Economy

Walker looks at borrowing to balance Alaska budget

Pat Forgey | December 13, 2015

JUNEAU -- Alaska Gov. Bill Walker's fiscal plan proposal puts a new focus on borrowing to maintain state spending, which state officials say could give the state more financial flexibility but would also raise costs for future generations, who would have to pay off the debt.

The state has billions in future retirement obligations it's been slowly paying down, and every year has to provide at least a minimal capital budget to accept matching federal money, mostly for highway projects.

Now Walker wants to deal with both those costs by borrowing, issuing $2.5 billion in pension obligation bonds to reduce annual retirement costs and additional general obligation bonds to meet state requirements to match the federal spending that brings nearly $1 billion a year to the state.

That would mean borrowing would be used to meet at least $400 million in costs that would otherwise be borne by the state's general fund, an amount, plus interest, that the state would have to eventually pay back. That's twice the $200 million Walker says would be raised by his income tax proposal.

Both bonding proposals will take legislative approval, and the general obligation bonds will also take voter approval next year in a general election. Walker's draft budget assumes legislative approval, for example budgeting $48 million in debt service for pension obligation bonds rather than the quarter-billion dollars the state would likely have to pay otherwise.

The state capital budget Walker made public Wednesday along with this fiscal plan calls for about $190 million in state spending for public works projects for the next fiscal year, but Revenue Commissioner Randy Hoffbeck said it would be a two-year bond proposal. Most but not all the capital projects are eligible for federal match. The match is usually split 90-10, with the federal government taking the much larger share.

What's eventually submitted to voters would be up to lawmakers to decide, but Hoffbeck said it was important that it only include the minimum amount necessary to get federal matching money.

Capital budgets and bonds often include multiple projects to win political and regional support, a process called "Christmas treeing" as more projects are hung on the bond bill, a something-for-everyone approach.

"One thing I want to be very clear on, this would be to fund those projects that would otherwise be funded out of the general fund, it would not be allowed to Christmas tree and become a wish-list package," Hoffbeck said.

The state can borrow at interest rates below what it expects to earn on its investments, so it makes financial sense to fund the capital budget by borrowing, Hoffbeck said.

But borrowing to pay matching costs would be unusual.

"I don't think the state has ever borrowed to make their match that I'm aware of," said Sen. Bert Stedman, R-Sitka.

In years past, the state has issued general obligation bonds with voter approval to boost capital spending, even in flush times, to take advantage of low interest rates.

Hoffbeck said because the bond election would occur after the next fiscal year had begun, officials would propose an appropriation from the general fund for the capital budget. That appropriation would be offset if the voters approved the bonds, reducing the draw on the general fund and the state's savings.

The projects themselves wouldn't be decided by the voters, just how they'd be paid for, so the highway projects wouldn't be at risk, he said.

"We need to make sure we have the money in there, particularly for the federal match portion, so we don't risk that by not putting it in and then not having the bond sale pass," Hoffbeck said.

That could threaten $860 million in transportation funding for highways, bridges, ferries and airports, according to the state budget. Other federal match projects include village safe water and wastewater infrastructure, energy housing and block grant programs.

Stedman called borrowing to make annual payments "a two-edged sword; it all depends on the economy."

If the stock market falls and the money invested decreases in value, the state could come out behind, he said.

Walker is also proposing $2.5 billion in borrowing for pension obligation bonds, to pay annual costs towards the state's unfunded liability. Hoffbeck said that amount would be divided among the public employee and teacher retirement systems, with the responsibility for paying off the bonds resting with the general fund and proceeds from the bond sale being deposited into the PERS and TRS trust funds. That would reduce the state's annual retirement costs.

"It would be structured in a way so as to not put the risk in the pension funds themselves," Hoffbeck said.

The goal is to give the state stable, predictable costs over time, he said.

In recent years the Alaska Retirement Management Board has become increasingly concerned about growing unfunded pension liability. Board leaders were unavailable for comment Wednesday on Walker's proposal. But in October, a retired state investment advisor, Michael O'Leary, said officials should be cautious about pension bonds. If markets take a downturn after the state's investments are made, Alaska may not even be able to recover its losses, let alone make the profits it needs to provide pensions.

Some legislators have previously urged use of pension obligation bonds, with Rep. Mike Hawker, R-Anchorage, a key advocate. A bill he introduced several years ago authorized up to $5 billion in pension obligation bonds.

Hawker was unavailable for comment last week, but said earlier this year the $5 billion authorization is still in place. But Hoffbeck said the Walker administration would seek new legislative approval.

The pension obligation bonds are what's known as "subject-to-appropriation bonds," meaning the bond holders only get paid back if the Legislature appropriates the money.

A new legislative approval would reassure bond buyers, he said.

"If the Legislature is not willing to voice support of it, we don't want that kind of noise going into the market when we try to sell bonds," Hoffbeck said.

Hoffbeck said the pension obligation bond proposal was "in its infancy," but the budget Walker made public Wednesday includes money to pay the debt service on the bonds, but not the additional hundreds of millions that would be needed for the retirement costs without the bonds.

The Legislature in past years already taken steps to reduce annual unfunded liability costs by extending the time on which it will pay off the liabilities and by shifting costs to municipalities.

If the Legislature chooses not to use pension obligation bonds to fund this year's extra retirement payment, there's no alternate version of the budget showing how much would be needed to be taken from the general fund. The retirement board has proposed a payment of $216 million that it said followed state law and was actuarially sound, but the Legislature previously included nonbinding "intent" language in a budget bill that would call for a payment of $261 million.

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