HOUSE FINANCE COMMITTEE
March 16, 2021
1:32 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:32 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
Representative DeLena Johnson (via teleconference)
Representative Andy Josephson
Representative Bart LeBon
Representative Sara Rasmussen
Representative Steve Thompson
Representative Adam Wool

MEMBERS ABSENT

None

PRESENT VIA TELECONFERENCE

Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue; Lucinda Mahoney, Commissioner, Department of Revenue.

SUMMARY

PRESENTATION: SPRING REVENUE FORECAST UPDATE - DEPARTMENT OF REVENUE

Co-Chair Foster reviewed the agenda for the day.

^PRESENTATION: SPRING REVENUE FORECAST UPDATE - DEPARTMENT OF REVENUE

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DAN STICKEL, CHIEF ECONOMIST, ECONOMIC RESEARCH GROUP, TAX DIVISION, DEPARTMENT OF REVENUE, introduced the PowerPoint presentation: Spring 2021 Forecast." He began the presentation with the agenda broken up into 3 sections on slide 2. First, he would provide a brief background about the revenue forecast, publication, and some of the key assumptions of the forecast. He would also walk through the revenue forecast first looking at total state revenue and then with a more in-depth focus on unrestricted general fund (UGF) revenue. Finally, he would provide additional detail around the petroleum revenue forecast.

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Mr. Stickel moved to slide 4 to provide some background into the spring revenue forecast. He reported that the fall forecast was published in December in the Revenue Sources Book. The book was an annual publication with all sorts of great information about historical and future revenue as well as information about the various taxes and revenue sources. The spring forecast came out in March of each year and was an update to the fall revenue forecast. It updated key tables and data. Both of the publications were available on the Tax Division website at tax.alaska.gov.

Mr. Stickel continued to slide 5 to review key Alaska economic indicators. While his focus was on revenue forecasting, he also liked to look at how the overall state economy was doing. The indicators gave him some insight into that. Data on slide 5 represented the most current data available for each of the indicators listed as of the morning of the previous day. There were several updates expected to be released later in March. State gross domestic product (GDP) was up significantly in the third quarter of 2020 following two quarters of significant losses. The second quarter of 2020 was the largest decline on record for state GDP with the Covid situation followed by the largest increase on record in the third quarter. He was expecting fourth quarter data to be released on March 26, 2021. It would provide him with an important insight into how the recovery had receded in Alaska.

Mr. Stickel reported that in terms of job numbers, the January Jobs data was released by the state's Department of Labor and Workforce Development (DOL) on Friday of the previous week. Employment in the state was still down by

23,000 jobs or 7.4 percent compared to the prior year in January. It was a significant improvement from the losses that the state saw the prior summer. However, it showed the state had a way to go to a full recovery in the job market. The largest losses had been in leisure hospitality, transportation, and oil and gas. Wages and salaries as of the third quarter had bounced back and were essentially flat to the prior year's levels. Looking at bankruptcies and foreclosures, those numbers continued to hold at relatively lower levels compared to the previous year likely due to a variety of factors including temporary aid, government programs, actions by relevant industries to forestall bankruptcies and foreclosures.

Mr. Stickel continued that housing starts, which was a forward-looking indicator, were down in 2020 versus 2019 which was somewhat expected with the overall levels of uncertainty and the job losses in 2019. Finally, the department had added a new indicator to the slide in response to some of the feedback from the committee in the fall forecast presentation. He looked at mortgage delinquency rates. The latest data was from June 2020 and third quarter data was expected in the current month. As of June, the average delinquency to rates were similar to the prior year with 1.4 percent of mortgages delinquent by 30 to 89 days and less that .5 percent for 90 or more days. His take on the information was that between government income support and lenders taking action to work with borrowers, there had not been a major uptick in delinquencies as of the previous summer.

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Vice-Chair Ortiz asked if the department kept the indicators by region or statewide only data.

Mr. Stickel thought that some data was available by region. The Department of Revenue (DOR) had been reporting based on statewide numbers.

Representative LeBon thanked Mr. Stickel for reporting that banks had been working with borrowers using tools such as loan forbearance agreements, refinancing, and restructuring. There were several tools that could be used by banks to assist borrows. He also appreciated the delinquency rate information. He thought it would be interesting to see how everything was played out in a year.

Mr. Stickel replied that economists would be looking at the effects of Covid-19 for a significant amount of time.

Mr. Stickel moved to slide 6 which showed some of the key assumptions of the spring revenue forecast. He indicated that while the Covid-19 situation seemed to be improving, it remained a source of uncertainty in the forecast. The pandemic had impacted every type of state revenue in some way over the prior year. The department's forecast represented a scenario for how the recovery would unfold. However, he cautioned that the uncertainty continued to be particularly large given the ongoing Covid situation.

Mr. Stickel discussed key assumptions. The department was forecasting a 6.75 percent annual return on investment for the Alaska Permanent Fund (PF). In terms of federal revenue, the forecast included the stimulus bills that were passed through the end of February 2021. The forecast did not include the stimulus package, the American Rescue Plan, passed by congress in the previous week. It would be a significant influx of state revenue that was not reflected in the spring forecast.

Mr. Stickel continued that for petroleum revenues, the estimates were based on a $61 per barrel oil price for FY 22. The department's protocol was to assume flat real prices beyond FY 22. Prices would increase with inflation only. For non-petroleum revenue the department was assuming that most underlying economic activity returned to pre-recession levels by FY 22. It was the same assumption included in the fall forecast. While optimistic about some of the proposals put forward to possibly some cruise ship tourism in the coming summer, the department assumed that there would be no large cruise ships for the summer of 2021, and a full recovery would not take place until 2024. The forecast pushed the recovery assumption by 1 year compared to what the department forecasted in the prior fall forecast.

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Representative Carpenter asked why the tourism recovery assumption extended out to 2024.

Mr. Stickel answered that the tourism recovery assumption was a source of significant uncertainty. He elaborated that

when he was developing the fall forecast, he had numerous discussions with different stakeholders in the tourism industry to understand what a recovery path might look like. It was clear that the state would not go from zero to 1.4 million cruise ship passengers in one year. The recovery assumption the department built in was that cruise ship levels would reach 50 percent in the first year, 75 percent in the second year, and 100 percent in the third year. The benchmarks were not based on any particular information. Rather, the department tried to come up with a reasonable scenario. He reported that in developing the spring forecast when it appeared that there might not be a cruise ship season in the summer of 2021, the department pushed the set of assumptions out one year. The scenario was uncertain which was the reason he drew attention to the assumptions the department made. He hoped that things could turn out better than projected.

Co-Chair Foster noted Representative Josephson had joined the meeting.

Representative Rasmussen spoke to tourism. She thought there was significant uncertainty with the cruise lines. She reported having a meeting with a couple of industry representatives earlier in the day. The feedback she received was impacts to small businesses providing tours and other excursions on land could also impact the cruise lines, as they brought in significant revenue from selling those tours on the ship. She suggested that how the legislature handled things at the state level and the ability to bridge the season for small businesses throughout Alaska could impact 2023 and 2024.

Representative Wool reiterated the cruise ship levels indicated by Mr. Stickel. He had heard that some people would choose to fly rather than take a cruise to Alaska. He thought that as the vaccination rate improved, additional travel would be likely, and the economy in Alaska would improve accordingly.

Mr. Stickel responded that vaccination was one of the reasons for potential optimism. The Covid-19 situation was difficult to predict. He hoped there would not be another leg down with new variants. The approach the department took was to be very clear on its assumptions. The department was assuming a 75 percent capacity in 2023 and would continue to monitor capacity going forward. The

assumptions helped people to review the department's forecast numbers.

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Mr. Stickel moved to slide 7: "Relative Contributions to Total State Revenue: FY 2020." The slide showed the relative importance of different sources of total state revenue for FY 20. He highlighted that federal revenue, investment earnings, and oil and gas were the largest sources of revenue. All other sources of revenue added up to slightly more than 12 percent of total revenue in FY 20. He iterated that the slide reflected total revenue. In future slides he would present subsets of total revenue including unrestricted revenue.

Mr. Stickel continued to the spreadsheet on slide 9 which showed the total state revenue from all sources for FY 20 and the department's forecast for FY 21 and FY 22. The total revenue came from four sources: Investments, federal receipts, petroleum, and other non-petroleum. Within the revenue forecast and budget documents revenues were broken out further into four categories that described the restrictions around how the monies could be used. reflecting the total revenue forecast from FY 20 to FY 22. Unrestricted general funds (UGF) could be used for any purpose. Most of the budget discussions would center around UGF as would the remaining slides of the current presentation.

Mr. Stickel continued that there were 3 other categories. There were designated general funds, revenues technically available for appropriation but customarily used for a specific purpose. For example, half of the alcohol tax revenue was customarily appropriated to the alcohol and drug abuse treatment and prevention fund. Other restricted funds were dedicated in how they must be used in some way and truly not available for general appropriation. An example would be the constitutional dedication of royalty revenue to the PF and the school fund. Another example would be aviation motor fuel tax revenue which federal law dictated must be used for specific purposes. Federal revenue also had to be used for certain purposes. The department considered all federal revenue to be restricted revenue in the forecast.

Representative Carpenter asked about the number for the total state revenue for FY 20 in the spring forecast was different than the number in the fall forecast. He wondered why the number changed if the number was historical.

Mr. Stickel responded that the historical numbers in the fall forecast were mostly finalized. However, some of them were preliminary. He indicated that when the department released the fall revenue forecast the state's comprehensive annual report had not been finalized. There were some numbers that were revised slightly between the fall forecast and the spring forecast.

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Mr. Stickel continued to report on slide 9. He relayed that total state revenue from all sources for FY 20 was $8.7 billion. The forecast was $11.6 billion for FY 21 and $11 billion for FY 22. The UGF portion was $4.5 billion for FY 20. The department was forecasting $4.7 billion for both FY 21 and FY 22. He noted on the righthand side of the slide there were two columns showing the percentage changes from FY 20 to FY 22 and from FY 21 to FY 22.

Mr. Stickel moved to slide 10 and reminded members that for the remainder of the presentation he would be focusing on UGF revenue forecast since that was where most of the budget discussions and flexibility about how the monies could be used laid. Investment revenue was currently the largest source of UGF to the state and contributed nearly $3 billion in FY 20 and forecasted to be $3.1 billion in FY 21 and FY 22. The main element was the percent of market value (POMV) transfer from the PF that began in FY 19. In response to some feedback, he had separated out the PF piece in the presentation.

Mr. Stickel continued that petroleum revenue generated about $1.1 billion UGF in FY 20. It was forecasted to contribute $1.2 billion in FY 21 and $1.3 billion in FY 22. Lastly, non-petroleum sources were estimated to contribute slightly under $400 million of UGF in each of the following 2 years. He indicated the next several slides he would walk through each of the revenue sources in greater detail.

Mr. Stickel advanced to slide 11: "Unrestricted Revenue Forecast: FY 2020 and Changes to Two-Year Outlook." The slide summarized some of the key changes to the UGF

forecast. Between the fall forecast released in December [2020] and the current spring forecast released on the prior day, the department's forecast of oil prices for the Alaska North Slope (ANS) was increased by $7.73 per barrel for FY 21 and by $13 per barrel for FY 22. The price increases were based on continued recovery in stabilization in the oil markets as the economy continued to recover from the Covid related recession.

Mr. Stickel reported no change to the forecast for FY 21 and FY 22 for the PF transfer due to the way it was calculated. In terms of UGF revenue, the FY 21 forecast had been increased by $332 million. The FY 22 forecast had been increased by $460 million. He had not included oil production on the slide. However, he noted that the production forecast for ANS oil production was increased by 4,700 barrels per day for FY 21 and by 20,100 barrels per day for FY 22. Between the improved outlook for oil price and oil production, they counted for the increases to the revenue forecast.

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Representative Rasmussen asked Mr. Stickel to repeat the revenues for FY 21.

Mr. Stickel responded that for FY 21 the average daily production forecast for ANS oil was increased by 4,700 barrels per day. For FY 22 the forecast was increased by 20,100 barrels per day.

Mr. Stickel relayed that slide 12 provided more detail on each of the sources of UGF revenue starting with investments. The PF transfer was the largest source of UGF in the forecast contributed $2.9 billion in FY 20 and was expected to contribute slightly under $3.1 billion in FY 21 and FY 22. In addition to the PF transfer, there was a small amount of other unrestricted investment revenue that was primarily earnings on the cash balances of the general fund.

Mr. Stickel detailed slide 13 which showed the estimated transfer for each of the following 10 years. The transfers were estimated to be more than $3 billion every year growing to $3.7 billion by FY 30. The forecast assumed a 6.75 percent annual return, the current official return assumption being used by the Alaska Permanent Fund

Corporation (APFC). The forecast was based on a 5 percent POMV calculation. He noted that the baseline forecast did not consider any additional draws on the PF beyond the statutory POMV draw.

Mr. Stickel moved to slide 14: "Unrestricted Petroleum Revenue: FY 2020 to FY 2022 Totals." The state levied a property tax on all oil and gas property in the state and generated slightly more than $100 million per year. He highlighted that it represented the state's share of property taxes. Also, over $400 million was generated for municipalities each year in oil and gas property taxes. The municipal share was not reflected in the state's revenue forecast. The state levied a corporate income tax on qualifying corporations doing business in Alaska. He reported that FY 20 was a very challenging year in the oil industry, and since the corporate income tax was a tax on profits, there was essentially zero revenue in FY 20. The department was forecasting $25 million in each of FY 21 and FY 22.

Mr. Stickel reported that the oil and gas production tax was the state's severance tax on petroleum. For the North Slope it consisted of a net profits tax with a gross minimum tax floor. The production tax was expected to bring in $311 million in FY 21 and $376 million in FY 22. Royalties from oil and gas production on state land are the largest source of unrestricted petroleum revenue bringing in $675 million in FY 20 and forecasted between $700 million and $800 million in each of the following 2 years. He pointed out that the slide reflected only the unrestricted revenue share of the royalties. About 30 percent of royalties were considered restricted revenue including the portion of royalty revenue deposited to the PF and also a portion deposited to the school fund. Later in the presentation he would dive into some of the key assumptions underlying the petroleum revenue forecast.

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Representative Wool referenced Mr. Stickel's presentation about the order of operations presented on March 3, 2021. One of the points he made at the time was that the total tax paid to the state was $163 million. He wondered where the number was reflected on slide 14.

Mr. Stickel responded that it related to the oil and gas production tax on slide 14. The bottom line in the order of operations presentation was looking at the department's fall forecast for FY 22. That number was currently $376 million. Based on higher oil prices and higher oil production in the forecast he was expecting an increase in the production tax revenue compared to what he had expected in the fall forecast.

Representative Wool thought the state was looking at an increase of about $200 million. He asked if he was correct. Mr. Stickel responded in the affirmative. The exact increase for FY 22 was about $213 million to the production tax forecast.

Representative Josephson noted there being a significant amount of talk in the hallways about revenue replacement from the federal government's American Rescue Plan Act monies. There was concern about whether those dollars would be limited to certain types of spending. He wondered about those dollars being used for revenue replacement if Alaska could make a case for revenue decline due to Covid-19. He asked if Mr. Stickel thought it would be a good argument for the state to make.

Mr. Stickel responded that one way to look at the potential impacts of Covid and the Covid recession would be to look at the forecast issued in fall 19. It was the last forecast before Covid took place. In terms of other commentary on the recovery plan and potential actions he deferred to the commissioner of DOR.

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LUCINDA MAHONEY, COMMISSIONER, DEPARTMENT OF REVENUE, reported that the department had looked at Covid impacts and had done an analysis beginning from 2019 through the current year. Regarding the interpretation regarding what constituted revenue replacement, she was awaiting guidance from the U.S. Treasury to establish what the rules would specifically mean. Until the department received the information, it would be premature for her to provide a detailed response.

Mr. Stickel advanced to slide 15 to examine the unrestricted non-petroleum revenue totals from FY 20 to FY 22. He pointed out that the slide only showed the

unrestricted non-petroleum revenues. The largest component was taxes. Corporate income tax, typically the largest non-petroleum tax type, generated slightly more that $100 million in FY20. The department was forecasting smaller revenues over the next 2 years, and he would go over the details in the next slide. Other significant taxes included mining license tax, insurance premium taxes, fisheries taxes, and excise taxes. In addition to taxes, the other non-petroleum revenues included licenses and permits, charges for services, fines and forfeitures, rents and royalties from non-petroleum sources, and miscellaneous revenue. All of these non-petroleum items added up was expected to be $389 million for FY 21 and $355 million for FY 22.

Mr. Stickel continued to slide 16: "Unrestricted Revenue Forecast: Non-Oil & Gas Corporate Income Tax (CIT)." The slide provided detail on the corporate income tax forecast. There were 2 major unusual impacts to consider in the current circumstance. First, because of the recession, profits fell in many industries in 2020. Some industries, such as the tourism industry, were facing a very challenging 2021 and beyond. Second, there were CARES Act impacts. He reiterated that a provision of the federal CARES Act allowed corporations to carry back any net operating losses from tax years 2018 through 2020. The losses could be carried back for up to 5 tax years and potentially receive refunds for previous taxes paid.

Mr. Stickel continued that there was also a provision that allowed companies to accelerate certain alternative minimum tax refunds to calendar year 2019. Under Alaska's corporate income tax statutes, the state adopted the federal tax code by reference. The Coronavirus Aid, Relief, and Economic Security (CARES) Act provisions of the net operating loss carry back were automatically applied to Alaska's tax. For general corporate income tax, he was expecting lower revenue in FU 21 even before the CARES Act based on the weakness in the economy. The CARES Act impacts further reduced FY 21 revenue by $20.5 million down to a $55 million forecast. For FY 22 he was estimating $83.6 million of CARES Act related refunds bringing the net down to $10 million for FY 22. Based on an assumption of economic recovery in most industries, the department forecasted that general corporate income tax revenue rebounded to $130 million by FY 23.

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Mr. Stickel relayed that slide 17 was a similar chart but for the oil and gas income tax. The industry was especially hard hit by Covid and essentially paid no corporate income tax for FY 20. The department was forecasting very low revenues for FY 21 even before the CARES Act impacts. He was also forecasting 25 million for FY 21 after the CARES Act impacts. For FY 22 the department was anticipating $56 million in CARES Act related refunds bringing the net revenue to a total of $25 million. For FY 23 the department was forecasting $110 million from the oil and gas corporate tax.

Representative Wool referred to slide 16 and slide 17 in aggregate he suggested that the state would have about $162 million in lost revenue due to the corporate income tax being linked to the federal tax code with regards to the federal CARES Act that allowed the carry back losses for petroleum and non-petroleum corporations. The states revenue was $163 million less in FY 22 due to the corporate tax law. He asked if he was accurate.

Mr. Stickel replied that the $162 million between the 2 taxes would be the total impact of the CARES Act provisions. In terms of the revenue reductions, if a company could not carry back the losses, they could carry them forward which would result in a total revenue deduction to the state across the 2 years would be somewhat less.

Representative Wool suggested that if companies carried the losses back, they could carry them back 5 years. If companies carried them forward, he wondered if they could be divided up over the 5 years rather than all in one year in 2023.

Mr. Stickel replied that the provision under the CARES Act allowed a company to carry a loss back and offset up to 5 years of prior years' taxes paid if they were paid. Absent that provision, the rule was that a company could carry a loss forward and offset up to 80 percent of their taxable income in a future year.

Representative Wool suggested that if the provision was not in place and a company carried a loss forward, 80 percent of $160 million would be realized in 2023. He wondered if

revenue for 2023 would be down 80 percent over the following year if they carried their losses from 2021.

Mr. Stickel replied that the answer was more nuanced based on the subset of companies that had the losses and when they would be expected to have sufficient income to offset those losses. The concept was correct - that if a company did not carry back the loss in the current year, they would carry it forward in future years.

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Representative Carpenter wondered if it was safe to say that the tax picture for FY 23 would likely change. Mr. Stickel confirmed that there was uncertainty in the FY 23 number. He indicated that what he did know was that tourism-related companies accounted for a significant share of the expected carry back losses for the non-petroleum corporate tax. The department was not expecting recovery in the non-petroleum companies in terms of corporate taxes until after 2023. He added that to the extent that some of the recent policy action helped those companies return to profitability, it would offer a potential upside to the forecast.

Mr. Stickel moved slide 19 that started with the oil price. It showed DOR's spring 2021 price forecast for ANS crude and a comparison to the previous fall forecast. The oil price forecast was based on the futures market projections as of the final week of February [2021]. The department used the futures market to forecast FY 22 and held the forecast constant in real terms beyond FY 22. The department had seen that oil prices had stabilized over the previous few months as demand had recovered and markets had worked through some of the excess supply. In total, the spring forecast for FY 21 was $53.05 per barrel which was $7.73 per barrel higher than the fall forecast. He reported that for FY 22 the forecast had increased by $13 per barrel to $61 per barrel.

Representative Carpenter assumed, comparing the fall forecast to the spring forecast numbers, that the fall forecast numbers were also based on futures projections.

Mr. Stickel replied he was correct. The department used the same protocol for both the fall and spring forecasts.

Representative Carpenter thought the fall forecast had been stuck at $55 per barrel and the forecast was a decline from that dollar amount. The exact opposite occurred. However, it was not from the state's guessing. It was based on what the future's market thought was going to happen. He asked if he was correct.

Mr. Stickel reported that in the fall forecast, the department based the FY 22 forecast on the futures market projections for Brent crude. As of the final week in November it yielded a FY 22 price of $48 per barrel. The department updated the spring forecast using the exact same methodology to yield the price forecast of $61 per barrel.

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Mr. Stickel indicated that slide 20 showed how the department's price forecast compared to various other sources of forecasts as of March 9, 2021. The Alaska North Slope price forecast was compared to Brent price, the benchmark crude the department used for comparison because of it being a widely traded global crude of a similar quality as ANS crude and generally priced similarly in the market. He pointed out the comparison of forecasts to the Brent forecast from the Energy Information Agency (EIA), the current futures market outlook, and average analysts' forecasts. The slide indicated that for the following couple of years the state's forecast was in the range of other sources of oil market expectations.

Mr. Stickel turned to slide 21. He highlighted that oil prices could turn out differently than forecasts. The chart showed how unrestricted revenue for FY 22 would change with oil prices higher or lower than forecasted. As a rule of thumb, below the department's forecasted price, each dollar change in ANS equated to about $25 million of unrestricted revenue. Above the state's forecasted price each dollar change equated to about $35 million of unrestricted revenue.

Mr. Stickel continued to slide 22 to discuss the production forecast. The slide showed the forecast for ANS production as well as a high case and low case over the following 10 years. The production forecast was prepared in collaboration with the Department of Natural Resources (DNR). Compared to FY 20, the state was showing a slight increase in production for FY 21 to 480,000 barrels per

day, then a slight decrease in FY 22 to 460,000 barrels per day.

Mr. Stickel explained that the reduction in drilling in FY 20 due to Covid was one of the major drivers behind the fact that the state was looking at a slight production decline in FY 22. However, for FY 23 and beyond, the department expected production to increase reaching 565,000 barrels per day by FY 30. There were two major factors that contributed to the outlook for increasing production. The first factor was the assumption that drilling would resume in the existing fields. He had seen some positive announcements recently and was hoping to see some more in the near future. He also hoped to see a reevaluation of the forecasted long-term decline rate assumption for the existing fields by DNR. The second factor was an improved outlook for new fields coming online based on the higher oil price forecast. As always, the production forecast was the most likely value taken from a range of possible outcomes. Comparing the high and low cases, by 2030 production could be as high as 800,000 barrels per day or as low as 300,000 barrels per day.

Mr. Stickel advanced to the graph on slide 23 that showed the base case spring forecast for ANS oil production and how it compared to the fall 2020 forecast. Over the full 10-year period the forecast had increased for each of the years due to a combination of lower expected decline rates at the existing fields compared to the fall forecast assumption as well as an improved outlook for new developments based on the higher oil forecast.

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Representative Wool found it interesting in forecasting that a slight change in oil price for a short period affected the outcome out 10 years. The previous few slides reflected an increased projection several years out. He referenced slide 10 showing that the price of oil changed from $50 per barrel to $60 per barrel and stayed parallel 8 years to 10 years out. He wondered if the numbers were fickle.

Mr. Stickel replied that in terms of the oil production forecast there were two significant components to the increase in the production forecast. The first component was the improved outlook for new development based on

higher oil prices. The second component was that DNR took a look at the existing fields and the reservoir history and reevaluated the expected long-term decline rate. He noted the challenge of oil price forecasting. While the department thought its forecast was the most accurate given point-in-time, it was worthwhile considering what would happen under higher or lower prices. He thought the chart on slide 21 might help to understand how higher or lower prices would impact the revenue forecasts. The Department of Revenue also prepared a 10-year outlook with sensitivity to oil prices and looked at a range of possible oil prices to help policy makers understand how higher or lower prices would impact revenue.

Representative Wool suggested that when the price of oil went up production went up also. He mentioned fracking. He wondered if his line of thinking was accurate. He was skeptical looking 10 years ahead. He asked how often DNR conducted an assessment in the decline of fields.

Mr. Stickel understood that DNR looked at the decline rates and revisited the assumptions on a regular basis. They updated the forecast twice per year for DOR's revenue forecast. He deferred to DNR regarding any nuance questions about production forecasts. He relayed that DNR had delivered an excellent presentation on the fall forecast to the committee. He was certain DNR would be happy to provide detailed information on their spring production forecast as well.

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Representative Carpenter had looked back at the fall forecast. He was currently looking at the Brent forecasts on slide 20. He noted that the DOR, Nymex, analysts, and EIA forecasts from the fall did not see an increase in the price from $55 to the current price. He wondered what was happening and what did everyone miss. He thought of Covid, elections, or a worldwide influence. He asked Mr. Stickel to share his thought on what was currently happening.

Mr. Stickel responded that forecasting oil prices was extremely challenging which was the reason for the range that could be seen on slide 21. IN terms of what had changed in the market, he thought the economic recovery and the optimism about a potential in an improvement in the Covid situation had gone better than anticipated. He had

discussed the roll-out of vaccines, a process that had gone better than expected. He mentioned demand and the general economic recovery had gone better than expected. He largely attributed the change to a better-than-expected recovery. He was looking at a note earlier in the day from an economic analyst who was comparing how long it took the economy to return to the prerecession trend in historical recessions versus the current recession. The current recovery was proceeding much quicker than historically was the case.

Mr. Stickel reported that slide 24 continued on to look at how allowable lease expenditures for the North Slope had changed over the past decade as well as a forecast for the next 10 years. Company spending was an important measure of current and planned Investment in Alaska. It was also something the department tracked because the costs of production were deductible in the production tax calculation.

Mr. Stickel continued that in FY 20 North Slope capital expenditures were $2.6 billion and operating expenditures were $2.9 billion. It was the second year in a row of increases. For FY 21 with the Covid situation and the low prices earlier int eh fiscal year, he had seen significant cutbacks in spending. He was expecting that for FY 21 North Slope spending would be down by $2.7 billion year over year.

Mr. Stickel indicated that there were signs of recovery. The department was forecasting increases in North Slope spending in FY 22 and FY 23 based on some of the investments in the new developments such as Willow and Pitka as well as the resumption of drilling in the major fields. Long-term, he was expecting capital expenditures to stabilize at a little over $2 billion per year.

Mr. Stickel relayed that on the operating expenditure side there was a reduction in the previous year. He was expecting that some of the reductions become permanent. Companies had figured out how to reduce costs, and some of the cost reductions would be maintained over time.

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Representative Rasmussen asked how a $2.7 billion loss in capital investment trickled down and affected Alaska's economy.

Mr. Stickel replied that in general, a $2.7 billion reduction in capital spending would be significant. In the forecast for FY 22 oil production was expected to decline year over year. On one hand, less activity would take place which would impact jobs and the money spent with service providers who would also be impacted. He noted that for native corporations, one of the major service providers on the North Slope, shareholder dividends would be affected. He confirmed that the loss of capital investment would reverberate throughout Alaska's economy. The optimism about future spending bouncing back he definitely hoped would pan out.

Representative Rasmussen asked Mr. Stickel to speak to how many different support companies serviced the larger oil companies on the North Slope.

Mr. Stickel responded that there were several companies involved with the North Slop operations that employee many people and generated significant economic activity in the state. He could follow up with some numbers.

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Mr. Stickel reported that slide 25 showed a similar history in forecast for transportation costs. The transportation costs were shown on a per barrel basis and they included all the costs of getting oil from the North Slope to market including feeder pipeline tariffs, the Trans Alaska Pipeline tariff, and tanker costs. The department was forecasting $8.89 per barrel average transportation costs for FY 21 and $9.72 per barrel for FY 22. The interesting take-away for the slide was that DOR was forecasting that transportation costs would remain under $10 per barrel through FY 30. It was largely a function of oil production and that the department was forecasting some modest increases in production. The costs of operating transportation infrastructure were being spread out over a slightly increased number of barrels over time which helps to keep the lid on transportation costs.

Representative Rasmussen noted that a $2 increase in transportation costs was fairly substantial. She thought

the cost equated to about $8 to $10 per barrel. She asked Mr. Stickel to highlight what happened between FY 19 and FY to explain the steep increase.

Mr. Stickel answered that one of the impacts was production was expected to be slightly lower in FY 22. He suggested that when production showed even slight declines, there was an increase in transportation costs on a per barrel basis. He noted that when production increased, transportation costs stabilized on a per barrel basis.

Representative Rasmussen asked, if there was a massive change in the oil tax structure, whether prices could be driven even higher as a result of lower production. She thought that if the financials did not work because of oil taxes getting too high at a certain point companies might decide to make investments in other places.

Mr. Stickel replied that anything that caused production to increase would place downward pressure on the pre barrel transportation costs. Conversely, anything that caused production to decrease would put upward pressure on transportation costs on a per barrel basis. There were a number of factors, fiscal policy being one of them, that could influence production potentially.

Representative Rasmussen asked how Alaska ranked in terms of transportation costs compared to Texas and North Dakota. Mr. Stickel responded that Texas was relatively close to the delivery point for oil. Whereas South Dakota suffered from relatively high transportation costs. There was a significant distance from the production area to market.

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Representative Wool understood the relationship between how much oil was being moved and the cost per barrel to move it. A set fixed cost was cheaper per barrel. The forecast was showing a 25 percent increase in transportation costs over the next couple of years and DOR's forecast was also showing an increase in production in the same period. He argued that increased production should make the cost go down per barrel. He did not understand the correlation. He commented that in FY 13 the price was different but the production was higher. The price at the time was just over $11 per barrel. He wondered if the cost was slightly fickle.

Mr. Stickel answered that there were multiple factors influencing transportation costs. Looking back at the early twenty-teens in addition to higher price production there were also significantly higher costs such as higher marine transportation costs. In terms of Representative Wool's comments about production increase, he clarified that the production forecast had increased for all years. In absolute terms DOR was forecasting a year over year decline in production in FY 22. His comments about production and the transportation costs for FY 22 were based on the fact that DOR was, in absolute terms, expecting that production would be lower in FY 22 which correlated with the higher per barrel transportation costs that he was expecting. Beyond FY 22 the department was forecasting increased production in absolute terms year-over-year which correlated with a stabilized transportation cost on a per barrel basis.

Representative Wool commented that the difference in price was a large percentage, whereas a difference in production was a small percentage. He realized it was not a dollar-to-dollar comparison. He believed transportation costs should be looked at with additional scrutiny later.

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Representative LeBon noted it had been stated that forecasts were either wrong or lucky. He asked how much one-on-one investigation with the industry players in developing the forecast took place. He wondered if the department reached out to the industry to get a feel for forecasting numbers out to FY 30 or were they just a best guess.

Mr. Stickel responded that in terms of the petroleum revenue forecast the department maintained an open dialog with industry. The department required industry to provide it with detailed production plans once a year for the fall forecast. The department also required the industry to provide a 5-year outlook of capital and operating expenditures twice a year for the fall and spring forecasts. In additional to the data that was submitted via tax returns, DOR met with key players ahead of each forecast to have discussions about their plans, what they were seeing, and some of DOR's assumptions and they

provided feedback. The state definitely incorporated industry input into the forecast.

Representative LeBon wondered if the forecast assumed that the Arctic National Wildlife Refuge (ANWR) was being developed. Mr. Stickel responded, "No." He explained that the high and low case on slide 22 were based on the same subset of fields in the forecast. The high and low case represented the improved chance of occurrence for those fields that were in the forecast as well as different potential production paths for each field. For a given field there could be a higher or lower than expected long-term decline rate. The ANWR production was not in the department's forecast presently.

Representative LeBon noted that at one time it was projected that 1 million barrels would get back into the pipeline. He wondered if that projection assumed several things would happen together. He mentioned many factors. The likelihood of all of the factors lining up was a longshot at best. In order to get back to 1 million barrels of oil per day would take a combination of events to occur.

2:46:04 PM

Representative Rasmussen was reviewing the history of oil production. It appeared that between FY 10 FY 14 production was relatively stable between 400,000 and 640,000 barrels per day each month. She asked if there were other factors in that 4-year to 6-year period that caused the transportation costs to go from about $6 per barrel to over $10 per barrel. She was confused as to what caused the large increase in a short window of time with relatively stable production levels.

Mr. Stickel mentioned that there was a new methodology agreed upon for Trans-Alaska Pipeline Tariffs which affected the costs. There was also an increasing share of production from fields that were paying feeder pipeline tariffs. He explained that as an increasing share of production took place further away from the inlet of the Trans-Alaska Pipeline, the tariffs of getting the oil to pump station 1 became part of the transportation costs. Another factor was general inflation of costs.

Representative Wool noted that on slide 22 the difference between the low and the high forecast was equal to the

amount of production there was currently – about 500,000 barrels per day. It seemed like a generous range in terms of forecasting. He asked how much of the transportation costs were related to pipeline and tanker in percentages.

Mr. Stickel responded that just looking at FY 22, the total transportation cost was estimated to be $9.72 per barrel. He reported the breakdown of the total transportation cost: $3.43 per barrel for marine costs; $5.82 per barrel for the Trans-Alaska Pipeline Tariff; $.63 for feeder pipeline tariff; -$.07 per barrel for a combination of other costs and quality bank. The quality bank adjustment was an adjustment for in-state refineries which effectively high-grade the oil stream slightly. Therefore, they pay into the bank which was adjusted into the net-back cost.

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Mr. Stickel turned to the final slide of the presentation, slide 26, which looked at tax credits. He reiterated that prior to 2016 there were various tax credits in statute that could either be applied against tax liability or turned into a tax credit certificate. The certificates could then be purchased by the state at face value.

Mr. Stickel continued that in 2016 and 2017 the legislature made changes to the credit laws that put sunset provisions in place for new credits. Companies could no longer earn any credits eligible for state purchase. However, there was still an outstanding balance of tax credit certificates that were earned prior to the sunset dates.

Mr. Stickel continued that there was an estimated $739 million of outstanding tax credits that were available for state purchase at the end of FY 21. There was a statutory formula that suggested an annual appropriation that might be made for purchase of those credits. The formula was based on either 10 percent or 15 percent of the estimated production tax levy before subtracting tax credits. For FY 21 no appropriation was made. For FY 22 the statutory appropriation was estimated at $114 million, an increase from an estimated $60 million in the fall forecast. He suggested that for the spring forecast if the statutory appropriation was made in each year beginning in FY 22, all outstanding credits would be paid off by FY 27.

Representative Josephson reported that in the 30th legislature he would get frequent visitors, typically from Manhattan. He noted Bank of America for example. They would be accompanied by a lobbyist and pleaded for their tax credits. Those visitors were no longer pleading and not because of Covid or a lockdown. He asked if banks had decided not to hit their heads against the wall or had gone belly-up. He wondered if Mr. Stickel knew why legislators were no longer being dunned.

Mr. Stickel heard that the holders of the tax credits would still like to be paid for their tax credits. He could not speak to why they had not been knocking on the representative's door.

2:54:14 PM

Commissioner Mahoney responded that the banks had been visiting the Department of Revenue and were still looking for the credits to be purchased by the state. The department was continuing to pursue solutions avoiding the solution overturned in the Supreme Court. As she got closer to identifying the proper solution, she would let the committee know.

Representative LeBon confirmed that lenders never moved on or forgot. They wanted to do everything to collect the debt. He was glad to hear the commissioner was working on a solution.

Representative Wool mentioned the governor's current proposal to pay $60 million in tax credits out of Alaska Industrial Development and Export Authority (AIDEA)'s funds. He asked for clarification around the figure of $114 million.

Commissioner Mahoney responded that $60 million was the original budgeted amount with the funding source being from AIDEA. The department had just released the numbers with revenue updates. Obviously, the liability for FY 22 was much higher due to the increase in price. However, she had not had an opportunity yet to discuss the issue with the governor or with the Office of Management and Budget (OMB). Those conversations would be occurring over the following few weeks.

Representative Carpenter was speaking to industry. He relayed that there were financial structures in place such that if the tax credits did not get repaid, there would be negative consequences to operators that were promised payments in the past. He argued that it was not an option for the state not to pay its debts.

Mr. Stickel was available for questions.

Co-Chair Foster invited the commissioner to make final comments.

Commissioner Mahoney summarized that the state's fiscal revenue outlook for FY 21 and FY 22 was much better presently than it was in the fall forecast. She reported that for FY 21 the increase UGF over the fall forecast was $332 million. For FY 22 the increased total UGF was $60 million. The increased revenue estimates as well as the improved economic indicators, good returns on the state's large investments, excellent vaccine availability, and the additional federal stimulus dollars created a sense of optimism.

Commissioner Mahoney commented that regarding the American Rescue Plan that was approved in the prior week, it was likely on legislator's minds how the $2.9 billion allotted to Alaska would be rolled out. She indicated the department would be needing guidance from the U.S. Treasury as to how the money could be spent. The Office of Management and Budget would manage the entire process. As OMB put together their documents the information would be shared with the legislature. She thanked the committee for scheduling the hearing on short notice. The department wanted to ensure that the information was provided to the finance committees as soon as possible.

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

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ADJOURNMENT

3:01:44 PM

The meeting was adjourned at 3:01 p.m.