

House Finance Budget Subcommittee
FY21 Operating Budget

January 29, 2020

APFC – 40 Years

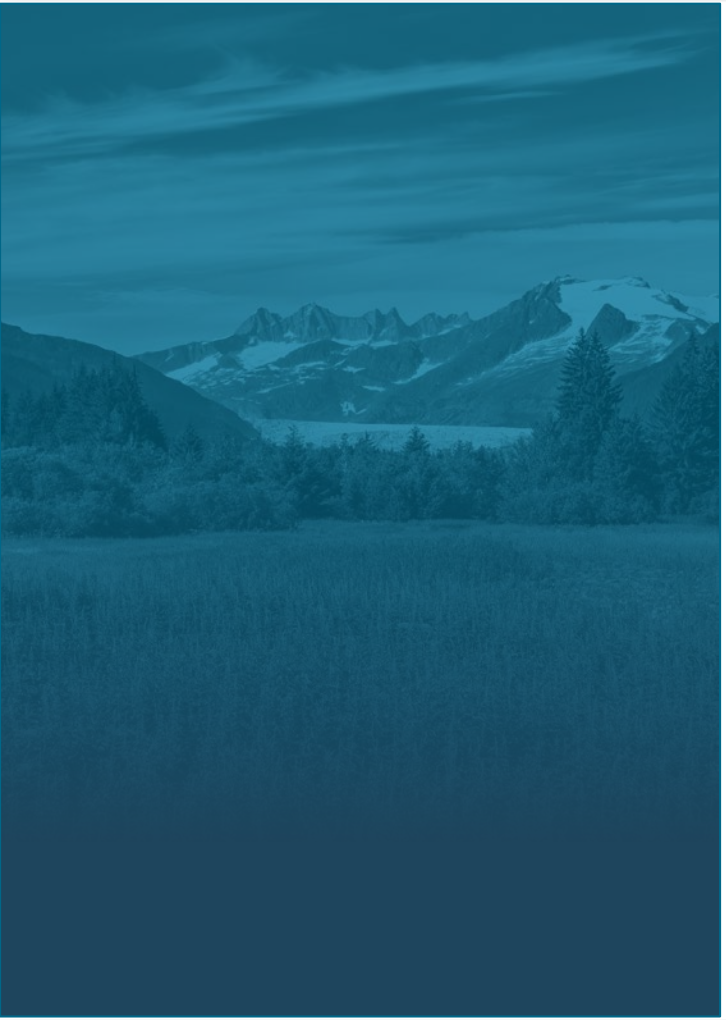
Forty years ago, on April 8, 1980

- Governor Jay Hammond signed SB 161 into law, establishing the Alaska Permanent Fund Corporation as an independent state entity tasked with the management and investment of the Alaska Permanent Fund.

Today

- APFC is a talented, award-winning, investment firm that embodies the resiliency, integrity, and pioneer spirit of Alaska.
- The influence of our dynamic, Alaskan corporation extends around the world based on APFC's practices of good governance, transparency, and a long-term investment horizon.





Generating Revenue for AK

As stewards of the Alaska Permanent Fund, our team possesses the skill and efficiency to ensure that Alaskans benefit from this resource for generations to come.

APFC's Mission

To manage and invest the assets of the permanent fund and other funds designated by law.

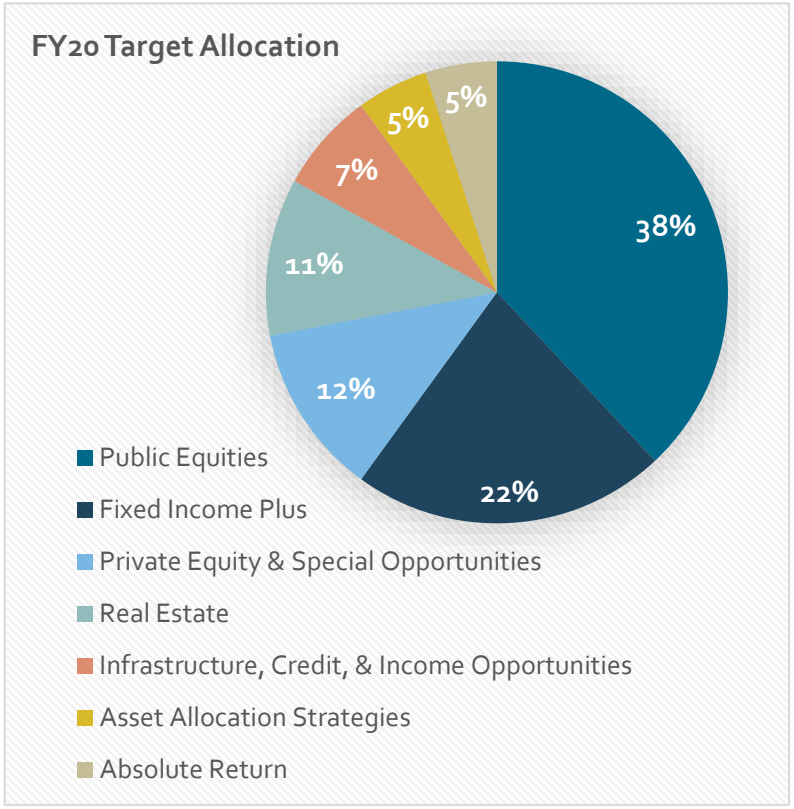
APFC's Vision

To deliver sustained, compelling investment returns as the United States' leading sovereign endowment manager, benefitting all current and future generations of Alaskans.

APFC's Values

Integrity – Stewardship – Passion

Asset Classes and Performance



As of June 30, 2019	FY19	3 Year	5 Year
Total Fund	**6.32%**	**9.96%**	**7.13%**
Public Equities	2.96%	11.49%	5.61%
Fixed Income Plus	9.28%	na	na
Private Equity	19.18%	21.56%	23.09%
Real Estate	-1.29%	5.25%	7.47%
Private Income: Infrastructure	10.94%	13.19%	11.94%
Absolute Return	1.94%	5.27%	2.64%
Asset Allocation	2.50%	3.29%	1.95%

Reliance on Corporate Activity

The Earnings Reserve Account (ERA) is established in Alaska Statutes as an account to hold the realized earnings from the Permanent Fund's investment portfolio, and is subject to legislative appropriation.

- SB 26, CH 16 SLA 18 established a POMV rules based structure for Fund withdrawals – a percentage of the average market value of the Fund for the first five of the preceding six fiscal years.
- Inflation Proofing AS 37.13.145 (c) protects the future value of the Principal by transferring a portion of the earnings to the Principal to maintain the long term sustainability of the Fund.
- APFC's operations and investment management of the Fund's assets are supported by the ERA.
- Agencies working on the collection of royalties also receive appropriations from the ERA.

Operating Budget Appropriations	FY20	FY21 GOV
Percent of Market Value – POMV	2,933,084,100	3,091,492,927
Inflation Proofing the Principal	943,000,000	0
APFC Operations	17,800,400	17,680,700
APFC Investment Management Fees	150,498,700	129,400,600
Dept. of Law	2,617,700	2,618,300
Dept. of Natural Resources	6,132,600	6,149,500
Dept. of Revenue	97,900	98,400

Fund Source: 1105 Alaska Permanent Fund Corporation Receipts (Other)

APFC's Budget

APFC's Budget

- Recognizing the importance of the Fund to the present and future economic health of Alaska, the Board and staff carefully consider the best structure for APFC and the asset allocation to meet the high expectations of stakeholders.

- APFC's budget is developed on zero-based budgeting principles and built each year to reflect anticipated needs of the Corporation in managing the assets under our stewardship.

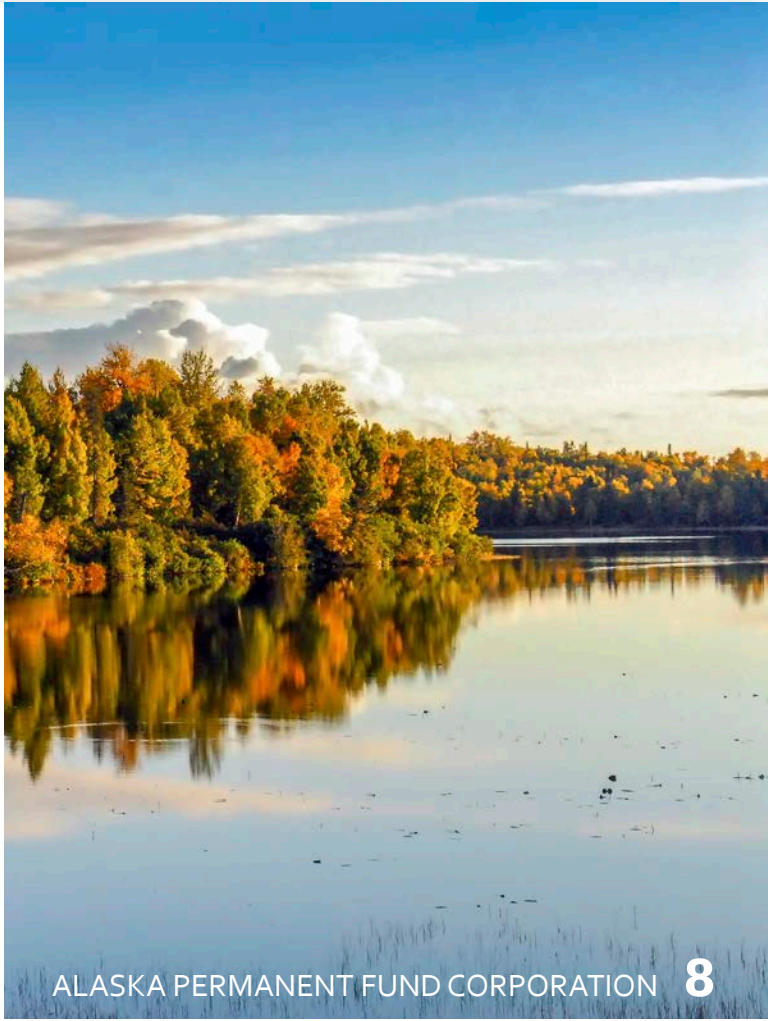


Transparency

It is important to note that the Board of Trustees and the Corporation have always been transparent regarding how the appropriations to APFC are budgeted and spent.

The budget is approved and discussed in open, public meetings, and budget materials and reports are included in public board meeting packets.

Members of the public can find detailed information about the Corporation's budget, investment strategy, investment management fees, and performance at apfc.org.



FY21 Proposed - Board Approved

The Board of Trustees Proposed FY21 Operating Budget for APFC

- Maintains two allocations: APFC Operations and APFC Investment Management Fees.
- The operations allocation includes an increment of $3.8 million in personal services for:
  - Implementing an incentive compensation plan,
  - Addition of 1 new position,
  - Standard retention adjustments,
  - Board honorarium, and
  - 3% vacancy adjustment (decrement).
- Reduces travel, contractual services and commodities, collectively by $1.1 million from FY20 authorized.
- Reduces Investment Management Fees by $21.1 million primarily due to the discontinuation of the external CIO program.
- Yields a 10.9% reduction from FY20 authorized to BOT proposed.

FY 20 – FY 21 Comparisons

	Authorized	BOT Proposed	
	FY2020	FY2021	FY20 to FY21
Operating Allocation	**$17,800,400**	**$20,500,857**	**$2,700,457**
Personal Services	$11,861,200	$15,659,502	$3,798,302
Travel	$929,000	$700,000	($229,000)
Services	$4,174,900	$3,404,405	($770,495)
Commodities	$435,300	$336,950	($98,350)
Capital Outlay	$400,000	$400,000	$0
Investment Mgmt Allocation	**$150,498,700**	**$129,400,638**	**($21,098,062)**
Total Appropriation	**$168,299,100**	**$149,901,495**	**($18,397,605)**

	Authorized	GOV Proposed	
	FY2020	FY2021	FY20 to FY21
Operating Allocation	**$17,800,400**	**$17,680,700**	**($119,700)**
Personal Services	$11,861,200	$12,839,400	$978,200
Travel	$929,000	$700,000	($229,000)
Services	$4,174,900	$3,404,400	($770,500)
Commodities	$435,300	$336,900	($98,400)
Capital Outlay	$400,000	$400,000	$0
Investment Mgmt Allocation	**$150,498,700**	**$129,400,600**	**($21,098,100)**
Total Appropriation	**$168,299,100**	**$147,081,300**	**($21,217,800)**

APFC Operating – FY 21 Governor

Staff Retention and Merit

Retention and merit adjustments are essential to the responsible management of the Fund, maintaining continuity of our program and our successful efforts in supporting and recruiting our APFC professionals.

This increment includes the following adjustments -

- $764.6 = 6% taking into account lack of past funding
- ($45.8) = Vacancy Adjustment to support rate of 3.11%

	PSVCs	Merit & Retention
FY 16	$8,185,100	$164,000
FY 17	$9,489,700	$216,000
FY 18	$9,600,700	$0
FY 19	$11,861,200	$0
FY 20	$11,861,200	$0
FY 21	$12,839,400	$764,600

	FY2021
Retention & Merit Adjustments – All Staff	$720,700
Real Estate Position – Salary & Benefits	$257,500
Operational Efficiencies	($1,097,900)
FY 21 Operating Allocation	**($119,700)**

Fund: 1105 Alaska Permanent Fund Corporation Receipts

APFC Operating – FY 21 Governor

Real Estate Asset Manager

1 new position to bring the corporation one step closer to managing a subset of real estate properties in-house.

- The anticipated cost saving of brining this particular Asset Manager in-house is $2.5 million. Currently, these duties are performed by an external advisor that collects their fees through a net-of-fee arrangement.

Real Estate holdings comprise over $4.0 billion in value for the portfolio. APFC has partial or complete ownership of residential, retail, industrial, and office buildings in the United States and abroad.

Every time APFC collects rent on these properties or sells one at a profit, the money earned flows to Earnings Reserve Account.

Currently have 4 in house staff and 7 external advisors.

	FY2021
Retention & Merit Adjustments – All Staff	$720,700
Real Estate Position – Salary & Benefits	$257,500
Operational Efficiencies	($1,097,900)
FY 21 Operating Allocation	**($119,700)**

Fund: 1105 Alaska Permanent Fund Corporation Receipts

APFC Operating – FY 21 Governor

Travel
Reduction of $229,000 based on FY19 actuals.

Contractual Services
Decrement of $770,500.
- Mainly attributable to reductions in IT contractual services related to the general support of the Corporation.
- Skills that have been developed internally for in-house support, contracting assistance will be used efficiently when necessary.
- Expenses for the Business Continuity Disaster Recovery (BCDR) project have also been refined.

Commodities
Decrement of $98,400.
- IT is the primary driver of this reduction. With the team accomplishing several of their major goals their ongoing budgetary requests are becoming more defined, and funding required for workstation replacements is now on a regular schedule.

	FY2021
Retention & Merit Adjustments – All Staff	$720,700
Real Estate Position – Salary & Benefits	$257,500
Operational Efficiencies	($1,097,900)
FY 21 Operating Allocation	**($119,700)**

Fund: 1105 Alaska Permanent Fund Corporation Receipts

Management and Performance Fees

Managing an investment fund is a balance, not only of risk and return, but of cost and reward. In addition to making reasoned investment decisions, managing the costs of investing the Fund is a key part of the Corporation's fiduciary duties. The fees associated with externally managed assets generally consist of two types: management and performance.

Management Fees - Fees paid to an external manager for compensation regardless of the rate of return on invested assets and expenses for APFC's management of assets. APFC has three methods for the tracking and payment of management fees.

Fees Funded by Investments - Fees are retained by the investment manager from the assets under its management. The fee amounts are netted against the income before it is distributed back to the Fund and are not included as part of the annual APFC investment management fee allocation in the operating budget.

Fees Funded by Investment Management Allocation - Fees are paid directly by APFC after an invoice is received. These investment fees reflect the value of assets under management, contractual fee terms for external management and the internal costs associated with effective portfolio management such as investment systems, due diligence, and custody fees.

Fees/Expenses Funded by APFC Operations Allocation - Operating expenses are directly related to the management the portfolio's assets. Includes personal services, travel, contractual services, commodities and equipment.

Performance Fees - Fees paid to an external manager after the invested assets have generated a return on investment above the agreed upon hurdle rate. A year in which performance fees are paid is a year in which assets have performed well above expectations.

APFC Investment Management

Investment Management Fees

The amount included in the FY21 request is based upon Callan's growth assumptions by asset class, the Fund's asset allocation, and the contractual fee terms for external management. Of the $22.2 million reduction, $17.4 million is attributed the termination of the External Chief Investment Officer (ECIO) program within Alternatives.

Investment Due Diligence

Reduction of $591,000 – attributable to a decrease in subject matter experts.

Investment Systems

Increment needed to implement a Public Equities Portfolio Risk System and a Private Assets Analytics system to enhance portfolio analytic capabilities.

Custody Fees

Bank of New York Mellon is the custodian of the Fund's assets. Custody fees are increasing as exposure to emerging markets increases, some of which require additional support services.

Investment Mgmt	Authorized	**BOT Request & GOV Proposed**	Variance
	FY2020	FY2021	
Investment Mgmt Fees	$136,520,085	$114,297,218	($22,222,867)
Investment Due Diligence	$7,178,200	$6,587,000	($591,200)
Investment Systems	$5,300,415	$6,716,420	$1,416,005
Custody Fees	$1,500,000	$1,800,000	$300,000
Total Inv Mgmt Allocation	**$150,498,700**	**$129,400,638**	**($21,098,062)**

Fund: 1105 Alaska Permanent Fund Corporation Receipts


Return on Investment

FY21 Governor Proposed Budget

2014-2019
Value Generated = $6.2 billion
Budgets = $600 million
Profit = $5.6 Billion

The FY21 GOV proposed budget includes an overall reduction of 12.6%.

	Authorized	Governor Proposed		FY19 Statutory Net Income
	FY2020	FY2021	*Variance*	$3,305,000,000 avg. $13.1 million per trading day
Operating	$17,800,400	$17,680,700	*($119,700)*	1.3 days
Investment Management	$150,498,700	$129,400,600	*($21,098,100)*	9.9 days
Total Appropriation	**$168,299,100**	**$147,081,300**	***($21,217,800)***	**11.2 days**

Value Generated

FY 19

Revenues	$ 3,907,500,000
Operating/Investment Expenses	$ 132,600,000

Value Generated Per Day (based on 251 active trading days through FY19)

Total Fund	$ 3.9 B / 251 = $15.6 M per day
Statutory Net Income	$ 3.3 B / 251 = $13.1 M per day

APFC staff is actively engaged in making direct investments and overseeing our external manager partnerships:

- APFC has 57PFT; 2PPT, 2 Summer Interns
- 32 External Public Equities Managers
- 7 Real Estate Advisors
- Private Markets Partnerships:
  - Fund to Fund / Co-Investments / Direct Investments



FY21 APFC Budget

APFC recognizes this evolution in the Fund's role to generate revenue to support state services and programs; as such, APFC looks to the State to ensure that resources are available to support APFC's investment and management needs for ongoing success in generating long-term returns.

A robust, healthy Permanent Fund is important to all Alaskans. Adequate funding for staff, travel, training and other tools is necessary to allow the Corporation to fulfill its dual role of protecting the Principal of the Fund for the benefit of all current and future Alaskans and providing a revenue source to help balance the State's budget.




Questions