# Alaska Permanent Fund House Finance Committee February 24, 2016

Alaska Permanent Fund Corporation

# 1969: The debate begins

Alaska receives $900 million in Prudhoe lease sale bonuses

Prior year state budget: $112 million

# 1976 voters guide

***"Alaska's state government [should] set aside a rainy day fund to benefit this and future generations of Alaskans."***

Alaska State Chamber of Commerce

*Alaska Voters Agreed:*

*By a margin of 75,588 to 38,518, voters decided to create the permanent fund*

# The Alaska Constitution

Article IX, Section 15, provides:

At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the **principal** of which **shall be used only for those income-producing investments specifically designated by law** as eligible for permanent fund investments. *All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law* [Effective February 21, 1977].

# From 1976 to 1980, Alaskans debated the Fund’s purpose:

~~Development bank~~

or

Investment fund

# 1980: Investment Fund Concept adopted, and with it:

## Senate Bill 161

Created the Alaska Permanent Fund Corporation to manage the investments of the Fund, separate from the state's other investments managed by the Department of Revenue. This bill also created a Board of Trustees to oversee the Fund and started the legal list of allowed investments.

## Senate Bill 122

Created the Permanent Fund Dividend program.

# APFC Board of Trustees

- Six board members
- Two state members
- Four public members
  - Appointed by Governor
  - Experience in finance, investments, or business management
  - May only be removed “for cause”

# Statutory investment rules evolve

- Evolution from legal list to prudent-investor
- Starting in 2005: “Prudent-investor rule” guides investment of Fund assets
  - Duty of care
  - Duty of loyalty
- The Board will maintain a reasonable diversification of assets

# Fund Advantages

**Size**

- Access to investments
- Ability to negotiate fee savings

**Time Horizon**

- No set liability

# Fund Challenges

**Location**

- Business travel to financial centers
- Recruitment from financial centers

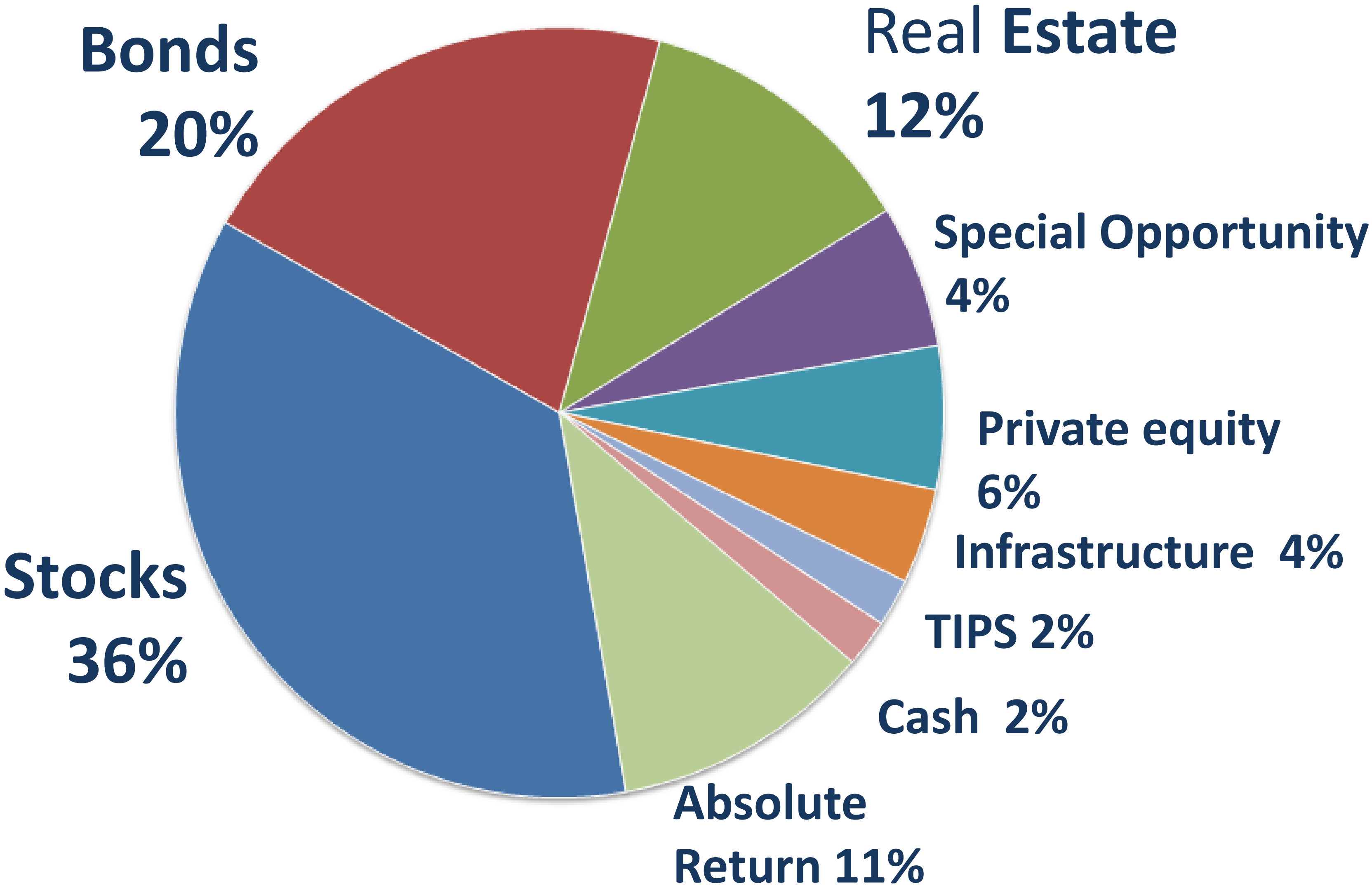
**Flexibility**

- New resources often arrive long after they are needed due to lengthy budget process

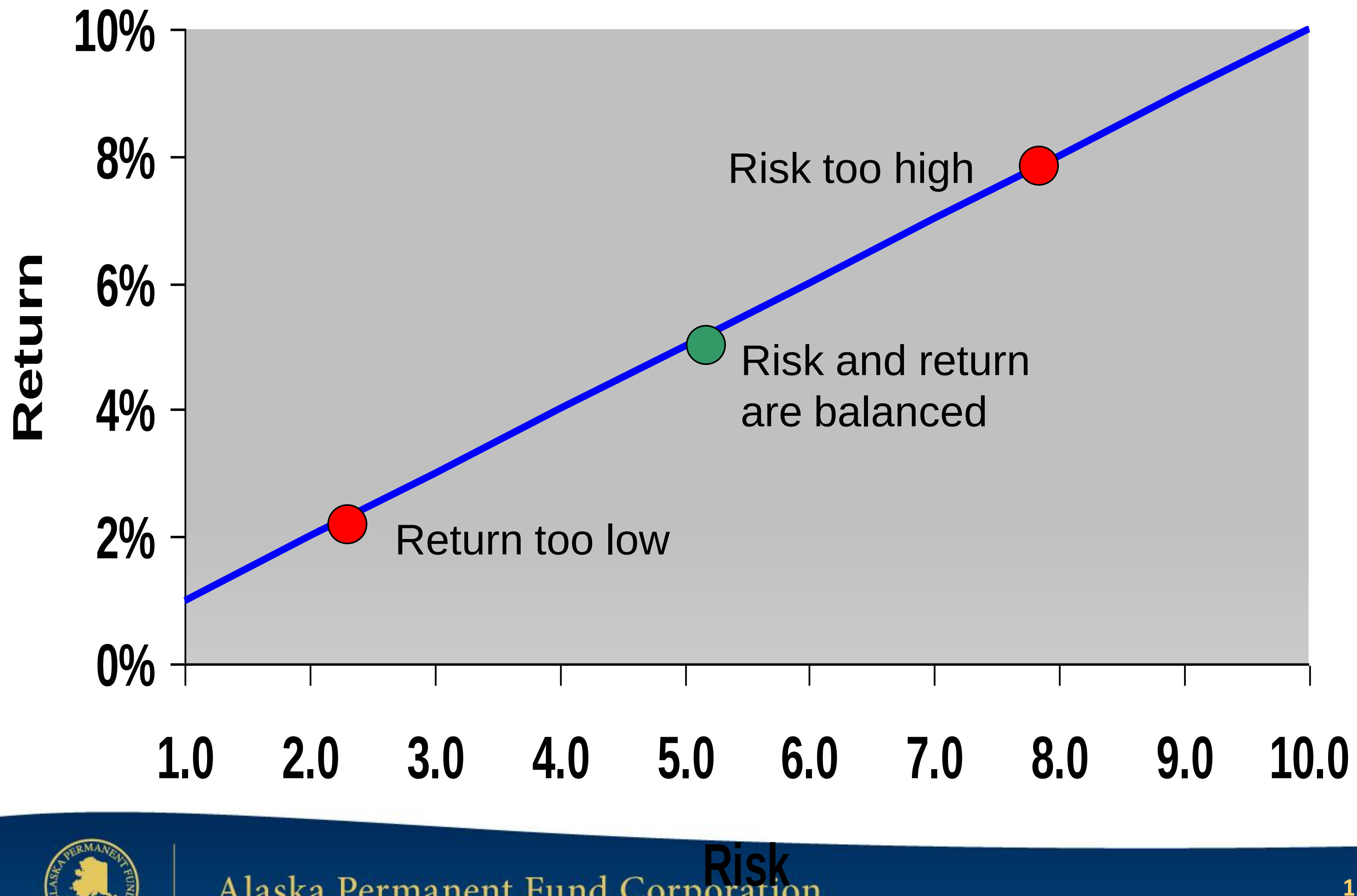
**Staff size**

- Small staff limits bench strength, creates gaps during travel and vacancies

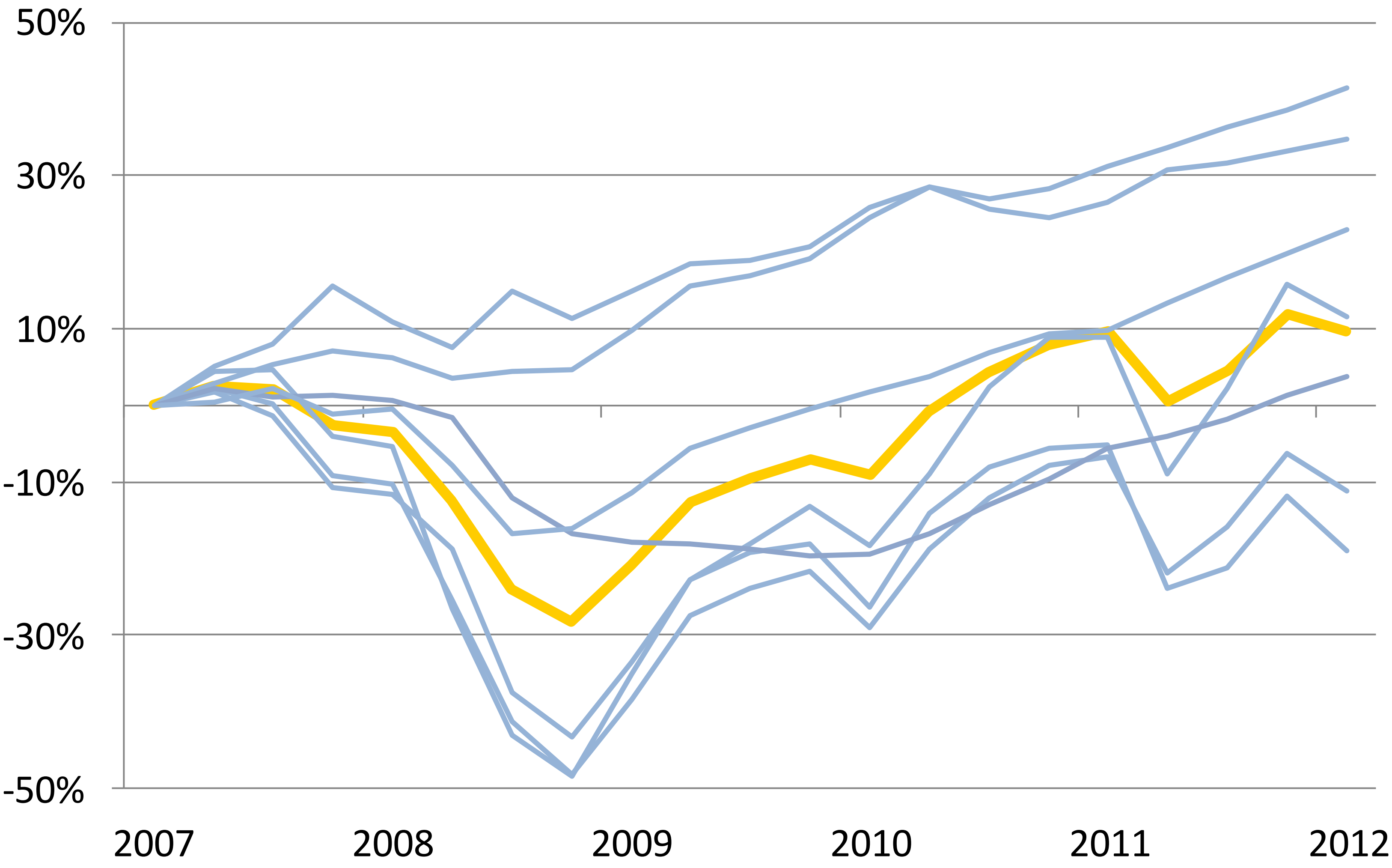
# Target Asset Allocation



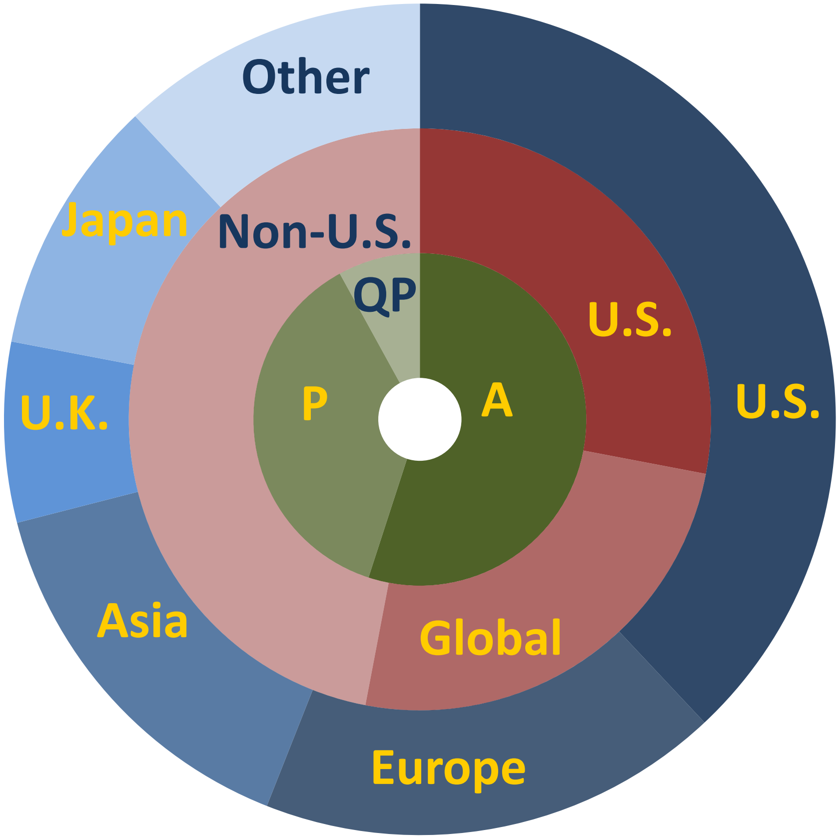
# Risk vs. Return



# The effect of diversification



# Stock Portfolio




**$20.9 billion as of 06/30/2015**

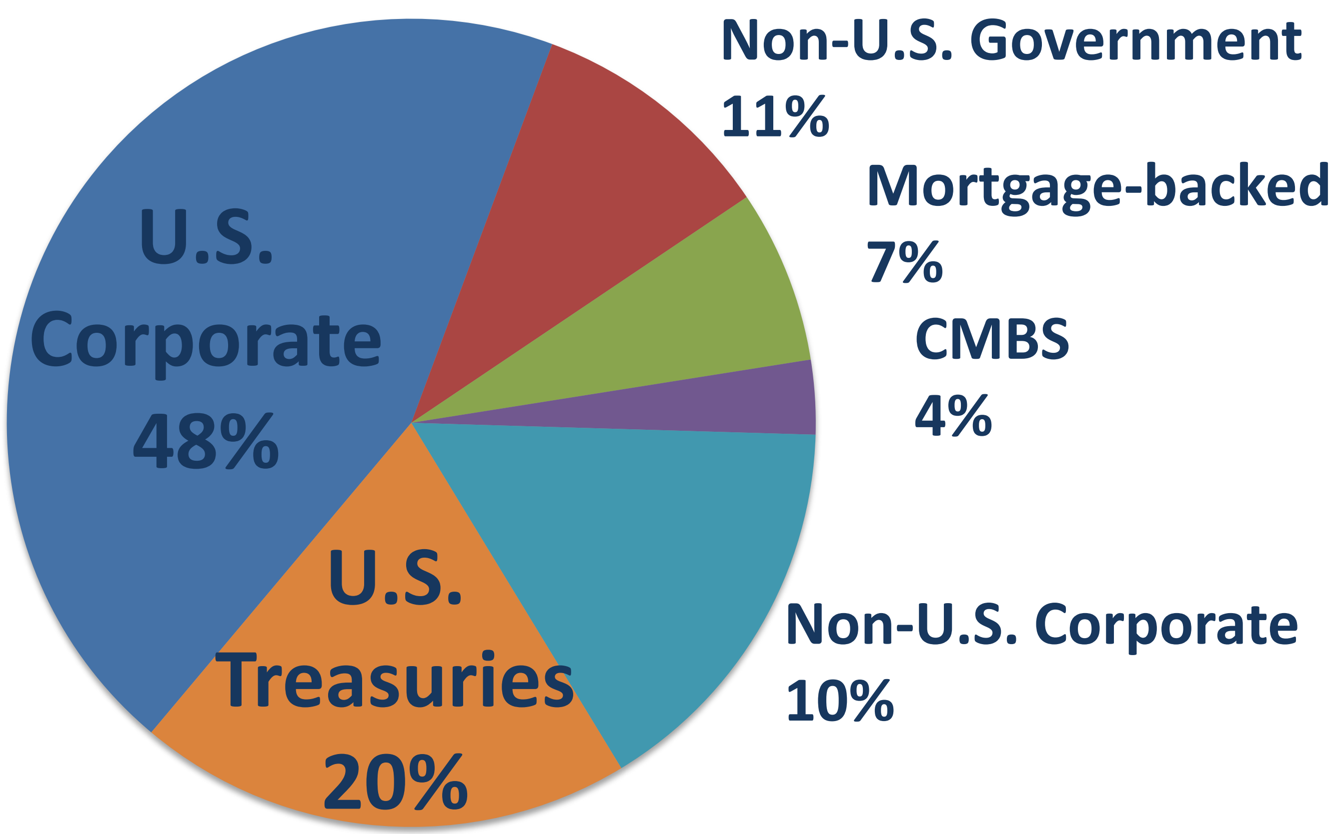
By country or region

By mandate:
U.S., Global, Non-U.S.

By management:
Active, Passive,
Quasi-passive

# Bond Portfolio Composition

**$11.1 billion as of 06/30/2015**

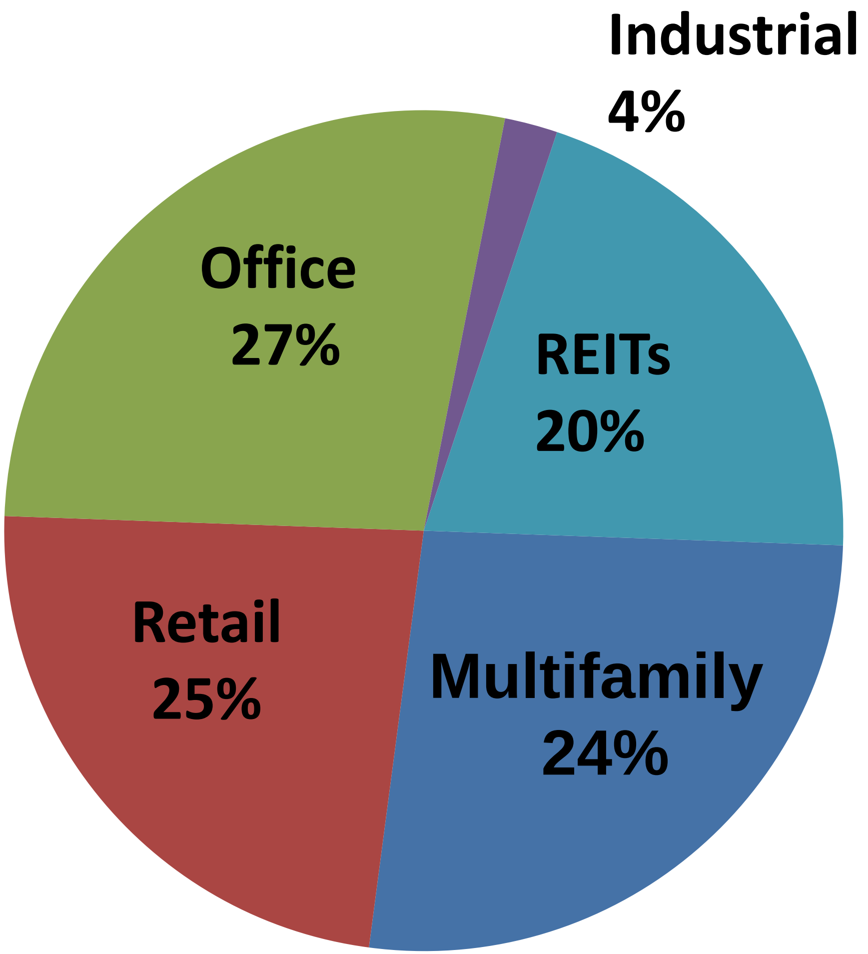


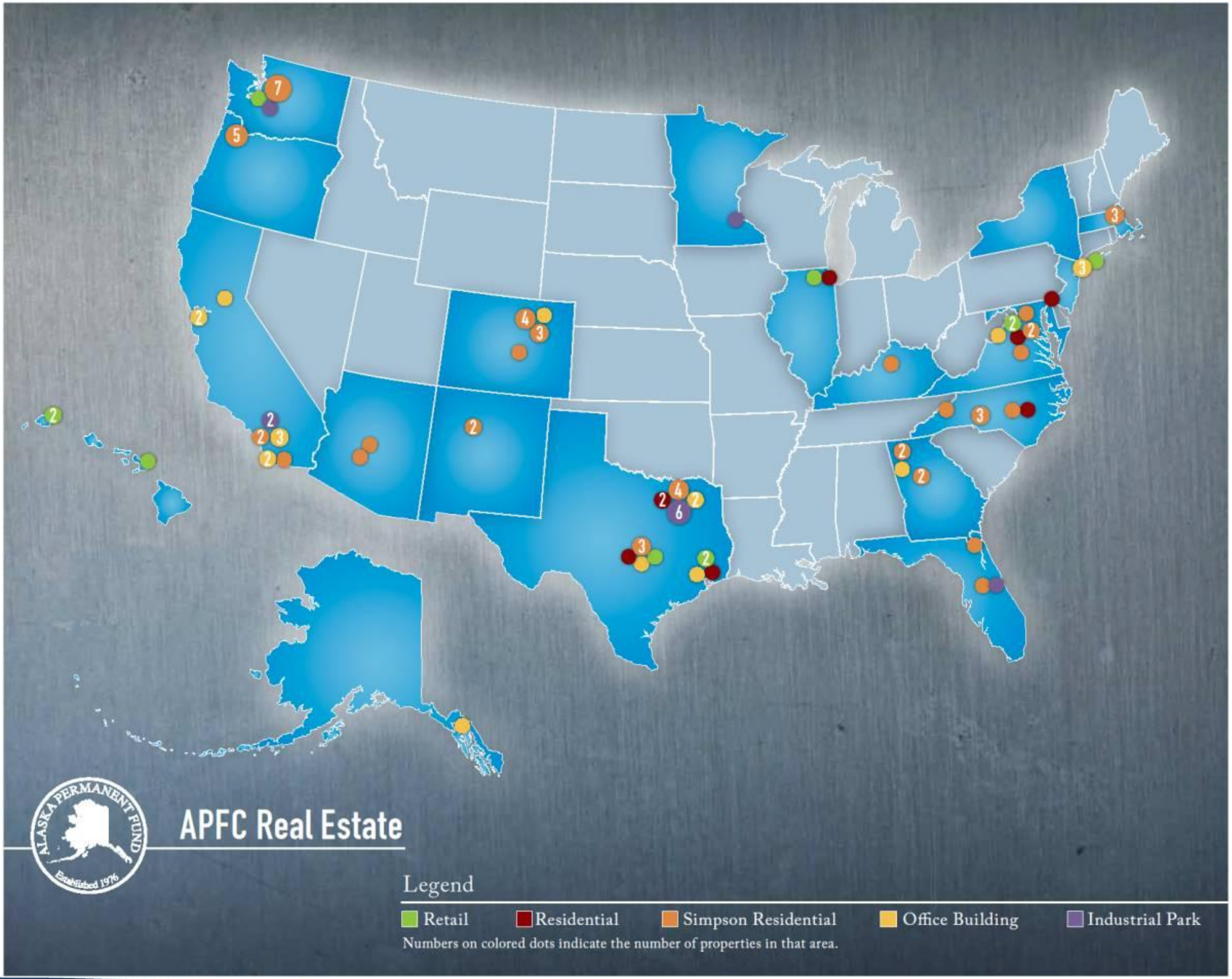
# Real Estate

$6.5 billion as of 06/30/2015

58 directly held properties

Exposure to Europe growing




APFC Real Estate
Legend
Retail
Residential
Simpson Residential
Office Building
Industrial Park
Numbers on colored dots indicate the number of properties in that area.

# Tysons Corner Center

# Absolute Return

$5.3 billion as of 06/30/2015

Externally Managed-$2.5 billion

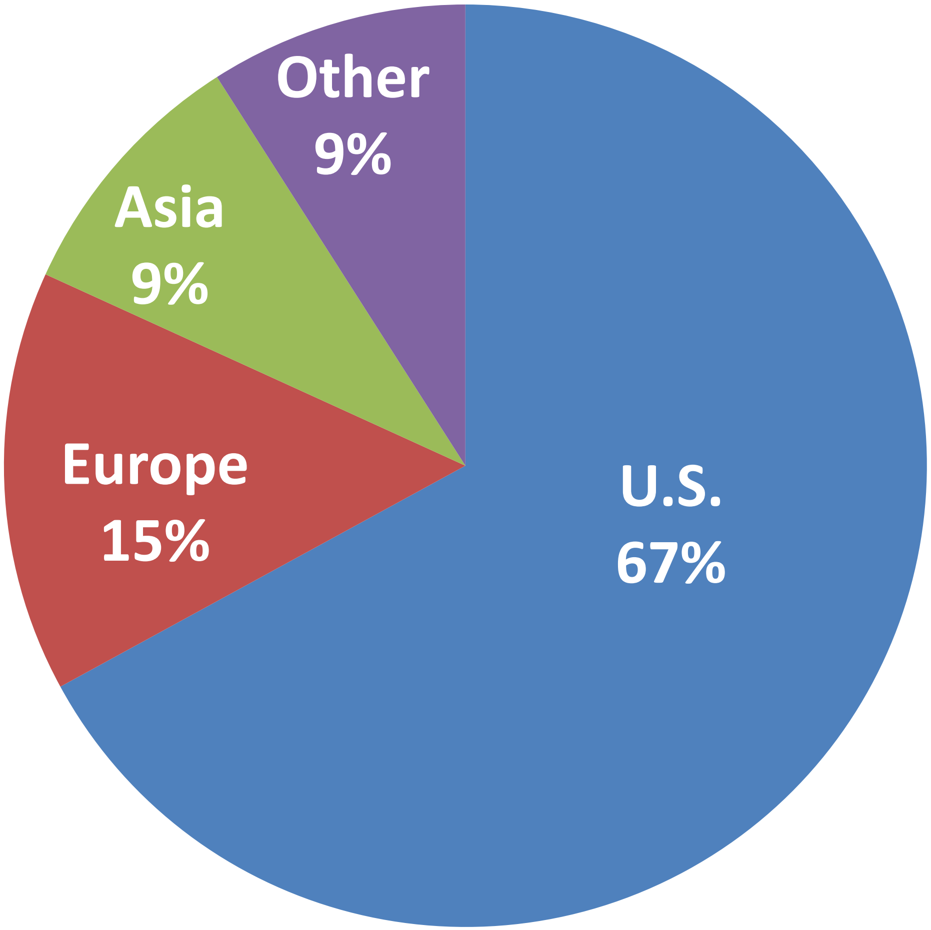
Internally Managed-$2.8 billion

# Private Equity

$3.2 billion as of 06/30/2015

2,800 underlying companies

Co-investment program implemented in FY2014

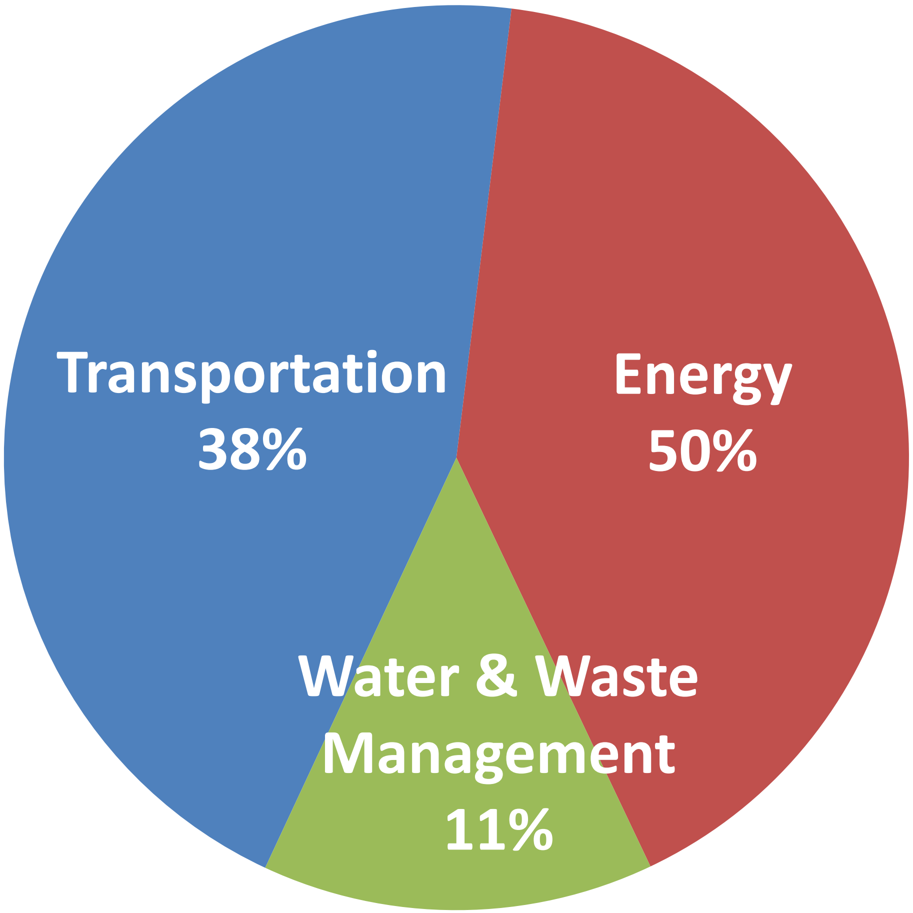


# Infrastructure Holdings

$1.5 billion as of 06/30/2015

Properties in the U.S., U.K., India, Argentina and Canada

Co-investment program implemented in FY14, currently at $35 million



# Special Opportunities

Direct investments in private companies-examples: Juno Therapeutics and Denali Therapeutics

Direct investments in specialized funds-examples: Dyal and Blackstone funds

$1.9 billion as of 06/30/2015

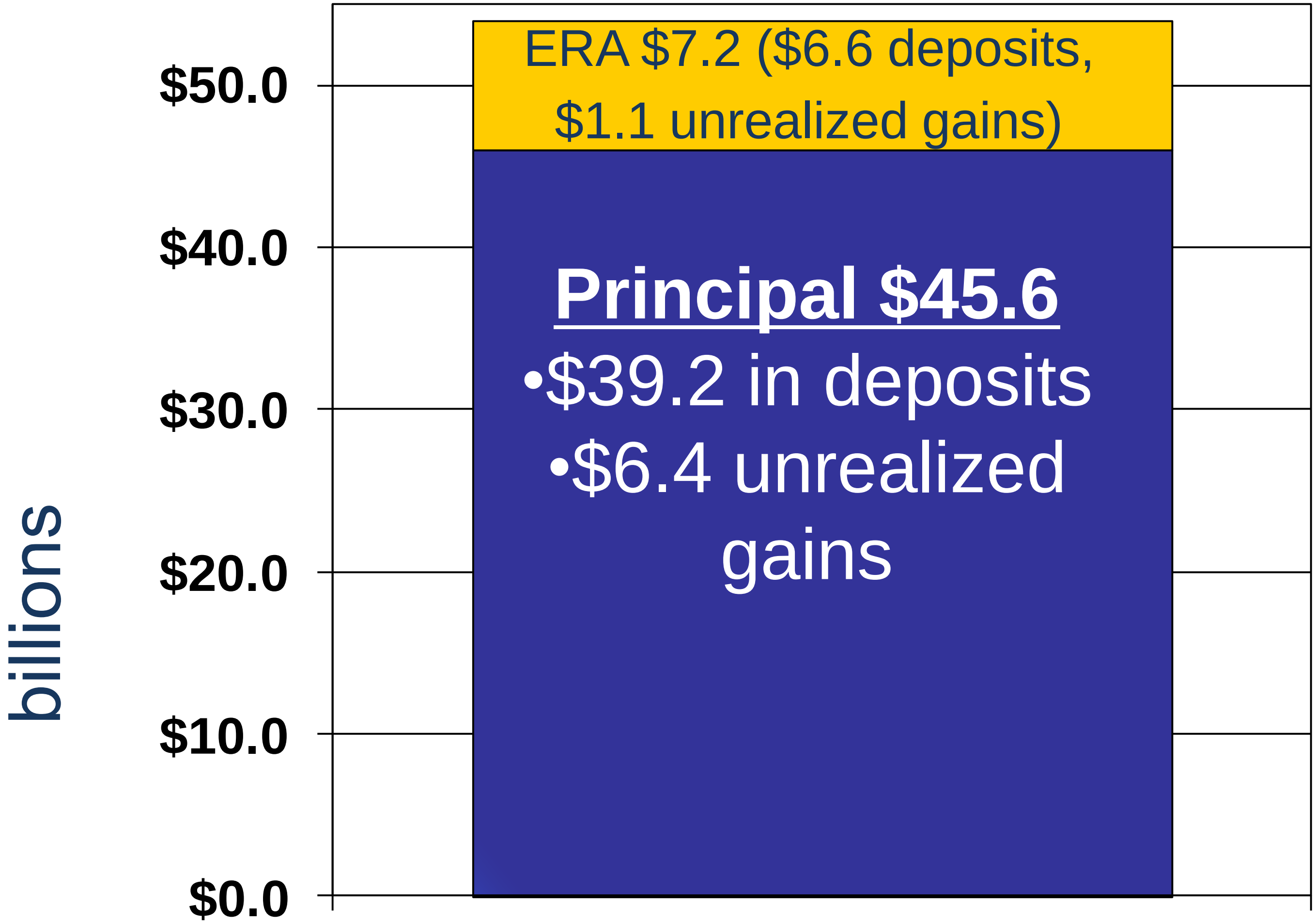
# Statutory Net Income

Principal (income-producing investments)

Net Income gets deposited into the ERA

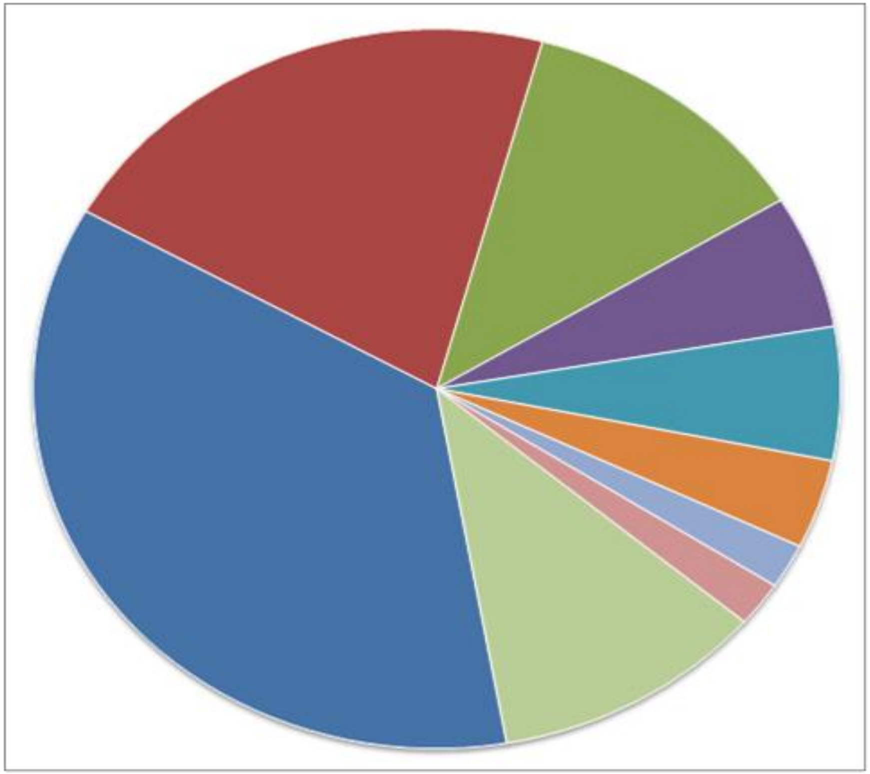
Income in ERA available for Appropriation

# Fund breakdown

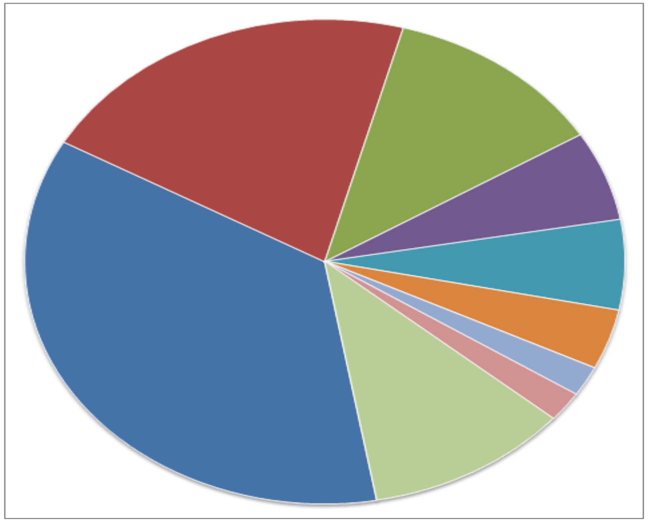


# Pro rata share of main fund assets, not cash, are transferred to ERA

## Main Fund allocation



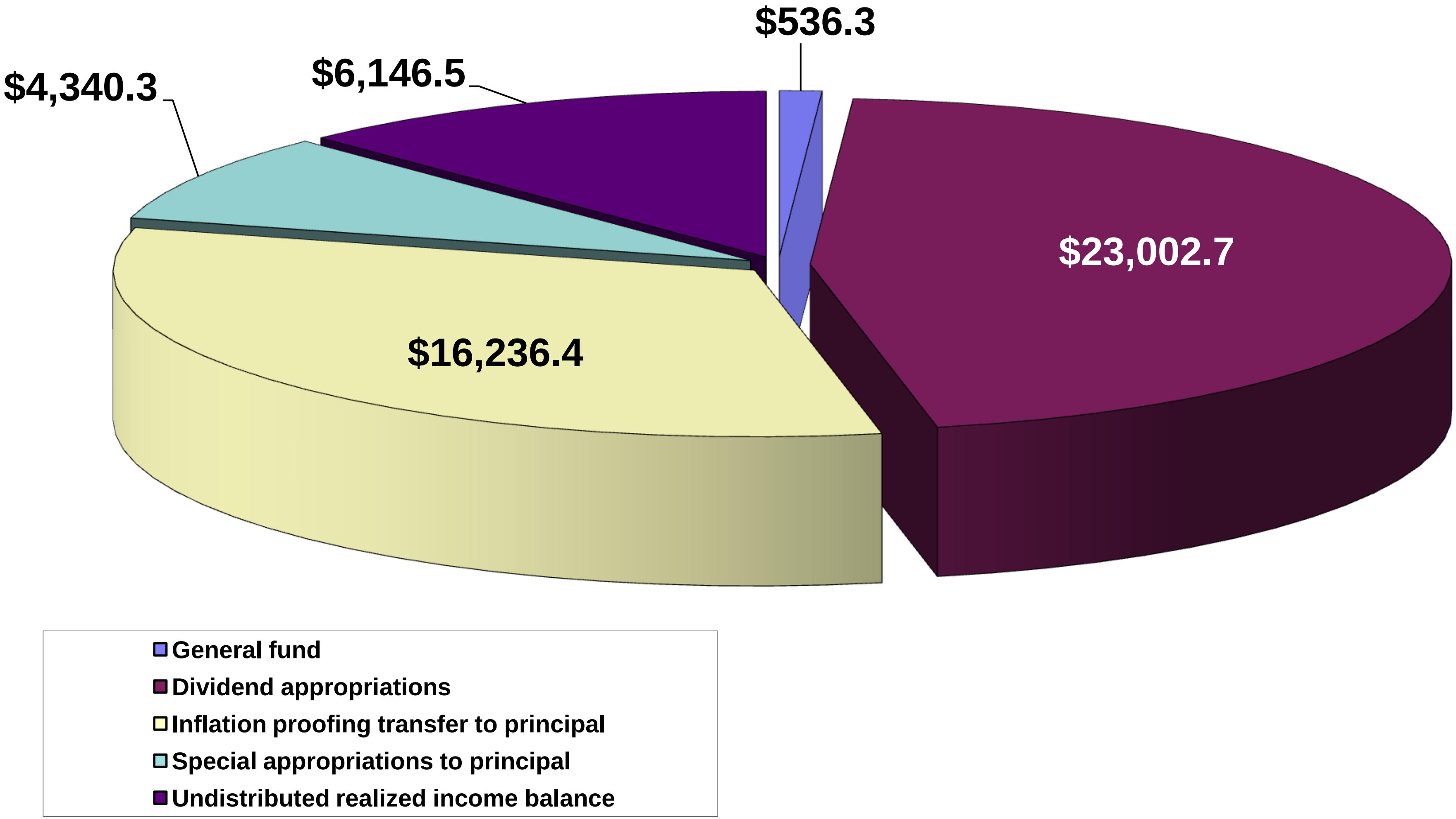
## ERA allocation



# Statutory Net Income

| Fiscal Year | Realized Net Income | Realized Return |
|---|---|---|
| 2005 | $1,754 | 6.30% |
| 2006 | $2,689 | 8.66% |
| 2007 | $3,428 | 9.96% |
| 2008 | $2,938 | 7.77% |
| 2009 | ($2,475) | -7.86% |
| 2010 | $1,590 | 4.91% |
| 2011 | $2,143 | 5.96% |
| 2012 | $1,568 | 4.02% |
| 2013 | $2,927 | 6.97% |
| 2014 | $3,530 | 7.52% |
| 2015 | $2,907 | 5.67% |

# Use of Realized Net Income



# Inflation proofing

- Provides a deposit back to corpus
- Maintains purchasing power of corpus
- Added $16.2 billion to corpus
- Based on value of corpus on June 30 and inflation rate for prior two calendar years

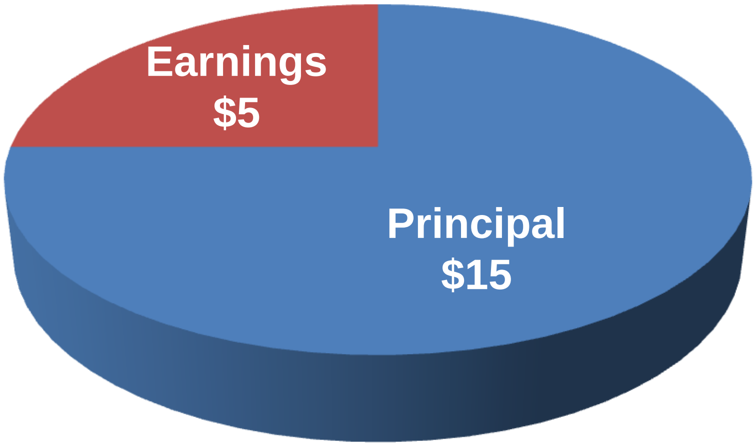
| Fiscal Year | Transfer |
|---|---|
| 2005 | $641 |
| 2006 | $856 |
| 2007 | $860 |
| 2008 | $808 |
| 2009 | $1,144 |
| 2010 | $0 |
| 2011 | $533 |
| 2012 | $1,073 |
| 2013 | $743 |
| 2014 | $546 |
| 2015 | $624 |

# Money in and out, and current value

| | | |
|---|---|---|
| **$39.2 billion** Deposited into Principal | **$45.6 billion** Market Value of Principal | **$52.8 billion** Total Fund Value 6/30/15 |

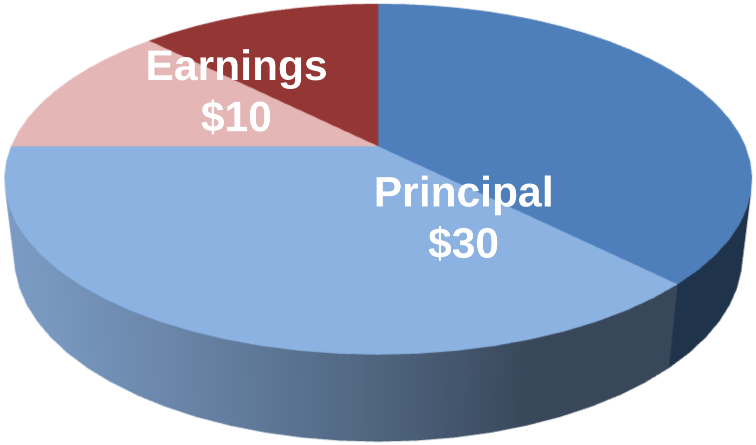
# Principal vs. Earnings Reserve

- The Fund buys an investment for $20
  - Earnings reserve reflects 25% of total fund
  - $20 investment was funded with
    - $15 of principal
    - $5 of earnings



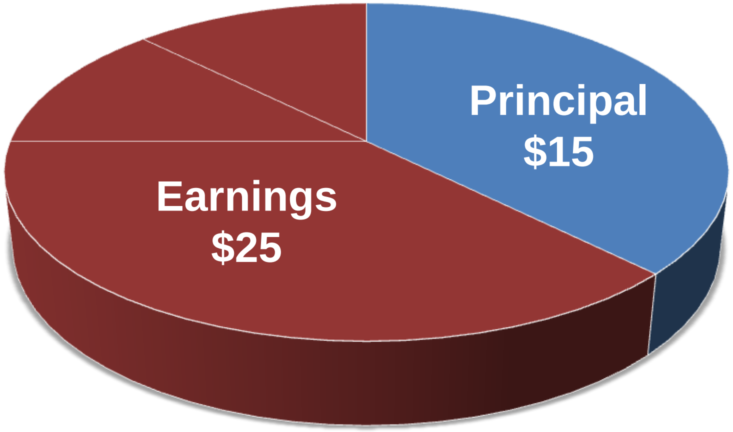
# Capital Appreciation

- The value of the investment appreciates from $20 to $40
  - $20 in unrealized gains are distributed proportionally
    - Principal's share now worth $30
    - Earnings reserve's share now worth $10
  - Unless APFC sells (realizes) a portion of the investment,
    - The increased value reflects unrealized gain, not statutory net income
    - No income is transferred from principal to earnings



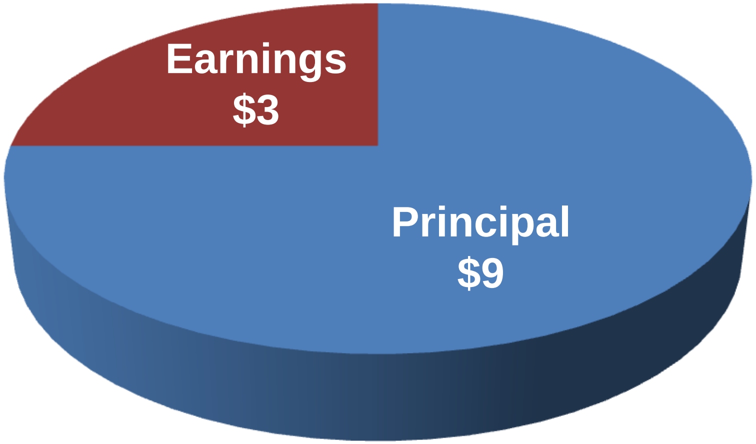
# Harvesting Gains

- APFC sells the investment for $40, and the $20 unrealized gain is realized
  - $15 remains in principal to cover its cost
  - $15 realized gain is transferred to earnings reserve
  - Earnings reserve now has $25
    - $5 original cost
    - $5 of its realized gain
    - $15 of realized gain from principal



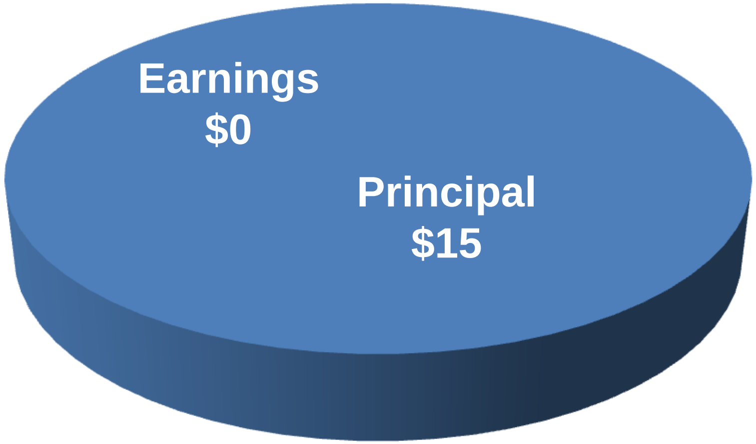
# Capital Depreciation

- The value drops from $20 to $12
  - principal investment is valued at $9, reflecting unrealized loss of $6
  - Earnings investment is valued at $3, reflecting unrealized loss of $2
- Should APFC sell
  or hold?



# Realizing Losses

- Assume we conclude it is prudent to sell the investment for $12
  - $12 is returned to principal from sale proceeds
  - $3 is moved to principal from earnings reserve
  - Leaving earnings reserve with a loss of $8
- Note: with a long-term time investment horizon, this activity is rare (example-2009)



# ERA Going Forward:

- Liquidity Consideration:
  - Some APFC asset classes, like private equity, are illiquid, making a portion of the ERA illiquid
  - Yet all of the ERA is “available for appropriation”
- Volatility Consideration:
  - Permanent Fund and ERA are subject to ups and downs experienced by capital markets
  - Going forward, is a long-term time horizon for ERA workable?

# ERA Going Forward:

- Counterweight:
  - Net Income in ERA is immediately invested alongside main fund
  - allowing the nominal value of this income to remain deployed and continue earning income until it is appropriated
  - Over the last ten years, the Fund's annualized return was 6.4%