



APFC

ALASKA PERMANENT
FUND CORPORATION

Bicameral Working Group Alaska Permanent Fund

June 2019

The Alaska Constitution

In 1976, Alaskans voted 75,588 to 38,518 in favor to amend the Constitution of the State of Alaska and created the Alaska Permanent Fund.

Alaska Constitution Article IX

Section 15. Alaska Permanent Fund

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.

Legislative Findings AS 37.13.020

The people of the state, by constitutional amendment, have required the placement of at least 25% of all mineral royalties received by the state into a permanent fund. The legislature finds with respect to the fund that:

- The Fund should provide a means of conserving a portion of the state's revenue from mineral resources *to benefit all generations of Alaskans.*
- The Fund's goal should be *to maintain safety of principal while maximizing total return.*
- The Fund should be used as *a savings device managed to allow the maximum use of disposable income* from the Fund for the purposes designated by law.



1980 The Corporation AS 37.13.040

The Alaska State Legislature passed SB 161 in 1980 establishing the Alaska Permanent Fund Corporation.

The purpose of the Corporation is to manage and invest the assets of the permanent fund and other funds designated by law in accordance with AS 37.13.010-37.13.190.

APFC operates as a separate state entity under the oversight of an independent Board of Trustees who serve as fiduciaries of the Alaska Permanent Fund.

A fiduciary responsibility is a legal obligation of one party to act in the best interest of another. When a party knowingly accepts the fiduciary duty on behalf of another party, they are required to act in the best interest of the principal, the party whose assets they are managing.



The Board of Trustees AS 37.13.050

The Board consists of six members appointed by the governor.

- Two of the members must be heads of principal departments, one seat is designated for the Commissioner of Revenue.
- The four public members of the board must have recognized competence and wide experience in finance, investments, or other business management-related fields.

The Board sets investment policy, reviews the portfolio's performance, and works together with management to determine the Corporation's strategic direction.

As fiduciaries, the Trustees have a duty to Alaskans in assuring that the Permanent Fund is managed and invested in a manner consistent with legislative findings.





History

Investment Responsibilities

1980 Original Language AS 37.13.120

- (a) The prudent-man rule shall be applied by the board in the management and investment of Alaska permanent fund assets. The prudent-man rule as applied to investments of the corporation means that in making investments the board shall exercise the judgment and care under the circumstances then prevailing which an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income.
- (b) The corporation assets shall only be used for income-producing investments.
- (c) The board shall maintain a reasonable diversification among investments unless, under the circumstances, it is clearly prudent not to do so.
- (d) The board shall submit long-range and quarterly investment reports to the Legislative Budget and Audit Committee.
- (e) The corporation may not borrow funds or guarantee from principal of the Alaska permanent fund the obligations of others.
- (f) The board may enter into and enforce all contracts necessary, convenient or desirable for purposes of the corporation.

1980 Original Investment Vehicles

AS 37.13.120 (g) – (i)

- Obligations insured or guaranteed by the United States
- Certificates of Deposit (CDs) issued by US Banks
- Shares & CDs issued by chartered savings and loans in Alaska
- CDs issued by Alaska banks
- Corporate debt and notes rated AA or higher
- Residential mortgages and commercial loans, containing federal guarantees
- Futures contracts for the purpose of hedging
- Asset allocation limits:
 - 25% corporate debt | 15% residential mortgages

AS 37.13.120 (l)

- The board shall invest the assets of the corporation in in-state investments to the extent in-state investments are available if the in-state investments
 1. Have a risk level and expected yield comparable to alternate investment opportunities; and
 2. Are included in the list of permissible investments in (g) of this section.



Changes Over Time ...

1982

Amended Allowable Investments:

- Added collateral requirements for illiquid CDs
- Added dividend yielding equities (foreign & domestic)
- Changed definitions of federal guarantees to match revised security requirements
- Changed asset allocation limits to:
15% mortgages | 15% real estate | 10% foreign equities | 20% foreign CDs | 50% US corporate debt & equities

1986

Added rating requirement of “A” to collateral for illiquid CDs

1989

Added language:

- Allowing for foreign corporate debt rated “AA” or better
- Allowing for foreign government debt and CDs
- Broadening the definition of allowable foreign stocks
- Broadening the definition of allowable future contracts

Repealed and replaced asset allocation limits to:

15% mortgages | 15% real estate | 20% CDs | 50% corporate stocks & debt securities (foreign & domestic)



Changes Over Time 1992 ...

- Redefined CDs, removing secondary market liquidity requirements
- Reduced rating requirement for corporate debt to “A” from “AA”
- Removed certain mortgage insurance requirements
- Added permission for Board to establish/modify investment guidelines, subject to review and comment by Legislative Budget and Audit Committee prior to adoption
- Amended collateral requirements
- Changed asset allocation limits to:
 - 15% mortgages | 15% real estate | 20% CDs | 50% equities
 - 5% corporate, domestic, foreign and taxable municipal debt



Changes Over Time ...

1994

Amended real estate limits, raising investment amount from \$20,000,000 to \$150,000,000

- Total value of investment can exceed \$150,000,000 if 33% of investment property is owned by other institutional investors

1996

Rating requirements changed to “investment grade”

Asset allocation limits changed to:

55% Stocks | 15% Real Estate | 20% CDs | 15% Mortgages

5% Other types of investments, subject to prudent investor rule

- Recognized ‘other’ may cause aggregate investment to exceed applicable limits

Changes Over Time ...

1999

Amendments:

- Allowed to borrow money with respect to real property investments provided no recourse to APFC or Fund
- Updated collateral and rating thresholds for debt investments
- Added real estate investment trusts (REITs) to allowable investments list
- Allowed the Fund to wholly own institutional sized real estate (no longer limited to 67% ownership)
- Changed asset allocation limits:
 - 55% Stocks | 15% Real Estate | 20% CDs | 15% Mortgages
 - 5% Other types of investments, subject to prudent investor rule

2004

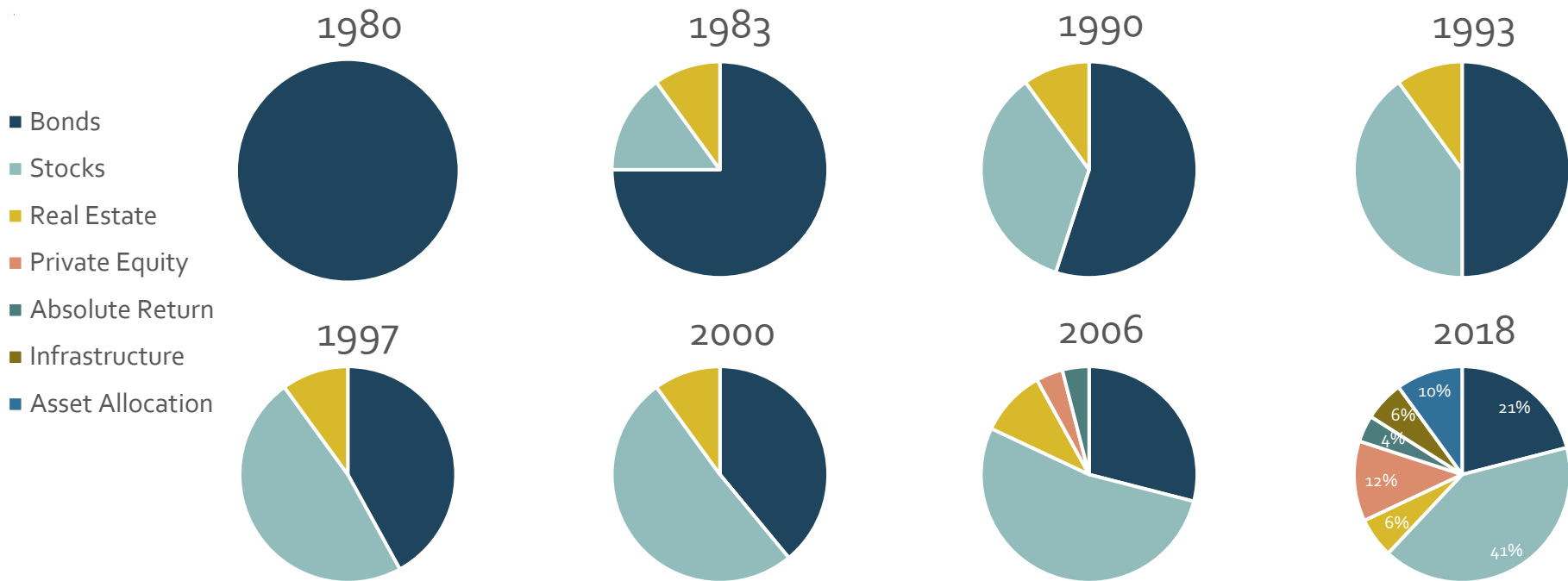
Amended Language:

- Borrowing for any investment vehicle (not just real estate) non recourse to APFC or the Fund
- Increased asset allocation limit for the “Other” category from 5% to 10%

2005 Current Language Adopted AS 37.13.120

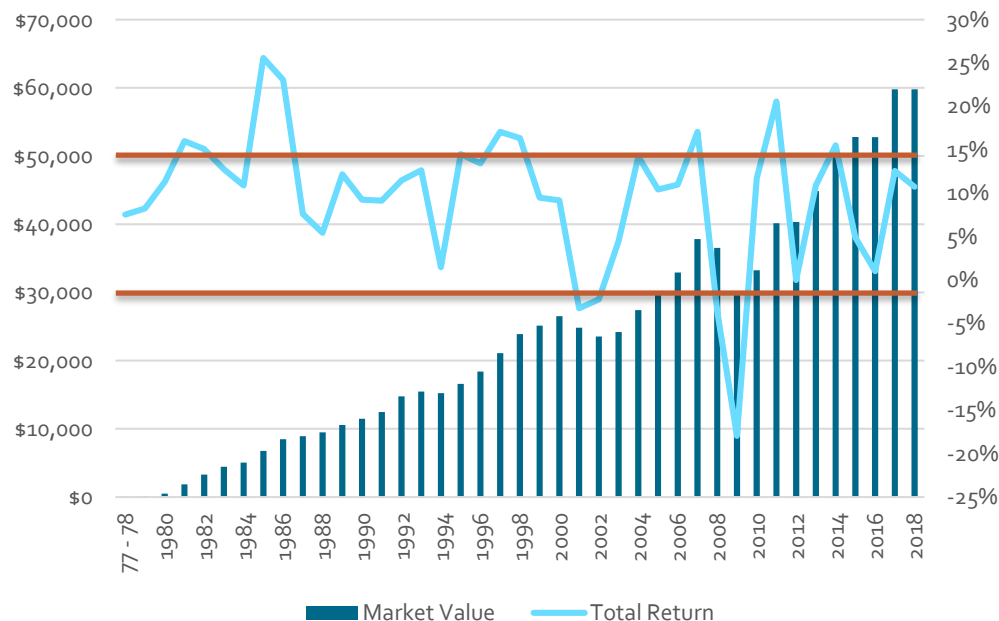
- (a) The board shall adopt regulations specifically designating the types of income-producing investments eligible for investment of fund assets. When adopting regulations authorized by this section or managing and investing fund assets, the prudent-investor rule shall be applied by the corporation. The prudent-investor rule as applied to investment activity of the fund means that the corporation shall exercise the judgment and care under the circumstances then prevailing that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the designation and management of large investments entrusted to it, not in regard to speculation, but in regard to the permanent disposition of funds, considering preservation of the purchasing power of the fund over time while maximizing the expected total return from both income and the appreciation of capital.
- (b) The corporation may not borrow money or guarantee from principal of the fund the obligations of others, except as provided in this subsection. With respect to investments of the fund, the corporation may, either directly or through an entity in which the investment is made, borrow money if the borrowing is nonrecourse to the corporation and the fund.
- (c) The board shall maintain a reasonable diversification among investments unless, under the circumstances, it is clearly prudent not to do so. The board shall invest the assets of the fund in in-state investments to the extent that in-state investments are available and if the in-state investments
 - (1) have a risk level and expected return comparable to alternate investment opportunities; and
 - (2) are eligible for investment of fund assets under (a) of this section
- (d) The corporation may enter into and enforce all contracts necessary, convenient, or desirable for managing the fund's assets and corporate operations, including contracts for future delivery to implement asset allocation strategies or to hedge an existing equivalent ownership position in an investment.
- (e) Before adoption of a regulation under (a) of this section, the regulation, in electronic format, shall be provided to the Legislative Budget and Audit Committee for review and comment. The board shall submit investment reports to the committee at least quarterly.

Historical Asset Allocation based on actuals



Fund Value and Returns in millions

- 1977** The Permanent Fund receives its first deposit of dedicated oil revenues totaling \$734,000. Initial Legislation permitted an investment list that included only fixed income securities such as treasury bonds.
- 1983** Following changes to the statutory investment list, the Fund makes its first investment in the stock market, and later that year, in directly held real estate.
- 1990** After the Legislature expands the statutory investment list, the Fund begins to invest in stock and bond markets outside the United States.
- 2005** The Legislature makes a significant change in how Permanent Fund investments are determined by removing the allowed investment list from state law. The Trustees will make investment decisions under the guidelines of the prudent investor rule.





Investment of the Fund

Today: Investment Responsibilities AS 37.13.120

When adopting regulations or managing and investing fund assets, the prudent-investor rule shall be applied by the corporation. The corporation shall exercise the judgment and care that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the designation and management of large investments entrusted to it, not in regard to speculation, but in regard to the permanent disposition of funds, considering preservation of the purchasing power of the fund over time while maximizing the expected total return from both income and the appreciation of capital.

The corporation may not borrow money or guarantee from principal of the fund the obligations of others. Except the corporation may, either directly or through an entity in which the investment is made, borrow money if the borrowing is nonrecourse to the corporation and the fund.

The board shall maintain a reasonable diversification among investments unless, under the circumstances, it is clearly prudent not to do so. The board shall invest the assets of the fund in in-state investments to the extent that in-state investments are available and if the in-state investment provides the same risk-reward benefit as other investment opportunities.

Allocation Structure

The asset allocation structure is organized by growth and income strategies, as well as liquidity objectives.

This strategic categorization provides a framework for ensuring that investment return targets are commensurate with the risks undertaken.

The Board of Trustees reviews the Asset Allocation annually.

ASSET ALLOCATION STRUCTURE

GROWTH

Tradeable/Liquid
• Public Equities
(Stocks)

Illiquid
• Private Equity
• Absolute Return
• Allocation Strategies

INCOME

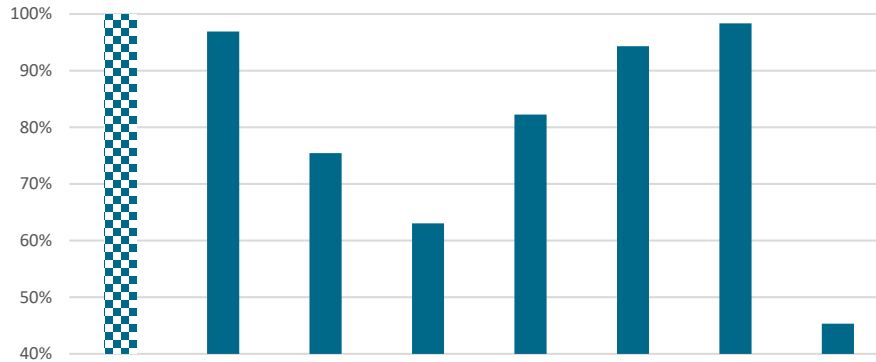
Tradeable/Liquid
• Fixed Income Plus
(Bonds)
• Cash

Illiquid
• Real Estate
• Infrastructure

Each asset class contributes to the total Fund return and provides quality and diversity of the portfolio's investments.

Diversification: Benefit Reflected in VaR Contribution

Ratio of "Contribution VaR" to "Stand-alone VaR"



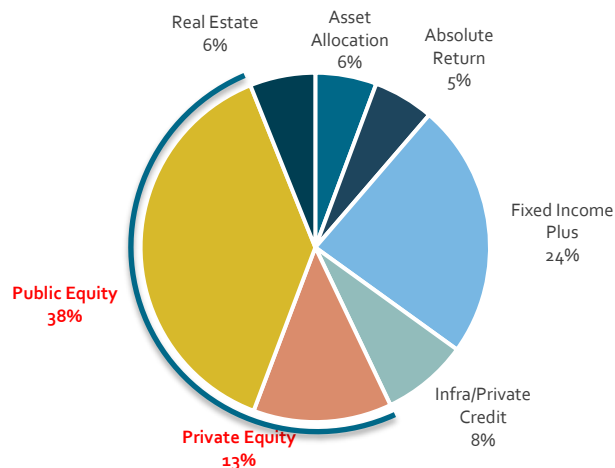
	Total Fund	Asset Alloc.	Absolute Return	FI Plus	Infra & Pvt Crdt.	Pvt Equity	Public Equity	Real Estate
Asset Allocation \$bn	\$65.7	\$3.7	\$3.7	\$15.5	\$5.2	\$8.4	\$25.1	\$4.0
Standalone VaR as % of respective portfolio NAV	17.4%	3.4%	4.6%	6.2%	14.3%	45.1%	24.8%	13.5%

Value at risk (VaR) is a measure of the risk of loss for investments. It estimates how much a set of investments might lose (with a given probability), given normal market conditions.

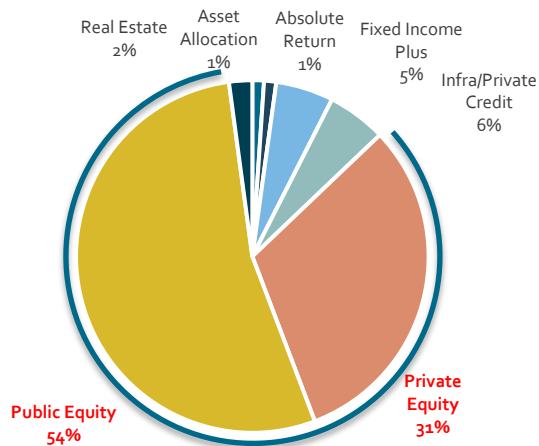
- Private equity continues to have the highest proportionate stand-alone VaR (45.1%), followed by public equity (24.8%)
- Given the high correlation between these two, their respective contribution to overall risk (VaR) is also high.
- On the other hand, the fixed income and real estate exposures increase diversification benefit, with much lower contribution proportions.

Asset Allocation & VaR: Breakdowns

Asset Mix



VaR Mix



Risks are more concentrated

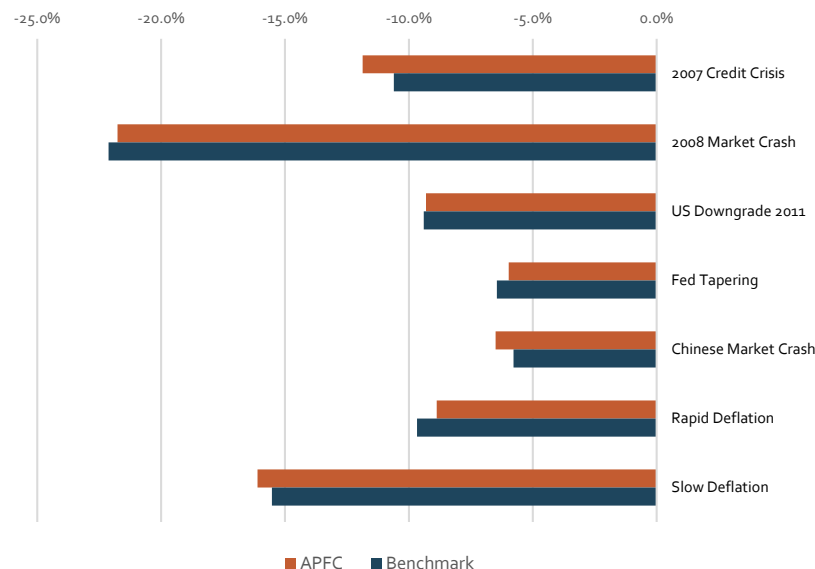
- The Asset mix 'seems' more diversified than actual underlying risks.
- Of the total risk pie, approximately 85% is equity risk (private & public equity).
- Equity (related) risk is likely to exist within Absolute Return and Asset Allocation portfolios as well
- Diversifiers (away from equity risk), which include interest rates/spreads and real estate, aggregate to only about 10% - 13%, in risk terms

Net Asset Value (NAV)	VaR (1 year, 97.5% cl)	VaR (% of NAV)
\$65.7 billion	\$11.4 billion	17.4%

Tail Risk: Current Portfolio During Extreme Events

Tail risk is the risk (or probability) of the chance of a loss occurring due to a rare event, as predicted by a probability distribution. Tail risks include events that have a small probability of occurring, and occur at both ends of a normal distribution curve.

Scenario	Definition
2007 Credit Crisis	Credit & liquidity crisis stemming from a severe slowdown in the housing market causing significant widening of credit spreads and increased implied volatility.
2008 Market Crash	S&P 500 down 20% (2000 bps).
US Downgrade 2011	The period starts with 50% chance US downgrade indication from S&P standards and ends with Operational Twist announcement from the Fed (stock market losses and bond market gains).
Fed Tapering Talk 2013	Equity & bond markets sold off. EM suffered badly due to hot money flight back to U.S.
Chinese Market Crash	Chinese stock market crash beginning with the popping of the stock market bubble on June 12, 2015.
Rapid Deflation	Oil down 60% (6000 bps); ST Inflation down 350 bps; Mortgage spreads tighten 25 bps.
Slow Deflation	LT deflation down 200 bps; LT Treasury Rates down 100 bps; Mortgage spreads tighten 25 bps.



In 3 of the 7 historical scenarios, value decline for APFC is more than the benchmark: the '2007 Credit Crisis', the 'Chinese market Crash', and the 'Slow Deflation' periods.

Performance

as of March 31, 2019

	FY19 9 mos.	3 Years	5 Years
Total Fund	3.07%	9.33%	7.24%
Passive Index Benchmark <small>(60 Stocks 20 Bonds 10RE 10 TIPs)</small>	2.39%	7.43%	4.86%
Performance Benchmark	3.50%	8.31%	6.03%
Total Fund Return Objective CPI+5%	4.60%	7.20%	6.47%



Awards & Accomplishments

- Marcus Frampton, CIO, named one of *Private Equity International's* 40 under 40 Future Leaders of Private Equity and *Trusted Insight's* Sovereign Wealth Fund CIO of the Year for 2019.
- Jared Brimberry, Senior Portfolio Manager was selected as one of *Private Debt Investor's* (PDI) Rising Stars 2019
- Selected as **North American Limited Partner of the Year for 2018** by *Private Equity International*
- APFC received dual nominations for **2018 Partnership of the Year** for *Institutional Investor's Allocators' Choice Awards* and won the award for our Capital Constellation Partnership:
 - Private Market Partnership, Capital Constellation - won
 - Public Market Partnership, Middle East Africa South Asia (MEASA) Fund with McKinley Capital - nominated
- *PEI's Private Debt Magazine* recognized APFC in their inaugural **30 Most Influential Investors in Private Credit**
- Recognized as **North American Private Equity Institutional Limited Partner Investor of the Year for 2017** by *Private Equity International*
- Awarded *Institutional Investor's* Sovereign Wealth Fund of the Year in Hedge Fund Investments in 2017

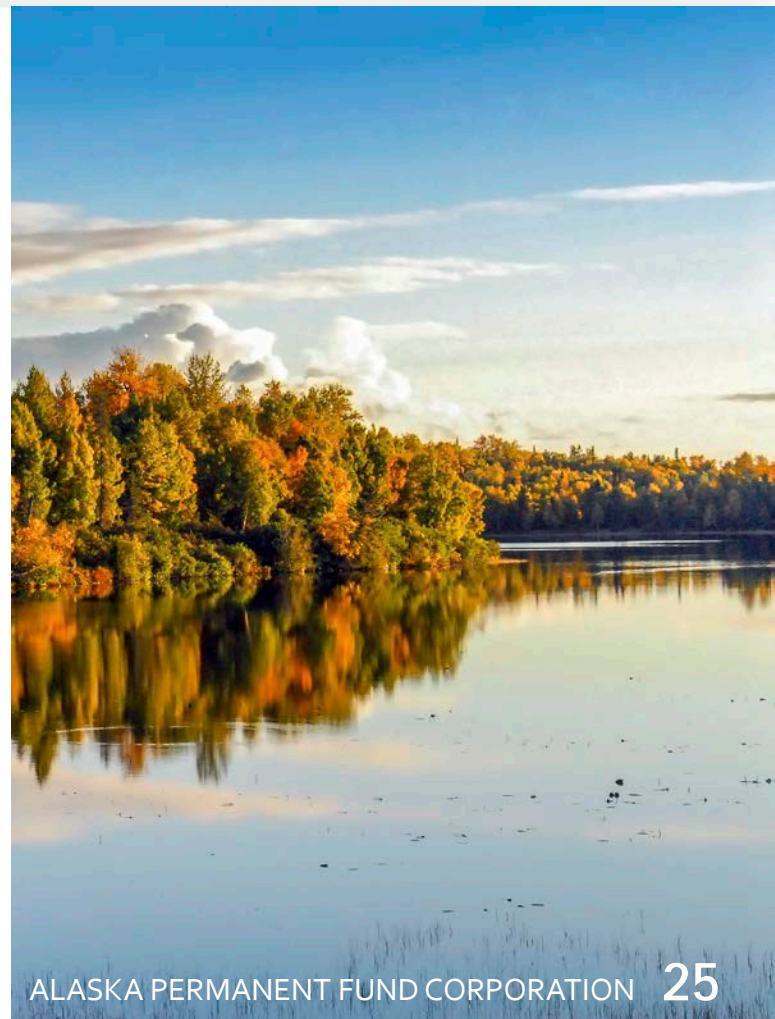
The background of the slide is a solid teal color. Overlaid on this background is a close-up photograph of a pine branch with several long, thin needles and two small, immature pine cones. The image is semi-transparent, allowing the teal background to show through.

Structure of the Fund

The Fund

The Fund is comprised of two accounts which are invested together under the same asset allocation.

- The Principal is constitutionally established and shall only be used for income-producing investments specifically designated by law under AS 37.13.120.
- The Earnings Reserve Account (ERA) is statutorily established under AS 37.13.145(a) to hold the income of the Fund and shall be invested in investments authorized under AS 37.13.120.



Principal as of May 31, 2019

The Alaska Constitution articulates that the Principal shall only be used for income-producing investments. It is permanently protected for all generations of Alaskans.

Contributions to the Principal since Inception:

\$17.2 Billion in Royalties

The State Constitution directs “at least 25% of all” Alaska’s mineral royalties be deposited into the Principal AS 37.13.010 (a)(1). Alaska Statute AS 37.13.010 (a)(2) directs an additional 25% for leases after 1979.

\$16.2 Billion in Inflation Proofing

Protects the purchasing power of the Principal for all generations of Alaskans. The statutory calculation, as set forth in AS 37.13.145(c), is based on the Consumer Price Index applied to the total Principal amount. It is calculated at the end of each fiscal year based on those two numbers and is subject to appropriation by the Legislature.

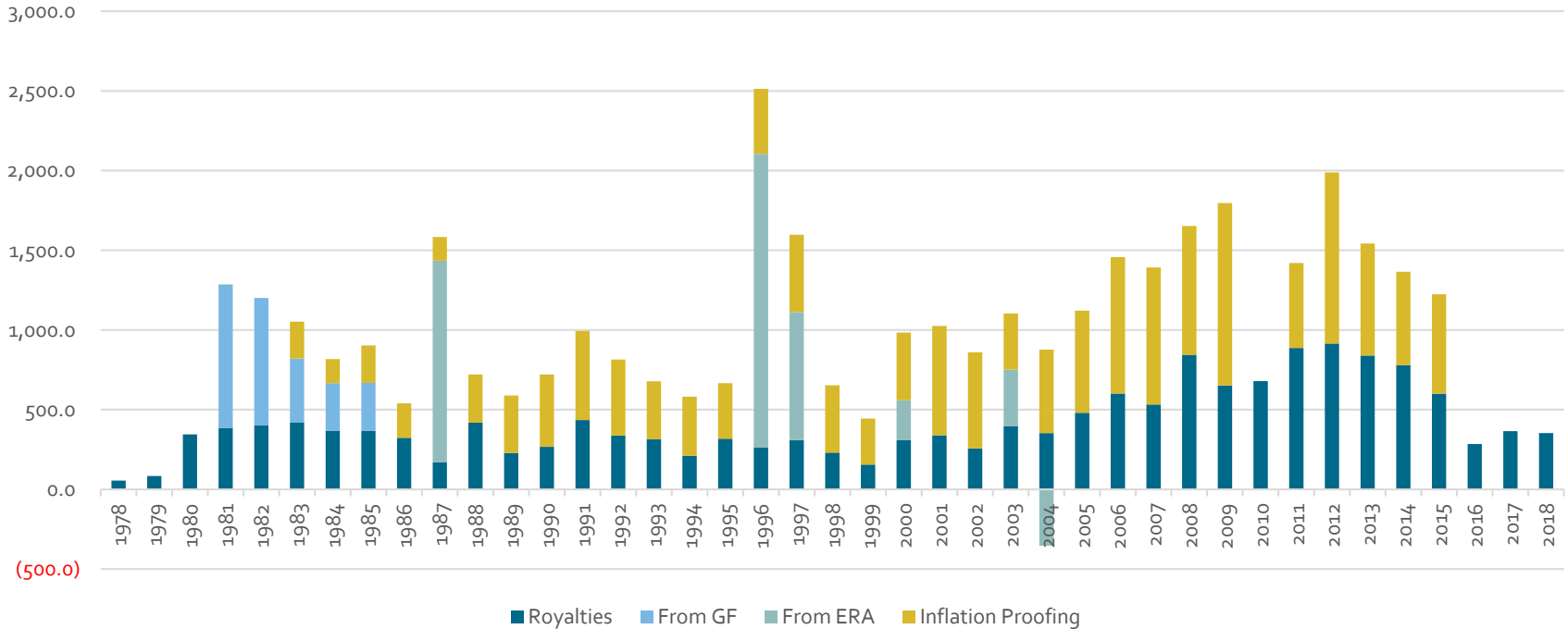
\$7.1 + 9.4 = \$16.5 Billion in Special Legislative Appropriations

Based on legislative actions, appropriations have been made to the Principal from the Earnings Reserve Account \$4.3B and the General Fund \$2.7B. For FY20 the 31st Alaska State Legislature has also authorized a special appropriation of up to \$9.4 Billion from the ERA to the Principal of the Fund to preserve these resources for generations of Alaskans.

~\$4.8 Billion in Unrealized Capital Gains/Losses

The Principal holds a pro-rata share of the cumulative unrealized gains/losses on investment assets from the time they are purchased to present. Once an asset is sold, the realized gains/losses from the investment are directed to the ERA.

Contributions to Principal in millions

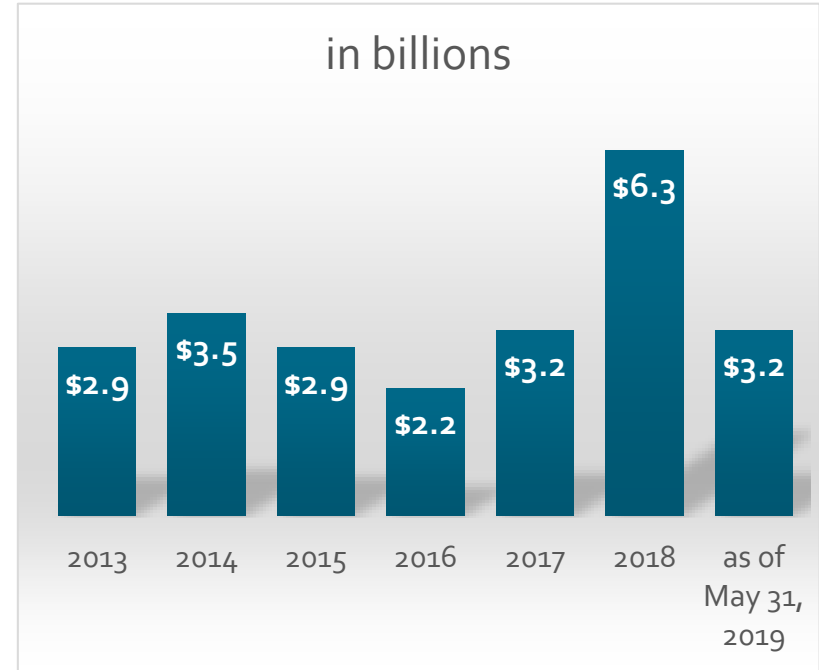


Note: In FY03 the legislature made a special appropriation to principal of \$354.2 million.

In FY04 this was reclassified as pre FY04 inflation proofing in accordance with the FY04 supplemental budget bill.

Statutory Net Income AS 37.13.140(a)

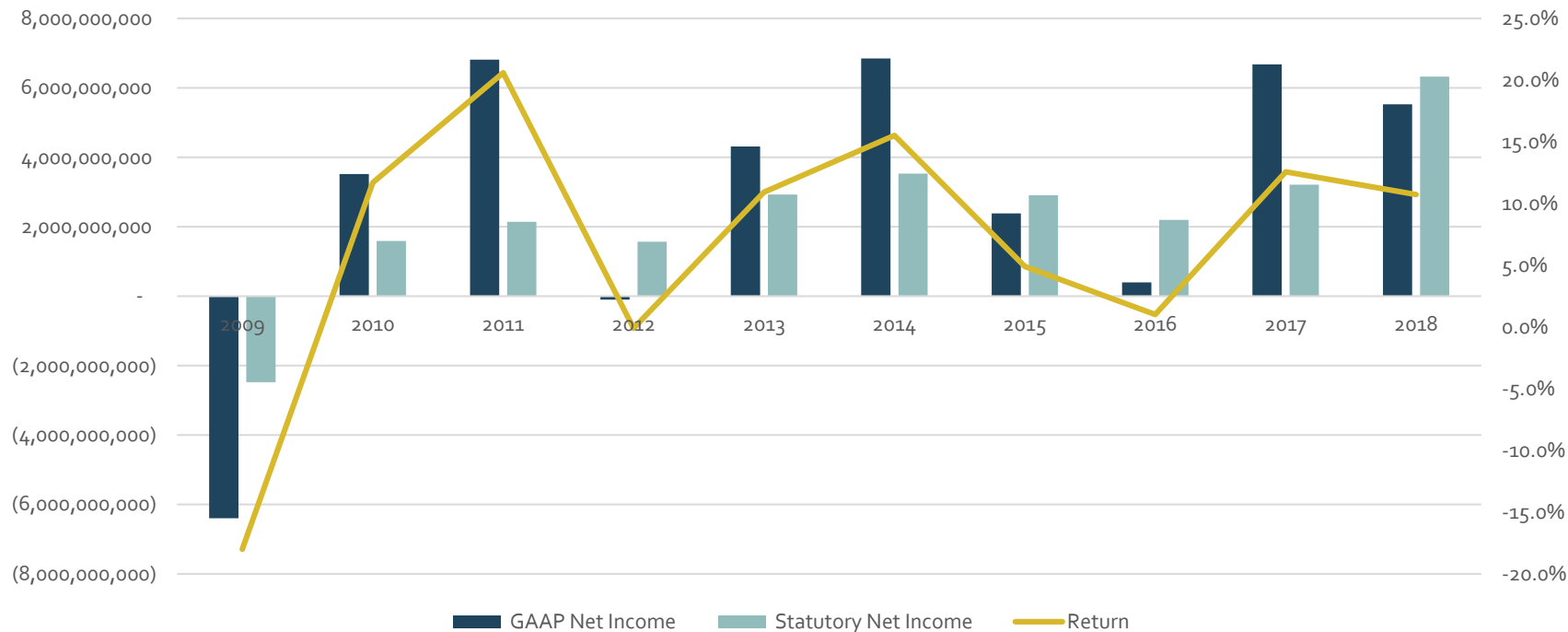
- The Constitution requires all “income” be deposited into the General Fund, unless otherwise provided by law.
- AS 37.13.140(a) Statutory Net Income defines what “income” to the General Fund is, excluding *unrealized gains and losses*, and directs it to the ERA.
- Net realized gains and investment income are the funds in the ERA that are subject to appropriation by a simple majority of the Alaska Legislature.
- Net realized gains =
realized gains accumulated during the fiscal year
(-) minus realized losses accounted for during the year.



Accounting Net Income

- Accounting Net Income includes unrealized gains and thus differs from Statutory Net Income which does not.
- In 1997 , Generally Accepted Accounting Principals (GAAP) changed the definition of accounting income, thus requiring APFC to value all investments at fair market value.
- Fund values must include unrealized gains and losses based on this GAAP rule. This information is provided on our monthly financial statements and in the Annual Report.
- Unrealized gains earned by Principal are part of Principal, upon realization the gains are transferred to the ERA adding to the amount “realized for future appropriation.”

Net Income and Return over the last 10 fiscal years



POMV – AS 37.13.140(b)

The Board of Trustees has long supported the percent of market value (POMV) concept, including a constitutional amendment that would ensure no more than a sustainable amount was taken from the annual earnings of the Permanent Fund.

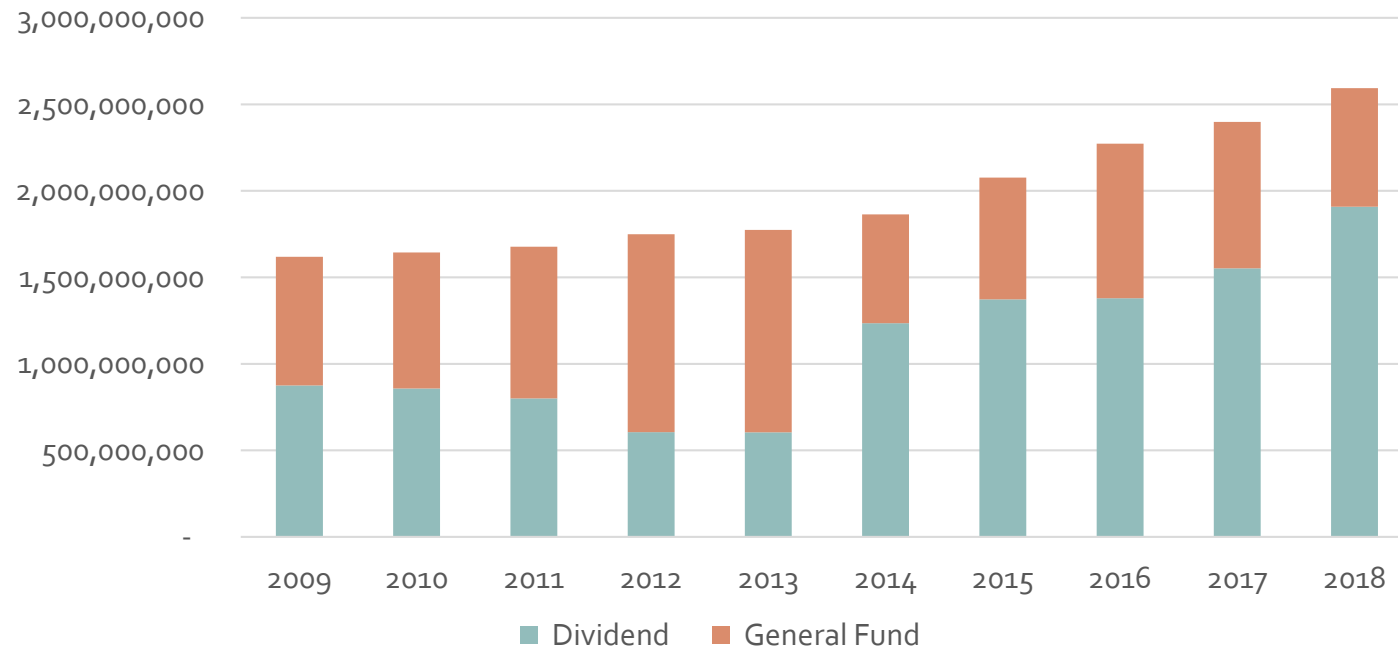
- Resolutions 18-04, 04-09, 03-05 and 00-13.

This methodology is designed to create a *known and manageable* withdrawal structure from the Fund to provide benefits for both current and future generations of Alaskans.

In 2018, the POMV structure was created in statute (SB 26, CH16 SLA 18) – it allows for an annual draw from the Fund of 5.25% (stepping down to 5% in FY22) based on the average market value of the Fund for the first five of the preceding six fiscal years.

- This draw is subject to annual appropriation by the Legislature and can be used for any state government service or program, including the dividend program.
- The POMV draw for FY19 was \$2.7 billion and for FY20 is \$2.9 billion. It is estimated to be \$3.1 billion for FY21.

Illustrative POMV Calculation & Distribution



POMV based on 5% of historic *market values*.

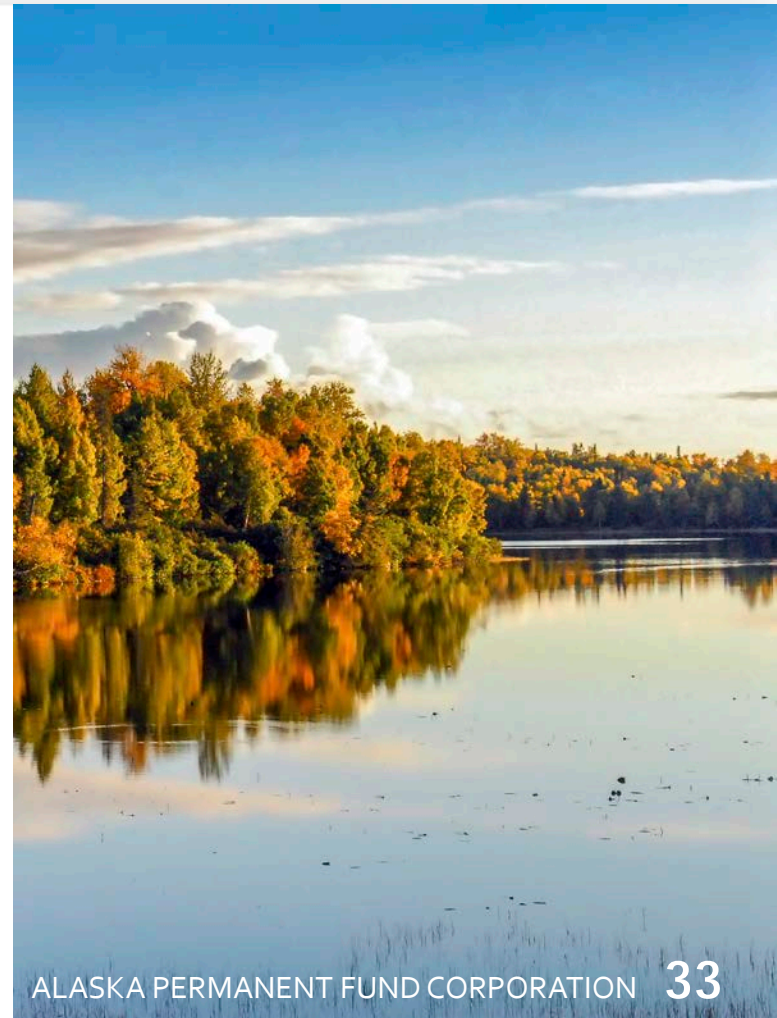
Assumes dividend calculation based on AS 37.13.145(b) - 50% of *net income* available for distribution.

POMV Draws

	Fund Value	Nominal POMV	Effective POMV
FY 19	\$64.9 B	5.25%	4.20%
FY 20	\$66.1 B	5.25%	4.44%
FY 21	\$67.6 B	5.25%	4.57%

POMV is calculated on the average market value of the Fund for the first five of the preceding six fiscal years.

Effective value is based on the projected fiscal year six Fund value at the time of the draw.





Earnings Reserve Account

The ERA is established under AS 37.13.145(a) as an account to hold the net realized earnings from the Permanent Fund's investment portfolio.

This includes monthly income such as stock dividends, interest from bond holdings, real estate rental fees, as well as realized gains/losses from investments that have been sold.

Monthly financial statements posted on APFC's website provide information as to the value of the Fund and the ERA at the end of each month.

As of May 31, 2019, the value of the ERA totals \$19.0 billion. This includes \$17.0 billion of accumulated realized earnings of which \$3.9 billion is recognized as being committed/appropriated to the FY20 POMV draw and to Inflation Proofing the Principal. There are also \$2.0 billion in unrealized gains attributed to the ERA's pro-rata share of Fund investments that have not been sold.

On June 30, at the end of each fiscal year, Fund values are "trued up" and closed in conjunction with the completion of an annual, independent financial audit.

The ERA does not have its own investment mandate.

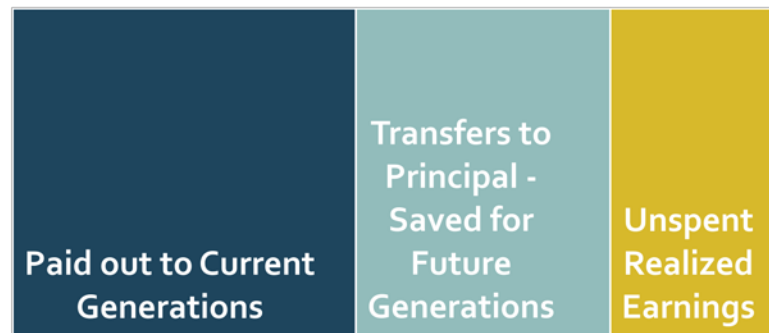
The ERA is subject to legislative appropriation.

Use of Fund Earnings from ERA Since Inception

projected with close of FY19 on June 30, 2019

- **Paid out of ERA = \$30.8 B**
 - Dividend Transfers = \$24.4B
 - POMV (FY19-20) & GF Appropriations = \$6.1B
 - Alaska Capital Income Transfers = \$367.9 m
- Transfers from ERA to Principal = \$21.4 B
 - Inflation Proofing
 - Special Appropriations
- Unspent Realized Earnings in ERA = \$13.7 B

TOTAL \$66.1 B



Earnings Spent \$30.8 Billion
Earnings Saved \$35.3 Billion

Annual Use of ERA

- POMV rules based structure for Fund withdrawals maintains the long term sustainability of the Fund.
- Inflation Proofing AS 37.13.145 (c) protects the future value of the Principal.
- 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	FY19	FY20
Percent of Market Value – POMV	2,722,600,000	2,933,084,100
Inflation Proofing the Principal	942,000,000	943,000,000
APFC Operations	18,074,600	17,800,400
APFC Investment Management Fees	150,498,700	155,795,000
Dept. of Law	2,619,100	2,617,700
Dept. of Natural Resources	6,044,800	6,132,600
Dept. of Revenue	94,500	97,900

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

FY20 Fund Appropriations HB 39 Language

From
ERA to
General
Fund

\$2.9 billion
FY20 POMV

\$27.0 million
Capital Income Fund
(Amerada HESS)

To
Principal
from
ERA

\$943 million
FY20 Inflation Proofing

\$9.4 billion
Special Appropriation
(following all other FY20 ERA
appropriations)

To
Principal
from
Royalties

\$329.2 million
Constitutional Royalties 25%
(FY20)

\$251.1 million
Statutory Royalties +25%
(FY18-FY20)

The Fund: Alaska's Renewable Resource

Board of Trustees Resolutions 18-01 and 18-04
Affirm the Importance of a Rules Based System

- Structure and Predictability
- Ability to Plan
- Investment Management Best Practice.

The Math

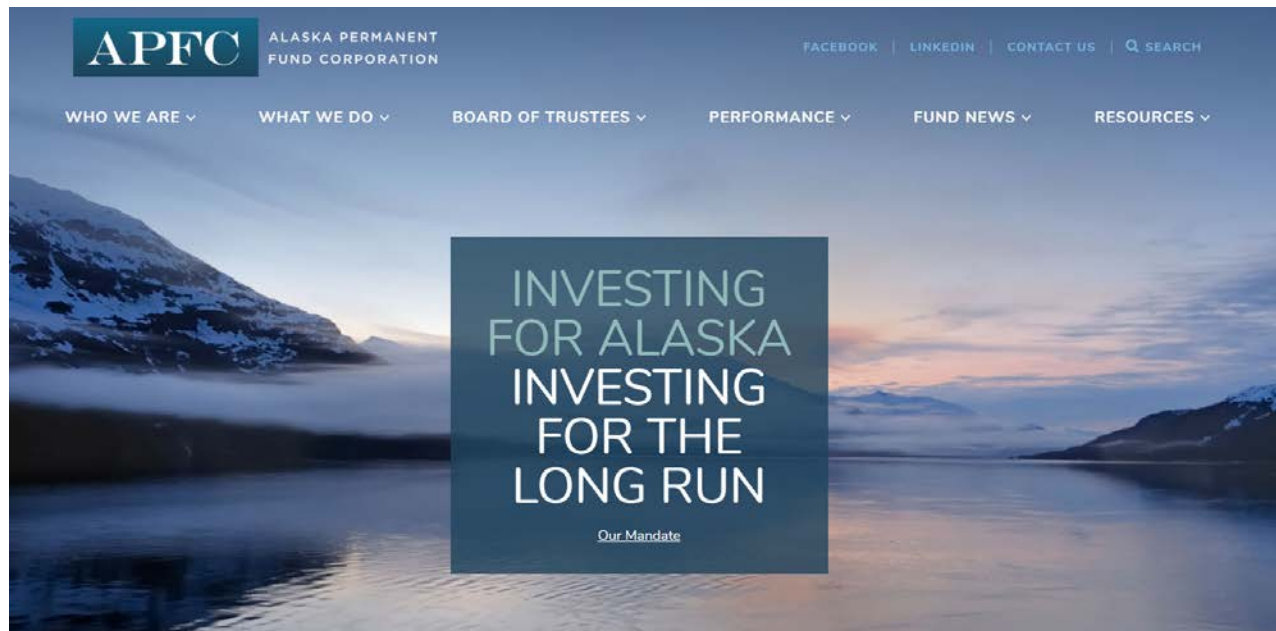
- More Drawn = Less Available for Future Expenditures and Generation of Investment Income.
- Spend Today or Invest for Tomorrow.



A scenic landscape photograph of a calm lake with snow-capped mountains in the background. A bright sun is visible in the upper right sky, creating a lens flare effect. The foreground shows a rocky shoreline with small waves. The word "Questions" is centered in the image in a white, sans-serif font.

Questions

Additional Resources



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