

SCOMM

101:56

Crib Sheet for LRFPC Members

Forward Funding

Also known as cash based budgeting. Under this system some or all of the state budget would be based on cash in hand rather than on projected revenues during the year. Often advocated as a means of adding stability and certainty to the budgeting process. Major concern with this approach is whether the gain in certainty is worth the opportunity cost of revenue or reserves that must be diverted to achieve it. Also a question of whether the same protection against oil price volatility can be achieved through use of reserve funds, spending limits or other fiscal measures.

Oil Futures

Under this proposal some or all of the state's budget would be protected from oil price volatility by "price hedging" on the commodity futures market. For example, at the time the legislature agrees on a budget for the upcoming fiscal year based on an average price of ANS crude, that price could be locked in for the year by selling futures contracts. A customized hedging program for the state budget (or royalty oil share) would involve a combination of futures, swaps and options to forecast and protect the budget from price volatility beyond a certain range – much like an insurance policy that costs some money to protect from disaster. Several other states and countries with large petroleum revenue streams have adopted these programs. The main difficulties with this approach are that it is often associated with speculation or gambling by the public, it is very confusing to explain to policymakers and the associated financial service fees tend to be fairly high – perhaps 5% of the amount being hedged.

Constitutional Budget Reserve

The CBR was established by voters in 1990. It requires that proceeds from settlements of certain mineral tax and royalty disputes with oil companies be deposited into a special fund. Revenues may be drawn from the CBR up to the amount spent in the previous fiscal year by a majority vote of the legislature if "money available for appropriation" (including the Permanent Fund Earnings Reserve) is less than the previous fiscal year. However, if money available is more than was spent in the previous fiscal year, a 3/4 vote of each house of the legislature is required to draw from the CBR to balance the state budget. The amendment also requires that any draws from the CBR be paid back with general fund revenues in excess of appropriations in subsequent years.

Statutory Budget Reserve Fund / Appropriation Limit AS 37.05.540

Requires that all money in excess of appropriations be deposited into the budget reserve fund (statutory), which is a separate account in the general fund. The spending limit provision within the budget reserve statute requires that spending be limited to 5% above that in the previous year plus the change in inflation and population since the beginning of the previous year (starting in 1986). As a practical matter, this measure has not worked to constrain spending – according to the statutory spending limit, the state general fund budget could be as high as \$3.95 billion for FY 96.

Permanent Fund Variations

Cremo Plan

This plan seeks to turn declining natural resource revenues into a relatively steady, perpetual source of funds for state government. A constitutional amendment would require that all revenues derived from natural resources, the Permanent Fund and cash reserves be placed into a single fund, which would be invested aggressively by a corporation similar to the Permanent Fund Corporation. Stringent rules would govern withdrawal of money to fund state government. In the first year, the withdrawal amount would equal 20% of the average market value of the fund during the 12 preceding calendar quarters. For the next 10 years – the transition period – the withdrawal rate decreases gradually until it reaches the long term stable rate of 6% per year (on a growing corpus). The plan would require additional taxes to fully fund government at its current level. Dividends would have to compete on an equal basis with other spending priorities.

Inflation Proofing First

Realized Fund earnings go into the Earnings Reserve Account (ERA). Current statute (AS 37.13.140) requires that one-half of 21% of the Fund's net income for the past five fiscal years be made available for the payment of dividends and other appropriations each year, i.e., dividends have first call on earnings. If enough remains in the ERA after paying out dividends, an additional amount sufficient to offset the effects of inflation on the Fund principal is then appropriated to the corpus. The inflation proofing first provision would reverse the current order of precedence, giving inflation proofing first call on Fund earnings and thereby better protecting the principal of the Fund from earnings swings and the erosion of Fund principal by inflation over time.

Rieger Plan (SB 51)

This plan ensures automatic inflation proofing of the Permanent Fund by requiring that only real earnings net of inflation be reported by the Corporation. The aim is to make the statement of earnings more realistic and reflective of actual economic performance. It will also have the added effect of lowering the amount put on the table each year for legislative appropriation – for dividends or other uses, thereby better protecting the principal of the Fund.

40/30/30 Plan

This plan was last sponsored by then Senator Jan Faiks in 1990 to divide the earnings of the Permanent Fund into three separate streams:

- 40% towards inflation proofing the Fund principal;
- 30% to pay dividends; and
- 30% to the general fund.

• *Cons Fund Reserve (SRS, 1990)*
• *+ Spending Limit*

M. Fouse - 258-5511

CREDIT COMMENTS

If derivatives are permitted, the issuer should ensure that the skills and systems are in place to monitor and manage the risks associated with derivatives. Also it is important that municipal issuers have the checks and balances in place to ensure that the investment guidelines and policies are being followed. Examples of prudent

checks and balances include board or committee oversight, frequent marking to market, and an independent third-party audit of the portfolio.

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ALASKA LEGISLATURE TO VOTE ON FUTURE OF AHFC

Legislation proposed on March 24, 1995 by Alaska Gov. Tony Knowles holds promise for the future financial stability of the Alaska Housing Finance Corp. (AHFC).

If the state legislature approves the bill in the form presented to S&P, the 'A+' G.O. and 'A-1' Eurocommercial paper ratings of the corporation will be removed from CreditWatch and assigned a stable outlook. If the legislation does not pass, AHFC's ratings will remain on CreditWatch, pending further review.

STATE TRANSFER PLAN

The governor's bill calls for enactment of an agreement between the state commissioner of revenue and AHFC, known as the State Transfer Plan. The plan fixes AHFC payments of \$270 million to the state's general fund over five years, beginning in fiscal 1996 with an initial payment of \$70 million. This payment, along with four \$50 million installments, cannot exceed the corporation's net income earned in the prior fiscal year. AHFC's earnings are projected to be more than \$100 million for fiscal 1995 and should remain strong, barring a precipitous economic decline. Should AHFC post losses such as during the 1986-1989 Alaskan recession, when the corporation lost \$124 million, payments to the state may not occur.

AHFC's \$1.7 billion equity base, \$908 million of which is unrestricted as of Dec. 31, 1994, will be substantially protected for bondholder security. The corporation relies on these reserves to absorb a significant level of loan losses resulting from unexpected fluctuations in the Alaskan economy.

Any payment made by the corporation to the state must be approved by AHFC's board of directors. The board must certify that the corporation's equity base will remain at the prior year's level or such a level to support the G.O. and Eurocommercial paper ratings. This requirement is in addition to meeting financial covenants under various bond indentures.

The security measures are important for maintaining long-term capital adequacy and liquidity, especially since AHFC pledges its G.O. to over \$2.51 billion of debt, including \$150 million of commercial paper. S&P rates only \$1.4 billion of this debt, based solely on the AHFC G.O. pledge (see list). Certain obligations, such as AHFC's veterans mortgage program, receive higher ratings due to the higher rated collateral or credit sup-

AHFC ratings as on CreditWatch; implications
revised as necessary

	Rating
\$348.95 mil. gen. corp. bonds, sec. 1977-1, 1977-2, 1977-3, 1976-1, 1980-1, 1983-1	A+
\$40.085 mil. gen. corp. bonds, sec. 1991A, 1992A, 1993A-2	A+
\$218.3 mil. gen. corp. purpose bonds, sec. 1985A, 1986A	A+
\$200 mil. gen. corp. rev. bonds, sec. 1991A, 1991C	A+/A-
\$22.835 mil. gen. corp. rev. bonds, sec. 1991B	A+
\$160 mil. Eurocommercial paper prog.	A-1

ports underlying each issue (See Aug. 15, 1994 CreditWeek Municipal).

Included in the legislation is authorization for \$30 million of AHFC G.O. bonds to pay for deferred housing maintenance at University of Alaska campuses. If the legislation passes, bond proceeds will pay for renovations at university dormitories helping to pay down the \$150 million deferred maintenance backlog across the university system. Debt service payments for the bonds will be paid directly from AHFC's general account over the next 11 years. Although this outflow will put additional pressure on the corporation's general account, S&P does not expect that debt service will substantially decrease liquidity. Impact AHFC's ability to support outstanding G.O.s, or make payments under the State Transfer Plan.

The G.O. and Eurocommercial paper ratings of AHFC were placed on CreditWatch with negative implications on Feb. 23, 1995 reflecting uncertainty over the scope and magnitude of future corporate asset transfers to the state's general fund. Rating implications were revised to developing on March 19, 1995 reflecting the introduction of the legislation, as well as efforts by the state to establish long-term solutions to ensure the state's future financial stability.

LONG-RANGE PLANNING

Recent efforts by Alaska ('AA' G.O. debt) to rectify financial instability resulting from volatile oil revenues could lead to decreased reliance on AHFC payments beyond the State Transfer Plan. On Feb. 10, 1995, the state legislature created a bipartisan Long-Range Financial Planning Commission. The commission's primary goal is to propose financial and capital planning procedures and to look for ways to promote economic stability and diversification, thereby lessening dependence on the oil industry.

The commission's proposals ultimately could lead to future G.O. debt issuance by the state, an

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CREDIT COMMENTS

declining oil revenues make it increasingly difficult for the state to continue its practice of funding capital projects on a pay-as-you-go basis.

THE FUTURE

S&P continues to have some concerns about additional AHFC payments and outright asset transfers to the state, beyond the proposed State Transfer Plan. AHFC payments represented 10% of the state's unrestricted revenue, the second-largest item in fiscal 1995. Moreover, since debt issuance requires voter approval, AHFC's equity base could be a more politically attractive alternative to remedy budget shortfalls resulting from lower-than-projected oil revenues. AHFC has repaid the state \$595 million of its \$1.07 billion contributed capital appropriation under various repayment plans, including the State Payment Plan (\$200 million) and the State Dividend Plan (\$114 million), which is being phased out.

Despite the concerns, the commission is expected to propose alternatives for the legislature to develop more stable revenue and expenditure budgeting procedures. S&P also expects that AHFC's management will successfully collaborate with Gov. Knowles' administration and the legislature over the next five years to devise longer-term and more predictable solutions in resource allocations involving AHFC. A downgrade could occur if agreements that ensure bondholder protection at AHFC's current rating level cannot be reached over the next several years. S&P will continue to monitor the legislation and assess the commission's findings, due July 15, 1995, for potential effects on AHFC's credit quality.

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GEORGIA INVESTMENT IN EDUCATION SPURS DEVELOPMENT

Under Gov. Zell Miller, Georgia has increased funding for primary and secondary education to levels that are unprecedented in the state's recent history. This investment has played an important role in the state's current economic strength and the revision last week of its G.O. rating outlook to positive from stable.

This effort has been dubbed the "Georgia Research Alliance." The state has used its private and public universities as tools for economic development by promoting a working alliance between the academic and corporate communities in fostering research into such areas as telecommunications, environmental technology, and biotechnology. In addition, the new Chancellor of the University System of Georgia, Stephen R. Porch, is reviewing the university system's admission standards with the goal of upgrading them.

Realizing that a large number of jobs created in the state's economy require more training than a high school education provides, the state also has increased resources to the state's technical schools over the past four years. These schools have become a key ingredient in the state's economic development efforts. Over \$130 million has been appropriated for the planning, design, and construction of new technical schools. Of this amount, nearly \$23 million came from lottery proceeds. This level of investment in technical education facilities in Georgia is unparalleled.

The Department of Technical & Adult Education's budget has increased to \$203 million in fiscal 1996, from \$120 million in fiscal 1993—a 67% increase in only three years. The number of full-time faculty added to the department during this period increased by 137 positions and non-faculty positions are up by 101 positions, a 12.7% increase.

EDUCATION HELPS ECONOMY

Georgia's economy is exhibiting solid growth, spurred by an expanding population, continued corporate relocations, and the impact of the 1996 Olympic Games. Total nonagricultural employment increased 5% in 1994—the seventh-fastest growth rate in the nation.

Georgia's four key industries—construction, transportation, trade, and services—have provided the bulk of this job growth. The state's service sector, which grew 7.6% in 1994, is expected to expand by over 180,000 jobs by the end of the decade and become the state's largest employment sector. This continued expansion in the state's economy has positive long-term implications for Georgia's G.O. rating. S&P rates Georgia's G.O. bonds 'AA+', and the outlook was revised to positive from stable only last week. Part of the reason for the outlook revision was the expansion of the state's economy and the prospects for continued growth over the next few years.

While much of this growth can be attributed to variables outside the control of state government, most economists believe a well-trained and educated work force plays a key role in economic expansion. This element of job creation can be severely affected by the policies and practices of the state.

GEORGIA RESEARCH ALLIANCE

The Georgia Research Alliance is a partnership among Georgia's public and private universities and private corporations designed to move Georgia to the forefront of growth in the high-technology industry. It already has had a demonstrated impact on economic development efforts.

SENATE JOINT RESOLUTION NO. 30
IN THE LEGISLATURE OF THE STATE OF ALASKA
NINETEENTH LEGISLATURE - FIRST SESSION

BY SENATOR RIEGER

Introduced: 5/9/95
Referred: JUD, FIN

A RESOLUTION

1 Proposing amendments to the Constitution of the State of Alaska relating to the
2 budget reserve fund.

3 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

4 * Section 1. Article IX, sec. 17(b), Constitution of the State of Alaska, is amended to read:

5 (b) The purpose of the budget reserve fund is to help stabilize State
6 spending from year to year. If the amount of unrestricted revenue available [FOR
7 APPROPRIATION] for a fiscal year is less than the combined amount of unrestricted
8 revenue and money from the fund appropriated for the previous fiscal year, an
9 appropriation may be made from the budget reserve fund. However, the amount
10 appropriated from the fund under this subsection may not exceed the amount necessary
11 [, WHEN ADDED TO OTHER FUNDS AVAILABLE FOR APPROPRIATION,] to
12 provide for total appropriations from unrestricted revenue and from the fund equal
13 to the amount of appropriations made from those sources [IN THE PREVIOUS
14 CALENDAR YEAR] for the previous fiscal year. The legislature shall implement
15 this subsection by law. For purposes of this subsection, "unrestricted revenue"
16 means all money received by the State during a fiscal year except money held in

1 trust, received from the federal government for a particular purpose, or dedicated
2 to a particular purpose as permitted by this constitution.

3 * Sec. 2. Article IX, sec. 17(d), Constitution of the State of Alaska, is repealed.

4 * Sec. 3. The amendments proposed by this resolution shall be placed before the voters of
5 the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the
6 State of Alaska, and the election laws of the state.

Sunday 16 MAY 95



DAVID
REAUME

Oil-price surge has firm base

Two months ago, I went out on a limb in a forum sponsored by another newspaper and forecast that the West Coast price of North Slope crude oil would top \$17.50 per barrel by the end of the year. Some limb!

Thanks largely to rising world demand, declining production outside of the Organization of Petroleum Exporting Countries and a falling dollar, the West Coast price roared past \$17.50 in late March and has fluctuated between \$17.90 and \$18.75 per barrel since mid-April.

Anyone who has followed this column for the past several years will understand when I say that I was surprised by the suddenness of the surge in oil prices but not by the fact that it happened. Since well before the 1991 Persian Gulf War, I have been explaining to anyone who cared to listen that rising oil prices were quite likely to turn the much bally-hoed state of Alaska fiscal crisis into something better described as a bother.

A comparison of today's West Coast price (about \$18 per 42-gallon barrel) to the Alaska Department of Revenue's spring 1995 base-case price forecast for the coming fiscal year (\$16.52 average of West Coast and Gulf Coast prices) is revealing. If the new higher prices hold, the deficit for fiscal 1996 will be reduced from the much reported \$600 million to something more like \$300 million.

If, in addition, prices should happen to rise thereafter at a not outrageous 2 percent per year (after adjustment for inflation), the deficit of nearly \$1.5 billion per year forecast by some for the end of the decade simply will not happen.

This turnabout from the price weakness of a year ago has the doomsday forecasters in a tizzy. The tension must be especially acute at the University of Alaska

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REAUME

REAUME: Fundamentals solid

Continued from Page C-1

Anchorage Institute of Social and Economic Research, the source of a series of grim projections.

One former ISERite who must really be squirming is Lee Gorsuch, the recently installed chancellor of UAA. In his previous position as director of ISER he was principally responsible for presenting the dire predictions to the university's board of regents and to the Alaska Legislature and governor.

In no small part due to Gorsuch's eloquence and zeal, the university's budget was slashed to the point where buildings are now crumbling on the Fairbanks campus for lack of maintenance, key faculty have departed everywhere and the Juneau campus has been all but reduced to the status of a community college.

Of course, Gorsuch and his former colleagues at ISER can never really be proved wrong. They could always argue that the real fiscal crisis is just over the horizon and that it has only been deferred and not eliminated. But if we pin things down to a more precise timetable, their position is looking ever more extreme.

The five-year odds on a fiscal crisis of the proportions they have been predicting have now shrunk to the imperceptible, largely because the world economy has been restructured and set on a new long-term economic growth path that five years ago only a few optimists thought was achievable. With OPEC's share of world oil production approaching the magic 50 percent mark, oil prices may well be moving onto their own parallel, long-term growth path.

That, of course, is the crux of the issue. Are we really seeing the beginning of a new era in oil price behavior or are we simply seeing a temporary surge?

The May 1 issue of the Alaska Department of Revenue's *ReveNEWS* suggests that the March/April experience can be attributed to relatively transient factors such as the imprisonment of the two Americans in Iraq, seasonal increases in demand, and weather-induced delays in tanker passage through the Gulf of Alaska.

In my opinion, and let me clearly label it as such, the reasons given by the Department of Revenue are simply those floating about the bars and coffeehouses where traders swap stories, and do not represent the closely guarded views of the oil companies themselves. More is at work here — the "more" being the factors I identified earlier: dramatic structural change in the world economy and a major repositioning of OPEC relative to its customers.

□ David M. Reaume is a Juneau-based economist. His opinion column appears every fourth Sunday.