

HOUSE FINANCE COMMITTEE
February 7, 2022
1:33 p.m.

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CALL TO ORDER

Co-Chair Foster 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
Representative DeLena Johnson
Representative Andy Josephson
Representative Bart LeBon (via teleconference)
Representative Sara Rasmussen (via teleconference)
Representative Adam Wool

MEMBERS ABSENT

Representative Steve Thompson

ALSO PRESENT

Deven Mitchell, Executive Director, Alaska Municipal Bond Bank Authority, Department of Revenue; Ajay Desai, Director, Division of Retirement and Benefits, Department of Administration; Kevin Worley, Chief Financial Officer, Department of Administration.

PRESENT VIA TELECONFERENCE

Emily Ricci, Chief Health Administrator, Division of Retirement and Benefits, Department of Administration.

SUMMARY

PRESENTATION: STATE DEBT and CREDIT RATING

PRESENTATION: PERS/TRS UPDATE

Co-Chair Foster reviewed the meeting agenda.

^PRESENTATION: STATE DEBT and CREDIT RATING

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DEVEN MITCHELL, EXECUTIVE DIRECTOR, ALASKA MUNICIPAL BOND BANK AUTHORITY, DEPARTMENT OF REVENUE, provided a PowerPoint presentation titled "February 2022 Credit Review and State Debt Summary" (copy on file). He discussed the credit rating agencies on slide 2 and noted that the state had credit ratings from Moody's, Standard and Poor, and Fitch of Aa3/AA-/A+. He noted that the state had obtained the highest credit rating in 2010, and there had been a series of downgrades in the state's credit since 2016. Compared to other states, Alaska was in the bottom quartile. He qualified that the state still had a strong credit rating, and it had not impacted the state significantly in the instances when it had issued debt.

Mr. Mitchell moved to slide 3 and discussed why credit ratings were relevant. He discussed the differences in credit ratings as shown on the chart on the bottom right of the slide. He explained that when bonds were sold there were maturities in each year. He discussed increasing interest rates in market over the previous year and previous month. The rates did not rise symmetrically across the yield curve. The rates would have variation, and the current market had increases greater at the short end of the curve compared to the long end of the curve. He commented that future predicting was difficult and typically wrong, but the consensus was that rates would go up over the next several years. He discussed potential rate increases in terms of basis points and percentages and commented that the previous year was the first year with a material increase in interest rates.

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Mr. Mitchell moved to slide 4 and discussed challenges with credit ratings. He thought the biggest challenge with the state's credit rating was the ongoing fiscal imbalance by generating less revenue than there had been need for appropriation. He mentioned the percent of market value (POMV) transfer from the Permanent Fund and the ongoing discussion regarding its use. He mentioned the state's 10-year plan reflecting a surplus in the current and following

fiscal year, and the fact that there were arguments that the surplus might be from one-time revenues. He considered that there was still a surplus and reflected that it had been over 10 years since the state had a surplus or projected a surplus. There were still deficits forecast for 2024 through 2029 based on the fall Revenue Sources Book (RSB).

Mr. Mitchell mentioned reductions in state spending, a projection of balanced budget, an improved oil price environment, and significant improvement in the funding ratios for Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS). He highlighted that actuarially at the end of the fiscal year, the retirement systems were 85.5 and 92.5 percent funded, which was extraordinary considering the 50 percent to 60 percent funding levels in 2013.

Representative Josephson looked at the 85.5 and 92.5 percent funding ratios for PERS and TRS. He noted that a person the previous week had given a funding ratio of 76 percent. He asked for detail on the difference.

Mr. Mitchell answered that the Division of Retirement and Benefits would have more detail. He relayed that as of June 30, 2019, PERS was funded at 78.4 and TRS at 85.9. The previous year PERS was funded at 76.9 and TRS was funded at 84.7. There had been improvements in subsequent years and taking out some of the actuarial analysis and looking at the information in isolation, the funding ratios improved even more due to a smoothing process for balances with the trust. He thought the ratios were even better than what was stated in the presentation.

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Representative Edgmon stated that some of the best analyses of the state's fiscal situation had come from the writings of the three credit rating agencies. He looked at the bottom of slide 4 related to the perception that the majority of operating revenues and the state's economy were primarily reliant on petroleum development. He wondered why there would be a perception that the majority of the state's operating revenue came from oil revenues when 65 percent of the state's funding for government operations came from earnings of the Permanent Fund. He asked for more detail.

Mr. Mitchell answered that the claim about oil revenue was also a frustration of DOR, and DOR had discussed the matter with the rating agencies. He related that the ratings agencies defaulted by historical practice, and things happened generally happened slowly in the ratings agency world. He thought the state was a unique, and that it was necessary to say the same thing over and over again.

Representative Edgmon thought it would stand to reason that when talking about the three largest credit ratings agencies in the world, that the fact the state spent down its savings and Constitutional Budget Reserve (CBR) would be of concern.

Mr. Mitchell thought that when agencies considered the state, the agencies recognized that there was more than the CBR available. He recognized that there were political challenges with the use of the CBR. He thought the CBR's depletion was a significant factor in downgrading the state's credit rating.

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Representative Carpenter stated that the bullet point identified by Representative Edgmon was also confusing to him. He thought the concept of operating revenues and the state economy were largely disconnected. He asked how many states had two-thirds of their operating revenues from investment.

Mr. Mitchell answered, "None."

Representative Carpenter considered that the system did not work for Alaska since the state did not "fit into the mold." He stated that the state's biggest long-term challenge was not oil. He thought it indicated there was a disconnect with the ratings agencies and Alaska's particular situation.

Mr. Mitchell agreed that it was challenging for the state to conform to the criteria the ratings agencies had established. He detailed that post-housing crisis there had been a lot of regulatory oversight and congressional interest in the rating process. When agencies looked at the state, they wanted a score for the economy. Alaska's economy was small and did not meet a certain threshold. He

thought Moody's had a minimum size to achieve an AAA credit rating for economy, which was something like \$75 billion. He noted that the state's GDP fluctuated greatly with the price of oil, and typically did not hit that number unless the price of oil was up to \$150/bbl. He articulated that it was a struggle to show the state had a diverse economy that was not completely reliant on oil as it may have been in the past.

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Representative Carpenter asked for the connection between a percent of market value (POMV) draw of \$3 billion to \$5 billion and the health of the state's economy, especially considering that \$3 billion to \$5 billion might be spent completely on state revenue.

Mr. Mitchell answered that he, along with others from DOR had made the argument that what Representative Carpenter had described was one of the strengths of the state, in that there was revenue derived by the economy used to fund state government and provide cash payments to state residents. He commented that there was no other state like that.

Representative Carpenter stated that Moody's was not as concerned with the state's spending as much as the size and health of the economy. He pondered how Moody's and other agencies viewed the Permanent Fund earnings helping state government but not the economy if the interest of the agencies was on the economy.

Mr. Mitchell answered that the Permanent Fund was but one component looked at by agencies. He elaborated that the agencies did take the state's reserve position into consideration. He discussed the credit given for the facets of the state's economy and reiterated the difficulty of getting Alaska to conform to the rating systems and matrices used by rating agencies. He continued that it was difficult when there was credit strength coming from a different structure than other states may have.

Representative Rasmussen referenced the reductions to the CBR. She asked why the ratings did not reflect the growth in the Permanent Fund.

Mr. Mitchell responded that the Earnings Reserve Account (ERA) of the Permanent fund was reflected as an available reserve compared to years when the ERA had a much smaller balance and the CBR balance was much higher to show the liquidity position of the state compared to previous years. He commented that there was a lot of policy and politics that revolved around the use of reserves, which the agencies were also aware of and took into account. He noted that at one point the state did not even get credit for the ERA, and it had been viewed as "off the table" in the past and had only been available for PFDs. He commented that passage of legislation and the use of the Permanent Fund earnings through the POMV transfer in part for state government was what had stabilized the credit rating of the state during the slide between 2016 and 2020.

Representative Rasmussen found it surprising that Alaska would not have a higher position as a state with substantial reserves. She estimated that Alaska was likely in the top 25 percent of other states in terms of an annual budget and amount in reserves. She understood the impact of federal policy and thought a conversation with the federal delegation was warranted.

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Representative Wool thought slide 4 was very informative and candid. He thought the legislature regularly discussed the challenges listed on the slide. He looked at the bullet point at the bottom of slide 4 that indicated Alaska's economy was narrow and relatively small and commented that oil was a smaller part of the state's economy than it used to be. He asked if there was any discussion by credit agencies or others that related to the state's gross domestic product (GDP) growing without its revenue growing.

Mr. Mitchell replied that the department brought up the fact that the state had the ability to tax its economy for revenue generation, and it was a credit strength. He considered how the agencies considered the state's economy, and explained the agencies continued to use standards that Alaska did not conform to well. He mentioned Department of Labor and Workforce Development statistics on employment and commented that there was a diverse pie chart depicting types of employment. He commented that the portion of employment attributed to oil and gas was relatively small

at 3 percent, but it generated revenue that spun into other sectors.

Mr. Mitchell thought there was an ongoing struggle to ensure that the rating agencies were as informed as possible and that the state conformed to the extent possible to the rating agencies' standards. He thought the biggest issue was why the state was not recognized as much for the strengths it had. He thought part of the issue was the lack of a fiscal plan. He mentioned past special sessions and difficult budget processes, which was reviewed by the credit agencies.

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Representative Wool mentioned the state's large savings account mentioned by Representative Rasmussen, drawing 5 percent as the state's major revenue source and not knowing the future of oil, he considered that the Permanent Fund could function as a "retirement plan" for the state for hundreds of years. He thought the fund was not functioning as a savings account. He stated that it was not desirable to dip into a retirement account, but rather have it gain value.

Representative LeBon asked for comment on the governor's proposed general obligation (GO) bond that would require voter approval in November. He asked if the payment on the bonds would take priority over all other spending if they passed.

Mr. Mitchell answered that GO bonds were a full faith credit pledge by the state and would have the highest constitutional requirement for payment, and would be paid with or without appropriation.

Representative LeBon stated that the committee had been told recently that the reason for the GO bond was because of investment earnings from the Permanent Fund (which he thought one could say were directly connected to repayment of the bonds) were earning much more than what the state would be paying on the bonds. He suggested considering the investment earnings of the Permanent Fund had priority over all other spending if the voters approved the GO bond. He considered that access to the earnings was the equivalent of a CD or savings secured loan at a bank, which had an ensured repayment. He wondered if the state's interest rate

on a GO bond pledge would improve because of the near guarantee of repayment.

Mr. Mitchell thought Representative LeBon made great points in reference to the potential of purchasing bonds of the state. He continued that the state could not make a direct linkage between a fund other than a bona fide reserve on a revenue bond issue, which had a finite size allowance, otherwise the bonds would not be tax exempt. He cited that the Permanent Fund was operating independently and putting out investment returns, and then there was the bond issue being considered. He surmised that the committee should be sophisticated enough to look at the issue holistically, while understanding that there was a revenue stream derived from investment income and there was an allowance to use tax-exempt debt at the same time. He added that one did not want a bright line drawn between the two.

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Representative LeBon surmised that voter approved GO bonds would be as close to a guarantee of repayment as possible.

Representative Johnson commented on the market's desire for stability. She commented that the perception became the reality whether or not it was the fact, Alaska not being able to get the word out of what was true and who it is. She mentioned a bipartisan working group that had tried to put forward a plan. She had seen a February 5 Market Watch opinion piece about money trouble with Alaska's oil fund. She believed the headline was damaging to perception. She noted that the governor had put forward a handful of bills and believed that the bills addressed things on the slide such as bridge funding. She stated that one of the things legislators did not always hear was about the context of what the state's financial "big picture" looked like. She would appreciate talking about the situation in terms of reality.

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Mr. Mitchell moved to slide 5, "Alaska's Most Pressing Credit Rating Challenge," which showed a table including historical revenues and spending, as well as state savings accounts and POMV transfers. He highlighted the 'Historical General Purpose UGF Revenue' column and made note of the decline from nearly \$7 billion in 2013 to a low of \$1.3

billion in 2017. He noted that all of the years (2013 to 2022) showed a deficit reflected in red in the 'Unrestricted Surplus / (Deficit)' column. He reminded that 2022 was a year where the deficit was flat, which he intended to highlight the next time he met with ratings analysts, regardless of how the situation was achieved. He pointed out the change in net position in the last column that showed that every year the UGF revenue was in deficit, but not every year was there a loss in net position because of restricted revenues. He explained that the state had created a structure that was conservative at its core, and as a result more than half the time there was not a deficit even when the budgetary outcome reflected a deficit.

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Mr. Mitchell offered to skim over some slides that had to do with outstanding debt. He turned to slide 7 and discussed the state debt obligation process. He highlighted that any debt of the state had to be authorized by law, and in some instances by the constitution, and in others (such as GO bonds) by the voters. He noted that there was not a lot of flexibility in state debt and referenced a Supreme Court decision from 2020 that limited the ability to borrow other than for a real property, GO bond projects, and revenue bond structures.

Mr. Mitchell noted that there were very few revenue bond structures because of the prohibition against dedication of state revenues. He mentioned the University, the airport system, and some federal items that were exceptions. He mentioned state reimbursement programs such as The School Debt Reimbursement Program, the Transportation And Energy Reimbursement Program, which had been partially funded in recent years. He offered that from a credit perspective, it was a positive for the state even while negative at the local level as the costs were picked up by local taxpayers. The state was able to diminish its spending by not funding the program and the local obligation bonds for the projects. He mentioned the retirement systems and that the state was obligated to constitutionally or statutorily pay through the payment structure.

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Representative Rasmussen asked if the legislature taking up legislation to look at ending the moratorium on ending bond

debt reimbursement would negatively impact on the credit rating.

Mr. Mitchell did not believe it would have a negative impact. He expanded on the question. He suggested that there would be a different way the state could participate in funding of schools rather than through a reimbursement program. He pointed out that the municipalities had shouldered a burden recently, and he thought it made more sense if the state funded its portion and the municipalities funded their portion. He mentioned that in the communities of Dillingham and Haines, he had been concerned when he had heard the program would not be funded because they had large projects to provide for local education and the state was not providing payments. He continued that when there was a limited budget sometimes there was not opportunity to raise the extra funds. He suggested that the legislature do a "deep dive" on how education was funded if a moratorium were considered.

Representative Rasmussen clarified that she was not referring to the existing bond debt. She was asking about legislation that would put a moratorium on bond debt reimbursement so that the state would not take on additional bond debt agreements with local communities. She wondered if a policy decision was made to end a moratorium and incur more bond debt if it would be a negative impact to the state's credit rating.

Mr. Mitchell did not believe there would be a negative credit reaction. He thought the way the program was structured, it presented challenges for municipalities when it was subject to not being funded at the whim of the legislature.

Representative LeBon asked about oil gas tax credits. He wondered if credit markets looked negatively at the state if it was not in compliance with paying the obligation.

Mr. Mitchell answered that the payment or nonpayment of the credits had not been a significant point of discussion for rating analysts. There was a combination of items that diminished the faith of investors in the state, and he thought the credits could be included. He thought the matter was similar to the School Debt Reimbursement Program in that it did not have a direct impact on the state's credit. He commented on the faith of repayment of a loan.

He stated the topic of the tax credits was one more thing the state could be asked about.

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Mr. Mitchell moved to a table on slide 8, showing the total debt in Alaska on June 30, 2021. The table came from an annual publication produced in January of each year called the Alaska Public Debt Books, which summarized state commitments on a priority basis. The top priority was GO bonds, followed by guaranteed debt and the Alaska Housing Finance Corporation (AHFC) Veterans Mortgage Program. He listed state-supported debt, which was subject to appropriation. The debt was limited to real property investments, the largest of which was Goose Creek Correctional Facility. He mentioned state-supported municipal debt, which was also classified as subject to appropriation. The state's portion of the GO bonds of municipalities was \$561 million, which was the portion the state would pay debt service on under the program parameters. The state reimbursement of capital projects had \$19 million outstanding.

Mr. Mitchell mentioned the pension systems and expected the numbers to diminish based on investment performance in the past year. He mentioned state moral obligation debt with the Alaska Municipal Bond Bank, which lent to municipalities. He mentioned that Representative LeBon had a bill pertaining to the Alaska Municipal Bond Bank. He mentioned state revenue debt and that there was limited opportunity for revenue bonds, with \$319.4 million outstanding currently. He mentioned multiple refinancings to ensure Anchorage remained as competitive a cargo hub as possible.

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Representative Wool asked for a definition of moral obligation in the current context.

Mr. Mitchell answered that moral obligation was a term recognized by financial markets and the municipal marketplace, which meant in a statutory construct one was required to create a reserve fund, which was typically one year's worth of debt service on bonds. The sufficiency of the funds must be reported to the legislative body, and in the event of a deficiency in the reserve there was an

expectation or moral obligation that the legislature would replenish the reserve. There had not ever been a request for a replenishment, so it was an untested moral obligation.

Representative Wool asked for verification that it did not mean that the debt was morally more valid than employee retirement or school bond debt, but rather was the construct of the reserve fund.

Mr. Mitchell agreed. He mentioned that there were social bonds that were getting closer to altruism. He addressed slide 9, which was a continuation of the table on slide 8 and the total debt in the state. He noted that the University had a surprisingly close linkage with the state. The University had to obtain permission from the legislature if it wanted to issue most debt. He noted that the information could be seen in the rating agency reports, including some of the impacts due to reductions in state support. He discussed state agency debt, primarily from AHFC, which was the largest issuer of debt in the state.

Mr. Mitchell continued that the Municipality of Anchorage was the second largest issuer of debt, and the Alaska Municipal Bond Bank was the third largest issuer of debt over the previous five years. He mentioned funding loans with long-term bonds, state capital project bonds issued for capital projects in the state, and bonds for a National Oceanic and Atmospheric Administration (NOAA) program without moral obligation for the state. He mentioned the Alaska Railroad and the Northern Tobacco Securitization Corporation, listed under 'State Agency Debt' on the slide. He continued to list 'State Agency Collateralized or Insured Debt,' including AHFC, the largest issuer with mortgage programs, as well as the Alaska Industrial Development and Export Authority (AIDEA), which had power revenue bonds.

Representative Josephson asked about when Mr. Mitchell discussed the capacity to take on new debt and what was fiduciarily responsible and what was not. He asked about the state capital project bonds, and whether they went into the calculus.

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Mr. Mitchell replied in the negative and noted that the state capital project bonds were supported by program receipts. There was an almost zero likelihood that the state would feel obligated to pay in an event of fiscal failure. He listed the GO bonds, state-guaranteed or state supported debt, or state moral obligation debt as items that would have some awareness when thinking about debt capacity.

Representative Josephson surmised they were looking more at slide 8 rather than 9.

Mr. Mitchell agreed that slide 8 had a greater correlation to the state's ability to finance.

Representative Edgmon was intrigued to know the City of Anchorage was the second largest issuer of debt in the state. He asked for detail.

Mr. Mitchell replied that Anchorage was the largest most sophisticated community in the state. He detailed that the city was operating in a fashion that might be more similar to a community in the Lower 48 and taking advantage of paying for projects with tax exempt bond proceeds and paying the debt over time with taxes of facility users. He considered that the city had a ballot proposition almost every year, and the debt could be for school projects; recreational projects; or water, sewer, and electric infrastructure.

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Representative Edgmon stated it was interesting that if there was a more sizeable capital budget there would be less of a need to bond in Anchorage.

Mr. Mitchell answered, "Most likely, yes."

Mr. Mitchell turned to slide 11 and discussed a publication called the Debt Affordability Analysis, which was statutorily required. He recalled that former House Finance Committee Co-Chair Representative Mike Hawker had sponsored the legislation to require the publication, which conformed to information that debt rating agencies liked to see. The agencies liked to see a discussion of what was affordable as well to ensure there were standards for providing

guidance to elected officials. The book discussed credit ratings.

Mr. Mitchell discussed the primary analysis that was undertaken in the publication, because Alaska did not lend itself well to a debt per capita analysis. The state had a relatively small population compared to a relatively high-income level as a state, when comparing revenue generation to population. There were other states that used percentages of revenue to determine capacity, and for Alaska the state's debt paid from the General Fund should not exceed 4 percent. He mentioned volatility in oil price, and that the projection for the current fiscal year would line up at 3.2 percent. There had been improved revenue projections since the fall forecast that could adjust the number slightly higher. The number rose to 7 percent when combined with other items the state supported like the School Debt Reimbursement Program.

Mr. Mitchell noted that the Debt Affordability Analysis book also identified currently authorized, but unissued debt. The book discussed refinancing parameters and short-term debt. The book took into account some of the issues surrounding the POMV, and the POMV transfer was considered UGF revenue. He thought a clearer path of how the POMV revenue would be split between PFDs and the state budget would be beneficial in determining capacity. He referenced PERS and TRS funding, which dwarfed the rest of state debt and would be addressed in a later slide.

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Representative Edgmon returned to the topic of a GO bond measure. He asked if the legislature could only authorize for specific projects, or could it authorize a set amount to go with federal funding for infrastructure that could come to the state in the following four or five years.

Mr. Mitchell directed the question to the Department of Law or Legislative Legal Services because it was a legal matter. He had seen local GO bond propositions that were broader, and mentioned the Northwest Arctic Borough, which had organized in part to provide better opportunities for education facilities. The borough had passed a \$100 million GO bond authorization for school facilities, and the allocation of the bonds had been done by the assembly over the years as projects came up in various communities.

Representative Edgmon noted a news article that indicated that the state had only had approximately 18 bonds in total. He asked if the bond bank had been granted legislative authorization in the past but not executed the authorization.

Mr. Mitchell replied that he was assuming Representative Edgmon was referencing the GO Bonds for the State of Alaska. He noted there had been instances where projects had not issued bonds due to other funding coming through. He referenced a 2008 transportation act, \$150 million of which was essentially funded through a General Fund appropriation two years later, so the bonds were never issued. The GO Bonds were essentially a contract with voters. He thought the matter had been challenged in court and believed that the administration could not fail to do projects that had been authorized for funding with approved GO bonds.

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Mr. Mitchell turned to slide 12 that showed the authorized bonding authority and outstanding obligations of the state. He noted that there were no authorized but unissued bonds. There had been nearly 70 GO bond issuances despite the relatively small number of issuances. He cited that there was currently a fairly mature debt portfolio outstanding for the state, with relatively rapid repayment underway as bonds had been outstanding for some time. He discussed bond repayment structures, with increasing annual payments for a period and then a declining amount a year or two after issuance. He cited that GO bonds were repaying at a rate of \$40 million or \$50 million over each of the next ten years. He read from the slide:

Annual principal repayments over the next five years are:

- GO bonds \$40 to \$50 million
- Lease bonds \$14 to \$20 million
- SDRP approximately \$60 million

Mr. Mitchell moved to slide 13, "Current General Fund Annual Payment Obligation." He noted that there was declining debt service every year after 2023, and there had been a peak in outstanding obligations in 2018. The largest

component of the obligation was the School Debt Reimbursement Program, which was declining rapidly.

Mr. Mitchell relayed that the final chart on the bottom of the slide was intended to show the overwhelming impact of the PERS/TRS special funding situation. He cited that in 2017 there was \$220 million, which was difficult to see in the chart on the bottom compared to the PERS/TRS funding. He hoped there would be some improvement as there was smoothing if the state did not have negative 30 percent year and could benefit from a reduction in annual payments. He thought the PERS/TRS being near fully funded was the strongest credit story to tell in the state in a long time.

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Mr. Mitchell continued to review slide 13. He discussed contemplation of whether the TRS/PERS was nearly enough to pay the obligations. He thought the funding was an amazing accomplishment for the state.

Representative Carpenter asked for a comparison between Mr. Mitchell's last statement that PERS/TRS were near fully funded and the perception from the previous slide and the comparative large pension liability.

Mr. Mitchell reiterated that the PERS/TRS funding was the most powerful credit story the state had at present. He detailed that the size of the unfunded liability at \$4 billion was an extraordinary liability relative to the size of the state's population. He continued that because of above-average investment performance that was not eroded by future experience the state was able to satisfy the liability.

Representative Josephson asked about the \$110 million item from the last calendar year on slide 12.

Mr. Mitchell answered that the item was the final issuance of the 2012 transportation act, which showed how long it took to build horizontal construction projects. He commented on the time frame of issuing the final portion of the authority.

Representative Josephson asked if whatever the state purchased with the funds was known in 2012 or if there was

legislative input. He asked who had decided how the money was spent.

Mr. Mitchell answered that it had been a GO bond approved by the legislature 2012 and ratified by the voters in November of 2012. The projects were all established but had taken a long time.

Co-Chair Foster thanked Mr. Mitchell for the presentation.

^PRESENTATION: PERS/TRS UPDATE

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AJAY DESAI, DIRECTOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, provided a PowerPoint presentation titled "State of Alaska Department of Administration Presentation to House Finance Committee," dated February 7, 2022 (copy on file). He had been with the department since January 2017 and brought about 34 years of experience.

He began on slide 2 showing a flow chart of how the Department of Revenue (DOR) and the Department of Administration (DOA) worked with the Alaska Retirement Management (ARM) Board. He cited that under Alaska statute, the board's primary mission was to serve as the trustee of the asset of the state's retirement systems, the state's supplemental annuity plan, different compensation plans, and the Alaska Retiree Healthcare Trust. He turned to slide 3 and highlighted membership in the defined benefit and defined contribution plans as of June 30, 2021. He noted that active members under the defined benefit plan were at 31 percent compared to 69 percent defined contribution plan members.

Mr. Desai turned to slide 4 and discussed the Employer Group Waiver Plan (EGWP) subsidy. The program was initiated in 2019 with the estimated subsidy for between \$40 million to \$60 million. He cited that in 2019 the state received about \$49.5 million, in 2020 the state received \$58.3 million, and in 2021 the amount was approximately \$64.4 million.

Mr. Desai addressed slide 5, "Additional State Contributions - Projected," which showed a table that used

information presented to the ARM Board at its October 2021 meeting.

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Mr. Desai advanced to slide 6, "PERS and TRS Health Care Trusts," with a table that showed the funded levels of PERS and TRS with and without normal cost contributions.

Representative Josephson asked what "NC" stood for on slide 6.

Mr. Desai answered, "normal costs."

Mr. Desai looked at slide 7, "Additional State Contributions - History," which showed a table. He noted that the state contributions between 2006 and 2022 added up to about \$8.1 billion.

Representative Josephson asked for verification that "normal cost" was cost that was not attributable to the unfunded liability problem, but rather expected cost of the plan.

Mr. Desai answered that the normal cost was typically defined as the benefit that was accrued during the previous plan year, and what it would take to fund the plan in the future.

Mr. Desai moved to slide 8 titled "Investment Experience":

The actuarial value of assets was reinitialized to equal fair value as of June 30, 2014 with the \$3Billion infusion from HB 119.

Beginning in FY15, the valuation method recognizes 20% of the investment gain or loss each year for a period of five years ("Smoothing").

Mr. Desai addressed recalled that in 2014 and 2015, there was \$1 billion funded to PERS and \$2 Billion for TRS. The table on the bottom of the slide showed the current earning rate assumption at 7.38 percent. He explained that with the excellent work by the ARM Board and DOR, the last two columns reflected 30 percent for PERS and 30.1 percent for TRS.

Mr. Desai advanced to slide 9, "Funded Status - Valuation Results," showing the funded status for PERS and TRS. For comparison purposes, the table showed 2019 and 2020, as well as 2021 draft numbers that were unpublished but presented to the ARM Board. He cited that in 2021 the Unfunded Actuarial Accrued Liability based on fair value of assets was \$579 million under PERS and negative \$537 under TRS.

Mr. Desai turned to slide 10, "Funded Status - Pension," and discussed the funded status of the pension. He noted that as of 2021, PERS was funded at 67.9 percent, and TRS was funded at 79.0 percent. He noted that the same numbers based on fair value of assets would be 77.3 percent under PERS and 90 percent under TRS.

Mr. Desai explained that slide 11, "Funded Status - HealthCare" showed the funded status for the defined benefit healthcare. He noted that all the numbers in red represented the old funding under the health plans, which had increased 125.2 percent under PERS as of 2021, and 134.2 percent for TRS. Similarly, the same numbers based on the fair value of assets would be 142.7 percent for PERS and 152.8 percent for TRS.

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Representative Josephson assumed medical costs in the defined benefit healthcare program were devastating the state's ability to sustainably fund the program. He thought the committee was being told that the program was now overfunded. He asked how it had happened.

Mr. Desai deferred to a colleague.

EMILY RICCI, CHIEF HEALTH ADMINISTRATOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION (via teleconference), explained that she could speak to a couple of reasons why things had changed rather dramatically since 2006 and the present. She relayed that some of the issue was related to plan management and thought the division had been consistently focusing on trying to identify ways to leverage volume to achieve better pricing. She mentioned rebidding contracts, third party administrators, and getting better value out of networks, which provided better pricing for the same services.

Ms. Ricci continued and referenced slide 5, and thought one the largest changes was the implantation of the Medicare Part D EGWP. With the EGWP being implemented in 2019, the state moved into overfunded status in the PERS and TRS plans as it related to the health plan. She mentioned that it was difficult to find opportunities where members' benefits were held harmless or improved and the state achieved significant financial savings through the addition of federal subsidies. She deferred to the chief financial officer to discuss how some of the remarkable investments from the treasury team had helped changed the liability status of the health plan.

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KEVIN WORLEY, CHIEF FINANCIAL OFFICER, DEPARTMENT OF ADMINISTRATION, elaborated that in the most recent fiscal year there were 30 percent returns. Additionally, the new prescription drug third-party administrator helped the health trust and provided significant benefit in FY 20. He continued that the biggest driver was the 30 percent return. There was a 12 percent increase from FY 20 to FY 20 for PERS and 13 percent for TRS.

Representative LeBon looked at the actuarial value of assets versus the fair value of assets on slide 11. He asked for an explanation of the difference between the with actuarial value of assets numbers and fair value of assets numbers.

Mr. Worley answered that the actuarial value of assets was a smoothed five-year average. The division looked at investment gains and assets, smoothed the numbers over a five-year period while recognizing 20 percent of the gain or loss to account for volatility. He continued that fair value of assets represented the value of assets if they were immediately liquidated and turned to cash while accounting for any debts at the time.

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Mr. Desai turned to slide 12 and discussed the historical rate of return and funded ratio. He looked at the expected rate of return for 2021 that was 7.3 percent, but the cutoff date was showed a rate of return of 27.62. He remarked that the TRS side showed a slightly higher rate of return at 27.65.

Vice-Chair Ortiz looked at the year 2000 where the funded ratio had been 95 percent followed by a significant drop down to as low as 52 percent. He asked for the reason for the drop.

Mr. Desai answered there were multiple reasons. He pointed out that during those years there was a certain questionable number, which was actually an actuarial error.

Mr. Worley answered that the healthcare costs were undervalued, so once that error was discovered the expectation saw a significant reduction.

Vice-Chair Ortiz asked for more information about the two factors.

Mr. Worley replied that annually the division had an actuarial valuation report completed by the consultants. He stated that there were various economic impacts on the results, including the dot com bust and the great recession.

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Vice-Chair Ortiz stated that obviously things had significantly improved since that time. The governor's budget had said they were okay with not doing a contribution for PERS/TRS, which would be a savings to the budget. He asked if there was potential the actuarial analysis could be wrong and the decision to not put funding into the liability could be problematic.

Mr. Worley highlighted what had changed since 2000, and remarked that that the actuarial recommendations and analyses had not occurred due to the economic impacts over the last 20 years.

Vice-Chair Ortiz stated his understanding there were certain safeguards in place at present that would make the outcome in 2022 less likely. He asked what the numbers would look like if there were a large market correction.

Mr. Desai responded that that the fair market value number would decrease significantly

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Representative Johnson asked wondered why the market changes did not line up with the actuarial issue.

Mr. Worley reiterated that there were significant impacts on the actuarial forecasts, which were due to points of economic downturns, and therefore beyond anyone's control. He furthered that he believed Vice-Chair Ortiz was referring to the healthcare cost only component that had been discussed in the public. He returned to slide 6, and pointed to FY 21. He remarked on the roughly \$68 million on the PERS side and \$25 million on the TRS side. The numbers represented a small amount, they continued to remain over 100 percent for both systems.

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Vice-Chair Ortiz asked if the term unfunded liability was separate from overfunding of healthcare costs.

Mr. Worley pointed to slide 9 showing the combined costs of the liabilities. He turned to slide 10 showing the pension funds were underfunded, and stressed that they could not move money between trust funds. The issue constantly facing the pension fund side was that it did not have the numbers the healthcare side had.

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Vice-Chair Ortiz understood that money could not be moved around once it was in one fund. He asked that because healthcare did not need funds in the current year, he asked if the money that would have gone to the healthcare side to the pension side unfunded liability.

Mr. Worley answered that because of the way the rates were set and adopted, by the board adopting a zero cost rate it reduced the effective contribution rate for employers.

Representative Carpenter asked if there were negative consequences to overfunding the healthcare portion of the pensions.

Mr. Worley did not believe there were any issues for overfunding the healthcare. The issue arose if there was overall overfunding of the entire pension.

Representative Josephson asked for verification that Mr. Worley believed that overfunding the pension was a problem, and he asked if there should be a change to provide greater flexibility.

Mr. Worley deferred to ARMB legal counsel for discussion.

Representative Josephson asked if it had to do with diminution of each trust.

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Mr. Desai advanced to slide 13 and referred unfunded actuarial liability for PERS and TRS. He reviewed an employer's pension and additional state contributions projection on slide 15. The pension assumed the 7.38 percent for 2022 to determine the 2023 rate. He turned to slide 16 and discussed FY 23 contribution rates for the defined benefit plans. He looked at slide 17 and discussed the FY 23 contribution rates for the defined contribution plans.

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Mr. Desai moved to a history of contribution rates on slide 18. He discussed projected pension benefit recipients on slide 19. He stated that the blue line reflected PERS and green reflected TRS. He shared that slide 20 showed the projected pension benefits payment.

Mr. Desai turned to health care cost trend rates on slide 21. He shared that moving forward, the rate would remain at 4.5 percent.

Representative LeBon looked at a summary of PERS and TRS participants on slide 3. He recalled that Tier I terminated in the early 1980s. He wondered whether 655 state employees were still working under the Tier I program.

Mr. Desai agreed. He reported that Tier I ended in 1986 and that there were still 655 active employees under the tier.

Representative LeBon stressed if a defined benefit program was rolled out, the state would be paying benefits out into the next century. He reiterated that it would be a major financial obligation to the state to return to a defined benefit program.

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Representative Carpenter looked at slide 21 and asked where the assessment had come from - he saw that the source was Buck.

Representative Edgmon thanked the presenters for the presentation. He agreed with Representative LeBon's comments. But he also pointed out the cost of not having a defined benefits plan resulted in a retention and recruitment issue, which was also a major cost to the state.

Co-Chair Merrick reviewed the schedule for the following day.

#

ADJOURNMENT

3:39:16 PM

The meeting was adjourned at 3:39 p.m.