SENATE FINANCE COMMITTEE
May 12, 2021
2:10 p.m.

2:10:02 PM

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 2:10 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Senator Bill Wielechowski

ALSO PRESENT

Alexei Painter, Director, Legislative Finance Division; Conor Bell, Legislative Fiscal Analyst, Legislative Finance Division.

SUMMARY

^LEGISLATIVE FINANCE DIVISION - PFD PRESENTATION

2:10:02 PM

Co-Chair Stedman discussed housekeeping. He relayed that the that the state had a finite amount of funds available, which was important to consider during the budgetary process. He added that today's discussion would prove useful when discussing rewrites to the dividend formula.

2:12:51 PM

ALEXEI PAINTER, DIRECTOR, LEGISLATIVE FINANCE DIVISION, introduced himself.

CONOR BELL, LEGISLATIVE FISCAL ANALYST, LEGISLATIVE FINANCE DIVISION, introduced himself.

Mr. Painter discussed, "Alaska's Fiscal Position and Projections" (copy on file). He looked at slide 2, "Disclaimer":

> Scenarios and adjustments in this presentation were requested by the Finance co chairs. Legislative Finance Division (LFD) is policy neutral and does not endorse a particular fiscal plan.

Mr. Painter shared that the assumptions in the presentation used the Senate budget that was currently before the committee, as well as updated permanent fund returns.

2:13:44 PM

Mr. Bell addressed slide 3, "About the Modeling Assumptions":

> • Revenue is based on Department of Revenue (DOR)'s Spring Revenue Forecast
> - Assuming $53 oil in FY21 and $61 oil in FY22, adding $331.7 million in FY21 and $459.6 million in FY22 compared to fall forecast
>
> • FY21 returns use Alaska Permanent Finance Corporation (APFC)'s actual total income through March 31 of $13,903 million, and actual statutory net income of $5,272 million
> - Assume APFC will realize an additional $350 million in Q4 due to interest and rental income
>
> • FY22 FY30 assumes 6.20 percent returns in FY22 30, unless otherwise stated
> - Default assumption is no inflation proofing for FY21 24, statutory inflation proofing after (consistent with legislative intent)
>
> • Assumes $50 million for supplementals and 2.0 percent inflation growth on agency operations
>
> • Assumes minimum $500 million left in CBR

- Full version of the model includes many revenue and spending options. LFD can work with legislators who wish to see additional options

- A simplified, shorter time horizon model is also available upon request

2:17:14 PM

Senator Wilson queried the accuracy of the assumption that Alaska Permanent Fund Corporation (APFC) would realize an additional $350 million the fourth quarter due to interest and rental income.

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Mr. Bell replied that the assumption was conservative. He said that, in absence of any gains in the stock market, the corporation had income sources that were reliable and consistent.

2:18:04 PM

Mr. Bell pointed to slide 4, "Projected Growth in Percentage of Market Value (POMV) and Other Revenue":

- Under these assumptions, the POMV draw is projected to grow faster than inflation from FY23-27 due to strong earnings in FY21

Mr. Bell explained that through the years of the forecast period the revenue outpaced inflation. He said that the 21.75 return in FY21 led to significantly higher POMV draws. He pointed out that the spring forecast showed rapid growth between FY23 through FY25 due to rebounding from the pandemic.

2:20:05 PM

Mr. Painter looked at slide 5, "Fiscal Summary with Capital Budget Placeholder." He explained that the slide reflected the first Senate committee substitute (SCS) for the Operating Budget; line 7 showed the Agency Operations and line 8 showed the Statewide Items in the SCS for the Operating budget. He stated that the Capital Budget assumption was one that had been used previously and was the governor's Capital Budget with undesignated general funds (UGF) in place of non-UGF sources, particularly Alaska Housing Finance Corporation bonds, the Power Cost Equalization fund, and the Alaska Mental Health Trust fund. He related that with this baseline Capital Budget the bottom line was a deficit, before paying a dividend, of $18.9 million - roughly a balanced budget without paying a dividend. He said that different dividend scenarios would be based on this budget baseline.

2:21:28 PM

Mr. Painter addressed slide 6, "Projected Reserve Balances with Senate CS and Capital Budget Placeholder." He noted that the numbers reflected approximately $1 billion in reserves.

2:22:08 PM

Senator von Imhof spoke to the CBR and the general fund and the fluctuation of cash flow. She spoke of emergency funding and the need for the $1 billion cushion.

Mr. Painter pointed to slide 7, "Fiscal Model: Budget before PFD." The slide showed no PFD, and the difference in the deficit number in FY22 was due to the assumption of supplementals of $50 million for future unidentified items. He noted that the model used constant 6.2 percent returns. He felt that the baseline was important because other scenarios could show a larger deficit in the earlier years than in the later years and each plan could look as if it fixed the fiscal problem. He explained that the assumption that revenue would grow faster than inflation resulted in every scenario showing improvement in the future.

2:24:21 PM

Senator von Imhof understood that the blue section of the bars showed all revenues going up. She asked about the capital assumption.

Mr. Painter relied that the model assumed a $176.7 million Capital Budget, grown with inflation. He said that this reflected a bare minimum Capital Budget. He recognized that the level of spending that would be necessary to keep up with deferred maintenance was higher than the assumption on the slide.

2:24:59 PM

Co-Chair Bishop assumed that the slide did not consider any federal funds that could be available in the future. He thought that additional UGF could make its way into the Capital Budget by way of federal dollars.

2:25:40 PM

Mr. Painter looked at slide 8, "Fiscal Model: Budget before PFD." He said that the slide showed the same base assumption using actual permanent fund earnings between 2000 and 2008, rather than the constant 6.2 percent return. He offered a brief history of the 2000-2002, recession and its effect on returns to the fund. He stated that under the scenario on the slide the ERA would dip down over the next few years and then rebound. The deficit would shrink rapidly - but not as rapidly as under the scenario on the previous slide. He relayed that the timing of the returns made a significant different in the surplus and that the model was sensitive to changes in assumptions when adding volatility.

2:28:00 PM

Mr. Painter addressed slide 9, "Fiscal Model: Budget before PFD." He said that the slide incorporated the worst year in the fund's history, 2009, which was the only year there had been a loss in the ERA. He said that the years following 2009 had been strong but noted that the ERA did not recover. He stated that the surplus in FY30 was larger than the last scenario, but the ERA was less healthy as a result of the volatility in the scenario.

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Co-Chair Stedman pointed out to the committee that there were several scenarios in the presentation that were followed up by the two different market return scenarios. He said that the model was useful to give committee members a feel for the non-linear financial markets.

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Senator von Imhof understood that the POMV was represented by the green in the bar chart on the left of the slide.

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Mr. Painter agreed.

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Senator von Imhof posited that even though the ERA in the model went down, the POMV was flattened overtime and was consistent.

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Mr. Painter replied in the affirmative. He said that the averaging of the POMV, even with volatility, was smooth.

2:29:51 PM

Mr. Painter looked at slide 10, "Legislative Finance Division 10 Fiscal Model: Budget w/ Statutory PFD." The slide showed that the deficit in FY22 would be $2.3, which had increased since the governor had introduced his budget in December 2020 due to higher returns in FY21 resulting in a larger dividend. He stated that in the scenario on the slide, the CBR was not enough to meet the deficit and additional draws form the ERA would be necessary to balance the budget. The effective POMV rates at the bottom of the slide showed that draws would be over 8 percent in some years, which would drain the ERA by 2030.

2:31:08 PM

Co-Chair Stedman understood that paying out a dividend of $3,485 in 2021 would make the FY22 draw 8.23 percent, which was substantially higher than the 5 percent draw.

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Mr. Painter agreed.

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Co-Chair Stedman asked about the negative $2,334 million in FY22 at the top of the chart.

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Mr. Painter replied that the figure would be the deficit in the current fiscal year.

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Co-Chair Stedman surmised that the figure was after the dividend was paid.

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Mr. Painter agreed.

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Co-Chair Stedman asked whether there had been a period of growth of the fund when the fund's balance had regressed in number.

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Mr. Painter replied that there had never been a period when the fund had gone down for more than a year or two at a time.

2:32:36 PM

Mr. Painter pointed to slide 11, "Fiscal Model: Budget w/ Statutory PFD." The slide incorporated the actual returns from FY00 through FY08. He noted the dotted line that reflected the budget, with the dividend, went down due to volatility. He said that the effect of having poor return years was a reduced dividend. He said that the overdraws were not as big as in the last scenario because dividends had been smaller. He noted that the ERA survived through the scenario - but in some years was essentially down to zero because of paying the amount needed to fill the deficits.

2:33:49 PM

Mr. Painter addressed slide 12, "Fiscal Model: Budget w/ Statutory PFD." He explained that in FY25, FY26, and FY30 there was a gap in the dotted line and the revenue to meet it, meaning that even after drawing out of the CBR down to zero, and drawing the ERA down to zero, there would still be insufficient reserves to meet the budget. The overdraws were large enough, combined with losses, would drain the ERA, and leave no funding for government.

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Co-Chair Bishop asked about the model in the out-years. He assumed that if there was no funding for government then there would be no funding to pay out a dividend.

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Mr. Painter agreed.

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Co-Chair Stedman noted the draw rate on the Permanent Fund and understood that overdrawing led to problems quickly.

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Mr. Painter agreed, and furthered that negative realized income, overdraws, plus the regular POMV draw, combined to drain the ERA quickly.

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Senator von Imhof understood that under the scenario there would be a need for additional revenue - such as taxes. She wondered how much in taxes would be needed.

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Mr. Painter replied that there was no single model to determine which one tax would fill the gap. He surmised that it would take a combination of tax sources. He felt that the recent ISER model showed the economic effects of the various options.

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Senator von Imhof thought that it was important to start modeling the economic impact of various taxes on working Alaskans.

2:37:16 PM

Mr. Painter pointed to slide 13, "Legislative Finance Division 13 Fiscal Model: Budget w/ 50 percent POMV PFD." The model used constant 6.2 percent returns. He shared that under the scenario the dividend would be $2,400 in FY22, which would leave $1.6 billion deficit in FY22, shrinking to $800 million by FY30. He said that the ERA would decline while the fund would barely grow and would not keep up with inflation.

2:38:18 PM

Co-Chair Stedman remarked that the previous slides were on the existing formula. He related that Slide 13 showed taking one half of the 5 percent draw for the dividend and using the other 50 percent for state operations. He said that under this model, the state would see a deficit of approximately $1.5 billion, on average per year, and other revenue would be needed to fill the gap.

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Mr. Painter agreed, and furthered that the model reflected $2.9 billion over the next two years that would have to be made up for with a combination of draws from some reserves, new revenue, or budget reductions.

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Co-Chair Stedman thought if the legislature set aside a $3 billion cushion in the CBR, and capped the portfolio at a 5 percent draw, the FY24 deficit would be approximately $1.1 billion.

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Mr. Painter agreed. He said that if the $3 billion were spent and no structural changes were made to the fiscal situation the state would go into FY 24 with a substantial gap. and explained that putting the $3 billion

2:40:13 PM

Co-Chair Stedman offered that the structural change would be increased revenue or decreased expenditures.

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Mr. Painter agreed.

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Co-Chair Stedman stated that the last two governors, and last four legislatures, had been unable to make and significant movement within the UGF that resulted in decreased expenditures. He felt that the slide suggested that the idea of implementing taxes was the most realistic for increasing revenue.

2:41:38 PM

Mr. Painter responded that as a nonpartisan employee he could not comment on the political viability of cuts or taxes. He offered that the Senate version of the Operating budget was approximately $4.5 billion, and the $1.5 billion deficit was one-third of that. He said an attempt to reduce the budget by cuts alone would mean reducing it by one-third, would prove extremely difficult if not impossible.

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Co-Chair Stedman asked whether UGF cuts over the last 5 years had remained flat.

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Mr. Painter replied in the affirmative and added that the current budget was comparable to that of FY18.

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Co-Chair Stedman hoped that those watching at home understood that the budget had already been significantly cut and the only viable option for increased revenue was taxes or revenue enhancements of some kind.

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Senator von Imhof asked whether the scenario on the slide mirrored the governor's current proposal.

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Co-Chair Stedman said that the governor proposed a 50/50 split at 5 percent POMV.

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Senator von Imhof pointed out that under the model there was a significant deficit in FY22, FY23, and FY24. She noted that the Department of Revenue had modeled that new taxes and a change to oil taxes would be needed to fill the deficit gap under the 50/50 plan.

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Co-Chair Stedman revealed that the committee would have further discussions the issue of the 50/50 split. He noted that even if the deficit projections were slightly off, they were still significant. He expressed concern at the magnitude of the overdraw illustrated in the POMV draw rates at the bottom of the slide. He noted the flat growth on the right-hand side of the slide. He hypothesized that if the portfolio could reach $100 billion, with a 5 percent or less POMV, the state could have the cash to manage deferred maintenance and infrastructure construction while also maintaining a healthy dividend and no taxes.

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Senator von Imhof commented on a draw rate of over 5 percent. She said that traditionally endowments and sovereign wealth funds did best at a consistent 5 percent draw. She said that any draw over 5 percent would erode the value of a fund overtime.

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Co-Chair Bishop stated that, while positions had been eliminated in departments to cut costs and "right size government," past attempts at income tax legislation had suggested the addition of personnel at the Department of Revenue.

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Co-Chair Stedman stated that the financial market was not linear and that consultants for the Permanent Fund had cautioned the projected returns for the next decade were lower than the last.

2:48:48 PM

Mr. Painter discussed slide 14, "Fiscal Model: Budget w/ 50 percent POMV PFD." The model used FY00 through FY08 returns. He shared the right of the slide showed that the ERA shrinks, rebounds with strong markets, and then shrinks again. He said that the deficit was approximately $1 billion per year, while the overdraws each year were 6.5 percent, or higher, to balance the budget. He said that the amount in the ERA was visibly reduced due to volatility.

2:49:53 PM

Mr. Painter addressed slide 15, "Fiscal Model: Budget w/ 50 percent POMV PFD." The slide used FY09 through FY17 returns. He noted that this model was worse than the statutory dividend model. The ERA was eliminated by FY30. He said that the deficits were comparable to the last slide and after FY24 there was no ERA worth noting.

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Co-Chair Stedman stated that if the corpus were to be rolled into the ERA, the negative volatility would not block the ability to extract 5 percent. He said that when looking at the concept of rolling the corpus in to the ERA, some of the slides would need to be adjusted to reflect the new percentages.

2:52:22 PM

Mr. Painter pointed to slide 16, "Fiscal Model: Budget w/ $1,000 PFD." The model used 6.2 percent constant returns. He shared that the deficit in FY22 was $744 million, shrinking to $334 million, and reaching a surplus in FY 25. He said that there would be an eventual surplus of $700 million by FY30. He relayed that FY22 through FY24 would require overdraws but would settle at 5 percent. He noted that the ERA was healthy in this scenario.

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Co-Chair Stedman noted that a $1 billion deficit was equal to approximately $1,600 per state resident.

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Mr. Painter looked at slide 17, "Fiscal Model: Budget w/ $1,000 PFD." The model used FY00 through FY08 returns. He said that the deficit had still shrunk in the scenario, turning to surplus in FY25 - but smaller than the previous scenario. He noted that the ERA remained healthy in the scenario and any overdraws were relatively small.

2:54:28 PM

Mr. Painter discussed slide 18, "Fiscal Model: Budget w/ $1,000 PFD." The model used FY09 through FY17 returns. He pointed out to the committee that because of the large negative market in the first year, the overdraws persisted from FY22 through FY28, but were minimal. He said that the result of the overdraws and the negative market performance meant that the ERA vanished, but the model was not considered a broken one. He explained that there was enough in the ERA to balance the budget, but barely, and in some of the years the ERA balance did not recover in the scenario despite the minimal overdraws.

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Senator von Imhof asked whether there was enough in the ERA to pay the POMV.

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Mr. Painter replied that the ERA balance on the slide was after paying the POMV draw and the overdraw. He added that it was tight - the ERA was essentially drained to nothing.

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Senator von Imhof surmised that the state lost fiscal footing for the next several years under the scenario on slide 18.

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Mr. Painter agreed.

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Co-Chair Bishop asked about FY25 and the surplus of $37 million on slide 17. He said that without any new revenue there would be no funds for a supplemental budget without and overdraw.

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Mr. Painter agreed and explained that the nature of the modeling was imprecise but anything within $100 million, either way, was close enough to balance within the modeling margin of error.

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Co-Chair Stedman added that 250 thousand workers in the state would have to pay $4,000 a piece to generate $1 billion.

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Mr. Painter addressed slide 19, "Legislative Finance Division 19 Fiscal Model: Budget w/ $750 PFD." The model used 6.2 constant returns. He noted that in contrast to the last scenario this slide showed two years of overdraws, with a balanced budget starting in FY24 and a surplus of $921 million by FY30.

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Mr. Painter pointed to slide 20, "Legislative Finance Division 19 Fiscal Model: Budget w/ $750 PFD." The model used the FY00 through FY08 returns. He stated that the scenario was like the last one with deficits in the first two years and a surplus in following years, with a healthy ERA, and a surplus balance of $509 million by FY30.

2:59:07 PM

Mr. Painter looked at slide 21, "Legislative Finance Division 19 Fiscal Model: Budget w/ $750 PFD." The model used the FY09 through FY17 returns. He related that the deficits persisted longer in the scenario - through FY26, with a balanced budget in FY27 and surplus in the following years. He said that the overdraws were small enough that the ERA persisted albeit barely.

2:59:42 PM

Mr. Painter addressed slide 22, "Fiscal Model: Budget w/ $500 PFD." The model used 6.2 percent constant returns. He noted that the budget would be balance by FY23, with surplus in the following years. He said that the overdraw would not affect the ERA balance and the ERA and corpus would grow.

3:00:23 PM

Mr. Painter pointed to slide 23, "Fiscal Model: Budget w/ $500 PFD." The model used the FY00 through FY08 returns. He noted the overdraw in the first year with a deficit of $424 million in FY22, which turned into a surplus in FY24.

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Co-Chair Stedman appreciated the numbers but recognized they were hypothetical.

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Mr. Painter hoped that there would not be another recession like in 2008.

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Co-Chair Stedman hoped that he could live to see the day when the reserves hit $100 million.

3:02:04 PM

Mr. Painter discussed slide 24, "Legislative Finance Division 24 Fiscal Model: Budget w/ $500 PFD." The model used FY09 through FY17 returns and showed the overdraw in FY22 with balanced budgets turning into surplus. He said that despite volatility the ERA would remain during this period and the fund would grow.

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Senator von Imhof noted the large drop in the first year and the subsequent claw back. She thought that the returns could not continue overtime because inflation would become a problem.

3:03:39 PM

Mr. Painter pointed to slide 25, "Impact of FY 22 Overdraw on ERA Balance and OMV Dra Constant 6.2 percent Returns." The bar chart assumed no inflation-proofing from FY21 through FY24. The chart showed what would happen if the amount pulled out in FY22 were equal to the statutory dividend. He said that the impact of the POMV draw would compound year after year and would increase the deficit by $632 million.

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Co-Chair Stedman asked whether the base number for the Capital Budget was $127 million.

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Co-Chair Bishop replied in the affirmative.

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Co-Chair Stedman relayed that the deficit number was as significant as an entire Capital Budget.

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Mr. Painter addressed slide 26, "Impact of FY 22 Overdraw on ERA Balance and POMV Draw." The bar graph assumed no inflation-proofing from FY21 through FY24. He said that the ERA would decline even without the overdraws and with the overdraws it would get down below $10 billion for a three-year period. He added that this would result in $566 cumulative difference in POMV which would have to be made up from another fund source.

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Mr. Painter looked at slide 27, "Impact of FY 22 Overdraw on ERA Balance and POMV Draw." The graph assumed no inflation-proofing form FY21 through FY24. He shared that there would be a reduction in the EA with the single draw in the first year. He related that one single overdraw could cause the elimination of the ERA entirely.

3:07:42 PM

Co-Chair Stedman announced that he had asked Mr. Painter to run a report on historical dividend growth. He said that the report would show the statutory number as well as the 50/50 plan. He spoke of the dividend amount in the event that the Callan & Associated numbers were accurate. He stated that the dividend formula that had been established

40 years ago had worked for decades but was not proving problematic due to the financial markets. He hoped that any formula established by the legislature would last for several decades. He asserted that the permanent fund was still a young fund and he hoped that the fund could stay healthy for future generations.

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AT EASE

3:12:47 PM
RECONVENED

3:12:53 PM

Co-Chair Stedman stated that the following day's agenda would be determined the following morning.

3:13:48 PM

Senator Olson announced that he would call in for Friday's meeting.

#
ADJOURNMENT
3:14:04 PM

The meeting was adjourned at 3:14 p.m.