HOUSE FINANCE COMMITTEE
January 19, 2024
1:34 p.m.

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CALL TO ORDER

Co-Chair Johnson called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Representative Neal Foster, Co-Chair

ALSO PRESENT

Adam Crum, Commissioner, Department of Revenue; Dan Stickel, Chief Economist, Department of Revenue.

SUMMARY

PRESENTATION: REVENUE FORECAST

Co-Chair Johnson welcomed committee members and staff. She gave an overview of the agenda for the day.

^PRESENTATION: REVENUE FORECAST

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ADAM CRUM, COMMISSIONER, DEPARTMENT OF REVENUE, introduced the PowerPoint presentation "Fall 2023 Forecast

Presentation House Finance Committee" dated January 19, 2024 (copy on file).

Co-Chair Johnson asked Commissioner Crum about Mr. Brandon Spanos, the acting director of the Tax Division within the Department of Revenue (DOR). She wanted to know the status of the position and whether there were recruiting efforts for the position.

Commissioner Crum responded that there was an initial posting for the position but there was an error in the posting that had since been fixed. He had gone through candidate resumes and there were interviews set up in the following week. Other employees had stepped up to compensate for the unfilled position.

Co-Chair Johnson asked if Commissioner Crum anticipated there being a new hire within the next few weeks.

Commissioner Crum responded in the affirmative. He assured her that all of the duties and responsibilities for the tax director were still being covered.

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DAN STICKEL, CHIEF ECONOMIST, DEPARTMENT OF REVENUE, advanced to slide 2 and detailed the agenda of the presentation. He continued to slide 4, which provided some detail on the revenue forecast. He noted that DOR published the fall forecast on December 14, 2023, and the forecast was published in the 2023 Revenue Sources Book. He explained that the book and the forecast became the basis for the governor's budget proposal. The department would update the forecast in March or April and the spring forecast would become the forecast that underlined the final version of the budget. The entire revenue book included significant information and charts and tables around state revenue sources and the ten-year forecasts for the sources. All of the information was available on the department's website, which was included as a link on the slide.

Mr. Stickel continued on slide 5. He reiterated that the fall revenue forecast was a one-point forecast within a range of uncertainty. The slide listed key assumptions that were considered in the forecast. He noted that any of the assumptions could be wildly inaccurate due to volatility.

The department was forecasting a 7.45 percent investment return for the Permanent Fund in FY 24 and 7.20 percent for FY 25 and beyond. The investment forecast incorporated actual revenue through the end of October of 2023 and a 7.45 percent projection through the end of the fiscal year. Investment revenues had significantly outperformed since the end of October of 2023. The department had incorporated stimulus funding into its assumptions about the federal impacts and the forecast included updated estimates of potential Infrastructure Investment and Jobs Act (IIJA) funding. The petroleum forecast was based on the Alaska North Slope oil price of $82.39 per barrel for FY 24 and $76.00 per barrel for FY 25. The department was projecting continued economic growth for non-petroleum revenues. Strong tourism was projected to continue with an assumption of 100 percent capacity for the 2024 cruise season. The department assumed a continued three-year recovery for the fishing industry. The forecast for the mining industry was based minerals prices from the futures markets.

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Representative Galvin asked for a better sense of perspective as to which assumption represented the biggest risk to the bottom line. She asked if the state would lose more money from a 25 percent drop in oil prices or from a 25 percent reduction in expected returns.

Mr. Stickel responded that in terms of short-term impacts, the largest component of the investment revenue to the general fund was the percent of market value (POMV) draw from the Permanent Fund. The draw was a fairly stable revenue source because the transfer to the general fund was based on the average ending value of the first five fiscal years out of the last six fiscal years. The general fund portion was less subject to volatility. Petroleum revenue had a progressive fiscal system which meant that revenue streams were significantly impacted by oil prices increasing or decreasing.

Representative Josephson referred to the Alaska North Slope oil price of $82.39. He asked what price projections the FY 24 operating was based on.

Mr. Stickel responded that he had a future slide on the topic. The spring forecast for FY 24 was $73 per barrel.

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Representative Stapp understood that all of the market pressure indicated downward trends. He asked whether there was reasonable expectation that $82.39 per barrel would be the average.

Mr. Stickel responded that oil prices were volatile and the likelihood that the barrel price prediction would be exact was low; however, the department had accurately predicted oil prices within a one dollar range as of the prior week.

Commissioner Crum added that for the public's knowledge, the estimate was derived during the first five days of December of 2023 and indicated the median oil price. The estimate would change as more complete data was collected, but the estimate would not be reflected in the forecast until it was updated in the spring.

Co-Chair Johnson asked when the spring forecast would be released.

Commissioner Crum responded that he was shooting for March 15, 2024.

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Co-Chair Edgmon understood that FY 24 was about halfway over. He asked whether the department considered low-case, mid-case, or high-case scenarios. The probability would seem to be a low-case scenario given the volatility in oil.

Mr. Stickel replied that the department acknowledged that the prices of oil were volatile and conducted a sensitivity analysis to look at the impacts of a range of oil prices. The department also had the ability to run a sensitivity analysis to look at different values for oil production and investment returns. He had a future slide illustrating the revenue sensitivity around oil prices in particular. The department was able to incorporate actual data through the end of November of 2023 for the FY 24 forecast issued in December of 2023.

Co-Chair Edgmon asked if the department released monthly tallies or forecasts.

Commissioner Crum responded that the department conducted an internal analysis but it was not planning on publishing its findings. The department used the data to ensure that the spring forecast was sound. If there were a massive global event, the department would work with the Office of the Governor and highlight the potential variances in prices. There was no intention of posting the internal analyses because the price predictions were tracking tightly to the actuals.

Co-Chair Edgmon thought the department had conducted monthly forecasts at some point in the past.

Commissioner Crum responded that his predecessor had conducted monthly forecasts.

Co-Chair Edgmon wanted to emphasize that monthly forecasts had occurred in the department's past.

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Co-Chair Johnson asked what would cause the projections to be released in April rather than March.

Commissioner Crum responded that the department was aiming to release the projections on March 15, and it was likely to do so. There was the possibility that the market could become volatile and an event like the war in Ukraine could cause the projections to be delayed. The projections were likely to be released on March 15 unless there was a catastrophic global event that would drastically change the market.

Co-Chair Johnson commented that there were two days of low oil prices in 2023, which were reflected in the [2023] spring forecast. She thought it was problematic.

Representative Ortiz asked for clarification that the FY 24 budget was based on a $73 assumption for the price of oil. He understood that on June 30, 2024, the average price would likely be $82.39. He asked if he was correct in his understanding.

Mr. Stickel responded in the affirmative. He had an upcoming slide with more details.

Representative Ortiz asked how much more revenue was expected. He asked if it was reflected in the $200 million figure.

Mr. Stickel responded in the affirmative.

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Mr. Stickel continued on slide 6, which was a visual depiction of the relative contributions to total state revenue in FY 23. The state revenue was dominated by federal revenues, investments, and petroleum. In FY 23, all other revenue sources amounted to about 7.4 percent of the total revenue.

Mr. Stickel moved to slide 7 and relayed that it was expected that federal revenue would account for almost 50 percent of total state revenue. Investment earnings were based on actual performance through the end of October of 2023 as well as a projection for the remainder of the investment for FY 24. He shared that earnings had significantly outperformed expectations.

Representative Galvin noted that the portion of expected total federal contributions reached nearly 50 percent in FY 24 which was up from 37 percent in FY 23. She thought a 50 percent reliance on federal dollars seemed high. She wondered if a high reliance on federal dollars was common and whether there was concern that the reliance could set the state up for failure.

Mr. Stickel agreed that 50 percent was a high share. The high number was related to temporary federal spending and COVID-19 relief funds. The ten-year projections incorporated the way in which the stimulus bills would flow through the budget and eventually taper off.

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Representative Hannan asked Mr. Stickel to describe the three main sources in gross dollars rather than percentages.

Mr. Stickel deferred the question because he had the exact numbers on an upcoming slide.

Representative Josephson understood that the investment earnings were up by $2.5 billion and the increase was even greater on the corpus [of the Permanent Fund] side. He asked if his understanding was correct.

Mr. Stickel responded that the estimate was based on all investment earnings and included both the corpus and the Earnings Reserve Account (ERA). The figure was an approximate number based on analysis.

Representative Josephson commented that there had been a much publicized concern about the state's inability to fund a dividend. He asked if the concern had been overcome.

Commissioner Crum responded that it was a much more positive outlook. The Alaska Permanent Fund Corporation's (APFC) consultant, Callan and Associates, confirmed that the outlook was improving significantly. He argued that there had been a massive step forward. The market returns were particularly significant in the domestic equity sector and had helped APFC as well as the Alaska Retirement Management Board (ARMB) funds.

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Mr. Stickel moved to slide 9, which showed a summary of the changes between the spring 2023 revenue forecast and fall 2023 revenue forecast. The slide was focused on the unrestricted revenue portions. The FY 24 assumption for oil prices had increased by $9.39 per barrel and the FY 25 assumption by $6.00 per barrel. The assumptions were based on the most current assumptions from the futures markets. There was a small decrease in the FY 25 Permanent Fund transfer to the general fund based on final performance information for FY 23. The value for the FY 25 transfer was now known with certainty. The unrestricted revenue, excluding the Permanent fund transfer, had increased for FY 24 by $228.3 million and for FY 25 by $86.9 million. The unrestricted revenue including the Permanent Fund transfer had increased for FY 24 by $228.2 million and for FY 25 by $79.1 million.

Mr. Stickel advanced to slide 10, which detailed the total revenue forecast for FY 23 through FY 25. The revenues were broken out into four different categories in the forecast and in the budget: unrestricted general fund (UGF), designated general funds (DGF), other restricted revenue,

and federal revenue. The remainder of the slides in the presentation were focused on the UGF revenues that could be appropriated by the legislature for any purpose. The designated general funds were technically available for appropriation for any purpose, but were customarily appropriated for a specific purpose, such as a share of the alcohol tax revenue being allocated to alcohol abuse treatment and prevention. He noted that federal revenue showed all federal receipts as restricted.

Co-Chair Johnson asked Mr. Stickel to detail the numbers on slides 8 and 9.

Mr. Stickel responded that the Revenue Sources Book reported that total state investment revenue for FY 23 was $4.7 billion, $1.8 billion for FY 24, and $5.5 billion for FY 25. Total federal dollars were $5.8 billion in FY 23, $5.9 billion in FY 24, and $6.3 billion in FY 25. Total petroleum revenue was $3.9 billion in FY 23, $3 billion in FY 24, and $2.6 billion in in FY 25. Non-petroleum revenues were $1.2 billion in FY 23 and $1.3 billion for both FY 24 and FY 25. Total state revenue in FY 23 was $15.5 billion, $12 billion in FY 24, and $15.6 in FY 25. He reiterated that totals were lower in FY 24 due to lower investment revenues. He highlighted that investment revenues would be about $2.5 billion higher if the numbers were run on the present day. The vast majority of higher investment revenues would be in the DGF and other restricted categories.

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Representative Stapp asked Mr. Stickel what a $1 per barrel price change equated to in terms of revenue to the state.

Mr. Stickel responded that a $1 change equated to about a $45 million to $50 million change to UGF revenue.

Representative Stapp commented that he understood that there was a $220 million change in revenue and a $9 price change in oil. He asked for an explanation of the numbers.

Mr. Stickel responded that there was a positive increase to the revenue forecast based on the higher oil price assumption that was partially offset by the impacts of a slightly lower production forecast. Increased expectation

for company spending or investment also impacted the production tax revenue.

Commissioner Crum added that there was about a $70 million dollar change in the prior year due to a decreased projection in oil production. He clarified that the dollar amounts originated from the production level projections.

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Co-Chair Edgmon understood that Mr. Stickel was referring to capital spending.

Mr. Stickel responded that the department had increased its expectations for capital spending. The Willow Project was one of the major fields coming online and the final investment decision at Willow was a positive development and increased the department's expectations and certainty around the project.

Co-Chair Edgmon commented that Mr. Stickel's response sounded like "positive speak" because the state was paying for the development in the short-term with the expectation that the state would be paid back in the future.

Representative Stapp observed there was a risk for the state. He thought the oil price upside was not as profitable to the state as it had been previously. He saw the same amount of revenue loss risk when the price decreased. He asked if his assessment was fair.

Mr. Stickel responded that there was a net profits based tax for production which meant that as companies spent more money, profits would decrease. If companies were to cut investments, there would be a higher share. Expectations for capital spending had increased based on positive development of projects like Willow and increased drilling in existing fields. Companies would benefit from making investments in the state.

Representative Josephson noted that the legislative auditors made sure that the capital and operating expenditures were qualifying expenditures. He understood that later in the decade, the state would begin to reap rewards from Willow.

Mr. Stickel responded in the affirmative.

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Mr. Stickel moved to slide 11. He would be focused on the UGF portion of the forecast for the remainder of the presentation. Investment revenue was one of the two largest sources with the biggest piece being the transfer from the Permanent Fund to the general fund. Investment revenue contributed about $3.5 billion of unrestricted revenue in FY 23, $3.6 billion was forecasted to be contributed in FY 24, and $3.7 billion was forecasted for FY 25. Petroleum revenues contributed $3.1 billion of unrestricted revenue in FY 23, $2.4 billion was forecasted for FY 24, and $2.1 billion was forecasted for FY 25. Non-petroleum revenues generated $466 million in FY 23, $455 million was forecasted for FY 24, and $485 million was forecasted for FY 25. Total unrestricted general fund revenues were over $7 billion in FY 23, $6.5 billion was forecasted in FY 24, and $6.3 billion was forecasted in FY 25.

Representative Galvin asked if there was a vision for the long term. She noted that there was a decrease in petroleum revenue year over year due to the increase in Willow project funds. She presumed that revenues would begin to increase again soon. She asked if there were big expenditures in FY 26 and FY 27.

Mr. Stickel responded that increased spending was part of the reasoning and the other part was oil prices that were projected to decrease. He continued to slide 12 and explained that the vast majority of UGF from investments was due to the Permanent Fund transfer. The transfer was expected to account for between 49 and 62 percent of total unrestricted revenue over the next ten years. In addition to the Permanent Fund transfer, there would be around $90 million of additional unrestricted revenue primarily due to the cash balances of the general fund.

Co-Chair Edgmon asked if the year during which the Permanent Fund lost 3.2 percent was 2021.

Mr. Stickel responded that he believed it was FY 22.

Commissioner Crum confirmed that it was FY 22 and the loss happened primarily in the month of June.

Co-Chair Edgmon asked whether FY 22 was incorporated into the current averages.

Mr. Stickel responded in the affirmative.

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Mr. Stickel moved to slide 13 which included some additional information on the market value transfer. The slide showed the real purchasing power of the transfer over time. The department was forecasting that the transfer to the general fund would be stable at around $1 billion in real terms. The figure would increase to $4.4 billion in nominal terms by FY 33 and was based on a long-term assumption of 7.2 percent returns for the Permanent Fund. A high-case and a low-case scenario was added in addition to the baseline and the projections examined a range of potential outcomes for the transfer. The transfer was reasonably predictable in the short term but there was a wider bandwidth of potential outcomes in the long term.

Co-Chair Edgmon understood that Callan was forecasting 6.25 percent returns in the ten-year forecast but 7.2 percent in the short term.

Mr. Stickel responded in the affirmative. The expected return had increased in recent years.

Co-Chair Edgmon understood that the fund total was almost $80 billion.

Mr. Stickel responded that there was a higher expected return value from a slightly lower starting value. The markets were up prior to FY 22 and the long-term expected return had decreased. The ending value for the fund was similar with a higher expected return.

Co-Chair Edgmon thought it was important to note that the value of the fund had decreased by about 10 percent. The Permanent Fund totaled $84 billion at one point in time and was increasing. He found it encouraging to hear that Callan was more optimistic than it was a few years prior.

Commissioner Crum responded that Co-Chair Edgmon's assumption was correct in that there had been significant course correction in response to lost funds. Callan had revised and updated its long-term projection of 7.2

percent. The assumption for real spending dollars in 2024 was using Callan's market long-term inflation rate assumption of 2.5 percent.

Representative Cronk understood that the POMV was being overdrawn because it was under 5 percent. He asked Commissioner Crum if it was concerning to him.

Commissioner Crum responded that he would refer to it as a real rate of return which involved subtracting the inflation aspect from the absolute rate of return. He noted it was important to be mindful of the real rate of return when considering withdrawal and the long-term sustainability of the fund. The process had been referred to as intergenerational equity against inflation for future spending power.

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Mr. Stickel continued to slide 14 and relayed that there were four main sources of petroleum revenue. The state levied a property tax on all oil and gas property in the state, which was a stable revenue source and generated about $125 million annually. The municipalities also levied a property tax on all oil and gas property which generated $480 million in FY 23. The department levied a corporate income tax on most oil and gas companies, but there were a few exceptions. The department was forecasting $240 million in revenue generated from the corporate income tax in FY 24 and $300 million in FY 25.

Mr. Stickel continued that the state's oil and gas production tax consisted of a tax based on net profits on the North Slope, against which companies could apply for a tax per barrel credit. There was a gross minimum tax floor calculation in the oil and gas production tax as well. A company's gross profit in addition to its spending totaled the company's net profit. Severance tax brought in about $1.5 billion in FY 23 and the department forecasted $938 million in FY 24. Royalties from state land brought in about $1.2 billion in FY 23 and were forecasted to bring in about $1.1 billion in FY 24 and $1 billion in FY 25. Since the figures were based on gross value, the revenue source was considered to be more stable than corporate tax or production tax which were based on net profits. There was also a significant restrictive revenue component that represented the share of royalties deposited by

constitution and dedicated to the Permanent Fund and school fund.

Representative Hannan asked Mr. Stickel to provide his thoughts on the corporate income tax. Up until a few years ago, small operators were the main entities that were excluded from the requirement of paying a corporate income tax; however, the largest petroleum operator in the state now was not paying corporate income tax. She asked if there had been analysis to show how much the state was losing by not requiring all operators to pay corporate income taxes.

Mr. Stickel responded that he did not have the exact numbers on hand, but he recalled that the spring 2023 forecast reported that it was around $100 million per year. He offered to follow up with the exact numbers.

Representative Hannan would like to be provided with the exact figures.

Co-Chair Johnson asked the department to provide the numbers to the committee at a later date.

Commissioner Crum clarified that the difference would be between an S corp and a C corp [S corps were taxed under Subchapter S of the Internal Revenue Service (IRS) code and C corps were taxed under Subchapter C].

Co-Chair Johnson asked the department to follow up via email.

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Mr. Stickel moved to slide 15 looking at the unrestricted non-petroleum revenues. The largest component of non-petroleum revenues was taxes and the largest component of taxes was corporate income taxes. He relayed that corporate income tax brought in $124.4 million in FY 23, the forecast for FY 24 was $130 million, and the forecast for FY 25 was $160 million. The increases were due to general economic growth and increased profitability as well as recovery in industries like mining and tourism. Other significant taxes included mining license tax, tobacco taxes, and various excise taxes. The line on the bottom of the slide represented unrestricted revenue from a range of other categories such as dividends to the state from state-owned operations, non-petroleum royalties, and licenses and

permits. He indicated that unrestricted non-petroleum revenues totaled nearly $500 million per year.

Representative Cronk asked whether there was an explanation for the reduction in fisheries taxes.

Mr. Stickel replied that the slide was specific to the UGF portion of the fisheries taxes and about half of the taxes were shared with municipalities. He emphasized that 2023 was a poor year for fisheries and the FY 24 collections represented a preliminary estimate of what the revenue would be for the 2023 catch year.

Representative Cronk understood that the fisheries were in trouble and revenue would continue to reduce because of the diminishing amount of marine life in the sea.

Mr. Stickel reiterated that 2023 was a tough year for the fisheries industry but the department was assuming a three-year recovery.

Representative Ortiz commented that the decline was because of fish prices rather than lack of fish. He asked why there was a decline in mining license taxes.

Mr. Stickel responded that mining license taxes primarily had to do with prices as well. Prices for precious metals such as gold and silver had increased but prices for base metals such as zinc and lead had decreased significantly. The zinc prices had declined so drastically that zinc mines in other areas of the world were closing down operations due to the low prices.

Co-Chair Johnson asked about the fisheries tax. She asked if the figures were based on a forecast for fish prices.

Mr. Stickel replied that the FY 23 fisheries revenue was known. The department had developed a preliminary estimate for FY 24 and had been advised by industry experts in order to make an accurate estimate. The department had assumed that prices would recover by FY 25.

Co-Chair Johnson was hoping that there was a reason for increased fisheries taxes in FY 23 and that there was a consensus that the market would recover.

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Mr. Stickel replied that the three-year assumption was admittedly naïve. The department thought that the events of 2023 were likely temporary. The assumption was in place for modeling purposes.

Representative Coulombe asked for an explanation of the insurance premium tax. She relayed that insurance had increased in the state and she was wondering what the tax was based on.

Mr. Stickel responded that insurance premium tax was based on a percentage of value for insurance premiums for certain companies that were not subject to the corporate income tax. He explained that the Department of Commerce, Community and Economic Development (DCCED) administered the tax and crafted the projections and DOR was not involved.

Representative Josephson asked whether the mining license tax was synonymous with severance tax.

Mr. Stickel responded in the affirmative. The mining license tax was a net income-based tax and it was the state severance tax on mining operations.

Representative Josephson asked if royalties were included on the slide.

Mr. Stickel responded that any royalties from mining on state land would fall into the "other" category on the slide. There were also significant mines that were not on state land.

Representative Josephson was accustomed to seeing the mining industry's contributions at around $100 million.

Mr. Stickel responded that the total contributions from the mining industry included mining license tax, rents and royalties, and the mining industry's share of non-petroleum corporate income tax. The department had the exact figures and he would be happy to follow up with the information.

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Representative Hannan asked for more information on the tobacco tax. She was aware that the tax division was keeping track of the amount of vaped tobacco. She asked if

the amount of vaped tobacco in the state was known and whether the state could collect taxes on it.

Mr. Stickel replied that the department had developed some estimates and he would be happy to follow up with the findings.

Mr. Stickel continued to slide 16 which relayed that the next portion of the presentation would detail the petroleum forecast assumptions. He moved to slide 17 which showed the ten-year oil price forecast for Alaska North Slope oil. The graph showed the difference between the spring 2023 revenue forecast and fall 2023 forecast. The department utilized features market projects through FY 32 to develop the fall forecast. As Commissioner Crum mentioned, the department used the final five trading days of December as a basis for the forecast and released the forecast on December 14, 2023. As compared to the spring forecast, the fall forecast included a $9.39 per barrel increase for FY 24 and a $6 per barrel increase for FY 25, but by FY 31 the delta decreased and the forecast was essentially unchanged from the spring forecast.

Mr. Stickel continued on slide 18, which was a chart comparing the forecast to various other forecast sources. The forecast was within the $70 to $80 range when compared with other forecast sources. The slide was updated as of January 17, 2024.

Mr. Stickel advanced to slide 19 and addressed the issue of volatility. The slide showed a forecast for FY 25 of $76 per barrel resulting in about $2.6 billion in general fund revenue before accounting for POMV. The slide looked at how the revenue number would change if company spending was held equal and the price of oil was the only element that varied. There was about a $45 million to $50 million change to unrestricted revenue from each dollar of oil price and the delta changed as the oil price increased and decreased. For example, if oil prices were about $100 per barrel, it would equate to about a $75 million impact for oil prices but if oil prices were $50 per barrel, the impact would be about $25 million.

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Mr. Stickel continued on slide 20 and detailed North Slope petroleum production. The general story was that there

would be fairly steady production for the next several years and declines in existing fields were offset by increased drilling on new fields. Beyond FY 26, the impact of new production was apparent, and it was forecasted that over 500,000 barrels of oil would be produced. The slide included a high case and low case forecast. If reservoir performance and other dynamics of the production were to come in differently than expected, there would be a wide range of potential outcomes for oil production.

Co-Chair Edgmon understood that the state was transitioning out of legacy fields to newer fields and different components of the oil tax structure would be coming into play. Production and price used to be indicative of the future of oil, but it seemed to not be the case anymore. He asked if he was correct that there was a transition taking place.

Mr. Stickel responded that he would characterize it as continued production and continued significant reinvestments in the legacy field and new developments. For the next several years, the relatively stable production outlook was due to the legacy fields and some of the reinvestments made by companies. The increase in the later years was due to the addition of new fields.

Co-Chair Edgmon commented that it seemed like there was a hybrid transition.

Mr. Stickel advanced to slide 21 which restated the production forecast and showed the comparison between the spring and fall forecasts. The production forecast for FY 24 though FY 26 had decreased but the production forecast for FY 27 through FY 33 had increased. There were substantial increases at the tail end of the fall 2023 forecast that suggested that production would be up by 66,000 barrel per day as compared to the spring 2023 forecast.

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Representative Josephson remarked that he would have expected that the red line on the chart [representing fall 2023] would have been higher than the blue line [representing spring 2023]. He asked what caused the separation.

Mr. Stickel responded that the Department of Natural Resources (DNR) could better provide the details. One of the significant factors was changes in expected well productivity and DNR reevaluated the performance expectations for new wells. The change in productivity was one of the factors in the forecasted decrease for the next few years; however, there was increased certainty around projects like Willow in the future which was reflected as an increase to the production forecast in later years.

Representative Cronk asked how the revenues for Willow would be paid out. He wondered how much revenue the state would actually receive.

Mr. Stickel replied that the department presented a detailed analysis of Willow in the last legislative session. In general, the state would collect property tax on Willow to the extent that the companies involved were subject to corporate income tax. The state would also collect production taxes on Willow. The royalties would go to the federal government, but half of the royalties would be shared back with the state. There would be certain restrictions around the ways in which the state could use the royalties.

Mr. Stickel added on slide 21 that the increased through-put from the production would reduce tariffs on the Trans-Alaska Pipeline System (TAPS) which would increase taxes and royalties from other fields.

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Mr. Stickel moved to slide 22 and detailed allowable lease expenditures and how the expenditures had changed in the last few years. A significant increase was expected for capital expenditures. He relayed that capital expenditures were $2.3 billion in FY 23 which was already a significant increase from the prior two years during which there were low oil prices due to the COVID-19 pandemic. The department was forecasting a significant increase in capital expenditures for FY 24 through FY 26 in excess of $4 billion per year. There were significant new investments in fields like Willow as well as other smaller new developments. A substantial amount of additional drilling was also happening at the legacy fields which was feeding into the increased capital expenditures forecast. The department was forecasting capital expenditures to

eventually taper off, but still remain robust at about $2.5 billion to $3 billion per year. Companies had made significant cuts in operating expenditures but inflation pressure had begun to increase the operating costs. The department expected operating costs to slowly increase throughout the forecast period.

Co-Chair Edgmon commented that he just spoke to one of his constituents about the issue and noted that it was complicated and confusing to the public. He would like to see a line on the graph that showed the projected oil revenue. He thought the forecast on the slide was good news; however, the state would "pay for it" in the short term. He thought it was important for the information to be easily digestible to the public.

Mr. Stickel responded that he would follow up.

Co-Chair Johnson asked for verification that the state was allowing capital expenditures and using the expenditures to offset the revenue of other fields.

Mr. Stickel responded in the affirmative. There was a "slope-wide ring fence" for North Slope oil production. The term meant that when a company calculated its taxes, the total lease expenditures from oil production on the slope subtracted from the value of the total oil production on the slope to generate the net profit calculation.

Co-Chair Johnson responded that it would not be any different if it were in the National Petroleum Reserve-Alaska (NPRA). The state was not receiving royalties because it was an issue of taxes rather than royalties.

Commissioner Crum responded in the affirmative. All other taxes were applied and assessed by the state.

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Representative Galvin understood that even if a development was not new, a company could still receive credit for expenditures. She asked if her understanding was correct.

Mr. Stickel responded that generally speaking, a company would add up the value of all the oil it produced and all of the investments it made in order to determine its production tax value and net profits tax calculation. The

calculation was the same whether the investments were in a new field or an old field.

Representative Galvin asked if the intent was to encourage new investments despite the tax law allowing both new and old investments.

Mr. Stickel replied that investments were incentivized by implementing a net profits tax. The ability to benefit from the investments was an integral part of the tax system. There were also some separate provisions that provided additional incentives for new investments such as the gross value reduction on production tax.

Co-Chair Johnson suggested that Mr. Stickel finish the presentation before the members ask any further questions.

2:51:44 PM

Mr. Stickel continued to slide 23 and detailed the transportation costs. The costs were deducted from the sales price of oil to calculate the value for both tax purposes and royalty purposes. The most significant costs were the marine costs and costs related to the pipeline. A slight increase to transportation costs was expected to occur in FY 24 and then a stabilization of the costs was expected for the remainder of the forecast period. The increase in FY 24 was driven mainly by increased marine costs.

Mr. Stickel concluded on slide 24. Prior to 2016, there were various oil and gas tax credits in state statute that could either be applied against a liability or could be turned into a tax credit certificate that could be presented to the state for cash purchase. Up until 2016, the state had purchased all of the requested tax certificates, but the process changed due to budget pressure. He explained that 2016 was the first year in which the full outstanding balance of tax credits was not purchased and in 2020 and 2021, there was no money appropriated for the purpose of tax credits. The outstanding balance created a liability and the legislature took action in 2016 and 2017 to phase out the ability to earn new tax credits, but the balance remained. For the last three years, the legislature had appropriated funds to purchase outstanding remaining credits and the tax credits were now completely paid off.

2:54:42 PM

Co-Chair Johnson asked if Mr. Stickel was finished with the slide.

Mr. Stickel responded that he was finished.

Representative Josephson was interested in tax credits and forgoing revenue or paying cash for capital efforts and production. He understood that there was a bill from the governor on royalty relief in the Cook Inlet and he was concerned that the bill would relieve royalty payments for existing production, but it seemed that only new production would be impacted. He asked if his understanding was correct.

Mr. Stickel thought DNR could provide a better response to Representative Josephson's question. His understanding was that the bill would apply to new production above and beyond what was included in the revenue forecast.

Commissioner Crum added that there were no cash-value tax credits in the bill.

Co-Chair Johnson suggested that Mr. Stickel take the remaining questions from the committee and then highlight the important components in the appendix of the presentation.

Representative Galvin referred to slide 10 and asked about restricted investment revenue reflected on the graph. She asked for some context to understand the rise and fall of the revenue.

Mr. Stickel responded that the department utilized actual returns through the end of October when it produced the revenue book for the FY 24 forecast. The returns had been negative for several of the funds through October. The department used an assumption of the returns for the remainder of the fiscal year, which was why there was a reduction in investment revenue in particular under both DGF and other restricted investment revenues. The Permanent Fund was in a negative situation as of the end of October. If the graph were to be updated to reflect the present situation, the negative $1.8 billion figure would be about a positive $570 million.

Representative Galvin appreciated the differentiation and understood the situation.

2:58:29 PM

Representative Ortiz referred to slide 20. He understood that the slide showed that there were about 500,000 barrels of oil produced per day and if the department's forecast were to come to fruition, about 600,000 barrels would be produced per day by 2033. He asked if he would be correct in saying that 2 million barrels per day were being produced 15 years prior.

Mr. Stickel replied that peak production was about 2 million per day, but it was more than 15 years ago.

Representative Ortiz commented that he understood the excitement about new development and projects, but it was not going to be the "big savior" because even the best case scenario numbers would not approach the peak production numbers. The state made about $9 billion in revenue in peak years and current projects were closer to $2.5 billion. He thought the ability for the state to "make everything work" was a lot lower than it used to be. He asked if his understanding was correct.

Commissioner Crum responded in the affirmative. The massive windfalls were not expected and only significant and catastrophic global events could bring about such windfalls. The forecast projected a steadiness and then a slight increase, but it would take much more to return to peak production numbers.

Co-Chair Edgmon added that the role of fracking in the country was impactful. The price of oil had not spiked as it normally would have in the past in response to the conflict in Israel.

Commissioner Crum replied that Alaska lines had been described as slow declining assets, which provided a diversification opportunity for oil companies. The prices were less likely to spike but also less likely to fall. The fracking aspect cushioned the country's oil prices against catastrophic global events.

Co-Chair Edgmon remarked that it was interesting that Alaska could be getting more oil but less revenue. The growth of the Permanent Fund was heartening. The state was not going to have the same amount of money as it did during peak times, but the future was promising.

Commissioner Crum replied he had met with credit rating agencies in New York in the prior week and just experienced a credit rating bump which was partially due to the consistent POMV draw for the past five years and the excellent performance of APFC. The diversification and steadiness were seen as a big positive and helped provide stability.

3:04:07 PM

Representative Cronk referred to an article on his phone that included statistics about the successes of the Canadian forestry industry. He thought that although Alaska had an oil industry, it did not have a forestry industry that could make up a significant amount of revenue for the state.

Commissioner Crum responded that he agreed. He added that Sweden had doubled its productive acres of forest in the last 100 years but Sweden's industry was mature. There was a project in progress to determine what a similar system would play out in Alaska. There were architectural and design changes in the world in order to sequester carbon. He aimed to develop the timber industry in the state because active forest management was a significant growth industry. He argued that the state could protect its forests by cutting trees down and growing more sustainable species over time.

Mr. Stickel thanked the committee for the opportunity to present the forecast.

3:07:24 PM

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

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ADJOURNMENT

3:07:56 PM

The meeting was adjourned at 3:07 p.m.