there was an expected budget deficit for any given year. For example, in the current year the state took \$960 million from the CBR first, then began drawing transfers from the ERA so that the money could stay at the Permanent Fund longer. The money could be brought over on an as-needed basis. It tended to occur quarterly and amounts changed. It depended on what was happening with cash flow.

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Ms. Leary indicated that for the next series of slides for each fund she would talk about she had two slides. The first was a historical depiction of the invested balances with general information about the funds. The second slide would have some statistical information and returns.

Ms. Leary turned to slide 8 showed the CBR historical invested assets in billions since it was created in 1990. There were three colors on the chart: Blue was the main fund; yellow was the sub fund; and grey was the statutory budget reserve (SBR) fund. The sub fund was created in FY 01 to yield a higher return. It directed the commissioner of DOR to use it assuming the funds did not need to be used for other purposes or any purpose within 5 years. The account was first utilized in 2008 with a \$4.1 billion deposit to the sub fund. It was then folded back into the main fund in 2015 when it was deemed that the 5-year threshold was drawing near and seemed in the best interest of the state to move it back into the main fund. The statutory budget reserve was shown on the slide to provide the magnitude of the reserve funds at one time. They were at their peak in 2017 with a balance of close to \$17 billion. She noted that the SBR was also invested in a separate account during the period 2013 to 2015. As a

result additional earnings were achieved. Currently the balance was at \$1.1 billion.

Ms. Leary advanced to slide 9: "Constitutional Budget Reserve Fund Fiduciary oversight: Commissioner of Revenue." The slide showed that the CBR was currently invested at 100 percent cash equivalence. She suggested that it was a very low risk targeted with a short investment horizon because it was uncertain how the funds would be used and when they would be depleted. The slide showed market values at the end of December for 5 years. As of December 31, 2021, the market value was \$1.1 billion. In the bottom left corner the 10-year return was 2.25 percent based on Callan and Associates' capital markets, assumptions that were used in developing the target asset allocations - in the current case, cash equivalents.

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Ms. Leary reviewed the PCE historical invested assets in millions on slide 10. The fund had grown from 2001 to 2020 to about \$1 billion. Currently 5 percent of the monthly average market value of the fund for the previous 3 fiscal years could be appropriated. If there were prior earnings that exceeded the amount of the cap, a certain percentage could go into other funds to support them as well.

Ms. Leary continued to slide 11: "Power Cost Equalization Fund Fiduciary oversight: Commissioner of Revenue." The slide showed the investment statistics. It was a high risk target with an intermediate investment horizon. The fund was lower reflecting a 60/40 equity to fixed income targeted asset allocation from 70 percent to 30 percent for the past couple of years to target closer to the needs of the funds for appropriations. On December 31, 2021, it had a balance of \$1.1 billion. The 1-year return as of December 31, 2020, was 7.76 percent. Over 5 years it was 8.87 percent and had fairly tracked the benchmark used for the fund. The Callan projected target return for 10 years was 5 percent.

Ms. Leary moved to slide 12: "Alaska Higher Education Investment Fund (AHEIF) Historical Invested Assets (in millions)." The fund was created with \$400 million from Alaska Housing Capital Corporation (AHCC) in order for the state to pay for performance scholarships and provide

grants to students. The fund's balance was \$344 million at the end of the fiscal year.

Ms. Leary turned to slide 13: "Alaska Higher Education Investment Fund Fiduciary Oversight: Commissioner of Revenue." She pointed out that the fund had grown to about \$391 million as of the end of December. The fund also had a high risk tolerance but was managed to a 70 percent equity and a 30 percent fixed income asset allocation target. It was a 1-year return was 15 percent for the period ending December 31st and the projected 10-year return was 6.37 percent Callan capital market assumptions.

Vice-Chair Ortiz asked about the Alaska Higher Education Investment Fund. The primary purpose was Alaska Performance awards and Alaska Advantage Education grants. He asked if the fund had been used for purposes other than to fund the two programs recently. Ms. Leary did not know the answer to the question. She thought Mr. Barnhill could address the question.

MIKE BARNHILL, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE (via teleconference), thought it had been used to fund the additional contribution to the Teacher's Retirement System 3 or 4 years prior.

Vice-Chair Ortiz asked how for the amount that was funded. Mr. Barnhill would get back to the committee with the amount. He thought it was close to \$100 million. Vice-Chair Ortiz asked if the draw had been a one-time event. Mr. Barnhill replied, "Correct."

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Representative Wool had been told recently that the PCE Fund was managed passively in something like a market fund. He asked if the Higher Education Fund managed in a similar way.

Ms. Leary replied that the funds that were managed by the Division of Treasury that were state state funds were managed in passive funds other than some of the fixed income which was done in-house. The way the set-up worked was that the division had a number of managers that it contracted with to invest some of the state funds. The division also had internal management, fixed income investment officers. The division had mandates for each

type of asset class such as domestic equity. Pools were created with the managers as part of the pools. Each state fund was invested in pools on a basis determined by the commissioner (70/30 fund or 60/40 fund). The division had a variety of funds it could choose from and pools depending on the needs of a fund, the purpose, the time horizon, and the risk level.

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Ms. Leary reported that slides 14 and 15 had to do with the general fund and other non-segregated investment (GeFONSI) funds. She turned to slide 14. There were approximately 185 funds that were managed together in one investment pool with one asset allocation. They were accounted for separately in the state accounting system but had the same asset allocation. Furthermore, the division split the pool into two different funds, GeFONSI I and GeFONSI II. She indicated that GeFONSI I had a set asset allocation that she would look at in the following slide. The GeFONSI II had a slightly more highly targeted return asset allocation. It was a subset of funds that could stand a higher rate of return.

Ms. Leary continued that the general fund itself which was what was referred to as the state's operating account, checkbook, or working capital fund was within GeFONSI I. At the height of 2012, the total was about \$9 billion. The amount fluctuated from year-to-year often due to the general fund, the largest fund within GeFONSI. At the end of 2020, the GeFONSI balance was \$2.45 billion. She also pointed out that the SBR was not included in the slide because she had showed it earlier. However, it was a part of the GeFONSI in its later years before the fund was utilized.

Ms. Leary moved to slide 15 which showed the investments of the GeFONSI I and GeFONSI II were similar. They both had moderate risk. GeFONSI II was moderately high with a slightly longer investment horizon in terms of the accounts managed within it. As a result, it had an asset allocation that included some equity, whereas GeFONSI I did not. The combined value of both funds was \$2.5 billion at the end of December 2020. The projected 10-returns for each account were slightly different: GeFONSI I had a return of 2.38 percent and GeFONSI II had a return of 2.78 percent. The 1-

year return as of December 31, 2020, was 1.49 percent for GeFONSI I and 3.5 percent for GeFONSI II.

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Representative Josephson referred to the chart on slide 14 and spoke about the general fund. It appeared that in 2012 the amount was about \$9.1 billion. He suggested that the amount was housed in the general fund momentarily before it was committed to paying for FY 13 or sent to the CBR. He suggested that someone looking at the chart should not surmise that the general fund had \$9.1 billion for an entire fiscal year because that was not the case.

Ms. Leary responded that at the time the CBR had been fully repaid. The money that went into the general fund was truly money for the general fund. There was not the need to restrict the balances because the state was not borrowing from someplace else. The general fund was and continued to be the largest fund.

Representative Josephson spoke of a hearing in the prior session. He had asked the amount left in the general fund. There was nothing left in the general funds at the time because everything was already committed. He was trying to reconcile Ms. Leary's comments about the balance of the fund at \$4 billion.

Ms. Leary responded that the division targeted a \$400 million balance in the general fund proper in order to pay bills coming due. Currently, anytime she saw the balance in the forecast for cash dropping below \$400 million for 5 days, the division called cash. The state was under a paradigm where cash was limited and it was taking money from either the ERA or borrowing from the CBR while keeping very tight constraints on the balance. She suggested that with SB 26 [Legislation passed in 2018 - Short Title: APPROP LIMIT AND PER FUND:DIVIDEND;EARNINGS] the state was getting money from the ERA. Therefore, balances could fluctuate up and down depending on cash, receipts, and uses at any particular point in time. For example, in the prior year there was a much higher balance in the general fund because the rest of the ERA money was placed in the fund and the state had borrowed slightly more than what was needed from the CBR even though there was a planned deficit. The deficit ended up not being as great as anticipated. She reiterated that \$400 million was the

target balance for the general fund. However, since money was being taken from the ERA, the division tried not to take more than what was needed.

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Representative Josephson believed it should not be thought of like money in the Higher Education Investment Fund. There was not a balance to tap, it was already tapped. The money was already committed. Ms. Leary agreed that the money was committed - it would be used for expenses.

Representative Wool did not see GeFONSI listed on slide 4. He suggested it was an account that money was moved through such as a checking account. It was a holding account of which a balance was kept. He thought the current balance was about \$2.5 billion. He asked for confirmation that it was a holding account and was not listed on slide 4. Ms. Leary responded that he was correct. The division referred to it as the state's checking account - a working capital account.

Representative Carpenter asked for the balance of the GeFONSI account after all of the state's expenses came due at the end of the previous fiscal year on June 30, 2020. Ms. Leary responded that the balance of June 30, 2020, of all of the GeFONSI accounts was \$2.5 billion. Representative Carpenter asked if she had stated \$2.5 billion. Ms. Leary responded, "That's correct."

Ms. Leary continued to slide 16 regarding the Public School Trust Fund (PSTF) and the historical invested assets. The fund had a long history back to 1978. The current balance of the fund as of the end of FY 20 was \$688 million. She indicated that with the passage of HB 213 (Legislation passed in 2018 - Short Title: PUB. SCHOOL TRUST FUND; EDUCATION RAFFLE] it was managed as one fund. It used to have an archaic principal and interest account. It was currently more of an endowment POMV method. The allowable amount that could be appropriated was 5 percent of the average market value for the 5 years preceding the prior fiscal year.

Representative LeBon wanted to go back to the answer Ms. Leary had supplied regarding the GeFONSI balance on June 30, 2020. He asked if she had stated \$2.4 billion. Ms. Leary responded in the affirmative.

Representative LeBon asked if the balance was due to the sweepable accounts being swept. Ms. Leary responded in the negative. She clarified that all of the balances she was speaking to in terms of investments were the actual amounts sitting in the bank which was very different from what would be shown on a budget - what the balances should be if all of the money came in and all of the expenses were paid out at a particular point in time at the end of the year. She reiterated that it was the actual cash balance sitting in the bank - the amount the division was managing for investments. Representative LeBon was viewing the account as an operating account or fund.

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Ms. Leary explained that the GeFONSI was comprised of 184 funds. The general fund (operating fund) was only one of the funds. It was the fund through which the state paid its bills. She listed several different funds and different types of funds. At the end of June 30, 202 there was \$2.5 billion in total in all of the 184 funds.

Representative LeBon asked if money held in the accounts of the Alaska Housing Finance Corporation (AHFC), the Alaska Industrial Development Export Authority (AIDEA), or the Alaska Energy Authority (AEA) in the accounts as well. Ms. Leary responded that the accounts Representative LeBon mentioned did not get invested with the GeFONSI. Unless the division was managing money on behalf of another corporation's fund, it was not included in the GeFONSI balances

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Representative Carpenter asked about the current budget under consideration for July 1, 2021. He had not seen a line item showing \$2.5 billion available for spending or cash flow. He suggested that at the end of FY 21, if there was money left over that had not been spent, he could not find it. The money appropriated for FY 22 was essentially new money. He was having a difficult time understanding that at the end of the fiscal year the state was not looking at a hold over balance. He asked for clarification.

Ms. Leary explained that the accounts that represented the \$2.5 billion included federal funds, designated funds, and

other state funds that had been populated with monies for particular program services, some of which could be used without further appropriation and some had been placed there many years prior and could be used by the programs accordingly. Many of the funds could not be touched and brought into the general fund (GF) and used for expense purposes. At the end of FY 20 there was about \$1 billion in unrestricted funds, the largest of which was part of the general fund. Some of the designated funds were for the Alaska Technical and Vocational Education Program, the Tobacco Use Education and Cessation Fund, some renewable energy grant funds, other revolving loan funds, and many of the smaller funded program dollars that had been set aside over the years and resided in the 184 funds.

Representative Carpenter understood that if the legislature budgeted a program for several years, the money for such programs spent in a certain fiscal year would be encumbered in the following fiscal year and funding for future years would be held in the GeFONSI account until spent. He thought the question should be about the unencumbered or unobligated amount left over in the GeFONSI accounts on June 30th. He asked if he was accurate.

Ms. Leary responded, "It would be." She added that by far the largest fund was the general fund in the unrestricted category. The amount was \$955 million of the \$1.24 billion that was part of the unrestricted balance. She explained that the reason the amount was high was because money was deposited into the account from the ERA right before the end of the year. She further explained there was a mismatch in terms of timing of when the state received revenues and when it paid expenses. At the beginning of the year there were several payments that had to be made including payments into pension accounts. The money that was in the GF proper at the end of the year was used up quickly and reflected cash flow and timing issues. When looking at the money coming in from such as the OMB fiscal summaries or the comprehensive fiscal reports, the revenue and expenses were matched in years where there no anticipated deficit. When money came in and was used demonstrated a cash flow issue which was the reason the GF balance was large at the end of FY 20.

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Representative Carpenter referred to the last bullet on slide 8 which indicated that appropriations from the CBR had to be repaid. He was aware that it was a constitutional requirement to payback the CBR and was the reason for the sweep. There was no mechanism in place for the state to meet its repayment obligation even if there was cash in the GeFONSI accounts at the end of the fiscal year. He asked Ms. Leary to comment on the the obligation voters instituted in 1990 when the CBR was created. He mentioned the \$900 million that was left over in the fund at the end of the fiscal year. The state had the obligation to pay itself back and money left over at the end of the fiscal year. However, there was no mechanism in place unless agreed upon by the legislature. He asked for the amount that would need to be repaid to the CBR again referring to slide 8. He wondered if the amount was the blue or yellow area on the slide.

Ms. Leary replied that on June 30th every year the sweep occurred on paper. The reverse sweep language included in all of the budgets she had seen allowed for the money to come back out of the account. The funds swept out and were returned as a paper transaction. All of the sweepable funds within the GeFONSI swept out and reverse swept back to the funds. The dynamic was used to avoid taking money out of one fund that was invested and selling everything and buying everything back. The transaction was done on paper and tracked by the Division of Finance and OMB.

Representative Carpenter was aware of the process Ms. Leary describe. His point was that there was an obligation that needed to be repaid, and the state had unencumbered excess funds at the end of the fiscal year that were either not being used for the following year's budget or for repaying the CBR.

Ms. Leary commented that the money in the GF account was being used, on a cash basis, to pay the following year's budget beginning on July 1. There was an obligation to pay back the full amount. The combination of the main fund and the sub fund at its highest point in time of what was borrowed had to be repaid. She thought the balance owed to the CBR was about \$12.83 billion at the end of FY 20.

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Representative Josephson had a bill in play that was addressing the issue being discussed. In October he began reading Hickel versus Cowper, the only case that talked about the meaning of sweep and reverse sweep. He thought the Wielechowski decision touched in it. There was a dispute in July 2018 about the CBR and the reverse sweep. Attorney General Clarkson took the position that all accounts were sweepable. In the case of Hickel versus Cowper, it did not say the same. For example it suggested that PCE, since it was housed in the Alaska Energy Authority Corporation, it was not sweepable. His bill took the same position. The last time any legislature looked at the meaning of the CBR and tried to create a statutory rubric to reflect what was required by the CBR was in 1994. The law was tossed out in Hickel versus Cowper. It was a complicated question.

Representative Josephson continued that in July 2018 there were important hearings in Senate Finance and the state's audit division and finance division took a slightly different view of what was sweepable. He reported that the Spill Prevention and Response (SPAR) fund could have as much as \$50 million in it and had to be accessible at a moment's notice in the event of a spill like the Exxon Valdez spill. The amount was fully committed by the legislature and could be used at any time. Whereas other funds, like PCE, were only partially committed. He claimed it was true that some of the funds, like the Higher Education Fund, were sweepable. However, there were legislators that did not want it swept. There were political elements to the issue. Lastly, in Hickel versus Cowper the court stated that not everything would be sweepable because it would use the prudent fiduciary rule. No legislature would possibly want to spend or sweep away everything. He reiterated the matter was complicated. The court looked at how much the legislature appropriated. He suggested that the sub fund be preserved because the monies needed to be available.

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Representative Carpenter suggested if the money in the DeFONSI was swept, it was not gone. Rather, it would be swept into the CBR which was invested. It would require a three-quarter vote for it to come out of the CBR. Essentially, whether the money was in a DeFONSI account or

the CBR, it was being invested and the fiduciary responsibility was being met.

Representative Johnson asked for Ms. Leary to provide a list of funds and their balances to the committee. Ms. Leary would be happy to provide the information.

Representative Wool had a question regarding the CBR having to be repaid to its highest mark which was about \$12 billion. He suggested that no matter how much was taken out it had to be repaid to the high-water mark. He thought it defied the purpose of a savings account. He did not understand the logic of having to pay back the CBR. Ms. Leary responded that it was a law on the books that had to be followed. She was unsure whether the amount to which the fund grew was imaginable at the time the CBR was created. She deferred to the deputy commissioner for further comments.

Mr. Barnhill responded that the constitution did not prescribe a specific payback period for when the legislature appropriated from the CBR. It also did not prescribe any payment of interest. The matters were committed to the discretion of the legislature. The legislature got to administer the payback including the details of when, how, and how much. There was a precedent for paying it back. The legislature had done so when it had the means to do so. There was nothing that required the legislature to pay back money at any particular time.

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Ms. Leary reviewed slide 17: "Public School Trust Fund: Fiduciary oversight: Commissioner of Revenue." It was a continuation of the information regarding the Public School Trust Fund showing the investment statistics. The Trust was a long-term fund that could handle high-risk investments and was a 70/30 split in terms of equities and fixed income in terms of its target allocation. The projected 10-year return was 6.37 percent and achieved a remarkable return of 15 percent in FY 20.

Ms. Leary moved to slide 18. She noted that the Treasury managed the state funds she had discussed as well as the retirement and benefits plan assets of the state. The Treasury Division invested the assets of 14 different plans in the 4 retirement systems. The fiduciary of the state's

retirement plans was the Alaska Retirement Management Board (ARMB) made up of 9 persons. The benefit plans were currently experiencing net outflows from the funds - about \$900 million in the previous 2 years. The funds continued to grow. The defined benefit plans were at \$30.3 billion as of January 31, 2021. It was the highest the accounts have been despite net withdraws. The state had experienced some great investment returns. She reported that the 36-year return was 8.91 percent combined for the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) defined benefit plans.

Ms. Leary continued to slide 19: "Public Employees Retirement System and Teachers Retirement System" She indicated the slide showed a more complex target asset allocation than seen in previous slides. It was more akin to how APFC managed their investments with private equity and real assets including real estate as part of the investment mix. As of December 31, 2020, the PERS balance was \$19.5 billion and the TRS defined benefit pension and health balance was \$9.5 billion. The returns as of September 2020 were 7.12 percent and 7.1 percent. There were slight differences in the returns due to cash inflows and outflows of the different funds. Both PERS and TRS and the other defined benefit systems were invested in the same pools. All 14 plans invested in the various pools.

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Vice-Chair Ortiz asked about the unfunded liability of PERS and TRS. Ms. Leary explained that the unfunded liability was the difference between the amount of current assets and the actuarial calculated liability - the amount that was owed to pay everyone through all of the pension systems until there was no one else to pay including beneficiaries. The total as of June 30, 2020, was about \$5.9 billion in unfunded liability which equated to 81.5 percent of funding. It was different for PERS than TRS. She elaborated that PERS was less well funded than TRS.

Representative Johnson returned to the subject of the CBR. She suggested that some of the audits indicated that the Federal Energy Regulatory Commission (FERC) funds that should have been deposited into the CBR but was deposited into the GF instead. She thought there was a difference of opinion about what Legislative Audit stated and what the

attorney general stated. She asked for comments. Ms. Leary deferred to Mr. Barnhill.

Mr. Barnhill indicated that it was a persistent and legal issue. The Department of Law had advised that settlements under FERC involving Trans-Alaska Pipeline System (TAPS) tariffs should be deposited into the GF. The Division of Legislative Budget and Audit disagreed and believed that such types of settlements should be deposited into the CBR. The amount at issue was just over \$1 billion. The Department of Revenue would continue to follow the advice provided by the Department of Law. The Division of Legislative Budget and Audit had given DOR notice that they would continue to adhere to their position. It would continue to be reflected in the state's CAFR as a disagreement between the legislative auditors and the Department of Law. He returned to the topic of when and how much to repay the CBR. It was up to the discretion of the legislature. In the event the state came into the \$12 billion needed to fully repay the CBR, the legislature would have the option to do so and to follow whatever advice it would like to follow.

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Representative Carpenter asked where the \$1 billion dispute was presently. Mr. Barnhill indicated that following the settlements the money was deposited in the GF and spent.

Representative Josephson thought the problem with having inconsistencies was that federal agencies such as Center for Medicaid Services and the Department of Treasury, was that they would look at the state's CAFR and would find that it was not balanced or that there was a dispute about the balance. The issue needed resolution.

Mr. Barnhill opined that the issue was a legal dispute and would not be resolved anytime soon. In his view the legislature did not have the ability to repay the CBR in the amount of \$12 billion let alone \$1 billion. In terms of how external stakeholders view the entry of qualification statements in the state's CAFR, the department just issued the last tranche of General Obligation (GO) Bonds in the prior summer under the 2012 GO Bond authorization. It was the department's view that the qualification did not have any material effect of the state's ability to issue nor on the rating or interest rate the state obtained.

Co-Chair Foster believed Legislative Legal Services thought the money should go into the general fund. Legislative Audit did not agree and brought in outside counsel who thought the money should go into the CBR. He believed the the Department of Law believe the money should go into the GF. He also thought there was an additional entity that had expressed an opinion. He asked if he was accurate. Mr. Barnhill was unsure of the number of attorneys that had weighed in on the issue. He indicated it had been a persistent issue over multiple audit cycles, attorneys General, and administrations. He did not know the position of Legislative Legal on the issue.

Ms. Leary moved to the next section of the presentation beginning on slide 21: "Cash versus Accrual balances." She relayed that treasury balances were in cash, what was in the bank presently. The accrual numbers, where everything should fall once money came in or out, could be seen in the budgets and CAFRs.

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Ms. Leary advanced to slide 22 which contained a diagram of the money that came into the cash management GF and what went out. She highlighted that all of the money that was flowing into the state came through the GF into the Treasury Division. The cash management team touched everything, if only for a moment, before it was sent on its way to where it was supposed to go. For example, it might go to debt service payments or school education payments. The cash management team did an excellent job of putting the funds into the right buckets.

Ms. Leary turned to slide 23 to review cash flow deficiencies. The slide also provided some history as to why the GeFONSI was as large as it was presently compared to the GF. In the past when the state had unrestricted revenue, it was deposited into the GF and was used for various programs. Overtime, many sub funds were created for particular programs which explains the 184 different funds within GeFONSI. The general fund had less money in it to pay for specific things throughout the year. The department had to control the money that was coming in and out of the fund more tightly.

Ms. Leary continued that there were mismatches between when revenue came in and when payments were made. She had provided an example earlier where the beginning of appropriations happened at the start of the year. Many of the state's programs were funded at the start of the year while at the same time the state did not have revenues coming in immediately to meet the transfer needs. Some federal programs required the state to spend money prior to reimbursement. There were also seasonal cash flow needs such as in the summer. The first 2 months of any fiscal year was also the same period of reappropriation. The state was not only paying for bills for the coming year it was also settling accounts from the prior year creating cash flow deficiencies.

Ms. Leary reviewed the cash deficiency memorandum of understanding (MOU) on slide 24. It was an MOU developed in the 1990s between DOR, the Department of Administration, the Department of Law, and OMB. It outlined the procedures that were followed when there were cash flow deficiencies. It included developing monthly cash projections in concert with the Tax Division to know what money would be coming in from the ERA. Balances were monitored through a forecast based on expected expenses on a daily basis. The division tried to make sure it had enough money ahead of time to meet expenses. The investment staff knew all account balances to invest or divest. At any given time, all of the money within the treasury was invested in some capacity.

Ms. Leary continued that as the division went through timing mismatches outlined in the MOU it allowed for temporary interfund borrowing. The order of funds had been the SBR, CBR, and ERA. It outlined steps for the division to take when there was not enough money. One of the steps was the division going before the legislature to get access to additional funding to pay state bills. If it was necessary, the division would have to prioritize what would be distributed and to restrict expenditures.

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Ms. Leary turned to slide 25 which reiterated the concept of using budget reserves as an answer to cash flow and structural revenue shortfalls. The operating budget contained language allowing for such appropriation authority. The Treasury Division had relied on the authority to address cash flow timing issues and revenue

shortfalls. She noted the CBR was repaid by FY 10 and the legislature started borrowing from it again in FY 14. As of the FY 20 CAFR just released, the balance owed to the CBR was \$12.6 billion.

Ms. Leary continued to slide 27 on the topic of revenue volatility. She explained that revenue volatility had been a significant for the state until a few years prior. The PEW study did an analysis comparing revenue volatility across all state, Alaska went off the charts because it was so reliant on oil prices. It had reversed in recent times. The Revenue Sources Book reported about 19 percent of the state's UGF would come from petroleum revenues and 72 percent would come from investment income. She believed it was a result of the passage of SB 26 [Legislation passes in 2018 establishing a POMV for the PF] and the amount of money that was flowing in the POMV from the ERA.

Ms. Leary moved to slide 28 to discuss volatility management techniques. The state had reserve funds which it was spending down quickly. There was the possibility of revenue anticipation notes and a set of bills that had been introduced to expand the ability to borrow with a line of credit for cash flow purposes. The line would not be used to assist with structural deficits. During the pandemic other states had established lines of credit. She noted that in general an entity had to pay money to have accessible funds such as a line of credit. There was usually a much great percentage cost to actually borrow any funds. It would be a tool that could be used by the Treasury Division rather than taking from other funds that targeted higher rates of return. A line of credit would allow the state to address cash flow needs throughout the year.

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Representative LeBon asked if the state had ever taken out an operating line of credit. Ms. Leary responded that currently, the Treasury was not able to take out a line of credit. However, it would be a useful tool. Representative LeBon clarified that the Treasury needed the legislature to approve establishing a line of credit. Ms. Leary responded affirmatively.

Ms. Leary reviewed slide 28 regarding volatility management techniques. One of the ways the division had managed

volatility was through the use of the ERA. The Treasury Division tried to take the money coming over to the GF in such a way that it was known, controlled, and had the least amount of impact to the PF managing its assets. It was a lever the division could pull. Managing the timing of state expenditures was important as well. It might be possible to push certain payments out to help with cash flow. For example, the division had done so with some of the public education fund transfers which used to be done at the beginning of the year. The division discussed how quickly the money was actually utilized and found that it was better to make a distribution monthly rather than quarterly. There were several opportunities for the state to manage its cash flow needs. There were certain payment that might be be able to push out.

Ms. Leary reviewed slide 29, the presentation take-aways. First, cash reserves were declining and would continue to decline with structural budget deficits. Even when the state had a balanced budget and all of the revenue was received, the state would still have cash flow mismatches. The Treasury was concern with cash management. She emphasized that cash flow forecasting was always wrong. As a result, the Treasury Division built in a 5-day requirement so that if the fund balances were low, the division could act. She noted that revenue shortfalls might occur if forecasting assumptions were wrong. However, the state currently had more assured investment income revenue coming from the ERA. Forecasts should be better moving forward under a new paradigm. Higher revenue volatility required greater cash reserves until the volatility decreased. Currently volatility was decreasing. Once the state figured out how to resolve the deficit, volatility might be reduced. Volatility technics were available. She concluded her presentation.

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

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ADJOURNMENT

8:37:58 PM

The meeting was adjourned at 8:37 p.m.