

HOUSE FINANCE COMMITTEE  
February 7, 2023  
1:32 p.m.

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CALL TO ORDER

Co-Chair Johnson called the House Finance Committee meeting to order at 1:32 p.m.

MEMBERS PRESENT

Representative Bryce Edgmon, Co-Chair  
Representative Neal Foster, Co-Chair  
Representative DeLena Johnson, Co-Chair  
Representative Julie Coulombe  
Representative Mike Cronk  
Representative Alyse Galvin  
Representative Dan Ortiz  
Representative Sara Hannan  
Representative Andy Josephson  
Representative Will Stapp  
Representative Frank Tomaszewski

MEMBERS ABSENT

None

ALSO PRESENT

Ryan Williams, State Debt Manager, Department of Revenue;  
Fadil Lamani, Deputy Commissioner, Department of Revenue.

SUMMARY

PRESENTATION: STATE DEBT SUMMARY & CREDIT REVIEW

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Co-Chair Johnson reviewed the meeting agenda.

^PRESENTATION: STATE DEBT SUMMARY & CREDIT REVIEW

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FADIL LAMANI, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, introduced himself and offered a PowerPoint presentation titled, "Credit Review and State Debt Summary," dated February 7, 2023 (copy on file). He began on slide 2 which included some information on his professional history and experience.

RYAN WILLIAMS, STATE DEBT MANAGER, DEPARTMENT OF REVENUE, introduced himself and offered his work history, also listed on slide 2.

Mr. Lamani advanced to slide 3 and provided the agenda for the presentation. He quickly moved to slide 5 to discuss general information about bond ratings. He explained that bond ratings were a way to measure the creditworthiness of a bond, which corresponded to the cost of borrowing for an issuer. The ratings typically assigned a letter grade to bonds, which indicated the credit quality of the issuer. Bond ratings were provided by third-party independent rating agencies and examples of rating agencies were listed on the slide.

Mr. Lamani continued that the rating agencies conducted a thorough financial analysis of the issuer based on published Public Finance Criteria (PFC) that generally focused on five primary credit factors: governmental framework, financial management, economy, budgetary performance, and debt and liability profile of the issuer. An issuer often produced an official statement disclosure, which provided contacts of the issuer. After the information was gathered, the rating agencies would assign an official rating. An investment grade was considered anything from a BBB rating to an AAA rating, and a non-investment grade was considered anything from a B to a BB rating. Investment graded bonds were considered low risk and had lower borrowing costs, while non-investment graded bonds provided for a higher risk and higher borrowing costs.

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Co-Chair Edgmon asked if bond rating agencies factored in the ten-year budgeting plan for Alaska.

Mr. Lamani responded that the agencies looked at all aspects of the forecast. The agencies mostly relied upon

the revenue resource book, but they also looked at the Office of Management and Budget's (OMB) ten-year forecast.

Co-Chair Edgmon commented that it was too early to opine on carbon tax credits being a primary source of revenue.

Co-Chair Johnson announced that Representative Ortiz had joined the meeting.

Mr. Lamani continued on slide 5. In the Department of Revenue's (DOR) recent rating meeting, the rating agency Moody's Investor Service indicated it was interested in the governor's vision as it pertained to carbon credits. It was too early to predict what the actual revenues would look like, but Moody's was interested in finding out more information.

Mr. Lamani continued on slide 6 which offered a snapshot of the state's current ratings from three agencies. Moody's gave the state a AA3 rating with a stable outlook, S&P Global gave the state an AA- rating with a positive outlook, and Fitch Ratings gave the state an A+ rating with a stable outlook. The slide also showed the history of ratings given to Alaska. The highest rating the state was ever given was a AAA rating in 2012. There had been a significant change to the rating in the last few years due to the adoption of the percent of market value (POMV) draw as well as the surplus in FY 22.

Representative Stapp asked if the bond rating agencies assessed the state's credit rating health on other factors such as long-term liability.

Mr. Lamani responded in the affirmative. The agencies also looked at factors like the debt service and the net pension obligation the state had on its books.

Representative Hannan asked if the Moody's rating of AA3 was worse than AAA. She asked how the ratings compared.

Mr. Lamani responded that Moody's ratings involved adding a number to the third letter. For instance, AA2 was essentially equivalent to an AA- rating. The other two rating agencies were relatively the same.

Representative Hannan asked if AA3 was a better rating than AA-, but worse than AAA.

Mr. Lamani responded that AA3 and AAA were equivalent.

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Mr. Lamani moved to slide 7 which compared Alaska's ratings to the ratings of all of the other states. Comparatively, the state had a solid and high credit rating, although some of the other states had more diverse economies and tax bases.

Representative Galvin noted that the committee had been asking many people about various statewide rankings. She asked if Mr. Lamani had been able to place the state within the ranking system.

Mr. Williams responded that generally speaking, the state was under the 50 percent baseline. There were many high rated states, many of which had a tax base that made it easy to calculate certain recurring revenues. He thought Alaska was outside of the box because it derived revenue from oil and gas and investment income.

Mr. Lamani continued on slide 8 and the long-term impacts of the bond ratings. He explained that the state was unique when it came to the rating evaluation. It was quite different when compared to other states because it was reliant on oil and gas and the earnings from the Permanent Fund Dividend (PFD). Other states had more stability as they trajected their budgets into the future. Many of the metrics utilized by the ratings agencies were things that the state did not conform to, such as the net pension obligations. Alaska's pension plans were well funded compared to other states, however from a metrics standpoint, the agencies compared the net pension liability to gross domestic product (GDP) as opposed to comparing the plan assets and the plan liabilities. He thought that it was not a fair comparison given Alaska's population.

Mr. Lamani continued that another concern of the rating agencies was being able to see a structurally balanced budget and how much it relied on the POMV from the earnings reserve account (ERA). The state had made strides since 2013 and had been able to reduce spending. There had also been an increase in the price of oil and funding levels within the pension. The goal moving forward was for the state to mirror its rating approach as it conformed to the

criteria of the rating agencies. Additionally, the state was planning on engaging another rating agency that would be responsible for crafting a more comprehensive assessment on credit quality.

Mr. Lamani moved to slide 10 and an overview of the current municipal market and noted that there had been some recent refunding effort for some of the state's outstanding bonds. The chart on the left side of the slide showed the current rates that were accurate as of January 26, 2023. The chart also included a comparison of the rates from week over week, and a comparison of the rates within the last month. The slide included the municipal market data as well, which indicated the yield curves of the various rating types.

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Co-Chair Johnson returned to slide 8. She highlighted that there had been issues with the tax credits in the state and certain large banks had decided against investing in Alaska due to climate change. She asked if the issues had an impact on the ratings.

Mr. Lamani responded that many of the rating agencies had taken the information into consideration. It was not easily distinguishable to what degree the information had an impact on the ratings due to the state offsets. If there was a concern, the agencies would look at the financial prudence of the state.

Mr. Lamani moved to slide 12. The Department of Revenue (DOR) had looked at the possibility of conducting a refinancing of some of the existing bonds, which were generally done if there was an interest rate environment that warranted cost savings. The purpose of refunding for the state was solely to benefit upon the favorable interest rates. The department decided to refinance the 2012A bonds and 2013B bonds, which resulted in a net present value savings of \$1.7 million. It did not change the maturities of the bonds, however there were some cost savings. The state had not been in the market for quite some time; however, within an hour of the state being in the open market, the state's bonds were all essentially sold. There was also a lot of interest in the state from large banks that had a strong view of the environmental, social, and governance (ESG) framework. Historically, issuers could receive a greater benefit if bonds included a call option

provision. There was legislation in 2017 that limited the bond issuers to 90 days to maturity. There were still some savings for the issuers, but the legislation limited the savings. He turned the presentation over to Mr. Williams.

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Mr. Williams began on slide 14 and detailed the state debt obligation process. State debt was authorized by law and could be a one-time issuance amount or a not-to-exceed issuance limit in statute. General obligation (GO) bonds were required to be approved by a majority of voters and were the only debt secured by full faith credit and taxing authority. The state bond committees authorized the method and timing of debt in order to best utilize the state's credit and debt capacity while meeting the authorized project's cash flow needs. The state had established other debt obligations reimbursement programs, such as the school debt reimbursement program (SDRP) and the HB 528 reimbursement program. He explained that SDRP had been periodically funded in 2017, 2020, and 2022, but there was no funding in 2021; however, FY 23 budget appropriations had offset prior year reductions. In the next few slides, he would speak on the unfunded actuarial assumed liability for the pension system. The unfunded liability utilized the June 30, 2022, actuarial report which was in draft form and would not be reviewed until June of 2023.

Representative Hannan asked if Mr. Williams knew what the total cost would be to pay off the state's portion of the SDRP.

Mr. Williams responded that there was approximately \$657 million outstanding in the SDRP, which was issued at the municipal level. After multiplying the percentages of each individual project within the Department of Education and Early Development (DEED), the total amount outstanding that was subject to appropriation was \$440.2 million.

Representative Hannan asked how many years of additional debt would be owed if the state followed the normal payback ratio and timeline.

Mr. Williams would follow up with the exact information. The moratorium was in place until 2025, but he believed the debt service schedule was 2040. He would double check the information.

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Mr. Williams continued on slide 15 and a chart on the state's GO bonds, certificates of participation (COPs) for the Alaska Native Tribal Health Consortium (ANTHC), lease revenue, and SDRP. The state's current outstanding general obligation was approximately \$800 million. The unrestricted general fund portion of payment in 2023 was approximately \$73.5 million for GO bonds and \$22.4 million for bonds that were subject to appropriation. The charts on the slide on the lower portion of the slide depicted the total GO debt outstanding as of June 30, 2022. He explained that GO debt service was considered an accelerated paydown and approximately 72 percent of the outstanding principal was paid down within 10 years.

Co-Chair Edgmon considered the bond rating agencies' perspectives in terms of measuring Alaska's solvency and its ability to make debt payments. He asked if it would be fair to say that there were two ways of measuring Alaska's indebtedness: the first being how much the state owed on an annual basis and the second being the percentage of revenues. Some of the numbers looked daunting, but he did not think Alaska was so different than other states. He asked if Mr. Williams could comment on the topic and put it into perspective.

Mr. Lamani responded that the state had never defaulted on the repayments of bonds which was why it had a high credit rating. In 2013 and 2014, the Governmental Accounting Standards Board (GASB) 67 and 68 were introduced, and the board took into consideration the state's aggregate liability. The assessment occurred over a longer period of time rather than assigning a rating at a specific point in time.

Co-Chair Edgmon commented that the state had the most able backstop in the nation due to the Permanent Fund. Additionally, the state passed the POMV draw in 2019, which he thought would be reassuring to the bond rating agencies and any other entity willing to invest in Alaska. He thought it was worth underscoring that the Permanent Fund was part of the state's overall portfolio.

Mr. Lamani responded that states essentially had a limited taxing authority in order to meet the debt obligations of

the bonds. Absent from the general fund being able to service the debt, the state would look at other means in order to service its obligations.

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Representative Josephson asked if Mr. Williams could outline the three COPs.

Mr. Williams responded that the three COPs were the parking garage at Alaska Housing Finance Corporation (AHFC), the housing facility project for ANTHC in 2014, and the Mat-Su lease revenue bonds for the Goose Creek Correctional Center.

Representative Josephson understood that the \$440 million outstanding for the SDRP were applications that were made prior to the moratorium. He asked if he was correct in his understanding that the state could not indefinitely have a moratorium due to the state's obligation to renovate and build. He understood that the debt could not be stagnant forever.

Mr. Lamani responded that DOR would not take a stance on the legal part of the question. He confirmed that the state had an obligation to ensure that the debt was serviced through the municipalities. The decision of whether to continue the moratorium was up to the legislative body.

Representative Stapp asked if there were any potential benefits in paying off the GO bonds earlier.

Mr. Williams responded that there were different dates associated with the original issuance of each of the subsets of outstanding bonds. For instance, if the balance were paid early, the escrow would need to be legally funded with principal on interest payments to the redemption date.

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Mr. Williams continued to slide 16 and highlighted the current principal outstanding for the obligations of the state in descending order on payment from the general fund. Number one on the list was GO bonds, followed by state guaranteed debt for AHFC's collateralized bonds. The next item was state supported debt, which included COPs and lease revenue bonds with state credit pledges and payments.

He explained that the pension system's unfunded actuarial accrued liability (UAAL) included the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS). The unfunded actuarial accrued liability was from the actuarial report from June 30 and totaled \$3.9 billion. The next item was state moral obligation debt, a majority of which was through the Alaska Municipal Bond Bank Authority and had about \$993 million outstanding. State revenue debt included both the state's international airport system and the University of Alaska (UA). He continued on to slide 17.

Representative Stapp thought that the outstanding pension liability might be off by a few billion dollars based on the prior presentations given to the committee by the Office of Management and Budget (OMB) and by the director of the Legislative Finance Division (LFD), Alexei Painter. He asked when the numbers would be updated and what the impact would be on the state's overall credit outlook.

Mr. Williams responded that there was a one-year lag and slide 16 represented the 2021 actuarial report for outstanding PERS and TRS liability. He explained that DOR utilized publicly available information through rating agencies. In December of 2022, the consulting company Buck Global had presented to ARMB the draft information regarding the 2022 actuarial report. The department had utilized the numbers when presenting information to the rating agencies with the disclaimer that the numbers were preliminary.

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Co-Chair Edgmon understood that Alaska had low debt overall in comparison to other states. He asked if his understanding was correct.

Mr. Williams concurred and added that the state had a modest debt program, especially in comparison to the current revenue projections. The state's outstanding debt was somewhat favorable, but agencies reviewed all aspects of the state's finances.

Co-Chair Edgmon commented that more often than not, the legislature did not receive the highest marks for financial management; however, he posited that the legislature had historically done a reasonable job of putting itself "in

the red." The bond rating agency reports he had read in the past talked about non-quantitative aspects of the state's overall financial health. The state had been declining in population for the last nine years and was losing many of its younger citizens. The population as a whole was getting older and there were workforce challenges going forward. He wondered if population decline had begun to seep into the verbiage in some of the bond rating agency reports.

Mr. Lamani responded in the affirmative and indicated that it was one of the agencies' frameworks under the category of economy. He confirmed that it was taken into consideration from a ratings perspective.

Co-Chair Edgmon corrected himself and stated that he meant to say "in the black" instead of "in the red."

Representative Hannan referred to the Northern Tobacco Securitization Corporation 2021 Tobacco Settlement Asset-Backed Bonds under state agency debt on slide 17. She thought the state had received revenue through the tobacco settlement, but it appeared on the slide that the state owed money. The interest was substantially more than the initial debt, and she assumed it was over a long period of time. She asked for clarification.

Mr. Williams responded that the bonds were refinanced in 2021. Originally, the state divested its position in tobacco settlement. The bonds were issued through a subsidiary of the Alaska Permanent Fund Corporation (APFC) and the state received certain capital project initiatives within the structure. He would follow up with the committee with more information.

Representative Hannan commented that there had been a policy debate about the legal smoking age being raised to 21. She wanted to know if there would be policy ramifications if the state did not comply with T-21 [federal legislation which raised the federal minimum age for sale of tobacco products from 18 to 21].

Mr. Williams would follow up with the requested information.

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Mr. Williams advanced to slide 19 which discussed the debt affordability analysis report. He explained that the annual update of the debt affordability analysis was required by AS 37.07.045 to be delivered by January 31. The report discussed credit ratings, current debt levels, history, and projections. The debt that was directly paid by the state was quoted as a percentage of the total revenues and forecasted revenues, which rolled into the analysis of the debt over the 10-year forecast horizon. The 2023 analysis determined that the state conservatively had a debt capacity of \$1.65 billion. Adjustments were made to the base analysis to recognize that there would be a POMV split between the Permanent Fund Dividend (PFD) and the state's budget, special funding for PERS and TRS, and future budgeted uncertainty and volatility within the state's revenue sources.

Representative Stapp asked for clarification that the analysis showed that the state's bonding capacity was \$1.6 billion.

Mr. Williams nodded.

Representative Stapp thought that with a \$70 billion investment fund, the state would theoretically have a higher bonding capacity.

Mr. Williams responded that the analysis was based on debt ratios of currently available revenue. It estimated an annual payment of debt service and determined what the difference would be over time as compared to the current outstanding debt. When the limit of 4 percent was used for the outstanding direct pay debt, the current value was calculated at \$1.65 billion. The total would be slightly less if other state supported payments were combined.

Representative Stapp understood that effectively, the debt service obligations were already incorporated into the structure.

Mr. Williams responded in the affirmative.

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Mr. Williams advanced to slide 20 to discuss the authorized bonding authority and outstanding obligations. He indicated that he had already gone over the majority of the items.

The fiscal year requirement for annual principal payments over the next five years on GO bonds was in the \$40 million to \$50 million range, lease bonds were in the \$17 million to \$24 million range, and SDRP outstanding was \$440.2 million. There was currently no outstanding GO authorization.

Mr. Williams continued on slide 21 and noted that the chart on the slide showed that the state was in somewhat of an accelerated paydown of debt. The general fund debt service payments peaked in 2018 at approximately \$230 million. The FY 23 general fund debt service payments included approximately \$95.9 million in state GO debt and state supported debt, and approximately \$81.2 million in state supported municipal debt. There was about \$851.5 million in remaining debt service.

Mr. Lamani concluded the presentation and asked if there were any questions.

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Representative Ortiz appreciated the presentation. He was expecting to see Mr. Brian Fetcher at the meeting and asked if Mr. Fetcher was no longer with DOR.

Mr. Lamani responded that Mr. Fetcher had moved on to other opportunities.

Co-Chair Johnson reviewed the following day's agenda.

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ADJOURNMENT

The meeting was adjourned at 2:26 p.m.