

ALASKA LEGISLATURE

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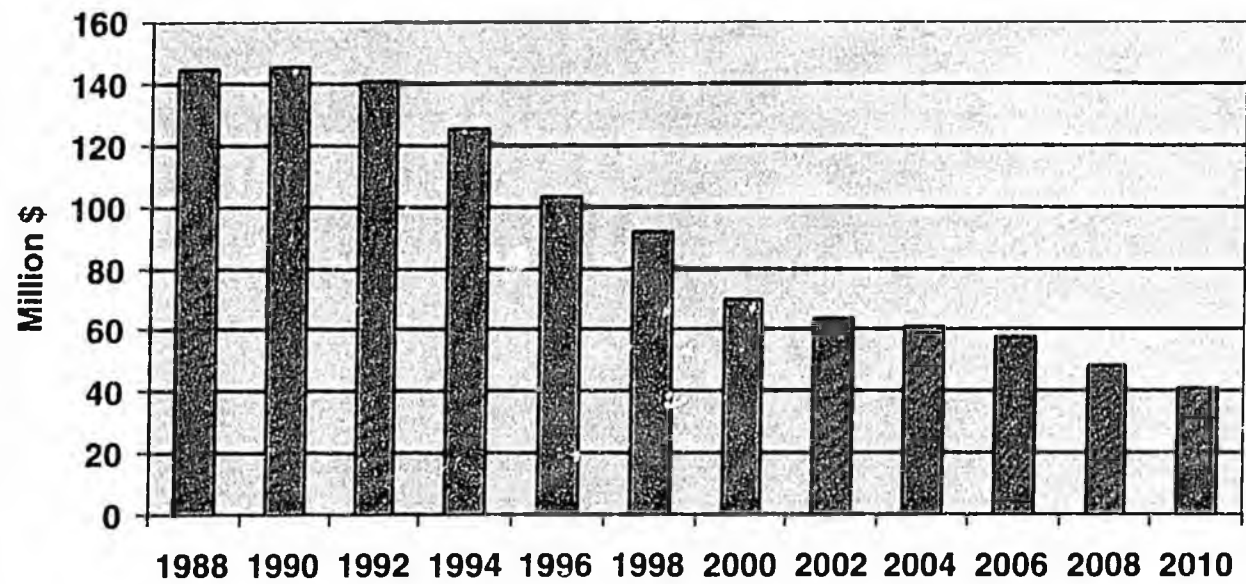
Alaska State Revenue Outlook General Fund FY01

Projected ANS Oil Price (Jan Futures) \$18.86
Projected No Slope Production Volume 1.045

Projected Oil Revenue	\$1,218.9
Projected Other Non Oil Revenue	\$ 386.7
General Fund Budget	\$2,419.4
Projected Draw from CBRF	\$ 813.3

CBRF Depletion Matrix				
\$ per Barrel				
Annual Budget		Fall 1999	Jan 2000	
Change	\$12.50	Forecast	Futures	\$22.50
+3.0%	Dec-01	Mar-03	May-03	Jul-04
OMB Proposed	Jan-02	Jul-03	Aug-03	Feb-05
+1.0%	Feb-02	Oct-03	Oct-03	Jun-05
0.0%	Mar-02	Jan-04	Jan-04	Feb-06
-1.0%	Apr-02	Apr-04	Apr-04	Oct-06

Revenue Sensitivity to \$1 per Barrel Change in Oil Price FY 1988--2010



Oil Revenue and the BP/ARCO Merger

- Production Tax
 - Tax base is the net-back value of production calculated as the destination sales price less transportation to destination.
 - Destination value is market value, currently defined as ANS spot price. We believe that oil prices will continue to be determined in the world market and that the merger will not affect destination prices.

Oil Revenue and the BP/ARCO Merger

- Production Tax
 - Department of Revenue and Natural Resources will continue to monitor closely the spot price to ensure that it is an accurate measure of destination value.
 - Transportation costs are actual cost. Therefore the allowable costs will largely be determined by the assets employed not who owns them.
 - We believe the merger may lead to some synergistic cost savings.

Oil Revenue and the BP/ARCO Merger

- Royalties

- Royalties are also based on the netback production value established by contract with the State.
- Both ARCO and BP contracts have been reopened and any final agreement on transportation and or value will be retroactive.
- The production divestiture and other concessions by BP were designed to protect the State's interest post merger.

Oil Revenue and the BP/ARCO Merger

- Property Tax
 - The property values should largely be unaffected by the merger since the production and transportation facilities are commonly owned and subject to appraisal methods based either on regulated cash flow or historical cost.
 - If the merger results in higher levels of investment the tax levels could increase.

Oil Revenue and the BP/ARCO Merger

- Income Tax
 - It is virtually impossible to calculate the effect of the merger on this tax type because modified apportionment is based so many elements.
 - Combining prior year returns of the merging companies shows less income tax.
 - Combining returns and combining companies is not the same. The purpose of combining companies is to produce more income.

FALL 1999 REVENUE SOURCES BOOK

Alaska Department of Revenue
Oil and Gas Audit Division

December 8, 1999



Tony Knowles, Governor
Wilson L. Condon, Commissioner
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STATE OF ALASKA

DEPARTMENT OF REVENUE

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December 8, 1999

The Honorable Tony Knowles
Governor of Alaska
P.O. Box 110001
Juneau, Alaska 99811-0001

Dear Governor Knowles:

Oil prices are more than double where they were at their low point a year ago, and the state treasury is several hundred million dollars healthier than we had anticipated in our spring forecast.

Alaska North Slope crude oil sold for an average of more than \$20 a barrel in the first five months of this fiscal year, and we expect the price to average \$20.11 for the full year ending June 30, 2000. That's a large increase from the Fiscal 1999 average of \$12.70, but I need to remind everyone that we don't expect the world oil market to hold at \$20 forever. Our forecast for Fiscal 2001 shows the price for North Slope crude averaging \$18.28 and then sitting in the low-\$18 and high-\$17 range for the next five years.

This year's higher prices are due to the Organization of Petroleum Exporting Countries and its agreement this past spring to cut production to force prices higher. Those production cuts, measured against the strong world economy, succeeded in drawing down oil stockpiles and driving prices higher. It's expected, however, that the enticement of higher prices and increased worldwide demand will push OPEC and other producing nations to pump more oil later in 2000, putting downward pressure on prices.

No matter what may happen in any one year, history proves that oil prices ride a roller coaster but generally come home to about the same spot. Over the past decade, the rolling 60-month average price for North Slope crude has been between \$16.39 and \$17.74 per barrel 95 percent of the time.

The other variable in forecasting state oil revenues, of course, is production. North Slope production averaged 1.164 million barrels per day in Fiscal 1999 but, as expected, that number is falling. We forecast this year's production at 1.058 million barrels per day and 1.045 million in Fiscal 2001. These production estimates do not take into account any new exploration activities that might be associated with the proposed acquisition of Arco Alaska by BP, or with the entry of other producers that might purchase North Slope leases sold off by BP. We believe the proposed acquisition would have a negligible effect on state revenues in the short term. Any long-term effect would depend mostly on production, not on which company owns which lease.

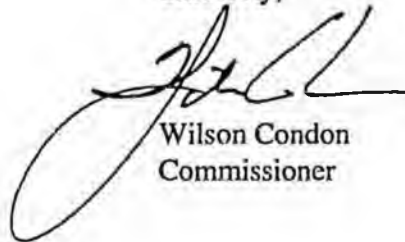
Though oil revenue takes center stage because of its volatility and the jobs that come from oil development, it is no longer the leading source of state revenues. Alaska's 20-year history of oil revenue in the No. 1 spot ended in 1998 when overall investment income took over the lead. As we look ahead to Fiscal 2001, oil will be in the third position behind investment income and federal funds.

Alaska's investment earnings will supply 33% of the state's projected revenues in Fiscal 2001, with federal funding comprising 27% of the total and oil revenues at 24%. That said, people need to remember that much of the state's investment earnings and all of the federal money we receive are restricted in one way or another. Looking only at the unrestricted revenue available for appropriation to cover many of the most important public services provided by government, we see that oil revenue will pay for 75% of those services in Fiscal 2001. The tables and figures on Pages 14-17 show this in greater detail.

Based on our price and production forecasts, and considering all of the state's other revenues, we expect the state will need to draw less than \$500 million from the Constitutional Budget Reserve Fund in Fiscal 2000 and about \$700 million in Fiscal 2001. With the higher prices, that's down substantially from the \$1 billion Fiscal 2000 draw expected in our spring forecast. But it's only a temporary reprieve. If all of the projections in this report come true, the CBRF would hit zero in January 2004.

I look forward to working with you, the legislature and the public as we work toward building a fiscal plan for the future.

Sincerely,



Wilson Condon
Commissioner

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I. GLOSSARY

The governor's Office of Management and Budget and the Legislative Finance Agency agreed this past spring to organize all sources of state funds according to their allowable uses under federal and state law. If, for example, federal highway funding can be used only for road projects, it doesn't make sense to list it with state tax revenue that the legislature can spend on anything it wants. The goal is to describe the budget in specific and complete terms that are understandable to anyone who wants to ask: Where does the state get its money?

Revenue listed in Table 1 on Page 13 shows the new money available for appropriation in each respective fiscal year, including oil revenues, other state taxes, federal funds and investment earnings. The table does not include balances in existing funds such as the Constitutional Budget Reserve Fund or the Permanent Fund Earnings Reserve Account. The revenue that went into those funds was counted in previous years and should not be counted twice. The balances are available and would be counted as state spending, however, if the legislature decided to appropriate the money.

- **General Fund Unrestricted Revenue:** This is all of the state's unadjusted revenue not limited by state or federal law, debt or trust restrictions, or other state or federal requirements or customary practice. It includes taxes, user fees and some investment earnings but does not include any federal money or Permanent Fund earnings. See Appendix Table C on Pages 82-83.
- **Unrestricted General Purpose Revenue:** Most legislative and public debate over the budget each year centers on this category. It used to be called *Net Disposable General Fund Unrestricted Revenue*. It includes General Fund Unrestricted Revenue minus such items as state fisheries tax revenue shared by law and customary practice with municipalities and regional aquaculture associations. It also can include two significant additions – dividends or transfers to the state General Fund by the Alaska Industrial Development and Export Authority and the Alaska Housing Finance Corporation. See Table 3 on Pages 16-17.
- **NoTUFF:** This stands for non-oil taxes, user fees and federal funds. It includes non-oil corporate income tax revenues, motor fuel and cigarette taxes, and other taxes and user fees collected by the state. It also includes all federal funding directed to the state, including construction money, such as for roads and airports, and operating money, such as for Medicaid and job training programs. Some of this money is restricted and some is unrestricted. See Table 19 on Page 45.
- **Federal Revenue:** When the federal government gives money to states, it restricts how that money can be used. Highway and airport construction funds, Medicaid and education funding cannot be used for other purposes. In addition to restricting how the money is spent, the federal government often requires states to put up matching funds to qualify for the federal funding. See Page 51.
- **Dedicated Revenue:** Revenue restricted by the Alaska Constitution fits into this category. Other than the Permanent Fund, which was approved by voters in 1976, all of the other revenues in this category existed in some form before statehood and therefore are not subject to the constitutional prohibition against dedicated funds. They include such accounts as the Fish and Game Fund, Disabled Fisherman's Fund and Public School Fund. See Page 53.

- **Trust Fund Revenue:** This includes funds held by the state in trust for specific beneficiaries. Examples include public employees and teachers retirement funds, the Advance College Tuition Program and the Alaska Mental Health Trust Fund. See Page 62.
- **Statutorily Restricted Revenue:** Though not dedicated in the constitution, this revenue is earmarked in state law for specific purposes. Examples include University of Alaska tuition payments, marine highway receipts, payments to various revolving loan funds, airport revenues and public corporation receipts, such as AHFC and AIDEA. See Page 53.
- **Customarily Restricted Revenue:** Though not set out in statute, these revenues have historically been restricted by the legislature. The largest item in this category is Permanent Fund earnings in excess of what is needed each year for dividends and inflation proofing. Though the money could be spent as *Unrestricted General Purpose Revenue*, the legislature has always chosen to retain it in the Permanent Fund's Earnings Reserve Account or appropriate it to the fund's principal.
- **Permanent Fund Statutory Income:** This is the total realized gain and loss of all Permanent Fund investment transactions during the year, plus interest and dividends earned by the fund. Though the legislature, by law, may appropriate the earnings for any purpose it chooses, the historical practice has been to restrict the use of realized income to Permanent Fund dividends, inflation proofing, and then either leaving the excess in the Earnings Reserve Account or transferring it to the principal of the Permanent Fund. The annual Permanent Fund dividend is based on statutory income.
- **Permanent Fund GASB (or Market) Income:** Under rules adopted by the Government Accounting Standards Board, the Permanent Fund's income – and that of any other government fund – is the difference between the purchase price of the investments and their market value at a given point in time, plus any dividends or interest earned on those investments. Under GASB rules, the Permanent Fund does not have to sell the investment to count the gain or loss as it changes value. It's called "marking to market," that is, measuring the value of the fund's investments by the current market price. This can produce a much different picture than *Permanent Fund Statutory Income*, which does not reflect fluctuating investment values until the assets are sold.
- **Constitutional Budget Reserve Fund:** Created by voters in 1990, the Constitutional Budget Reserve Fund holds the proceeds from the out-of-court settlement of oil and gas tax and royalty disputes since July 1, 1990. It generally requires a three-quarters majority vote of each chamber of the legislature to withdraw money from the fund.
- **Bond Authorizations:** This is revenue received by the state or one of its public corporations from the sale of bonds to finance construction projects or purchases. Though the money shows up as revenue, it must be paid back – just as homeowners must pay back the money they borrow to buy a house.

What's in this report?

Twice a year the Department of Revenue forecasts the future price and production of Alaska North Slope crude oil and all other revenue sources feeding the state treasury. The department's biannual forecast books reported in depth on oil prices, production and world market conditions, giving less attention to the state's investment income and other revenue sources. That was good enough when oil provided the overwhelming bulk of state revenues.

As North Slope production declines, however, state investment revenues are increasing. So, too, are federal funds. The state's revenue picture is changing, and no where is it more evident than in the Fiscal 2001 revenue forecast that shows oil revenues in third place behind investment income and federal funds.

Because of the fundamental shift in the state's fiscal future, the Department of Revenue decided to present its forecasts in a different format with more emphasis on non-oil revenue.

The Fall 1999 Revenue Sources Book is organized into five sections:

I. Glossary.

II. Executive Summary.

III. Oil revenues.

This includes oil and gas severance taxes, corporate income taxes, property taxes and royalties.

IV. Non-oil taxes, user fees and federal funds.

This category – called NoTUFF – includes alcohol, tobacco, fisheries, estate and motor fuel taxes, non-oil corporate income taxes, user fees, federal funds, university tuition and several other revenue sources.

V. Investments.

This includes investment earnings from the Alaska Permanent Fund, the Constitutional Budget Reserve Fund, the General Fund and other state investments.

Each section includes explanations of restricted funds – money restricted by the constitution, state statute, customary practice or federal designation – and explanations of unrestricted funds – money generally available for appropriation each year. It's the *Unrestricted General Purpose Revenue* category that becomes the focus of legislative and public debate each year. It's this money that pays for many of our most important public services, and the day-to-day operations of state government.

This new format for the revenue forecast is designed to provide public officials – and the public – with a complete picture of all of Alaska's revenue sources as people debate and decide the state's financial future.

II. EXECUTIVE SUMMARY

A. Total Revenue

Table 1 summarizes the state's total revenue outlook by major revenue component (Actual FY 1999 and projected FY 2000-2001).

Table 1. Total Revenue \$ Million		Actual		
		<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>
Oil Revenue				
<u>Unrestricted</u>				
Property Tax		48.8	45.7	43.8
Corporation Petroleum Tax		145.1	175.0	175.0
Severance Tax		371.1	576.9	459.0
Royalties (including Bonuses)		<u>348.2</u>	<u>588.7</u>	<u>501.6</u>
Subtotal		913.2	1,386.3	1,179.5
<u>Restricted</u>				
Royalties to Permanent Fund & School Fund		157.9	222.1	194.9
Settlements to CBRF		<u>50.0</u>	<u>30.0</u>	<u>150.0</u>
Subtotal		207.9	252.1	344.9
Subtotal		1,121.1	1,638.4	1,524.4
Non Oil Taxes, User Fees and Federal Funds (NoTUFF)				
<u>Unrestricted</u>				
Sales/Use Tax		93.6	92.2	92.0
General Corporation Tax		53.8	52.0	50.0
Fish Tax		21.5	26.2	21.4
Other Tax		4.5	5.7	6.3
Licenses & Permits		62.9	62.8	62.8
Charges for Services		31.8	33.8	34.3
Other		<u>63.5</u>	<u>100.1</u>	<u>74.9</u>
Subtotal		331.6	372.8	341.7
<u>Restricted</u>				
Federal Funds		1,376.2	1,771.0	1,771.0
Trusts		55.5	60.8	60.8
Dedicated Funds		63.4	57.8	57.8
Statutorily Restricted Program Receipts		655.4	560.5	568.5
Bond Authorizations		<u>199.6</u>	<u>0.0</u>	<u>0.0</u>
Subtotal		2,350.1	2,450.1	2,458.1
Subtotal		2,681.7	2,822.9	2,799.8
Investment Earnings				
<u>Unrestricted - General Fund Investments</u>				
		46.5	45.0	45.0
<u>Restricted</u>				
Constitutional Budget Reserve Fund		119.9	123.7	105.0
Permanent Fund Dividends		1,044.9	1,174.4	1,215.4
Permanent Fund Inflation Proofing		288.4	372.0	596.0
Required Deposits to PF Principal		41.0	27.0	31.0
GASB PF Income Net of Distributions		770.5	(597.4)	131.6
Other Appropriations		<u>2.5</u>	<u>0.0</u>	<u>0.0</u>
Subtotal		2,267.2	1,099.7	2,079.0
Subtotal		2,313.7	1,144.7	2,124.0
Grand Total		6,116.5	5,606.0	6,448.1

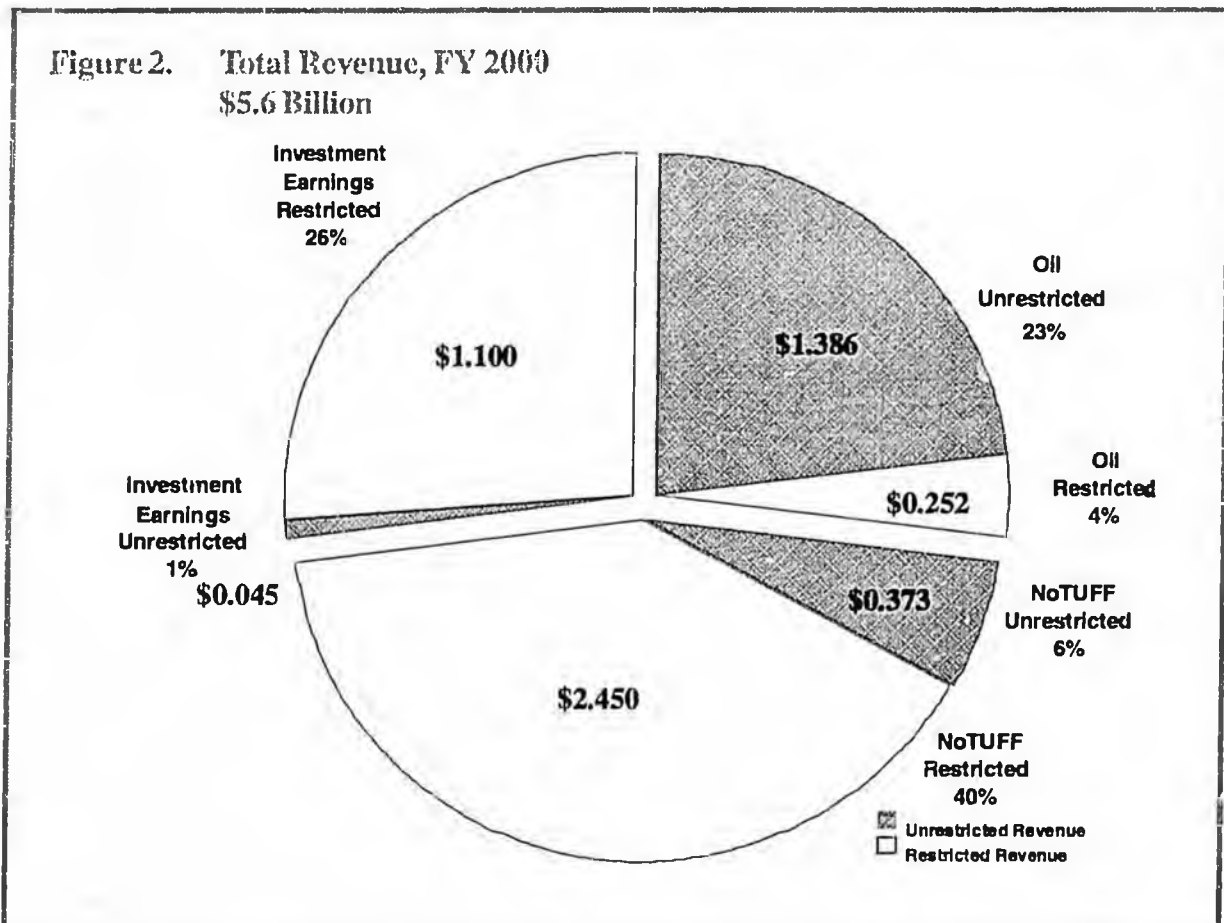
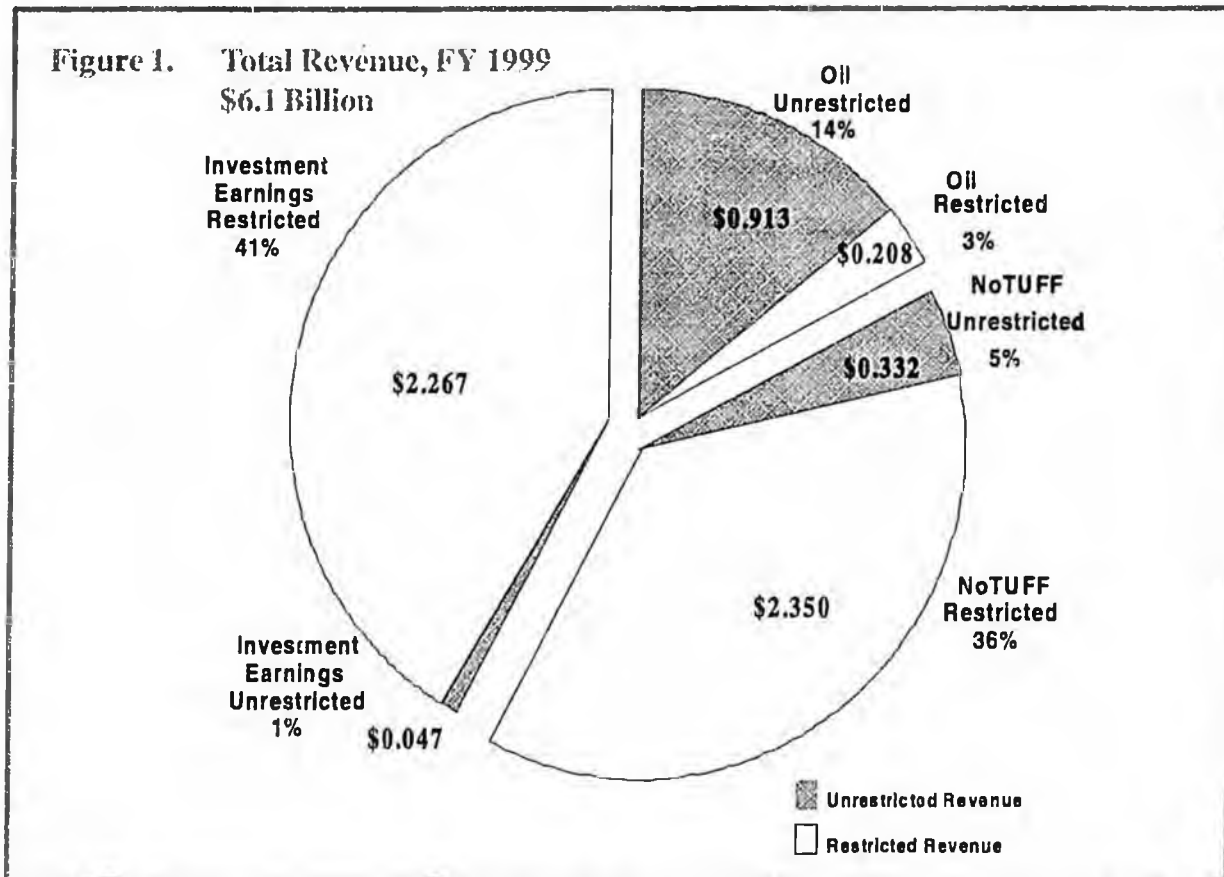


Figure 3. Total Revenue, FY 2001
\$6.4 Billion

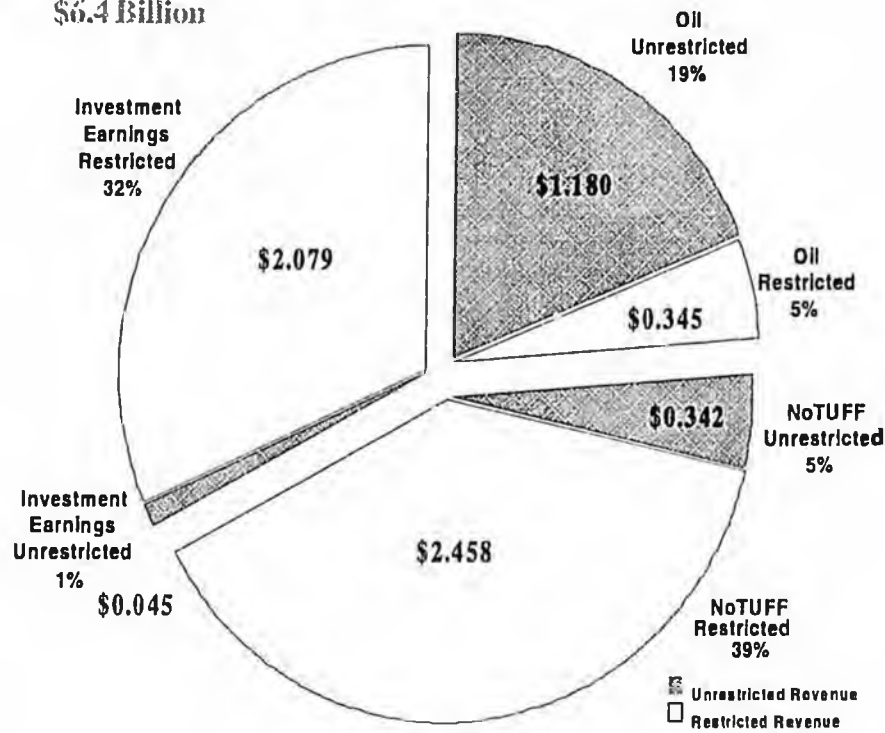


Table 2. Total State Revenue, Actual FY 1999 and Projected 2000-2001⁽¹⁾
Unrestricted and Restricted by Major Source
\$ Million

Revenue Source	Actual FY 1999	FY 2000	FY 2001
Unrestricted			
Oil Revenue	913.2	1,386.3	1,179.5
Non-Oil Revenue (NoTUFF)	331.6	372.8	341.7
Investment Earnings	46.5	45.0	45.0
Subtotal	1,291.3	1,804.1	1,566.2
Restricted			
Oil Revenue	207.9	252.1	344.9
Non-Oil Revenue (NoTUFF)	2,350.1	2,450.1	2,458.1
Investment Earnings	2,267.2	1,099.7	2,079.0
Subtotal	4,825.2	3,801.9	4,881.9
Grand Total	6,116.5	5,606.0	6,448.1

⁽¹⁾ Total unrestricted revenue as reported for AKSAS (State of Alaska Accounting System) with adjustments for certain municipal sharing of statewide taxes and additional spending restrictions. Detailed AKSAS reported unrestricted revenue and estimates, including certain spending based reporting adjustments, can be found in Appendix C.

B. Unrestricted General Purpose Revenue

Unrestricted General Purpose Revenue is the amount generally used for budget planning purposes. Table 3 on this and the next page sets out actual FY 1999 revenue and our forecast for FY 2000 and 2001.

We forecast *Unrestricted General Purpose Revenue* by first estimating *General Fund Unrestricted Revenue*, which includes all unrestricted revenue items in the Alaska State Accounting System (AKSAS), as well as certain program receipts. The governor's Office of Management and Budget and the legislature adjust the Department of Revenue's forecast of *General Fund Unrestricted Revenue* to derive a forecast of *Total Unrestricted General Purpose Revenue*. Reductions include: (1) earmarking revenue for specific programs such as the marine highway system; (2) pass-through revenue for qualified regional aquaculture and dive fishery associations; and (3) revenue shared with local governments and organizations (e.g., fisheries taxes). Additions include: (1) transfer payments from state-owned entities such as the Alaska Housing Finance Corporation and Alaska Industrial Development and Export Authority; and (2) settlements of legal disputes not subject to deposit into the CBRF.

See Appendix C for a derivation of *Total Unrestricted General Purpose Revenue* from *General Fund Unrestricted Revenue*.

	Actual		
	1999	2000	2001
OIL			
<u>Property Tax</u>	48.8	45.7	43.8
<u>Corporation Income Tax</u>	145.1	175.0	175.0
<u>Severance Tax</u>			
Oil and Gas Production	358.6	566.9	449.3
Oil and Gas Conservation	1.4	0.1	0.0
Oil and Gas Hazardous Release	<u>11.1</u>	<u>9.8</u>	<u>9.7</u>
Subtotal	371.1	576.9	459.0
<u>Royalties</u>			
Mineral Bonuses and Rents	25.6	5.0	5.0
Oil and Gas Royalties	<u>322.6</u>	<u>583.7</u>	<u>496.6</u>
Subtotal	348.2	588.7	501.6
Subtotal Oil	913.2	1,386.3	1,179.5

Table 3, cont. *Unrestricted General Purpose Revenue*

\$ Million	Actual		
	<u>1999</u>	<u>2000</u>	<u>2001</u>
NoTUFF			
<u>Sales/Use Tax</u>			
Alcoholic Beverage	12.2	12.0	12.0
Tobacco Products	15.2	14.5	14.3
Insurance Premium	28.4	28.1	28.4
Electric and Telephone Cooperative	0.2	0.2	0.2
Motor Fuel Tax-Aviation	5.4	5.4	5.4
Motor Fuel Tax-Highway	25.5	25.0	25.0
Motor Fuel Tax-Marine	<u>6.7</u>	<u>7.0</u>	<u>6.7</u>
Subtotal	93.6	92.2	92.0
<u>Corporation General Income Tax</u>	53.8	52.0	50.0
<u>Fish Tax</u>			
Salmon and Seafood Marketing	5.3	6.7	5.6
Fisheries Business	12.7	16.5	13.1
Fishery Resource Landing	<u>3.5</u>	<u>3.0</u>	<u>2.7</u>
Subtotal	21.5	26.2	21.4
<u>Other Tax</u>			
Mining	0.6	1.7	2.2
Estate	1.7	1.8	1.9
Charitable Gaming	<u>2.2</u>	<u>2.2</u>	<u>2.2</u>
Subtotal	4.5	5.7	6.3
<u>Licenses and Permits</u>			
Motor Vehicle	31.6	31.6	31.6
Other	<u>31.3</u>	<u>31.2</u>	<u>31.2</u>
Subtotal	62.9	62.8	62.8
<u>Charges for Services</u>	31.8	33.8	34.3
<u>Other Miscellaneous</u>	63.5	100.1	74.9
Subtotal NoTUFF	331.6	372.8	341.7
INVESTMENT EARNINGS	46.5	45.0	45.0
UNRESTRICTED GENERAL PURPOSE REVENUE	1291.3	1804.1	1566.2

C. Oil Price Forecast

Oil revenue will continue to account for over two-thirds of current *Unrestricted General Purpose Revenue*. Two elements are critical to the oil forecast: price and volume.

Almost all of Alaska's current oil production is delivered to refineries on the U.S. West Coast. Consequently, Alaska's royalty and severance tax revenue depends in large part on the market price of Alaska North Slope crude oil (ANS) in the U.S. West Coast refining centers. Table 4 below reflects actual prices for FY 1999 and the Department of Revenue's forecast of those market prices for the eleven-year period beginning with the current fiscal year, FY 2000, and continuing through FY 2010.

Table 4. Delivered Price for ANS Crude Oil
Average ANS Market Price, U.S. West Coast and Far East
\$ per Barrel

Fiscal Year	Average ANS Market	ANS West Coast	ANS Far East
Actual 1999	12.70	12.73	11.99
2000	20.11	20.13	19.76
2001	18.26	18.28	17.91
2002	17.69	17.71	17.36
2003	17.69	17.71	17.36
2004	17.69	17.71	17.36
2005	17.69	17.71	17.36
2006	18.20	18.22	17.86
2007	18.22	18.22	17.86
2008	18.22	18.22	17.86
2009	18.22	18.22	17.86
2010	18.22	18.22	17.86

The prices we are forecasting are consistent with the market prices experienced over the fifteen-year period since the 1986 oil price collapse. The figure on the next page depicts: (1) the monthly West Coast ANS market price from January 1991 through October 1999; (2) the 60-month moving average West Coast market price for the same period; and (3) a set of derived ANS futures prices for October 1998 and October 1999. ⁽¹⁾

⁽¹⁾ The derived ANS futures price is based on the spot market differential between WTI and ANS applied to the WTI futures prices as reported on the New York Mercantile Exchange.

The figure below clearly illustrates the volatility of the month-to-month crude oil prices; ANS West Coast prices during the pertinent time period ranged from just under \$10 per barrel to well over \$22 per barrel. In contrast however, during this same time period the 60-month moving average prices have ranged from a low of \$16.39 to a high of \$17.79 per barrel. The average of the 60-month moving averages is \$17.14 per barrel. Finally, the derived futures market prices reflected in Figure 4 show that the participants in that market anticipate a continuation of the post-1986 historic levels for oil prices. The derived futures price for ANS is virtually the same after three years whether the current price is very low (as it was in October 1998) or very high (as it was in October 1999).

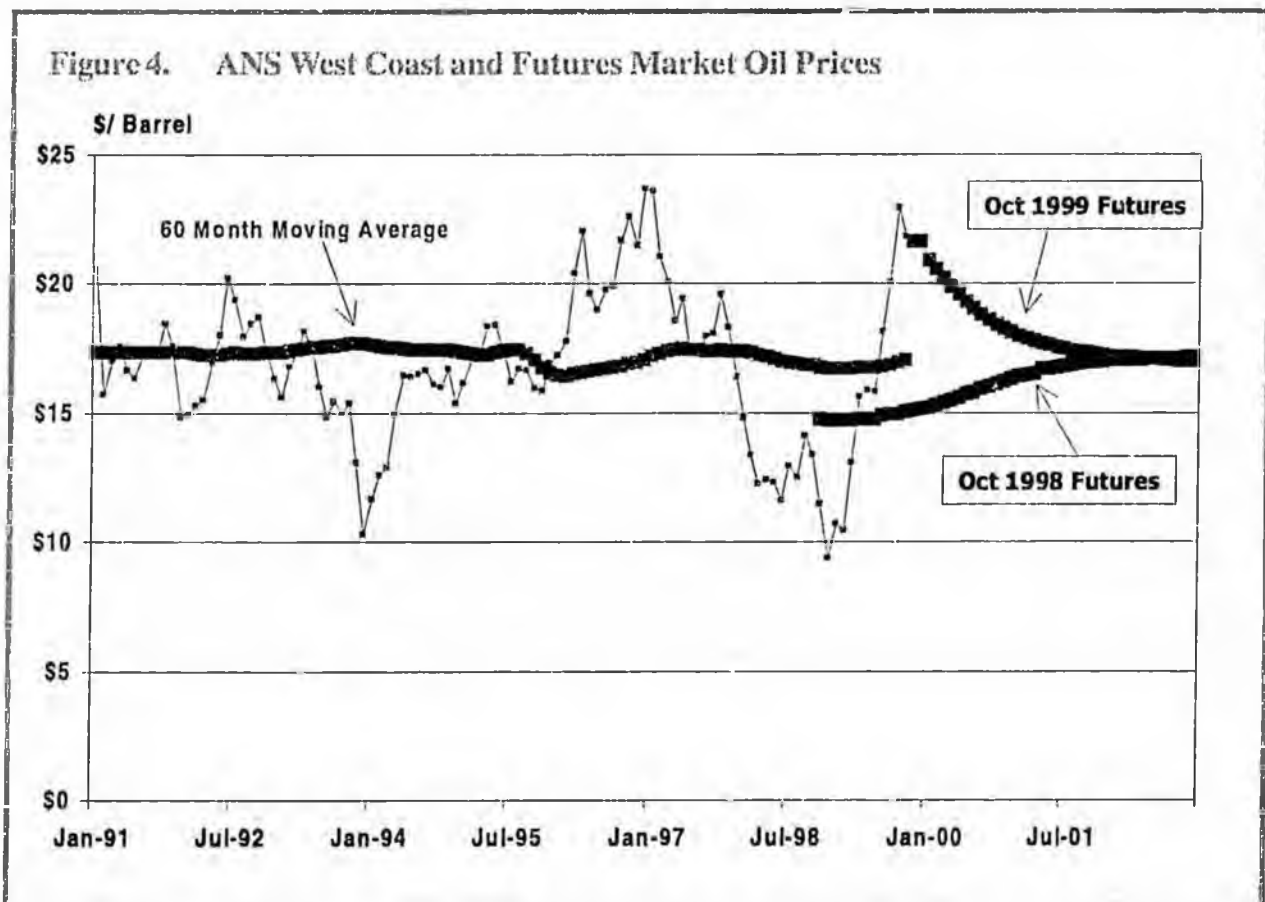
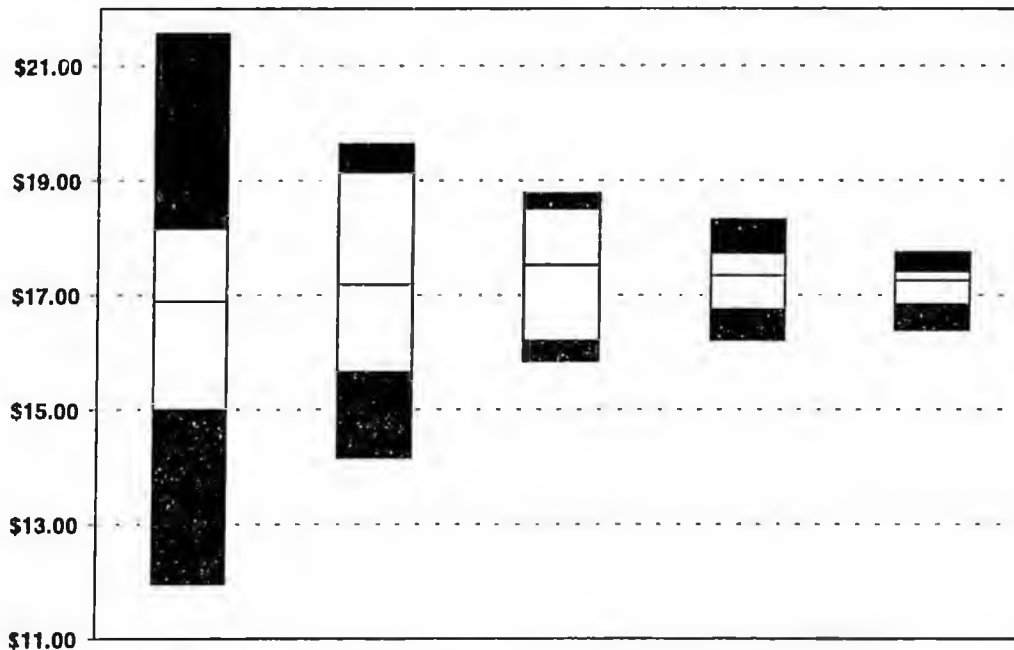


Figure 5 on the next page reflects another analysis demonstrating both the short-term volatility and the longer term stability of ANS West Coast market prices over the past fourteen years. The left hand bar depicts the variability of ANS West Coast oil price for each of the rolling 12-month time periods (from January 1986-October 1999). Ninety-five percent of those average prices fall between \$11.96 and \$21.57 per barrel; 50 percent between \$15 and \$18.17 per barrel; and the median of those 12-month average prices is \$16.88 per barrel.

The right hand bar depicts the variability of the rolling 60-month time period. The 60-month average ANS West Coast market prices were obviously very consistent. Ninety-five percent of those averages fall between \$16.39 and \$17.74 per barrel; 50 percent of the time, between \$16.83 and \$17.41 per barrel; and the median of those 60-month average prices is \$17.25 per barrel. The middle three bars in the figure reflect the variability of the rolling 24-month, 36-month and 48-month time periods.

Those whose perspective is only one year should focus on the price range reflected in the 12-month or left hand bar. The bars to the right are more appropriate for the longer term.

**Figure 5. Cumulative Average ANS Oil Price (January 1986-October 1999)
Moving Average and Confidence Intervals**



Percentile Ranking	\$ per Barrel				
	12-month	24-month	36-month	48-month	60-month
2.5%	21.57	19.63	18.78	18.32	17.74
25%	18.17	19.13	18.50	17.72	17.41
Median	16.88	17.18	17.53	17.35	17.25
75%	15.00	15.65	16.20	16.76	16.83
97.5%	11.96	14.16	15.84	16.21	16.39

The percentile ranking is the probability of exceeding the corresponding ANS oil price.

D. Oil Production Forecast

While the average delivered price for ANS crude oil over all five-year periods since 1986 has been remarkably steady at just over \$17 per barrel, ANS production volumes have declined steadily over most of that time period. In 1988, ANS production peaked at 2.005 million barrels per day; it has declined steadily since. Figure 6 on the next page depicts that decline. ANS production has dropped by 25 percent since FY 1997, the last year the state did not have to call upon its reserves to balance its budget.

Table 5 below summarizes the department's Alaska North Slope oil production forecast through FY 2010. Figure 7 reflects the historical and projected rates for ANS oil production. We forecast a temporary reversal of the ANS production rate decline and a slight increase in the production rate during the period FY 2003 to 2005. This increase is driven by new developments at Alpine in 2001, Liberty and Northstar in 2003, and new satellite production from Prudhoe Bay and other existing fields.

Table 5. ANS Crude Oil Production
Million Barrels per Day

Fiscal Year	ANS Production
Actual 1999	1.164
2000	1.058
2001	1.045
2002	1.031
2003	1.028
2004	1.045
2005	1.058
2006	1.049
2007	0.987
2008	0.930
2009	0.871
2010	0.810

Figure 6. ANS Historical Production

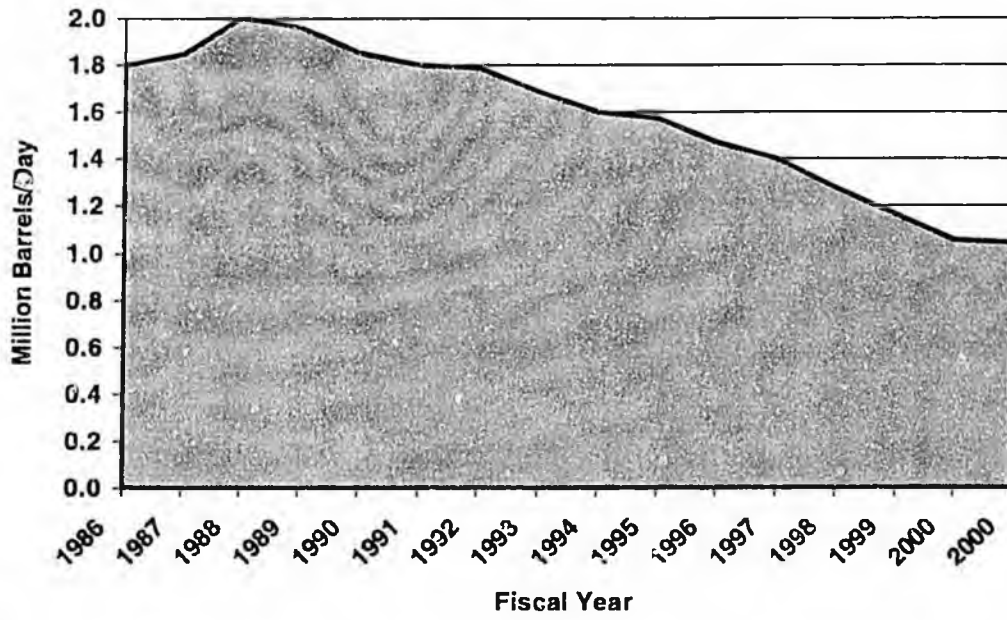
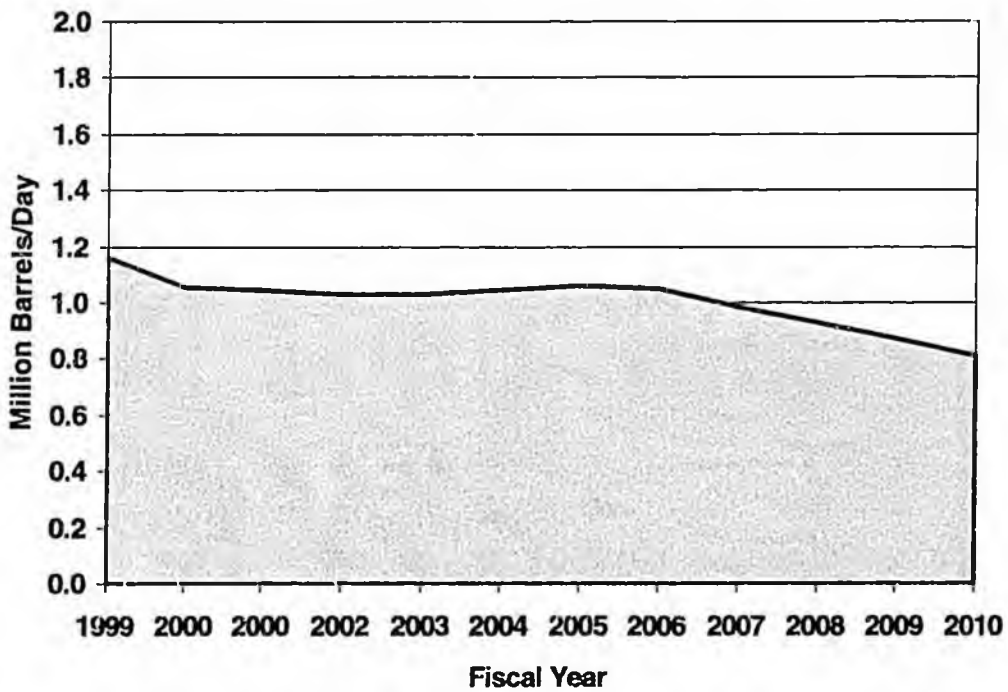


Figure 7. ANS Projected Production



E. Longer Term Unrestricted Revenue Outlook

Using the price and volume components developed in the last two sections, the table below summarizes the department's forecast of Total *Unrestricted General Purpose Revenue* through FY 2010.

Table 6. Total *Unrestricted General Purpose Revenue*,
Actual FY 1999 and Projected FY 2000-2010
\$Million

Fiscal Year	(see Table 12)	(see Table 20)	(see Table 36)	<i>Unrestricted</i>	
	<i>Oil</i> <u>Revenue</u>	<i>NoTUFF</i> <u>Revenue</u>	<i>Investment</i> <u>Earnings</u>	<i>General Purpose</i> <u>Revenue</u>	<i>Percent</i> <u>from Oil</u>
Actual 1999	913.2	331.6	46.5	1,291.3	70.7%
2000	1,386.3	372.8	45.0	1,804.1	76.8%
2001	1,179.5	341.7	45.0	1,566.2	75.3%
2002	1,082.4	346.3	45.0	1,473.7	73.4%
2003	1,048.8	346.3	45.0	1,440.1	72.8%
2004	1,038.4	339.4	45.0	1,422.8	73.0%
2005	997.4	339.5	45.0	1,381.9	72.2%
2006	992.0	339.5	45.0	1,376.5	72.1%
2007	920.0	339.6	45.0	1,304.6	70.5%
2008	843.1	351.7	45.0	1,239.8	68.0%
2009	771.8	351.7	45.0	1,168.5	66.1%
2010	696.5	351.5	45.0	1,093.0	63.7%

F. Constitutional Budget Reserve

Table 7 reflects the amount needed to make up the difference between the *Unrestricted General Purpose Revenue* the Department of Revenue forecasts and the annual General Fund budget of \$2.3 billion ⁽¹⁾ for each year from FY 2000 through FY 2010.

Table 7. Difference Between *Unrestricted General Purpose Revenue* and General Fund Budget - "The Gap"
\$Million

<u>Fiscal Year</u>	<u>Total Unrestricted General Purpose Revenue</u>	<u>General Fund ⁽¹⁾</u>	<u>Difference</u>
2000	1,804.1	2,300.0	(495.9)
2001	1,566.2	2,300.0	(733.8)
2002	1,473.7	2,300.0	(826.3)
2003	1,440.1	2,300.0	(859.9)
2004	1,422.8	2,300.0	(877.2)
2005	1,381.9	2,300.0	(918.1)
2006	1,376.5	2,300.0	(923.5)
2007	1,304.6	2,300.0	(985.4)
2008	1,239.8	2,300.0	(1,060.2)
2009	1,168.5	2,300.0	(1,131.5)
2010	1,093.0	2,300.0	(1,207.0)

As approved by voters in 1990, all of the money from oil and gas tax and royalty settlements are deposited into the Constitutional Budget Reserve Fund. Over the past nine years the state has deposited about \$5 billion into the reserve fund and has earned \$1.1 billion on the money.

For all but one of those years, the state has relied on the CBRF to fill the difference between *Unrestricted General Purpose Revenue* and the annual state budget.

Through September 1999, \$3.8 billion has been withdrawn from the CBRF to balance the budget, leaving a current balance of about \$2.3 billion.

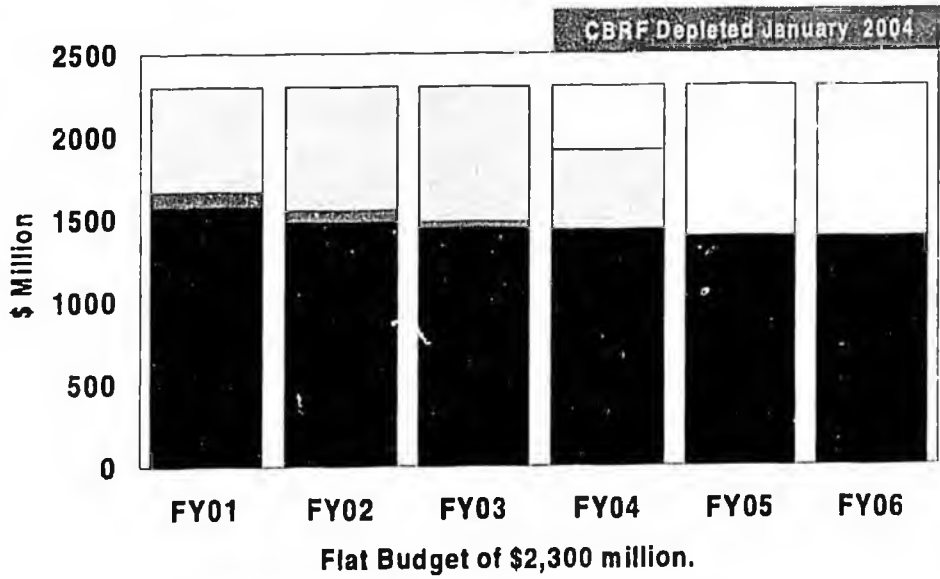
⁽¹⁾ Any budget figure used to derive "the Gap" will have its detractors. What about cuts? What about funding urgent needs? What about inflation and population growth? This amount, based on the FY 2000 General Fund budget of approximately \$2.3 billion, simply provides a reference point for analysis.

This table reflects the CBRF Depletion Matrix and the time period the fund could continue to be used to make up the difference between *Unrestricted General Purpose Revenue* and the General Fund budget at various oil prices and budget levels. For example, if we are correct in our oil price forecast and the General Fund budget remains at \$2.3 billion per year, the CBRF will be exhausted in January 2004.

Table 8. CBRF Depletion Matrix
\$ per Barrel

Annual Budget Change	<u>\$12.50</u>	Fall 1999 Forecast	<u>\$22.50</u>
+3.0%	Jan-2002	Jul-2003	Nov-2004
+1.0%	Feb-2002	Nov-2003	Aug-2005
0.0%	Mar-2002	Jan-2004	Apr-2006
-1.0%	Apr-2002	Apr-2004	Feb-2007
-3.0%	Jul-2002	Jan-2005	Jul-2010

Figure 8. Anticipated Life of the Constitutional Budget Reserve Fund



Covered By **Not Covered**

- Unrestricted General Purpose Revenue
- Draw from Current CBRF Earnings
- Draw from CBRF in Excess of Earnings (Includes current deposits)

Flat Budget of \$2,300 million.

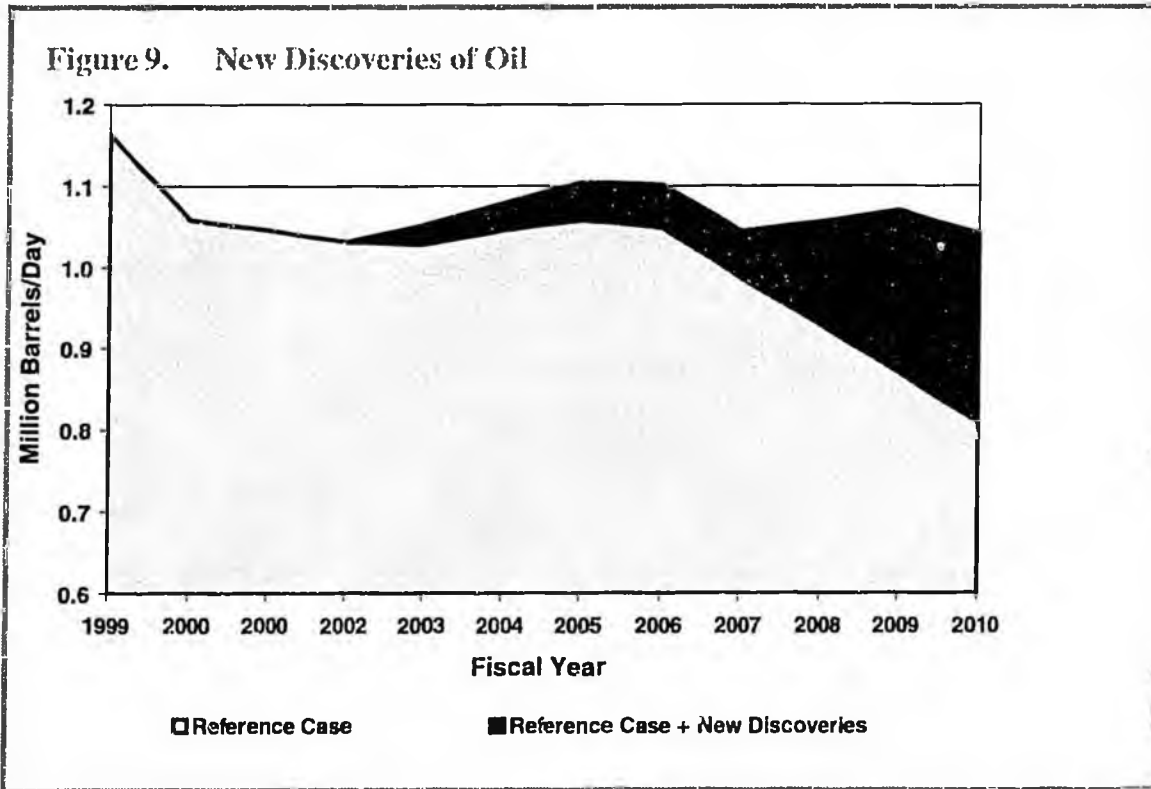
New Discoveries of Oil - How Much of "The Gap" Could They Close?

Our reference-case production forecast includes only production from known accumulations of oil. The U.S. Geological Survey has developed a procedure for estimating production from yet-to-be discovered reserves. The speculative barrels of production summarized in the following table were developed by the Department of Natural Resources in the spring of 1999 using that procedure. The additional revenue that could be generated from this production is reflected in Table 9 and Figure 9.

**Table 9. Possible Additional Revenue Effect of New Discoveries
Reference Case**

Fiscal Year	Million bbl/day Discoveries Barrels⁽¹⁾	\$Million New Additional Revenue
2002	0.0000	0.0
2003	0.0228	5.6
2004	0.0342	10.0
2005	0.0461	15.6
2006	0.0529	18.6
2007	0.0572	20.2
2008	0.1252	57.8
2009	0.1995	123.8
2010	0.2302	150.0

⁽¹⁾ See Appendix G for breakdown by field.



Finally, Table 10 reflects the effect this additional production would have on the projected life of the CBRF in three projected oil price scenarios: (1) our fall forecast prices; (2) a price of \$12.50 per barrel; and (3) a price of \$22.50 per barrel.

Table 10. Effect of New Discoveries of Oil on CBRF Life⁽¹⁾
\$ per Barrel

	<u>\$12.50</u>	<u>Fall Forecast</u>	<u>\$22.50</u>
Production Forecast	Apr-2002	May-2004	Jul-2006
Reference Case + New Discoveries	Apr-2002	May-2004	Oct-2006

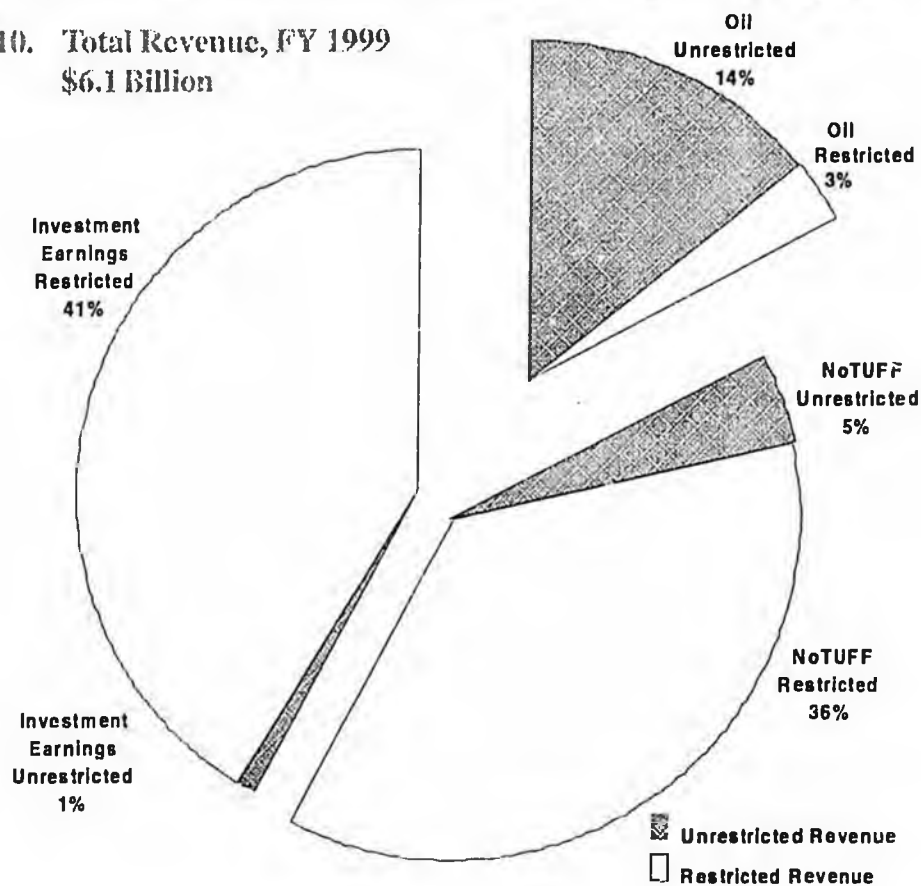
⁽¹⁾ Assumes Flat Budget

III. OIL REVENUE

Table 11. Total Oil Revenue,
Actual FY 1999 and Projected FY 2000-2001
\$Million

	Actual FY 1999	FY 2000	FY 2001
Unrestricted			
Property Taxes	48.8	45.7	43.8
Corporate Income Taxes	145.1	175.0	175.0
Severance Taxes	371.1	576.9	459.0
Royalties (including Bonuses)	<u>348.2</u>	<u>588.7</u>	<u>501.6</u>
Subtotal	913.2	1,386.3	1,179.5
Restricted			
Royalties to Permanent Fund & School Fund	157.9	222.1	194.9
Settlements to CBRF	<u>50.0</u>	<u>30.0</u>	<u>150.0</u>
Subtotal	207.9	252.1	344.9
Total	1,121.1	1638.4	1524.4

Figure 10. Total Revenue, FY 1999
\$6.1 Billion



General Discussion

Oil revenue includes revenue from both oil and gas. The state receives its oil revenue from four sources: oil and gas production tax, property tax, royalties and corporation income tax. The bulk of the revenue received from taxes and royalties goes into the General Fund for general purpose spending. Roughly 25 percent of the royalty revenue goes directly into the principal of the Permanent Fund and 0.5 percent goes into the Public School Trust Fund. Settlements of tax and royalty disputes between the State of Alaska and the oil producing companies go into the Constitutional Budget Reserve Fund (CBRF).

Figure 12 below shows the actual proportion of oil revenue from each source. The CBRF funds flow from disputes involving all four revenue types.

As can be seen from Figure 12, royalties and severance taxes constitute the largest part of oil revenue – both restricted and unrestricted. This section begins with a discussion of these two revenue sources, both of which are driven by price and volume. We then review the price forecasting methodology that underlies our forecast, as well as explore how those market prices are turned into wellhead values. We also review our volume forecast, and close this section with a discussion of oil and gas property taxes, oil and gas corporate income taxes and the restricted portions of oil revenue.

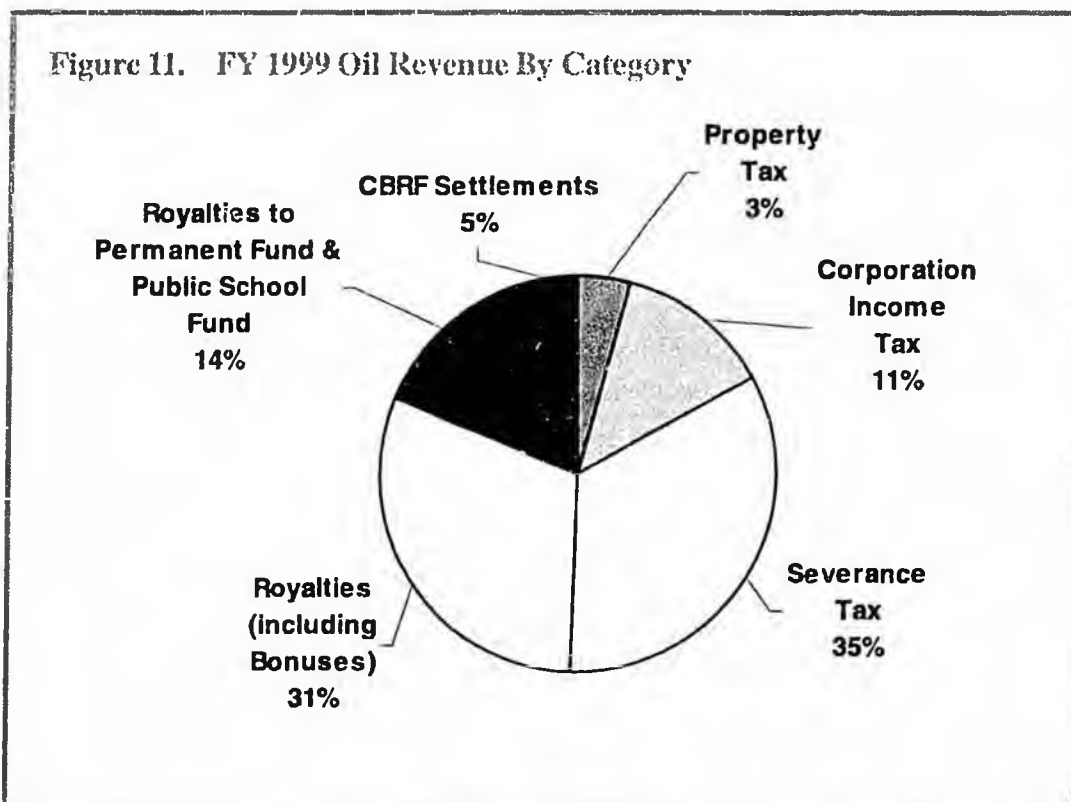


Table 12. Unrestricted Oil Revenue Projections.
Actual FY 1999 and Projected FY 2000-2010
 \$Million

Fiscal Year	Property Tax	Corporation Income Tax	Severance Tax	Royalties including Bonuses	Total Oil
Actual 1999	48.8	145.1	371.1	348.2	913.2
2000	45.7	175.0	576.9	588.7	1,386.3
2001	43.8	175.0	459.0	501.6	1,179.5
2002	42.0	170.0	406.9	463.5	1,082.4
2003	40.1	170.0	374.4	464.3	1,048.8
2004	38.2	165.0	356.9	478.3	1,038.4
2005	36.4	160.0	331.0	470.0	997.4
2006	34.6	160.0	326.7	470.7	992.0
2007	32.9	150.0	292.3	445.1	920.3
2008	31.3	140.0	255.4	416.4	843.1
2009	29.6	130.0	226.5	385.7	771.8
2010	28.0	120.0	197.2	351.3	696.5

Unrestricted Oil Revenue

Oil and Gas Production Taxes

All production of oil and gas in Alaska is subject to oil and gas production taxes. The taxes are levied on all production except for the state's royalty production. The taxes consist of the oil and gas production tax and the hazardous release surcharge that is only levied on oil. The conservation surcharge was repealed effective July 1, 1999.

Oil Production Tax.

The rate of taxation for oil varies depending on the vintage of the field and is further subject to the economic limit factor (ELF). The ELF varies depending on field size and well productivity.

The current severance tax rate on oil is 12.25 percent of production value, as determined at the point of production, for the first five years of production and 15 percent thereafter. There is a minimum tax of \$0.80 per barrel.

Both the percent of value and the cents per barrel tax rates are subject to the ELF. The appropriate tax rate is multiplied by the ELF to determine the effective tax rate.

The ELF formula for oil production is as follows: ⁽¹⁾

$$ELF = (1 - (300/PPW))^{((150,000/TP)^{1.5333})}$$

Where PPW = Average oil production per well per day in the field

TP = Average daily production from the field

^ = Exponential

⁽¹⁾If a field produces 300 barrels per day per well or less the ELF is zero (i.e., no severance taxes are assessed.)

The two exponents in the formula result in a tax schedule with extremely low tax rates for smaller, low productive fields and higher tax rates for larger, highly productive fields. There is a unique ELF for every combination of field size and well productivity.

The value of the oil production for taxes is determined by deducting allowable marine and pipeline transportation costs from the sales price to determine the value at the point of production. The sales price for most sales is tied by regulation directly or indirectly to the West Coast spot price of Alaska North Slope (ANS) crude oil.

Natural Gas Production Tax.

The severance tax rate on gas is 10 percent of production value. There is a minimum tax of \$.064 per million cubic feet.

The ELF formula for gas production is as follows:

$$ELF = 1 - (3000/PPW)$$

Where PPW = Average gas production per well per day in the field

The taxable value of gas depends on location and use. For Cook Inlet production, the value for LNG sales is based on the sales price in Tokyo less marine and pipeline costs; the value for sales to the fertilizer plant are indexed to the price of anhydrous ammonia; the value for sales for local use are based on the average of the sales contracts in effect each month. North Slope gas sales are taxed at a value equal to 10 percent of the average netback value of oil.

Hazardous Release Surcharge.

Following the grounding of the Exxon Valdez, this tax was enacted in order to provide a hazardous substance release emergency fund.

The surcharge is comprised of two components (1) a \$.03 per barrel charge on all oil production excluding public royalty barrels and (2) an additional \$.02 per barrel charge on all oil production whenever the balance in the state oil and hazardous substance release prevention and response fund falls below \$50 million. The balance of the fund was \$50 million or greater for all of FY 1999 so that the surcharge was \$.03 per barrel for the entire fiscal year.

All of the oil and gas production taxes are collected on a monthly basis.

Oil Royalties

Almost all Alaska oil and gas production occurs on state-owned lands that were leased by the state for exploration and development of oil and gas resources. As the land owner, the state can earn revenue both from lease sales in the form of rents and bonuses and also by retaining a royalty interest in any oil and gas produced from state leases.

Generally, the state issues leases based on a competitive bonus bid system with a royalty interest of 12.5 percent. Some currently producing leases carry a 16.67 percent royalty and some may have a royalty rate as high as 20 percent. The vast majority of current production is from leases that have a 12.5 percent state royalty interest.

The lease allows the state to take its royalty in barrels (in-kind) or as a percentage of the production value (in-value). Currently the state is taking approximately 50,000 barrels per day of Prudhoe Bay production in-kind and selling it to the Williams refinery in North Pole. The state's royalty share of Alaska North Slope production amounts to approximately 125,000 barrels per day.

The royalty oil taken in-value is priced according a formula that uses a market basket of spot crude oil prices closely approximating the West Coast spot price of oil, less a transportation allowance back to the lease.

Oil Production Revenue Forecasting Methodology and Assumptions

The Department of Revenue uses a variety of models and techniques to prepare the petroleum production revenue forecast. The forecast is developed from estimates of oil and gas production by field. The production forecast is developed by our engineering consultants in conjunction with the Alaska Department of Natural Resources and the Alaska Oil and Gas Conservation Commission.

The value of the production is forecast by developing a projection of the price of oil and the cost of shipping oil by tanker and pipeline to market. The oil price forecast assumptions are developed at a formal oil price scenario setting meeting with the assistance of state economists and financial professionals from the Department of Revenue, Department of Natural Resources, Department of Labor, the Office of Management and Budget and the University of Alaska.

Oil Price Forecast

The oil price forecast is based on a subjective assessment of both fundamental market assumptions and trend analysis by the participants at the price scenario meeting. The information presented and analyzed by the participants and our fall 1999 oil price scenario specific assumptions are in the discussion that follows.

Oil Market Fundamentals.

The reference case forecast for oil prices begins with an assessment of the future of market supply and demand. Given this assessment, the price scenarios are based on the relative success we assume OPEC will have managing the market share implied by our supply and demand scenario.

We assume the robust global economy will continue over the next five years, led by the United States and a rapidly recovering Asia. As a result, we project oil demand worldwide will grow in excess of 1.5 million barrels per day on an annual basis.

Non-OPEC production actually declined in 1999 because of the 16 months that AHS-quality crude sold at below \$15 per barrel. With higher prices, we assume non-OPEC production will increase by about 0.5 million barrels per day in both 2000 and 2001.

On net, this scenario suggests that OPEC production could expand by about 1 million barrels per day without putting downward pressure on oil prices. This is not a lot of additional production, given that the current OPEC agreement reduced actual production by 1.75 million barrels per day. When added to the fact that Iraq is not subject to production restraint under the current OPEC agreement, our forecast assumes OPEC will not be totally successful in preventing downward pressure on oil prices in the spring of 2000.

Our detailed assumptions about market fundamentals are contained in Table 13 on the next page.

Table 13. Global Market Assumptions
Million Barrels per Day

	Actual						
	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
DEMAND							
OECD							
North America	23.6	24.0	24.3	24.7	25.1	25.5	25.8
Europe	15.5	15.7	15.9	16.2	16.4	16.7	16.9
Pacific	<u>8.6</u>	<u>8.8</u>	<u>9.0</u>	<u>9.2</u>	<u>9.4</u>	<u>9.6</u>	<u>9.8</u>
Total OECD	47.7	48.5	49.3	50.1	50.9	51.7	52.5
Non-OECD							
Former USSR	3.9	3.9	3.9	3.9	3.9	3.9	3.9
East Europe	0.8	0.9	0.9	0.9	1.0	1.0	1.0
China	4.3	4.5	4.7	4.9	5.2	5.4	5.7
Other Asia	7.0	7.4	7.7	8.1	8.5	8.9	9.4
Latin America	4.8	4.9	5.0	5.2	5.3	5.4	5.6
Middle East	4.3	4.4	4.5	4.7	4.8	4.9	5.0
Africa	<u>2.4</u>	<u>2.5</u>	<u>2.5</u>	<u>2.6</u>	<u>2.6</u>	<u>2.7</u>	<u>2.8</u>
Total Non-OECD	27.5	28.3	29.3	30.2	31.2	32.3	33.4
TOTAL DEMAND	75.3	76.9	78.6	80.3	82.1	84.0	85.9
SUPPLY							
Non-OPEC							
OECD	21.4	21.6	21.9	22.2	22.5	22.9	23.2
Former USSR	7.5	7.5	7.5	7.5	7.5	7.5	7.5
Eastern Europe	0.2	0.2	0.2	0.2	0.2	0.2	0.2
China	3.2	3.2	3.2	3.3	3.3	3.3	3.4
LDCs ⁽¹⁾	10.8	10.9	11.0	11.2	11.3	11.4	11.6
Processing Gain	<u>1.7</u>	<u>1.7</u>	<u>1.8</u>	<u>1.9</u>	<u>2.0</u>	<u>2.1</u>	<u>2.2</u>
Total Non-OPEC	44.6	45.1	45.6	46.2	46.8	47.4	48.0
OPEC	27.5	29.0	30.1	31.3	32.4	33.7	35.0
OPEC NGLs	<u>2.8</u>	<u>2.8</u>	<u>2.8</u>	<u>2.8</u>	<u>2.9</u>	<u>2.9</u>	<u>2.9</u>
Total OPEC	30.3	31.8	32.9	34.1	35.3	36.5	37.8
TOTAL PRODUCTION	75.0	76.9	78.6	80.3	82.1	84.0	85.9

⁽¹⁾ Lesser Developed Countries (LDCs) include Asia (excluding China), Latin America, the Middle East and Africa.

⁽²⁾ Due to rounding to one decimal, columns may not exactly total.

Current Oil Market Situation.

Oil markets continue to tighten as OPEC production cuts and robust global economic growth combine to reduce worldwide inventories. OPEC's March agreement to reduce production — signed by all members except Iraq — called for production cuts from January 1999 levels of a little more than 2 million barrels per day. Although OPEC (less Iraq) trimmed output by about 1.75 million barrels — or nearly 85 percent of targeted reductions — October OPEC production (less Iraq) has increased by 400,000 barrels per day. This reduces current compliance to 65 percent of targeted cuts.

History suggests that market forces lead to lower prices when oil sells for more than \$20 per barrel. What is uncertain is when and how fast the correction will occur. The response of non-OPEC production to higher prices is uncertain. The production policy of OPEC and its ability to continue to act in concert represents a key uncertainty in our forecast, as is the health of the world's economy. Our reference case assumes the global economy remains healthy over the next five years, and we are not assuming any significant effects from computer transitions to the year 2000. A discussion of our assumptions for OPEC follows.

Organization of Petroleum Exporting Countries. We believe that OPEC production will allow some quota increases at its March meeting. This forecast assumes that over time oil prices above \$20 per barrel will provide strong incentives to increase non-OPEC production and encourage some OPEC members to stray from their quotas. Increased non-OPEC production will also motivate large OPEC producers, such as Saudi Arabia, to increase their own production to protect market share. As a result, our reference-case price projection anticipates some softening in oil prices beginning in the spring.

Table 14. OPEC Production ⁽¹⁾
Million Barrels per Day

Country	Oct-99	Production Cut		Target Cuts
		1999 Jan-99	Agreed Quota from Jan-99	
Algeria	0.740	0.810	0.731	(0.079)
Indonesia	1.310	1.335	1.187	(0.148)
Iran	3.530	3.713	3.359	(0.354)
Kuwait ⁽²⁾	1.890	1.990	1.836	(0.154)
Libya	1.320	1.352	1.227	(0.125)
Nigeria	1.970	1.970	1.885	(0.085)
Qatar	0.610	0.650	0.593	(0.057)
Saudi Arabia ⁽²⁾	7.550	8.100	7.438	(0.662)
UAE	2.050	2.190	2.000	(0.190)
Venezuela	<u>2.730</u>	<u>2.950</u>	<u>2.720</u>	<u>(0.230)</u>
Subtotal OPEC (less Iraq)	23.700	25.060	22.976	(2.084)
Iraq	2.830	2.580	-	-
Total OPEC	26.530	27.640	-	-

⁽¹⁾ Source: Middle East Economic Survey, November 15, 1999.

⁽²⁾ Share Neutral Zone output.

Alaska North Slope. ANS West Coast spot prices are currently averaging over \$24 per barrel, up dramatically from April 1999 (the release of our spring 1999 forecast) when they averaged \$15.64 per barrel. The recovery in world oil prices due to the OPEC cutbacks and the slowdown in non-OPEC production growth due to the low oil prices last year clearly influenced the price in the U.S. West Coast market. According to the U.S. Department of Energy, the U.S. West Coast imported a little over 171,000 barrels per day of ANS-quality oil from Iraq and Saudi Arabia in August, strengthening the link between ANS and key world marker crude oil prices.

ANS is typically sold with reference to U.S. benchmark crude oil — West Texas Intermediate (WTI). The price difference between ANS and WTI narrowed from \$1.80 per barrel last January to under \$1 in October. ANS sells for less than WTI primarily because it is a lower quality feedstock for most refineries. Over the past five years, the difference between the two crude oils has averaged roughly \$1.65 per barrel. Strong demand for ANS by West Coast refineries and a tight global market for ANS-quality crude oils contributed to this year's tighter spread. Based on the historic average, this forecast assumes a \$1.60 per barrel spread in FY 2001.

There is no spot market for ANS sold in Asia. As a result, we use the historical relationship between West Coast spot ANS and reported Asia sales value to project future Asia delivery prices (Table 4 on Page 18).

Ninety-five percent of Alaska's oil production taxes and royalties are closely tied to ANS spot oil prices for delivery to West Coast refineries, as reported in *Platt's Oilgram Price Report*. The West Coast spot price is used as the standard for computing state oil production taxes for sales for West Coast delivery and for establishing the value standard for sales in Alaska. Royalties are paid on the basis of different formulas for different producers. All of the formulas rely to some extent on a market basket of crude oil prices that includes the ANS spot price. At this point, we assume the spot price will continue to be a valid indicator of crude oil value in a post-BP/ARCO acquisition world.

Table 15. Fall 1999 Forecast Assumptions
\$ per Barrel

Fiscal Year	Market Price	ANS Marine Transportation	TAPS Tariff	Feeder Pipeline	ANS Wellhead
Actual 1999	12.70	1.42	2.70	0.11	8.47
2000	20.11	1.56	2.71	0.11	15.73
2001	18.26	1.38	2.82	0.14	13.92
2002	17.69	1.49	2.92	0.16	13.12
2003	17.69	1.49	2.91	0.18	13.11
2004	17.69	1.47	2.92	0.23	13.07
2005	17.69	1.53	2.96	0.30	12.90
2006	18.20	1.57	3.01	0.36	13.26
2007	18.22	1.51	3.14	0.35	13.22
2008	18.22	1.61	3.30	0.32	12.99
2009	18.22	1.72	3.45	0.29	12.76
2010	18.22	1.97	3.61	0.29	12.35

Oil Production

The production assumptions were developed on a field-by-field basis. The forecast is based on company-by-company assessed proven and probable reserves, development plans where available, and assessments by the technical personnel at the Department of Revenue, Department of Natural Resources and the Alaska Oil and Gas Conservation Commission.

The production forecast is only modestly changed from the spring 1999 forecast. Although there have been reports in the news media concerning additional production as a result of the proposed BP-ARCO acquisition, at this point it is unclear what, if any, additional investments or production will occur. Our fall forecast for FY 2000-2005 trims, on average, a little more than 6,000 barrels per day from our spring forecast. We continue to expect ANS production to remain above 1 million barrels per day through FY 2006, averaging 1.045 million barrels per day. Longer term, we expect production to decline after FY 2006 at an average rate of roughly 6.5 percent per year.

New developments at Alpine (2001 start-up), satellite fields in Prudhoe Bay and other existing fields, plus Liberty and Northstar (2003 start-ups), are key to holding off an overall North Slope production decline over the next six years.

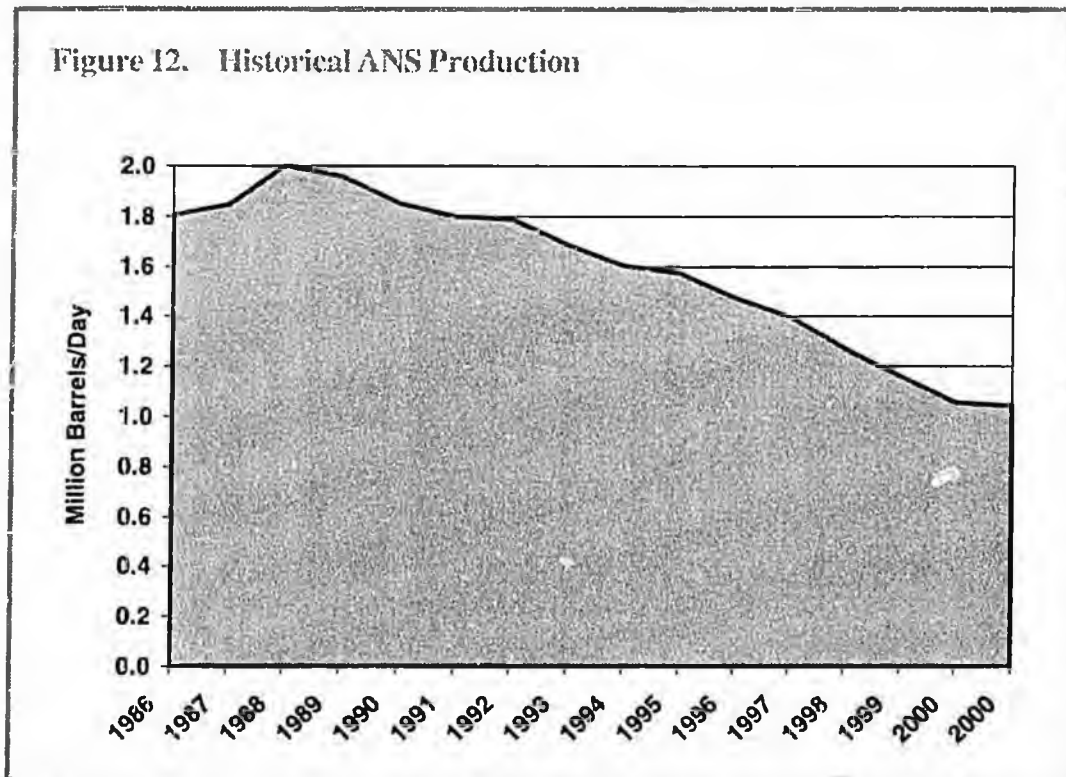


Table 16. ANS Oil and NGL Production

Million Barrels per Day

Oil	Actual FY 1999	FY 2000	FY 2001
Prudhoe Bay	0.5797	0.5159	0.4750
PBU-Satellites ⁽¹⁾	0.0032	0.0056	0.0165
Kuparuk	0.2408	0.2223	0.2064
West Beach	0.0024	0.0038	0.0045
Tabasco	0.0028	0.0105	0.0131
Tarn	0.0198	0.0216	0.0173
Milne Point	0.0490	0.0477	0.0454
Schrader Bluff	0.0055	0.0059	0.0065
Sag River	0.0008	0.0001	0.0010
Endicott ⁽²⁾	0.0398	0.0386	0.0353
Eider	0.0024	0.0013	0.0012
Badami	0.0027	0.0033	0.0040
Lisburne	0.0060	0.0063	0.0074
Point McIntyre	0.1164	0.0900	0.0725
Niakuk	0.0288	0.0262	0.0220
West Beach	0.0004	0.0018	0.0019
N Prudhoe Bay State	0.0000	0.0000	0.0003
Alpine	<u>0.0000</u>	<u>0.0000</u>	<u>0.0600</u>
Total Oil	1.1005	1.0011	0.9902
NGLs			
Prudhoe Bay	0.0557	0.0492	0.0470
Endicott ⁽²⁾	0.0036	0.0040	0.0035
Lisburne	0.0009	0.0008	0.0010
Point McIntyre	0.0027	0.0028	0.0025
Niakuk	0.0004	0.0004	0.0004
West Beach	<u>0.0000</u>	<u>0.0003</u>	<u>0.0004</u>
Total NGLs	0.0633	0.0576	0.0547
TOTAL			
Prudhoe Bay	0.6354	0.5651	0.5220
PBU-Satellites ⁽¹⁾	0.0032	0.0056	0.0165
Kuparuk	0.2408	0.2223	0.2064
West Beach	0.0024	0.0038	0.0045
Tabasco	0.0028	0.0105	0.0131
Tarn	0.0198	0.0216	0.0173
Milne Point	0.0490	0.0477	0.0454
Schrader Bluff	0.0055	0.0059	0.0065
Sag River	0.0008	0.0001	0.0010
Endicott ⁽²⁾	0.0434	0.0426	0.0388
Eider	0.0024	0.0013	0.0012
Badami	0.0027	0.0033	0.0040
Lisburne	0.0069	0.0071	0.0083
Point McIntyre	0.1191	0.0928	0.0750
Niakuk	0.0292	0.0266	0.0224
West Beach	0.0005	0.0022	0.0023
N Prudhoe Bay State	0.0000	0.0000	0.0003
Alpine	<u>0.0000</u>	<u>0.0000</u>	<u>0.0600</u>
Total Liquids	1.1638	1.0587	1.0449

⁽¹⁾ Includes Midnight Sun, Sambuca and PBU-Schrader.⁽²⁾ Includes Sag Delta.

Other Transportation and Production Costs

Transportation Costs.

Recent review of the projected shipping requirements based on our current ANS production forecast has led to a modest downward adjustment in our forecasted marine transportation costs. Although the forced retirement of vessels without double hulls per the Oil Pollution Act of 1990 and new more expensive vessels on order will increase costs, declining production will reduce shipping requirements. Moreover, the destination markets most distant and most costly from Valdez will be relinquished first as production declines.

Trans-Alaska Pipeline System (TAPS) Tariffs.

The TAPS tariff is determined according to the TAPS Settlement Methodology, a rate-making method approved by the Federal Energy Regulatory Commission that allows the TAPS owners to recover their costs, including an allowance for profit. Under the agreement, future tariffs will be determined by operating cost trends, the production rate and CPI-inflation.

TAPS tariffs are filed on a calendar year basis with new tariffs taking effect January 1 each year. The expected tariff filing for calendar 1999 is \$2.66 per barrel. Table 15 on Page 37 contains projected tariffs on a fiscal year basis for FY 1999-2010.

Feeder Pipeline Costs.

Table 15 also contains projected pipeline costs. Certain additional transportation costs are also incurred to move the various crude oils that comprise ANS to the trans-Alaska pipeline system. These include both feeder pipeline charges and other cost adjustments to account for the different qualities of oil entering the pipeline.

Wellhead Price.

The combination of ANS wellhead value and production by field is the basis for both state severance taxes and royalties. The wellhead value by field is calculated by subtracting the relevant pipeline tariff and marine transportation costs (as well as adjustments for North Slope feeder pipelines and pipeline quality bank) from the sales price.

Petroleum Property Tax

An annual tax is levied each year on the full and true value of property taxable under AS 43.56. The valuation procedure has been established for three distinct classes of property; exploration, production and pipeline transportation.

Exploration Property.

Value based on the estimated price which the property would bring in an open market and under the then prevailing market conditions in a sale between a willing seller and a willing buyer, both conversant with the property and with prevailing general price levels.

The raw data for market value is gathered by the state appraiser by reviewing the details of equipment sales, attending auctions and reviewing trade journals. This data is then applied to the taxable property, taking into account age, capacity, physical and functional obsolescence.

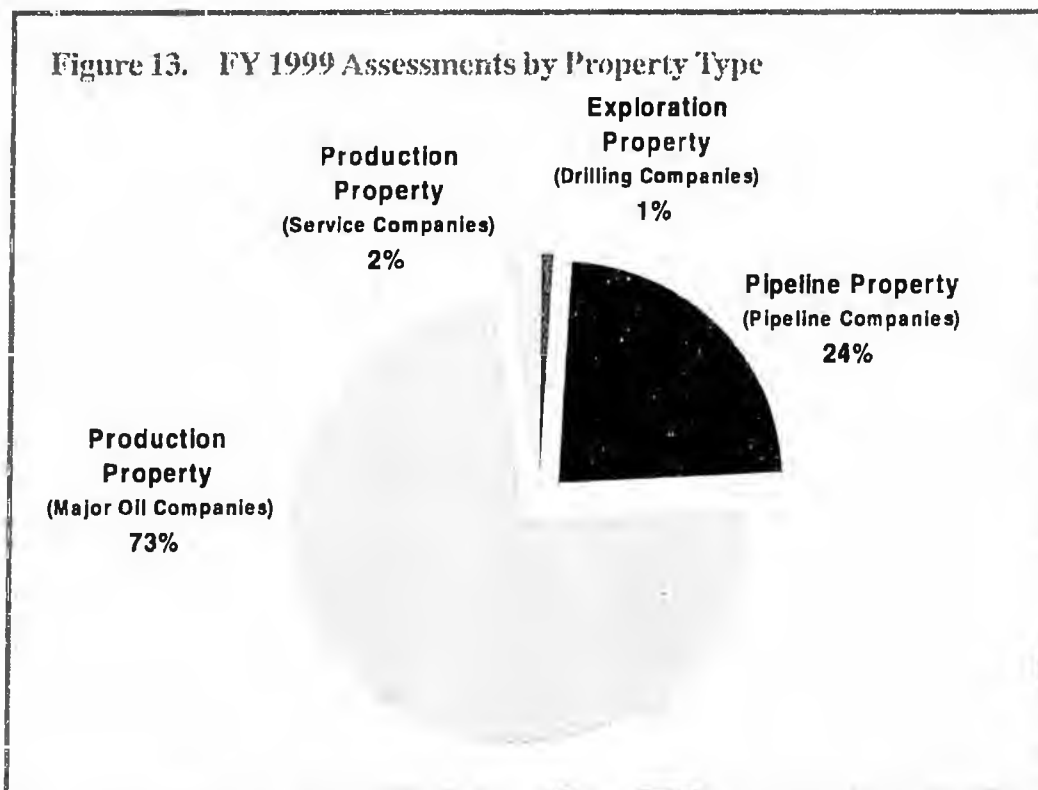
Production Property.

Value is determined on the basis of replacement cost new less depreciation, based on the economic life of the proven reserves.

In the case of an offshore oil or gas platform or onshore facility, the number of years of useful life is determined by when the facility reaches its economic limit, not the projected physical life of the property. The point when it is estimated that operating revenue will equal operating expense, plus the age of the facility, determines the total life. The depreciation factor becomes the years of remaining life divided by the total life.

Pipeline Transportation Property.

The full and true value of taxable pipeline property is determined with due regard to the economic value of the property based on the estimated life of the proven reserves of gas or unrefined oil into the transportation facility. We rely upon several standard appraisal techniques to value Alaska pipelines. The primary indicator is the income method which estimates value as the present worth of all future income streams that pipeline will earn. Over 95 percent of pipeline transportation property is accounted for by the Trans-Alaska Pipeline from Prudhoe Bay to Valdez.



The following table illustrates the distribution of the petroleum property tax between local communities and the state for FY 1999. The property tax is assessed by the state. The property is also taxable by the communities where the property is located. The local tax is on the state assessed value and is subject to the local property tax limitations established in AS 43.29.080, .090 and .100. The local taxes are creditable against the state tax and are collected directly by the local taxing authority.

Table 17. FY 1999, Distribution of the Petroleum Property Tax⁽¹⁾
\$ Million

<u>Borough</u>	<u>Gross Tax</u>	<u>Local Tax</u>	<u>State Tax</u>
North Slope	212.3	196.4	15.9
Unorganized	28.1	0.0	28.1
Valdez	13.3	13.3	0.0
Kenai	8.5	5.3	3.2
Fairbanks	6.1	5.0	1.1
Anchorage	2.4	2.2	0.2
Matanuska-Susitna	<u>0.1</u>	<u>0.1</u>	<u>0.0</u>
Total	270.8	222.3	48.5

⁽¹⁾ Other municipalities have less than \$50,000 in AS 43.56 revenues.

Petroleum Corporation Income Tax

Petroleum corporation income tax revenue is a function of the relative size of the corporation's Alaska-vs.-worldwide activities and total worldwide net earnings. The tax uses the modified U.S. federal taxable income for the corporation and apportions that income to Alaska using a three-factor approach: the proportion of the corporation's (1) tariffs and sales; (2) oil and gas production; and, (3) oil and gas property occurring in Alaska.

Forecast Methodology.

Oil corporation income tax revenue is very volatile, and consequently very difficult to predict. This volatility can be attributed to several factors:

- Carry-forward adjustments and refunds can interfere with year-to-year timing.
- Alaska revenue is calculated as a fraction of the taxpayer's total income as reported to the IRS, so events in far-off oil provinces, or technical reporting issues under the IRS code, can greatly effect Alaska income.
- The bulk of the tax is paid by three firms (Arco, BP and Exxon) so an extraordinarily unprofitable or profitable year for one of these firms can have a large influence on Alaska revenue.
- Severance tax, property tax and royalties, which were also estimated, are deductible for purposes of the income tax, so if we get one of these estimates wrong, income tax will also be wrong.
- Finally, there is the 'usual' overlay of swings in crude prices and number of barrels produced.

We begin our forecast of these revenues by using econometric methods to estimate the statistical relationship between historical collections of the tax and Alaska oil production value and estimated payments. Future collections are estimated based on this historical relationship and our production value forecast as well as forecasted apportionment factors.

The \$55 million decrease in petroleum corporation revenue in FY 1999 (from \$200.1 million in FY 1998 to \$145.1 million in FY 1999), and the projected \$29.9 million increase in FY 2000 (to \$175 million), is mostly a result of current and projected oil prices and production. Projected FY 2000 revenue is \$8.4 million less than the five-year average of \$183.4 million and \$23.0 million more than the 10-year average of \$152 million. Considering the high oil prices in FY 2000, the revenue forecast may seem low. However, the following two reasons reduce the expectation for historically high oil revenue in FY 2000: (1) oil companies will receive approximately \$16 million in corporation tax refunds; and (2) the companies have \$24 million in corporation tax carry-forwards to apply against future tax liabilities. The carry-forwards and refunds are a result of lower than expected earnings in 1998. After FY 2000, prices are expected to moderate and revenue will remain relatively stable through FY 2004. In the long term, revenue will decline with decreases in oil production and the size of Alaska-vs.-worldwide petroleum activities.

Restricted Oil Revenue

All the revenues discussed so far are unrestricted with the following exceptions broken out from Table 11.

Currently a minimum of 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the state are deposited into the Permanent Fund. State oil and gas leases issued, beginning in 1980, require a 50 percent contribution to the fund. In addition, 0.5 percent of all royalties and bonuses are deposited in the Public School Fund Trust. As explained earlier, any settlements with or judgments against the oil industry are deposited in the CBRF.

Table 18. Restricted Oil Revenue, Actual FY 1999 and Projected FY 2000-2001
\$Million

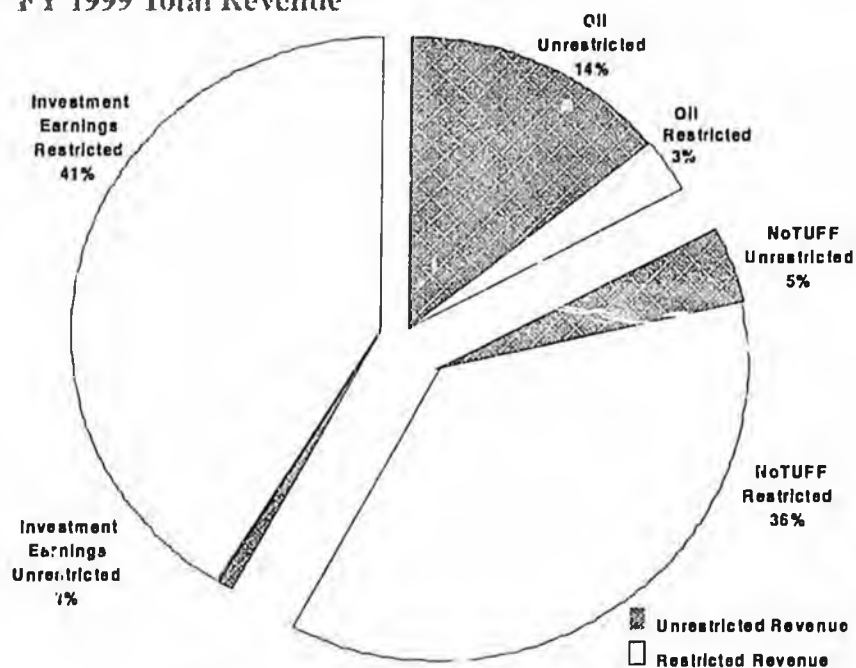
	Actual		
	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>
Restricted			
Royalties to the Permanent Fund	155.5	218.1	191.5
Royalties to the Public School Fund	<u>2.4</u>	<u>4.0</u>	<u>3.4</u>
Subtotal	157.9	222.1	194.9
Settlements to CBRF	<u>50.0</u>	<u>30.0</u>	<u>150.0</u>
Total	207.9	252.1	344.9

IV. NON-OIL TAXES, USER FEES AND FEDERAL FUNDS

Table 19. Total Non-Oil Taxes, User Fees and Federal Funds,
Actual FY 1999 and Projected FY 2000-2001
\$Million

	Actual:		
	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>
Non-Oil Taxes, User Fees and Federal Funds			
<u>Unrestricted</u>			
Sales/Use Taxes	93.6	92.2	92.0
Corporate Income Taxes	53.8	52.0	50.0
Fish Taxes	21.5	26.2	21.4
Other Taxes	4.5	5.7	6.3
Licenses & Permits	62.9	62.8	62.8
Charges for Services	31.8	33.8	34.3
Other	<u>63.5</u>	<u>100.1</u>	<u>74.9</u>
Subtotal	331.6	372.8	341.7
<u>Restricted</u>			
Federal Funds	1,376.2	1,771.0	1,771.0
Trusts	55.5	60.8	60.8
Dedicated Funds	63.4	57.8	57.8
Statutorily Restricted	655.4	560.5	568.5
Bond Authorizations	<u>199.6</u>	<u>0.0</u>	<u>0.0</u>
Subtotal	2,350.1	2,450.1	2,458.1
Total	2,681.7	2,822.9	2,799.8

Figure 14. FY 1999 Total Revenue



Unrestricted NoTUFF Revenue

The non-petroleum revenues are projected based on trend extrapolation, econometric analysis and assessment by state economists and resource and financial managers.

**Table 20. Unrestricted Non-Oil Taxes, User Fees and Federal Funds, ⁽¹⁾
Actual FY 1999 and Projected FY 2000-2010
\$Million**

<u>Fiscal</u> <u>Year</u>	<u>Sales/</u> <u>Use</u> <u>Tax</u>	<u>General</u>			<u>Charges</u>			<u>Total</u>
		<u>Corporation</u> <u>Income</u>	<u>Fish</u> <u>Tax</u>	<u>Other</u> <u>Tax</u>	<u>Licenses/</u> <u>Permits</u>	<u>for</u> <u>Services</u>	<u>Other</u>	
1999	93.6	53.8	21.5	4.5	62.9	31.8	63.5	331.6
2000	92.2	52.0	26.2	5.7	62.8	33.8	100.1 ⁽²⁾	372.8
2001	92.0	50.0	21.4	6.3	62.8	34.3	74.9	341.7
2002	91.9	50.0	21.8	6.8	62.8	34.3	78.7	346.3
2003	92.0	50.0	21.8	6.8	62.8	34.3	78.5	346.3
2004	92.1	50.0	19.2	6.9	62.8	34.3	74.1	339.4
2005	92.4	50.0	19.2	7.0	62.8	34.3	73.8	339.5
2006	92.6	50.0	19.2	7.1	62.8	34.3	73.5	339.5
2007	92.9	50.0	19.2	7.2	62.8	34.3	73.2	339.6
2008	93.1	50.0	19.3	7.3	62.8	34.3	84.9	351.7
2009	93.4	50.0	19.3	7.4	62.8	34.3	84.5	351.7
2010	93.6	50.0	19.3	7.5	62.8	34.3	83.9	351.5

⁽¹⁾ There are no Federal Funds in Unrestricted Revenue.

⁽²⁾ See reconciliation table in Appendix. One time release of mortgage-guarantee reserves from AHFC included in this number.

General Corporation Income Tax

The growth in general corporation tax revenue in FY 1998 (from \$48.4 million in FY 1997 to \$53.4 million in FY 1998) has slowed in FY 1999 (from \$53.4 million in FY 1998 to \$53.8 million in FY 1999), and is projected to reverse in FY 2000 (\$52 million) and then level off in FY 2001 at \$50 million. This projection is based on: (1) the trend in estimated payments; (2) the Alaska Department of Labor employment and earnings projections by sector; and (3) the national trend in corporate income tax revenues. General corporation revenue for FY 2000 is \$5.8 million higher than the 10-year average (FY 1990-1999) of \$46.2 million, and \$3.2 million lower than the five-year average of \$55.2 million (FY 1995-1999).

General corporation income tax revenue is a function of the relative size of the corporations' Alaska-vs.-U.S. activities and total U.S. net earnings. This revenue does not necessarily grow at the same pace as the Alaska economy. Additionally, the relative size of the sectors is different. For example, the finance sector comprises from 14 to 17 percent of the total Alaska general corporate tax liability (FY 1996-1998), but only 4 percent of yearly earnings (see Alaska Department of Labor Employment and Earnings Summary Reports for 1995, 1996 and 1997).

Sales and Use Tax

Alcohol and Tobacco.

Alcohol tax collections are up by \$0.4 million in FY 1999 (to \$12.2 million) from FY 1998 (\$11.8 million). This is higher than the 10-year average of \$12.0 million and the five-year average of \$11.9 million. We predict alcohol revenue will follow the existing trend and decrease to \$12 million in FY 2000 and remain flat for the short and long term.

On October 1, 1997, the state's cigarette tax rate increased from \$0.29 to \$1 per pack (for 20 cigarettes), and the tax rate on other-tobacco-products (e.g., cigars and smokeless) increased from 25 percent to 75 percent of the wholesale price. As result of the tax rate increase, total revenue from tobacco taxes has increased from \$16.2 million in FY 1997 to \$47.9 million in FY 1999 (an increase of \$31.7 million). FY 1999 is the first full year where the increased tax rate was in effect and there was no stockpiling effect. The revenue from the \$0.71 cigarette tax rate increase goes to the School Fund and is included under restricted revenue (see Table 22). The revenue from other tobacco products goes to the General Fund.

General Fund tobacco tax revenue decreased by \$0.2 million in FY 1999 (from \$15.4 million in FY 1998 to \$15.2 million in FY 1999) as a result of a decrease in General Fund cigarette tax revenues from \$11.9 to \$10.4 million. The decrease was a result of FY 1999 being the first full year where the higher tax rate was in effect and there was no stockpiling effect. The reason why General Fund revenues only decreased by \$0.2 million is that tax revenue on other tobacco products increased from \$3.5 million in FY 1998 to \$4.8 million in FY 1999. In FY 2000, we project General Fund cigarette and revenue from other tobacco products will decrease to \$14.5 million and continue to decrease gradually each year as a result of slower sales due to price increases by cigarette companies to pay for the nationwide tobacco settlement.

Motor Fuel.

In July 1997, the following changes were made to the Alaska motor fuel statute: (1) the gasohol exemption was repealed; (2) an exemption for marine bunker fuel was passed; and (3) the foreign flight exemption was expanded. Primarily as a result of these changes, highway gas revenue increased from \$19.9 million in FY 1997 to \$24 million in FY 1998, and aviation and jet fuel revenue decreased from \$8.1 million to \$5.3 million. In FY 1999, motor fuel tax revenues increased by the following: (1) highway increased from \$24 million to \$25.5 million; (2) marine increased from \$6.3 million to \$6.7 million; and (3) aviation increased from \$5.3 million to \$5.6 million. The highway tax revenue increase in FY 1999 is consistent with historically low retail gas prices. We predict highway tax revenue will decrease to \$25 million in FY 2000 and then remain flat for the short and long term. Marine fuel tax revenue is slated to increase from \$6.7 to \$7 million in FY 2000 due to increased fishing activity in 1999. It is then projected to return to the FY 1999 level. Aviation fuel tax revenue is projected to be flat at \$5.6 million.

Fisheries Business Tax

We project an increase of \$7.1 million in fisheries business revenue for FY 2000 (see Table 21). FY 2000 will be the first year since FY 1995 that fisheries business tax revenue has increased. The following reasons account for most of the projected increase (to \$33 million in FY 2000):

1. An increase in the quantity of sockeye and pink salmon.
2. An increase in the price and quantity of halibut.
3. An increase in the price of pollock.
4. An increase in the price of red king crab.

The projected FY 2000 fisheries business tax revenue of \$33 million is \$0.5 million higher than the 10-year average (FY 1990-1999) of \$32.5 million and \$0.5 million higher than the five-year average (FY 1995-1999) of \$32.5 million.

After FY 2000, shellfish volumes should decline due to tanner crab moving into the downward portion of its natural cycle. Additionally, salmon volumes are projected to fall and halibut prices to moderate from their FY 2000 highs. Consequently, we project that revenue will level off at \$26.2 million starting in FY 2001.

Table 21. Fisheries Business Tax
\$Million

	FY 1999 Actual		FY 2000 Projected		FY 2001-2002
	Value	Tax	Value	Tax	Change from FY 2000
Halibut	63	1.9	113	3.4	Catch Same/ Unit Value Down
Salmon	271	10.3	350	13.3	Catch Down/ Unit Value Same
Herring	12	0.5	12	0.5	Catch Same/ Unit Value Same
Shellfish	206	7.8	250	9.5	Catch Down/ Unit Value Up
Groundfish	171	5.4	200	6.3	Catch Same/ Unit Value Same
Total	723	25.9	925	33.0	

Licenses and Permits

This category consists, for the largest part, of motor vehicle registration fees. It also includes fees from professional and occupational licenses, hunting and fishing licenses, alcoholic beverage and other miscellaneous licenses and permits. The revenue from liquor licenses is shared with qualified municipalities. See specific breakout in Appendix C.

Other and Other Taxes

Other taxes include revenue from the state's mining license tax and estate tax. Other miscellaneous receipts include revenue from intergovernmental receipts, fines and forfeitures, timber sales, coal rents and royalties, and adjustments. See specific breakout in Appendix C.

Restricted NoTUFF Revenue

Table 22. Restricted Non-Oil Taxes, User Fees and Federal Funds
Actual FY 1999 and Projected FY 2000
\$ Million

	Actual FY 1999	(1) FY 2000
Restricted		
Federal Funds		
Federal Receipts	1,376.2	1,771.0
Dedicated Funds		
Fish and Game Fund	27.2	23.4
School Fund (Cigarette Tax)	32.7	30.1
Second Injury Fund Reserve Account	2.7	2.9
Disabled Fishermans Reserve Account	0.8	1.3
Fishermans Fund Income	<u>0.0</u>	<u>0.1</u>
Subtotal	63.4	57.8
Statutorily Restricted		
Alaska Housing Finance	103.0	85.6
University of Alaska	154.7	190.9
Science & Technology Endowment Income	13.0	12.2
International Airport	229.7	99.5
Marine Highway System Fund	73.9	76.2
Children's Trust Fund Earnings	0.3	0.4
Alaska Industrial Dev & Export Authority Receipts	16.0	18.0
Alaska Municipal Bond Bank Receipts	0.3	0.5
Intl Trade and Business Endowment Income	0.5	0.8
Other	<u>63.9</u>	<u>76.5</u>
Subtotal	655.4	568.5
Trusts		
Exxon Valdez Oil Spill Settlement	13.8	11.4
FICA Administration Fund Account	0.1	0.1
Public Employees Retirement Fund	21.5	25.0
Teachers Retirement System Fund	11.0	12.8
Judicial Retirement System	0.1	0.2
National Guard Retirement System	0.1	0.1
Alyeska Settlement Fund	0.4	0.0
Mental Health Trust Authority Authorized Receipts	7.5	10.2
Mental Health Trust Administration	0.8	0.9
Exxon Valdez Oil Spill Restoration Fund	<u>0.1</u>	<u>0.0</u>
Subtotal	55.5	60.8
Bond Authorizations		
Alaska Housing Finance Corporation Bonds	<u>199.6</u>	<u>0.0</u>
Total	2,350.1	2,450.1

(1) When necessary, we assume FY 2000 revenue for our FY 2001 forecast.

Federal Revenue

By FY 2000, federal funds will comprise more than a quarter of the state's total revenue. Federal funding has grown rapidly during the past few years although, for the most part, the funds are restricted to specific uses and most federally funded programs come with a state match requirement (a \$233 million requirement in FY 2000) or involve restrictions such as maintenance of effort requirements. Transportation and Medicaid account for the bulk of federal funds to the state.

These revenues are especially vulnerable to changes in federal law. Under the funding program Congress approved last year, Alaska's annual share of federal highway funding increased from \$220 million to approximately \$300 million. The current authorization period is through FY 2003. Federal Aviation Administration funding for airport construction and maintenance (\$60 million to \$70 million per year) is up for reauthorization during the current federal fiscal year. Likewise, the formula that determines the federal share of the Medicaid program is up for reauthorization in Congress during the next federal fiscal year. Changes in the Medicaid formula could affect federal revenues in Alaska by as much as \$50 million during FY 2001.

In the annual process of developing the governor's proposed budget, each department enters a projection for its expected federal funding. Due to the uncertainty caused by perennial delays in the federal budget cycle, these estimates are fairly rough at the time the fall forecast is released. However, the estimates can be expected to improve dramatically by the time the spring forecast is released.

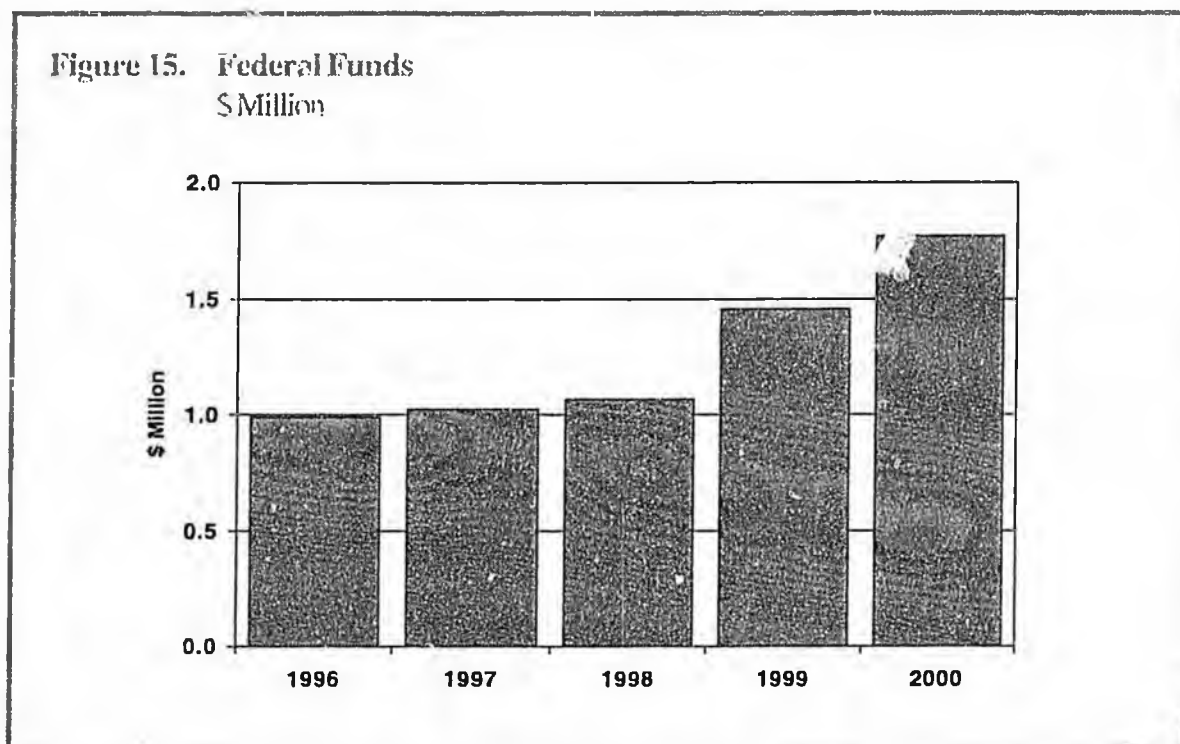
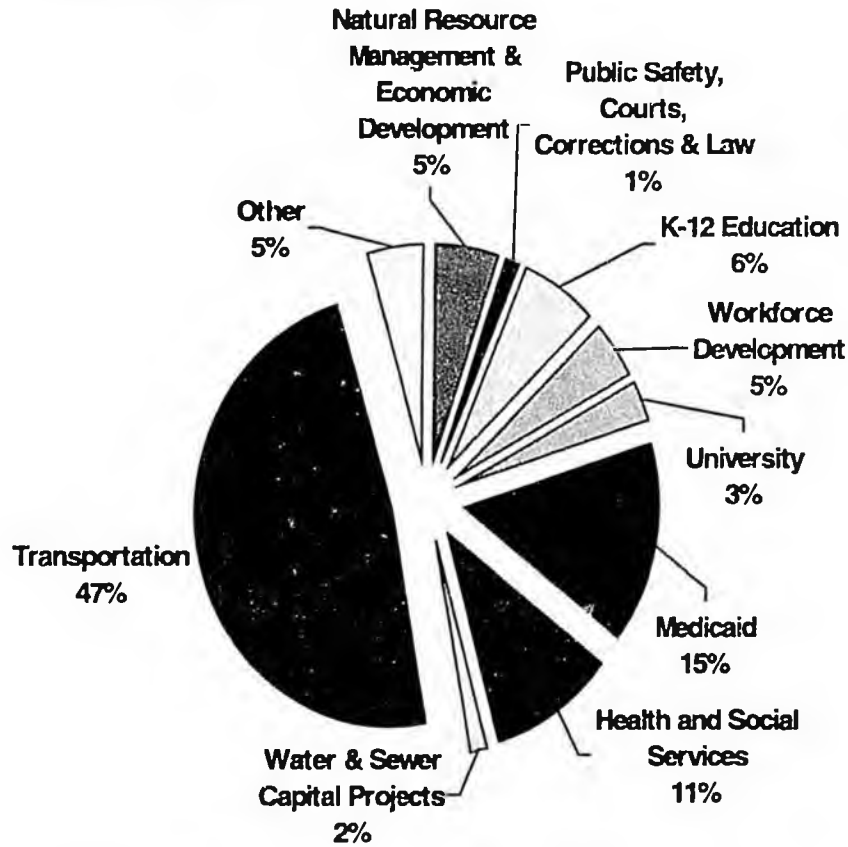


Figure 16. Disposition of FY 2000 Federal Funding
\$1,771 Million



Dedicated Revenue

Revenues restricted by the Alaska Constitution are considered dedicated funds. Other than the Permanent Fund, which was approved by voters in 1976, all of the other revenues in this category existed in some form before statehood or are dedicated by federal law and therefore are not subject to the constitutional prohibition against dedicated funds. Below are more detailed descriptions of the two largest funds in this group.

Fish and Game Fund.

The Fish and Game Fund is established in statute as a revolving fund to provide a source of revenue for programs that protect, enhance and restore sport fishing and hunting resources in Alaska. Although established in Alaska statute after statehood, the fund is nonetheless dedicated for its purposes because federal law requires it.

Most of the money comes into the fund from the sale of sport fishing, hunting and trapping licenses, and special permits and tags. However, the fund can also receive settlements in legal actions involving damage to fish and game resources, grants from the federal government and private donors, and other sources. Interest earned on money in the fund is returned to the fund.

In FY 1999 the fund provided \$27.2 million in revenue to the state. In FY 2000 the fund will provide \$23.4 million.

School Fund.

The School Fund exists to provide money for state education programs. The School Fund receives 76 percent of the state's tobacco tax on cigarettes, as well as all cigarette and tobacco products license fees and penalties. The state's remaining tobacco taxes are deposited in the General Fund. In FY 1999, the School Fund provided \$32.7 million to the state. In FY 2000, the fund is expected to provide \$30.1 million.

Statutorily Restricted Revenue

Though not dedicated in the constitution, this revenue is earmarked in state law for specific purposes. Following is a description of some of the more significant funds in this group.

Alaska Housing Finance Corporation.

The Legislature created the Alaska Housing Finance Corporation in 1971 to provide Alaskans with low-cost mortgage financing. AHFC issues taxable and tax-exempt bonds to generate the funds necessary to purchase mortgage loans.

In June 1992, the legislature consolidated the state's housing functions by merging AHFC, the Alaska State Housing Authority and the energy and housing programs of the Department of Community and Regional Affairs. Since the merger, AHFC responsibilities include:

1. Purchasing mortgage loans from private lending institutions.
2. Administering public housing and rental-assistance programs.
3. Providing multifamily, special-needs and rural-loan programs.
4. Providing home-energy and weatherization programs.

Generally, the corporation accomplishes its mortgage-related objectives by providing liquidity for qualified real estate and mobile home loans originated by financial institutions. The legislature authorized the corporation to issue its own bonds, bond anticipation notes and other obligations in amounts sufficient to carry out its purpose. Though the state unconditionally guarantees certain bonds issued to finance residences for qualified veterans, no other AHFC obligations are guaranteed by the state or constitute a debt of the state.

The corporation funds non-mortgage-related housing programs through various grant and program agreements with the federal departments of Housing and Urban Development, Energy and Health and Human Services, as well as capital and operating subsidies from AHFC's own funds. For FY 1999, AHFC provided \$79.9 million in grants to third parties for these programs.

Beginning in FY 1986, the corporation began a series of plans to transfer funds to the state. The following table summarizes the different types of transfers:

Table 23. Alaska Housing Finance Corporation Fund Transfers
\$ Thousand

	June 30	June 30	June 30	Cumulative	Total
	1999	1998	1997	Prior	Transfers
				Fiscal Years	to State
State Debt Repayment	0	0	0	29,800	29,800
Asset Purchases	0	0	0	252,300	252,300
Dividends	0	0	0	114,300	114,300
Direct Cash Transfers	24,020	70,000	50,000	277,000	421,020
Non-Housing Capital Projects	57,589	26,106	9,115	6,483	99,293
State Capital Project Bond Fund	<u>34,905</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>34,905</u>
Total	116,514	96,106	59,115	679,883	951,618

The legislature in 1998 authorized approximately \$224 million in capital project bonds of the corporation to finance state and municipal projects. The legislature agreed that the annual sum of withdrawals for repayment of the bonds, plus transfers to the state General Fund and corporate-funded capital projects, would not exceed the corporation's net income for the preceding year. The corporation views this bond authorization as a continuation of the legislature's plan, stated in 1995, to authorize \$103 million annually from AHFC to the year 2006.

The next table compares AHFC net income to the total state authorizations and actual expenditures:

Table 24. Alaska Housing Finance Corporation Net Income
\$ Thousand

Fiscal Year	Prior Year Net Income	Total State Authorizations	Cumulative Expenditures	Total (2) Unspent Authorizations
1995	72,519	24,030	19,581	4,449
1996	96,058	128,140	115,391	12,749
1997	114,805	100,448	87,749	12,699
1998	108,326	132,014	101,222	30,792
1999	95,916	103,000	61,955	41,045
2000	<u>79,850</u>	<u>103,638</u> (1)	0	<u>103,638</u>
Total	567,474	591,270	385,898	205,372

(1) Includes one-time deposit to General Fund, not reflected in Table 22.
(2) This column reflects amounts that have been authorized to fund debt service and construction projects that neither AHFC nor the state have spent.

Alaska Science and Technology Fund.

The Alaska Science and Technology Endowment Fund was established in 1988 to promote and enhance the development and commercialization of technology in the state. The legislation endowed the fund with \$100 million and directed the Permanent Fund Corporation to manage the fund's investments.

Income from the science fund is distributed as grants under a competitive proposal process managed by the fund's nine-member board of directors.

Table 25. Alaska Science and Technology Fund
\$ Million

Balance June 30, 1998	\$129.1		
Balance June 30, 1999	\$124.9		
		Actual	Projected
		FY 1999	FY 2000
<u>Income Earned</u>			
Total return		10.6	4.9
Statutory net income		12.9	7.4
<u>Transfers to State</u>		13.0	12.2

International Trade and Business Endowment Fund.

The legislature established the International Trade and Business Endowment within the Alaska Science and Technology Foundation in 1997. Income earned by the trade and business endowment may be appropriated by the legislature to support programs for development of international trade and business. The Permanent Fund Corporation manages the endowment's investments.

Table 26. International Trade and Business Endowment Fund
\$ Million

Balance June 30, 1998	\$5.7		
Balance June 30, 1999	\$5.9		
		Actual	Projected
		FY 1999	FY 2000
<u>Income Earned</u>			
Total return		0.5	0.2
Statutory net income		0.6	0.3
<u>Transfers to State</u>		0.5	0.8

Alaska Children's Trust.

The Alaska Children's Trust Fund is a non-expendable trust fund, the income from which is dedicated to funding community-based programs and projects for the prevention of child abuse and child neglect. The trust provides individual grants of up to \$50,000 per year matched by other sources.

The legislature created the trust in 1988 and made the Revenue commissioner the fiduciary. Fund-raising and grant-making responsibility was originally vested in the Alaska Children's Trust Board. Those duties were reassigned to other entities in 1990 and 1993 before returning to the board in 1996. The first significant funding of the trust occurred in 1996, when the legislature appropriated \$6 million to the trust.

The board annually awards grants and, in an effort to encourage community support for the programs, the board may only finance up to 75 percent of the program costs in years one and two, 50 percent in years three and four, and 25 percent thereafter.

During FY 1999, the trust earned \$295,900 in dividends and interest and \$719,800 in net capital appreciation. Grants totaling \$289,380 were awarded in FY 2000. For FY 2001 and 2002, Treasury projects income for grants and other costs to be \$345,400 and \$361,100, respectively.

Transfer to the state was \$300,000 in FY 1999 and is projected to be \$400,000 in FY 2000.

Alaska Municipal Bond Bank.

The legislature created the Alaska Municipal Bond Bank Authority in 1975 to provide a mechanism for municipalities to finance capital projects. The authority issues bonds in the national financial market and uses the proceeds to purchase general obligation and revenue bonds issued by municipalities. The municipalities repay their debt to the authority, which then uses the money to repay its bonds.

The authority's bonds are payable only from revenues or funds of the authority and are not considered obligations of the state. The legislature appropriated \$18.6 million to the authority for establishing debt service reserve funds to provide additional security to bondholders, and this reserve allows the authority to enjoy an A rating from both Moody's and Standard and Poor's. The bond ratings and the excellent credit history allow the authority to borrow money at very competitive interest rates and pass the savings to the communities, which could not borrow money at such favorable terms in national markets.

Since its inception, the authority has issued over \$334 million in general obligations bonds, \$4 million in Coastal Energy Reserve Bonds and \$80 million in revenue bonds for construction of sewers, schools, roads, docks and other projects throughout Alaska.

The authority generates funds through fees, charges and interest on investments. At the end of each year, it transfers any excess revenue to the General Fund. The cumulative excess returned to the General Fund amounts to \$20.9 million over the life of the authority — more than the original amount appropriated to the authority by the legislature.

The following table summarizes the amounts returned to the state on an annual basis:

Table 27. Alaska Municipal Bond Bank

<u>FY</u> <u>Earned</u>	<u>Excess</u> <u>Earnings (\$)</u> <u>Returned</u> <u>to State</u>	<u>FY</u> <u>Payable</u>
1977	45,872	1989
1978	143,833	1979
1979	140,759	1980
1980	460,649	1981
1981	1,140,697	1982
1982	1,411,783	1983
1983	1,207,647	1984
1984	1,334,313	1985
1985	1,827,815	1986
1986	2,610,971	1987
1987	1,187,900	1988
1988	1,096,377	1989
1989	1,212,152	1990
1990	1,086,220	1991
1991	995,019	1992
1992	897,420	1993
1993	1,007,077	1994
1994	628,899	1995
1995	605,797	1996
1996	617,812	1997
1997	544,857	1998
1998	719,794	1999
1999	914,756 ⁽¹⁾	2000
2000	850,000 ⁽¹⁾	2001 ⁽²⁾
2001	<u>850,000</u>	2002 ⁽²⁾
	23,538,419	

⁽¹⁾ Includes administrative costs as reflected in Table 22 and deposits to the General Fund.

⁽²⁾ FY 2000 and 2001 payables are estimates.

Alaska Industrial Development and Export Authority.

Since the legislature established the Alaska Industrial Development and Export Authority in 1967, its mission has not changed — to diversify the economy and provide jobs for Alaskans.

AIDEA accomplishes its mission by offering various financing options to industrial, manufacturing, export and business enterprises within the state. AIDEA also has the authority to own and operate facilities that advance this goal.

AIDEA's total assets are approximately \$1.3 billion. These assets grew from an initial investment by the state of \$15 million in cash and a \$165 million existing loan portfolio.

The legislature in 1996 passed a measure calling on AIDEA to pay a yearly dividend to the state to help address the budget deficit. Under that law, the dividend ranges from 25 to 50 percent of net income for the fiscal year two years prior to payment of the dividend. AIDEA's board approves the amount of the annual dividend.

The dividend is based on several factors, including projected income in future years, project and loan cash-flow projections, impact on bond covenants, unanticipated needs and rating agency concerns.

AIDEA's board approved a dividend of \$15 million for FY 1997 based on AIDEA's 1995 net income of \$37 million. The board voted to make a \$16 million dividend available to the state in FY 1998 based on 1996 net income of \$43 million. For FY 1999, the board declared a \$16 million dividend, and for FY 2000 the dividend amount increased to \$18 million based on net income of \$43 million for FY 1997 and \$52 million of FY 1998 income. The increase in net income for FY 1998 is mainly attributed to a change in accounting practices requiring the recognition of unrealized gains and losses on investments as revenue. This change in accounting accounts for approximately \$7.7 million of the increase in net income for FY 1998.

AIDEA's net income for FY 1999 was \$37 million. The dividend amount based on 25 percent of this net income equals \$9.25 million, and at the 50 percent level equals \$18.5 million. The board votes in December to approve the dividend for FY 2001.

Table 28. Alaska Industrial Development and Export Authority Assets
\$ Thousand

<u>June 30</u>	<u>Net Income</u>	<u>Dividend Amount</u>	<u>Dividend Payable in FY</u>	<u>Dividend Percentage of Net Income</u>
1995	37,461	15,000	1997	40.04%
1996	42,902	16,000	1998	37.29%
1997	42,880	16,000	1999	37.31%
1998	52,374 ⁽¹⁾	18,000	2000	34.37%
1999	37,093 ⁽¹⁾	18,500	2001	49.87%
Total	212,710	83,500		

⁽¹⁾ The fluctuation substantially relates to unrealized appreciation and depreciation of investment securities required to be recognized pursuant to the Government Accounting Standards Board.

University of Alaska.

Established in territorial days, the University of Alaska is organized into four branches: statewide administration and three main campuses in Fairbanks, Anchorage and Juneau. Each main campus in turn administers satellite campuses in rural areas.

The University of Alaska is overseen by a Board of Regents appointed by the governor and subject to confirmation by the legislature. While other semi-autonomous state agencies are created in statute, the University and its board are uniquely embodied in the Alaska constitution.

In the current fiscal year, 55 percent of university revenue originates from federal receipts and statutorily restricted sources such as tuition and fees.

Table 29. University of Alaska Revenue
\$Thousand

	Actual 1999	FY 2000
<u>Federal Funds</u>		
Federal Receipts	54,506.2	63,434.2
<u>Statutorily Restricted Funds</u>		
UAA Interest Income	2,208.3	3,833.7
Dorm/Food/Aux. Services	29,136.8	33,395.3
Tuition/Fees/Services	48,685.0	59,843.9
Indirect Cost Recovery	14,646.7	19,382.2
University Restricted Receipts	<u>60,058.3</u>	<u>74,491.3</u>
Subtotal	154,735.1	190,946.4
<u>Other Funds Including GF</u>	189,942.7	211,915.3
Total	399,184.0	466,295.9

Marine Highway Fund.

The Marine Highway Fund was established to pay for the operations of the state's ferry system. Monies that flow into the fund include ticket receipts, other fees and legislative appropriations. In recent years, there have been no state General Funds directed into the Marine Highway Fund. With receipts paying for slightly more than half of annual operating expense, the fund balance is shrinking.

Appropriations from the Marine Highway Fund to operate the state ferry system were \$73.9 million and \$76.2 million in FY 1999 and 2000, respectively.

International Airport Fund.

Money to pay for construction and operations of Alaska's international airports in Anchorage and Fairbanks comes from two funds: the International Airport Construction Fund and the International Airport Revenue Fund. Bond sales provide the money for the construction fund. The revenue fund uses fees paid by airport users to pay for airport operations and maintenance. Bond debt is paid from a third fund that receives money from the revenue fund and to a lesser degree the construction fund.

Table 30. International Airport Fund
\$ Thousand

	<u>FY 1999</u>	<u>FY 2000</u>
<u>Revenue</u>		
International Airport Revenue Fund	50,509.4	74,467.1
International Airport Construction	<u>179,175.0</u>	<u>25,000.0</u>
Total	229,684.4	99,467.1

Trusts

Trusts are funds held by the state in trust for specific beneficiaries. Examples include public employees and teachers retirement funds and the Alaska Mental Health Trust Fund.

Alaska Mental Health Trust Fund.

In 1978, the Alaska Legislature redesignated lands set aside at statehood to support mental health programs as general grant land, eligible for sale, transfer or lease to municipalities, businesses or the public. Courts overturned that legislation in 1985, ruling that the trust be reconstituted to match as nearly as possible the original one million acres. Over the years, the Legislature passed several bills to comply with the court ruling. By 1997, the trust had been reconstituted, including a cash endowment of \$200 million.

Today, the Alaska Mental Health Trust Authority, overseen by a seven-member board of trustees, controls the trust and its funding of mental health programs. As a matter of policy, the board has chosen to pay out annually as income 3 percent of the year-end market value of the corpus of the fund. The Alaska Permanent Fund Corporation manages most of the fund's assets.

As with other trust funds, money becomes revenue to the state at the time it is appropriated to pay for program costs such as delivering mental health-related services and managing the trust's financial and land assets. In FY 1999 revenues from the trust were \$7,458,300. FY 2000 revenues are projected to be \$10,212,800.

Balance June 30, 1998		\$299.4	
Balance June 30, 1999		\$305.9	
		<u>Actual</u>	<u>Projected</u>
		<u>FY 1999</u>	<u>FY 2000</u>
<u>Income Earned</u>			
Total return	24.5		11.1
Statutory net income	30.4		17.4

The funds identified in Table 22 as Mental Health Trust Administration are transferred to the Department of Revenue, which has administrative responsibility for the Alaska Mental Health Trust. Costs of administration were \$812,300 in FY 1999 and are anticipated to be \$907,400 in FY 2000.

Retirement Funds.

Funds derived from contributions to and the investment returns of four retirement systems administered by the state are used to pay for: (1) the budget of the Alaska State Pension Investment Board; (2) the budget of the Employees Retirement Board; (3) the budget of the Teachers Retirement Board; (4) a significant portion of the budget of the Treasury Division of the Department of Revenue; (5) the money manager, custody, consulting and audit fees pertaining the management of the assets of those retirement systems; and (6) a significant portion of the budget of the Division of Retirement and Benefits in the Department of Administration.

The four systems are:

1. Public Employees Retirement Trust Fund.
2. Teachers Retirement Trust Fund.
3. Judicial Retirement Trust Fund.
4. National Guard and Naval Militia Retirement Trust Fund.

As of November 1999, the total assets of the four systems was just over \$12 billion. The actual contribution for FY 1999 from this funding source for state government operations, together with the projected contribution for FY 2000 and 2001, are reflected in the following table.

	Actual FY 1999	Projected FY 2000
Revenue		
Public Employees Retirement Trust Fund	21,546.9	25,008.6
Teachers Retirement Trust Fund	10,972.3	12,827.8
Judicial Retirement Trust Fund	147.3	182.3
National Guard and Naval Militia Retirement Trust Fund	<u>107.9</u>	<u>127.2</u>
Total	32,774.4	38,145.9

Bond Authorizations

This is revenue received by the Alaska Housing Finance Corporation from the sale of bonds to finance construction projects or purchases. Though the money shows up as revenue, it must be paid back.

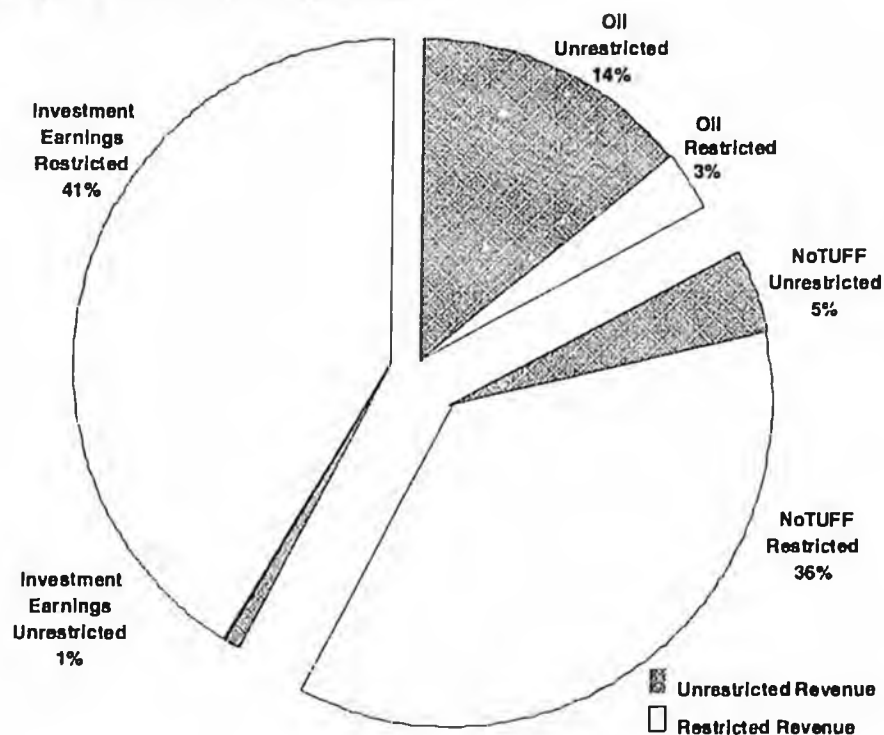
V. INVESTMENT REVENUE

**Table 33. Total Investment Revenue,
Actual FY 1999 and Projected FY 2000-2001
\$ Million**

	<u>Actual FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>
<u>Unrestricted</u>			
General Fund Investments	46.5	45.0	45.0
<u>Restricted</u>			
Constitutional Budget Reserve Fund	119.9	123.7	105.0
Permanent Fund Dividends	1,044.9	1,174.4	1,215.4
Permanent Fund Inflation Proofing	288.4	372.0	596.0
Required Deposits to Permanent Fund Principal	41.0	27.0	31.0
Permanent Fund Undistributed Net Income (GASB)	770.5	(597.4)	131.6
Other Appropriations ⁽¹⁾	<u>2.5</u>	<u>0.0</u>	<u>0.0</u>
Subtotal	2,267.2	1,099.7	2,079.0
Total	2,313.7	1,144.7	2,124.0

⁽¹⁾ Permanent Fund revenue used for oil and gas revenue-related matters.

Figure 17. FY 1999 Total Revenue



General Discussion

Investment Performance

The single most important determinant of investment performance for any fund is its asset allocation (i.e., relative proportion of the fund invested in the various available asset classes.) A number of studies have established that asset allocation determines over 90 percent of the difference in return between funds over time. Therefore, annually — or more often as circumstances require — the fiduciaries for the pertinent funds establish the asset allocation for each individual fund. The process combines qualitative judgments about the individual fund's objectives, constraints and risk tolerance with the quantitative analysis of financial markets.

The design of the optimal portfolio results from a quantitative process using the tools of the Modern Portfolio Theory and the Capital Asset Pricing Model to convert estimates of future asset class performance into an optimal set of investment portfolios. The set represents portfolios with the highest expected five-year returns for any particular level of risk.

The critical inputs for the quantitative analysis are the capital market projections for the next five years. Both the Department of Revenue and the Permanent Fund Corporation employ an independent consulting firm to supply these capital market projections. The firm currently under contract is Callan Associates Inc.

The capital market projections consist of: (1) expected returns of pertinent asset classes (includes appreciation or depreciation in value); (2) expected future volatility of those expected returns measured using the statistical benchmark standard deviation; and (3) correlations of expected returns among the various asset classes.

Callan uses four steps to form its capital market expectations:

1. Develop a five-year economic outlook for the United States and other major industrial economies.
2. Examine the historical relationships between major economic and financial variables and five-year asset returns.
3. Examine historical interrelationships of performance characteristics among the individual asset classes.
4. Perform a qualitative review of the conclusions reached in items 1, 2 and 3 by a firm policy review committee.

For 1999, Callan developed the following table with five-year estimates for expected return and risk.

Table 34. Expected Return and Risk
Percent

<u>Asset Class</u>	<u>Corresponding Benchmark</u>	<u>Expected Return</u>	<u>Expected Risk</u>
Equities			
Broad Market	Callan Associates, Inc.(CAI) Broad Mkt	9.4	16.3
Large Cap	S&P 500	9.0	15.0
Small Cap	CAI Small	11.2	25.3
International	Morgan Stanley Capital Intl EAFE	10.0	21.5
Fixed Income			
Domestic	Lehman Bros Govt Corporate	5.5	5.7
International	Saloman Bros Non-U.S. Govt	5.6	11.0
Intermediate Term	Merrill Lynch 1-5 Govt	5.1	3.3
Other			
Real Estate	-	8.0	16.5
Alternative Investments	-	12.3	36.0
Cash Equivalents	-	4.4	0.7
Economic Variables			
Inflation	-	3.0	1.8

Callan also prepares for the both the Department of Revenue and the Permanent Fund Corporation estimates of the correlation coefficient between the various asset classes. The correlation coefficient measures the association or co-movement among returns of various classes of assets. Correlation coefficients can vary from +1 to -1. If the returns of one security or asset class move in tandem with the returns of another security or asset class, the returns have a correlation of +1. If the two securities or asset class returns have a completely inverse relationship, the correlation coefficient will be -1. If the returns of the two securities or asset classes are completely unrelated to each other or are random, the correlation coefficient will be zero. The table below sets forth Callan's 1999 correlation matrix between asset classes:

Table 35. 1999 Callan Associates Inc. Correlation Matrix
Percent

	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>	<u>8</u>	<u>9</u>	<u>10</u>
1 Callan Broad Markets	1.00	0.96	0.90	0.57	0.35	0.29	0.02	0.51	0.57	(0.11)
2 Large Cap Equity	0.96	1.00	0.80	0.57	0.36	0.30	0.10	0.50	0.55	(0.10)
3 Small Cap Equity	0.90	0.80	1.00	0.44	0.31	0.21	(0.12)	0.50	0.65	(0.15)
4 International Equity	0.57	0.57	0.44	1.00	0.31	0.32	0.31	0.41	0.45	(0.25)
5 Domestic Bonds	0.35	0.36	0.31	0.31	1.00	0.97	0.56	0.40	0.20	0.12
6 Intermediate Term Bonds	0.29	0.30	0.21	0.32	0.97	1.00	0.57	0.34	(0.13)	0.26
7 International Bonds	0.02	0.10	(0.12)	0.31	0.56	0.57	1.00	0.04	(0.06)	(0.03)
8 Real Estate	0.51	0.50	0.50	0.41	0.40	0.34	0.04	1.00	0.30	(0.06)
9 Alternative Investments	0.57	0.55	0.65	0.45	0.20	(0.13)	(0.06)	0.30	1.00	0.07
10 Cash Equivalents	(0.11)	(0.10)	(0.15)	(0.25)	0.12	0.26	(0.03)	(0.06)	0.07	1.00

Using these estimates, Callan or Treasury models a set of optimal portfolios. Each of these optimal portfolios matches an expected five-year annual return with a particular level of risk measured in terms of the volatility of the expected return. Based on the risk level appropriate for each individual fund, the pertinent fiduciary selects the corresponding optimal portfolio as the asset allocation for the fund.

In estimating the earnings of each fund, the fiduciary first uses the best information available to forecast the investable balance of the fund over the forecast horizon. This information is combined with the estimated mean return for the fund's asset allocation to calculate the estimated earnings of the fund and the range of likely actual fund earnings. It is important to understand that return assumptions are long-term estimates and that substantial variability is possible in the short-term. The greater the risk, standard deviation, of an asset allocation, the greater the year-to-year variability of actual earnings. The department uses mean estimated earnings for all investment income. It has also provided an estimate of the range of possible outcomes for the various funds. It's critical to understand that the higher the expected rate of return, the greater the risk (volatility of return) for any fund's investments.

Unrestricted Investment Revenue

**Table 36. Unrestricted Investment Revenue,
Actual FY 1999 and Projected FY 2000-2010
\$Million**

Fiscal Year	General Fund Investments
1999	46.5
2000	45.0
2001	45.0
2002	45.0
2003	45.0
2004	45.0
2005	45.0
2006	45.0
2007	45.0
2008	45.0
2009	45.0
2010	45.0

General Fund and Other Non-Segregated Investments

The departments of Revenue and Administration have commingled assets of the General Fund with a large number of other governmental funds, managing them in a pool called the General Fund and Other Non-Segregated Investments (GeFONSI). The Department of Revenue, Treasury Division is responsible for investing the GeFONSI, and the Department of Administration maintains official accounting records for the assets of each of the funds in the investment pool.

The GeFONSI typically has a balance of about \$1 billion; the General Fund is the largest investor in the GeFONSI with a typical invested balance in the range of \$150 million to \$250 million.

Whether a GeFONSI participant receives investment earnings depends on applicable governing statutes. Each participant can be classified into one of three categories:

1. Some of the funds whose assets are invested in the GeFONSI are legally entitled to automatically receive the earnings attributable to the investment of those assets.
2. Other funds invested in the GeFONSI are entitled to receive the earnings attributable to the investment of their assets if the legislature chooses to appropriate the earnings to those funds. If the legislature does not appropriate the money to the individual fund, the General Fund receives the earnings.
3. Finally, there are a large number of funds invested in the GeFONSI whose earnings are automatically attributable to the General Fund.

Specific arrangements pertaining to the distribution of GeFONSI investment earnings are covered in a series of Memoranda of Understanding between the Department of Revenue and the Department of Administration.

With declining oil revenues and the corresponding decrease in available cash, a cash flow situation arises from time to time where the General Fund faces a cash deficiency. Because of the continuing decline in oil revenue, cash flow deficiencies have occurred every year since FY 1994.

Treasury, the Office of Management and Budget and the Division of Finance at the Department of Administration have developed a Cash Deficiency Plan. Under the plan, Finance requests that Treasury move money from the Constitutional Budget Reserve Fund to the General Fund whenever the General Fund balance is below \$100 million. The amount moved is a multiple of \$50 million.

If the General Fund balance exceeds \$200 million, and is expected to continue to exceed \$200 million for 30 consecutive days, Finance requests that Treasury move money from the General Fund to the Constitutional Budget Reserve in \$10 million increments.

The legislature must specifically authorize using the Constitutional Budget Reserve Fund to cover General Fund cash deficiencies. If, in any year, the legislature should fail to authorize sufficient use of the CBRF for this purpose, the Cash Deficiency Contingency Plan calls for Treasury, Finance and OMB to endeavor to use other funds in the GeFONSI to cover the shortfall or to seek additional CBRF authorization from the legislature.

Treasury currently invests the GeFONSI assets with the following in mind:

<u>Risk Tolerance</u>	Moderate. Some of the money in the underlying GASB funds has been appropriated and a material loss could affect the state's or an agency's ability to fulfill its obligations.
<u>Investment Objectives</u>	Limited exposure to principal loss. Conservative balance between income and principal safety income within moderate risk tolerance. Minimal inflation protection needed. High liquidity requirement.
<u>Time Horizon</u>	Short to intermediate. Treasury expects some of the money in the pool to be spent in less than one year.

Treasury's investment policy for the GeFONSI is 30 percent in short-term (maturities of 14 months or less) fixed-income investments and 70 percent in intermediate-term (one-to-five-year maturities) fixed-income investments. The investment policy has a plus or minus 8 percent band for each investment pool to avoid the expense of continually rebalancing the GeFONSI investments.

<u>Expected Return</u>	The expected return for the GeFONSI using Callan's 1999 capital market assumptions is 4.89 percent.
<u>Probability of a Loss</u>	The probability of a loss over a one-year period is 1.9 percent.

Restricted Investment Revenue

**Table 37. Restricted Investment Revenue,
Actual FY 1999 and Projected FY 2000-2001**
\$Million

	Actual		
	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>
<u>Restricted</u>			
Constitutional Budget Reserve Fund	119.9	123.7	105.0
Permanent Fund Dividends	1044.9	1174.4	1215.4
Permanent Fund Inflation Proofing	288.4	372.0	596.0
Required Deposits to Permanent Fund Principal	41.0	27.0	31.0
Permanent Fund Undistributed Net Income	770.5	(597.4)	131.6
Other Appropriations ⁽¹⁾	<u>2.5</u>	<u>0.0</u>	<u>0.0</u>
Total	2267.2	1099.7	2079.0

⁽¹⁾ Permanent Fund revenue used for oil and gas revenue-related matters.

Constitutional Budget Reserve Fund

Voters approved a constitutional amendment in 1990 requiring the state to deposit all proceeds from the resolution of oil and gas tax and royalty disputes into a new fund – the Constitutional Budget Reserve Fund.

The legislature may appropriate money from the CBRF to fund the operations of state government only under certain conditions. If, at any time, the amount of funds from other sources available to the legislature for appropriation is less than the amount appropriated to fund state government for the previous fiscal year, the legislature may appropriate from the CBRF on a simple majority vote. When the amount of funds from other sources exceeds the amount appropriated for the previous fiscal year, the legislature may appropriate from the fund only with a three-fourths vote of the members of each chamber.

The constitutional provisions governing the CBRF require the General Fund to repay the money appropriated from the CBRF if and when there is a General Fund surplus at the end of any fiscal year. The General Fund does not pay interest on the money it has "borrowed" from the CBRF. As of September 30, 1999, the General Fund had "borrowed" \$3,785 million from the CBRF.

The CBRF, by statute, retains its investment earnings.

As of September 30, 1999, the CBRF balance was \$2,270 million. Treasury's investment policy recognizes a two-year investment horizon for the CBRF. Very large draws on the CBRF to balance the FY 1998 and 1999 budgets, together with an expected \$400 million to \$500 million draw to balance FY 2000 budget, limit the investment horizon for the fund. The Department of Revenue has not altered the investment policy in response to the higher oil prices this summer and fall.

Treasury currently invests the CBRF with the following in mind:

<u>Risk Tolerance</u>	Moderate. Funds may be needed on relatively short notice.
<u>Investment Objective</u>	Low exposure of principal to loss. Modest current income requirement. Little inflation protection needed. Relatively high liquidity requirement.
<u>Time Horizon</u>	Short to intermediate.

Effective September 1, 1999, Treasury's investment policy for the CBRF is 15 percent in the short-term, fixed-income investment pool (maturities of 14 months or less), and 85 percent in the intermediate-term, fixed-income investment pool (one-to-five-year maturities).

<u>Expected Return</u>	The expected return for the CBRF using Callan Associates' 1999 capital market assumptions is 5.0 percent.
<u>Probability of a Loss</u>	The probability of a loss over a one-year period is 3.9 percent.

Figure 18. Constitutional Budget Reserve Fund

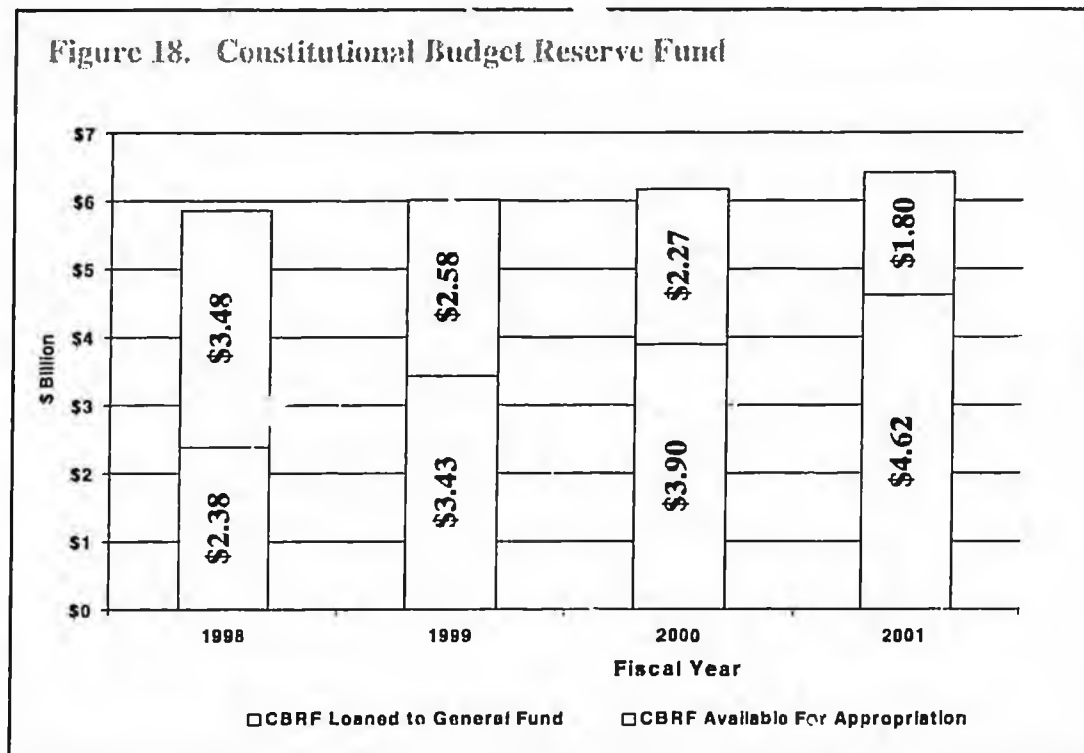


Table 38. Constitutional Budget Reserve Fund
\$Million

The fall 1999 revenue forecast for the Constitutional Budget Reserve Fund is summarized below.

CONSTITUTIONAL BUDGET RESERVE FUND	Actual		
	FY 1999	FY 2000	FY 2001
Beginning Balance ⁽¹⁾	3,559.1	2,628.3	2,269.7
Earnings ⁽²⁾	119.9	123.7	105.0
Petroleum Tax, Royalty Settlements ⁽³⁾	50.0	30.0	150.0
Loan or Payback to GF (prior year)	(98.4)	(48.9)	0.0
Loan or Payback to GF (current year) ⁽⁴⁾	<u>(1,002.3)</u>	<u>(463.5)</u>	<u>(723.2)</u>
Ending Balance Available for Loan to GF ⁽⁵⁾	2,628.3	2,269.7	1,801.5

⁽¹⁾ The FY 1999 activity reflects actual activity for the CBRF. Subsequent activity is estimated.

⁽²⁾ The projected earnings rate for FY 2000, 2001 and 2002 is 5 percent. These projections are based on Callan's capital market assumptions and Department of Revenue, Treasury Division's asset allocation.

⁽³⁾ Settlement estimates are provided by the Department of Revenue and Department of Law net of annual Federal Minerals Management Service payments.

⁽⁴⁾ The FY 2000 and 2001 CBRF draw projections are provided by the Office of Management and Budget and do not represent final budget numbers. The estimated future loan figures are slightly different than those found in Table 7. Table 7 assumed a flat budget while OMB's estimates in Table 38 assume certain portions of the budget will change with population.

⁽⁵⁾ Figure 20 uses an accrual basis while Table 38 used a cash basis of accounting. A FY 1999 year-end timing difference of approximately \$48 thousand accounts for different 'cash available for loan' figures between the figure and table.

Alaska Permanent Fund

In 1976, voters established the Alaska Permanent Fund by constitutional amendment. The amendment requires that at least 25 percent of the state's mineral lease bonuses, rentals, royalties and federal mineral revenue-sharing payments be deposited into the fund. The amendment also requires "all income from the Permanent Fund must be deposited into the General Fund unless otherwise provided by law." The legislature has, as described later, provided for use of some of the fund's income. The fund's principal, however, is protected by the constitution.

The legislature established the Alaska Permanent Fund Corporation (APFC) to manage and invest the fund's assets. The APFC is a public corporation managed by a board of trustees appointed by the governor.

The fund has grown significantly over the years, and as of September 30, 1999, had a market value of \$25 billion, of which slightly more than \$19 billion represents the fund's principal. The increase in market value has come from four primary sources:

1. Constitutionally required contributions to the principal.
2. Additional legislative appropriations to the principal.
3. Inflation proofing of the principal.
4. Fund earnings deposited into the earnings reserve account within the fund.

As fiduciaries for the fund, the trustees must have an investment objective that addresses the safety of the principal while maximizing total return. The board must also allow for maximum use of disposable income for purposes designated by law. To accomplish this, the board has adopted an investment policy that addresses risk posture, return, diversification and liquidity. Using this policy, the board adopted a strategic asset allocation by applying the basic process described earlier.

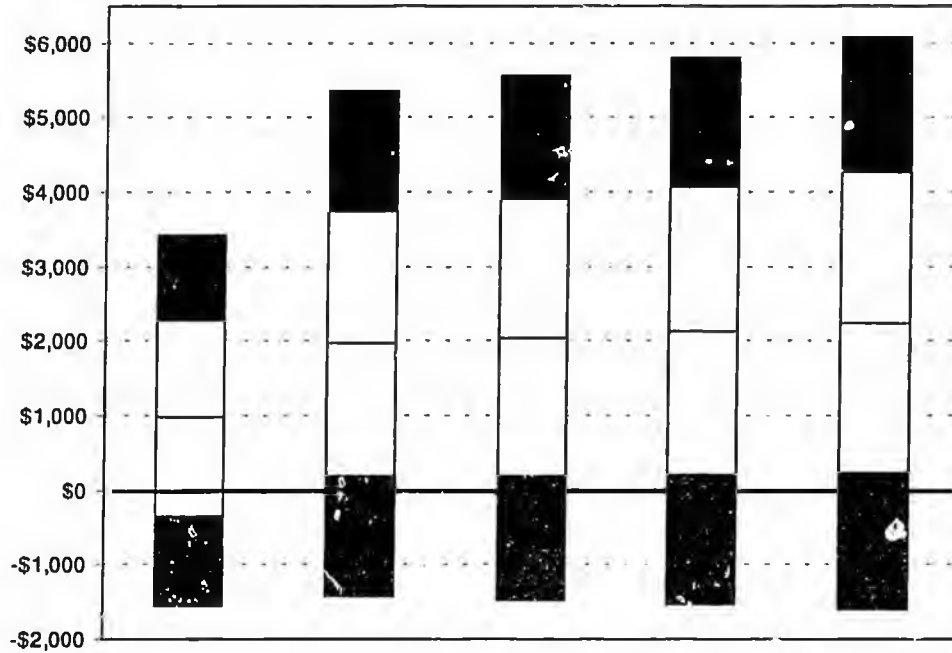
The trustees' current asset allocation is: 37 percent in domestic equities; 16 percent in international equities; 35 percent in domestic fixed income; 2 percent in international fixed income; and 10 percent in real estate. The investment policy has plus or minus bands for each investment class in the allocation to avoid the expense of continually balancing the fund's investments.

Accurately forecasting investment returns is like accurately forecasting oil prices: It's likely, but it's not an exact science. However, using the statistical tools employed in making the investment asset-allocation decisions described on Pages 68-70, it is possible to forecast the *likely* median return of a portfolio and the likelihood of higher or lower returns away from the median. The chart and table below reflect such an analysis of the current portfolio of the Alaska Permanent Fund.

Considering the Permanent Fund's performance for the first quarter of the fiscal year (July 1 – September 30, 1999), and the capital market assumptions supplied by Callan Associates Inc., we expect the fund's income (determined under principles set by the Government Accounting Standards Board (GASB)) to range around a median of \$976 million this fiscal year (Fiscal 2000). There is a 25 percent chance the Permanent Fund GASB net income could exceed \$2.2 billion; conversely, there is a 25 percent chance the fund would lose more than \$340 million this fiscal year. There is a 10 percent chance the Permanent Fund could earn more than \$3.420 billion and a 10 percent chance it could lose more than \$1.545 billion.

The likely range of returns for fiscal years 2001 through 2004 are reflected in Figure 19.

**Figure 19. Alaska Permanent Fund
Range of GASB Income
\$ Million**



Percentile Ranking	2000	2001	2002	2003	2004
10%	\$3,420	\$5,359	\$5,575	\$5,813	\$6,085
25%	\$2,270	\$3,753	\$3,905	\$4,072	\$4,263
Median	\$976	\$1,974	\$2,055	\$2,140	\$2,242
75%	(\$340)	\$190	\$198	\$209	\$222
90%	(\$1,545)	(\$1,416)	(\$1,471)	(\$1,531)	(\$1,600)

The percentile ranking is the probability of exceeding the corresponding level of GASB Income.

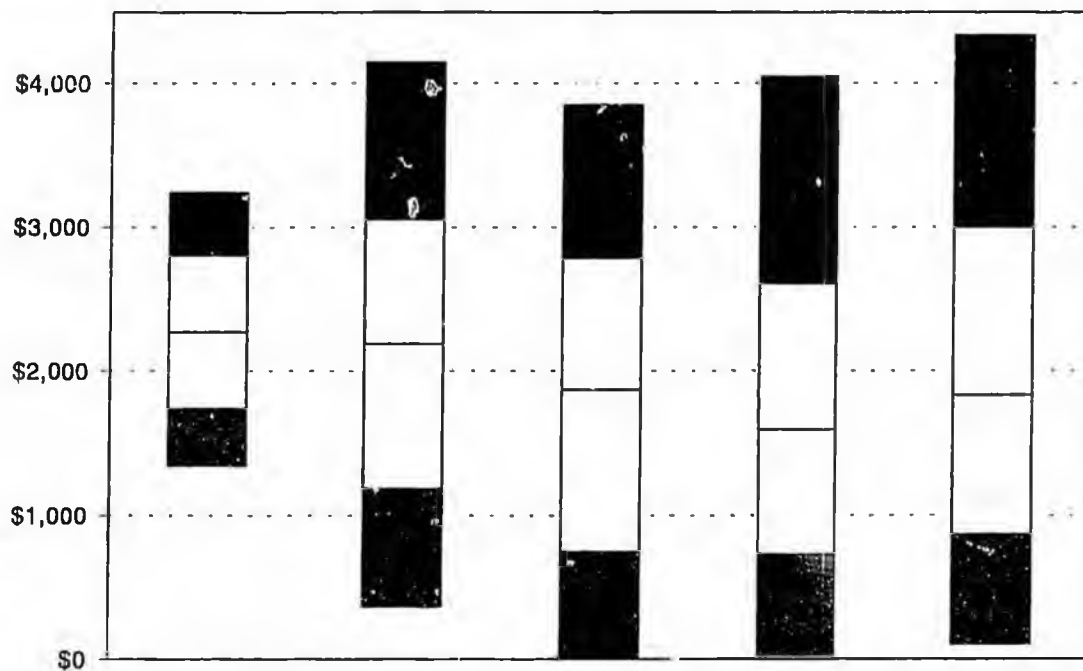
To calculate the fund's annual income for purposes of determining the Permanent Fund dividend, state statutes prescribe an income measure different from the one normally used for public funds. Public funds normally recognize changes in the value of investments as income, or as losses, as they occur at the end of each trading day, regardless if the investment is actually sold and the income or loss taken, or realized. To calculate the actual income used in determining the amount of the dividend, however, gains or losses on individual stocks and bonds are not recognized until the stock or bond is sold. As of December 1, 1999, there were more than \$3 billion in such unrealized gains in the Permanent Fund's portfolio.

As those gains are realized over time, or as they may turn to losses in some cases, they will cause the fund's *statutory net income* to differ significantly from the GASB net income figures reflected in Figure 19.

For FY 2000, we expect *statutory net income* to range around a median of \$2.276 billion. There's a 50 percent probability the Permanent Fund's *statutory net income* will range between \$1.740 billion and \$2.806 billion. There is an 80 percent chance it will range between \$1.348 billion and \$3.245 billion.

The graphic below depicts similar information with respect to the projected *statutory net income* for the Permanent Fund for Fiscal Years 2001–2004 as well.

**Figure 20. Alaska Permanent Fund
Range of Statutory Net Income
\$ Million**



Percentile Ranking	2000	2001	2002	2003	2004
10%	\$3,245	\$4,152	\$3,851	\$4,049	\$4,345
25%	\$2,806	\$3,063	\$2,789	\$2,612	\$3,004
Median	\$2,276	\$2,190	\$1,868	\$1,601	\$1,832
75%	\$1,740	\$1,189	\$752	\$734	\$867
90%	\$1,348	\$368	\$7	\$27	\$101

The percentile ranking is the probability of exceeding the corresponding level of Statutory Net Income.

The table on the next page reflects the projected balances for the Permanent Fund using the median GASB and statutory net income amounts found in Figure 19 and 20.

As noted, the Alaska Constitution requires the deposit of the income earned by the assets of the Permanent Fund "into the General Fund unless otherwise provided by law." The legislature has, by law "provided otherwise" and all Permanent Fund's income has been dedicated to the Earnings Reserve Account established by AS 37.13.145.

In turn, the income accumulated in the Earnings Reserve Account is statutorily dedicated to the Permanent Fund Dividend program (AS 37.13.140 and AS 37.13.145(b)) and to inflation proofing the principal of the Permanent Fund (AS 37.13.135(c)). Permanent Fund income in excess of the amount needed to satisfy the statutory dedication for annual dividends and inflation proofing – while legally available for other uses – has been customarily dedicated to the Permanent Fund itself.

Table 39. Alaska Permanent Fund
\$ Million

	Actual FY 1999	FY 2000	FY 2001
PERMANENT FUND ⁽¹⁾			
<u>Principal</u>			
Beginning Balance	18,516.0	19,000.9	19,618.1
Dedicated Petroleum Revenue	155.5	218.2	191.6
Inflation-Proofing	288.4	372.0	596.0
Deposits to Principal	<u>41.0</u>	<u>27.0</u>	<u>31.0</u>
End-of-Year Balance	19,000.9	19,618.1	20,436.7
<u>Earnings and Earnings Reserve Account (GASB Income)</u>			
Earnings Reserve Account (ERA) Beginning Bal	5,360.3	6,130.8	5,533.4
GASB Net Income	2,147.3	976.0	1,974.0
Dividend Payout	(1,044.9)	(1,174.4)	(1,215.4)
Inflation-Proofing	(288.4)	(372.0)	(596.0)
Deposits to Principal ⁽²⁾	(41.0)	(27.0)	(31.0)
Other Appropriations	<u>(2.5)</u>	<u>0.0</u>	<u>0.0</u>
ERA End-of-Year Balance (GASB)	6,130.8	5,533.4	5,665.0
<u>Earnings and Earnings Reserve Account (Statutory Income)</u>			
ERA Beginning Balance	1,388.8	2,590.4	3,293.0
Statutory Net Income	2,578.4	2,276.0	2,190.0
Dividend Payout	(1,044.9)	(1,174.4)	(1,215.4)
Inflation-Proofing	(288.4)	(372.0)	(596.0)
Deposits to Principal ⁽²⁾	(41.0)	(27.0)	(31.0)
Other Appropriations	<u>(2.5)</u>	<u>0.0</u>	<u>0.0</u>
ERA End-of-Year Balance (Statutory)	2,590.4	3,293.0	3,640.6
<u>Market Value</u>			
Principal End-of-Year Balance	19,000.9	19,618.1	20,436.7
ERA End-of-Year Balance (Statutory Income)	2,590.4	3,293.0	3,640.6
End-of-Year Unrealized Earnings	3,540.8	2,242.0	2,026.0
Dividends Payable and Other Liabilities	<u>1,314.0</u>	<u>1,174.4</u>	<u>1,215.4</u>
End-of-Year Balance (Market Value)	26,446.1	26,327.5	27,318.7
<u>Reconciliation</u>			
Dividends Payable and Other Liabilities	<u>(1,314.0)</u>	<u>(1,174.4)</u>	<u>(1,215.4)</u>
End-of-Year Balance (Market Value)	25,132.1	25,153.1	26,103.3

⁽¹⁾ Source: Department of Revenue estimates.

⁽²⁾ Deposits to principal include royalty litigation settlement payments that cannot legally be used to pay Permanent Fund dividends.

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