

SENATE FINANCE COMMITTEE  
February 6, 2015  
9:02 a.m.

[9:02:13 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:02 a.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair  
Senator Pete Kelly, Co-Chair  
Senator Peter Micciche, Vice-Chair  
Senator Click Bishop  
Senator Mike Dunleavy  
Senator Lyman Hoffman  
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Michael Burns, Executive Director, Alaska Permanent Fund Corporation (PFC), Department of Revenue; Laura Achee, Director of Communications and Administration, Alaska Permanent Fund Corporation, Department of Revenue.

SUMMARY

^PRESENTATION: ALASKA PERMANENT FUND CORPORATION

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MICHAEL BURNS, EXECUTIVE DIRECTOR, ALASKA PERMANENT FUND CORPORATION (PFC), DEPARTMENT OF REVENUE, began his presentation(copy on file). He turned to Slide 2, "Renewable resource":

- \$18.1 billion - deposited in Fund to date
- \$21.6 billion - dividends paid to date
- \$52.5 billion - current value

He relayed that of the \$18.1 billion in deposits, \$15.3 billion was in royalties. He presented slide 3, "FY2014 Performance":

- Total return - 15.5 percent
- Benchmark return - 15.7 percent
- Ending Balance - \$51.2 billion
- Change from FY13 - \$6.3 billion
- Dividend - \$1.2 billion

He explained that the corporation was structured conservatively, with less exposure to equities than some of its peers. He opined that the approach had slightly hurt the corporation, but was appropriate for the Fund. He noted (not on slide) that the actual income of the Fund was \$6.8 billion.

[9:05:56 AM](#)

Mr. Burns clarified that the change in the value of the Fund was \$6.3 billion, and took into consideration the in-flows from oil royalties and the dividend being dispersed; the actual gap earning of the Fund was \$6.8 billion.

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Vice-Chair Micciche requested an explanation the membership of the Alaska Permanent Fund Board, and a synopsis of the board's responsibilities. He understood that the board was appointed by the governor.

Mr. Burns responded that by statute the requirements to be on the board were pretty open ended, among them a background in business, accounting or finance investments. He noted there were four public members; one seat per year was appointed by the Governor; two Commissioners were members, one of which must be the Commissioner of Revenue.

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Vice-Chair Micciche referred to Slide 3. He wondered why the return was lower in 2014 than that of the retirement system.

Mr. Burns responded that returns varied from year-to-year and that the corporation had a longer profile horizon than the retirement system. He said that the Fund took advantage of private assets and had less exposure to equity markets than the retirement system.

[9:10:17 AM](#)

Mr. Burns turned to Slide 4, "Fund Performance," which was for periods ending June 30, 2014. The bar graph on the slide charted the Permanent Fund, the Benchmark, and the Median Public Fund. He noted that it was challenging to define the "benchmark" as evidenced in the slide. He added that the corporation was unique and had few peer groups; there were seven other corporations in the country with similarly structured permanent funds.

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Vice-Chair Micciche asked what types of funds were invested into the Median Public Fund.

Mr. Burns responded primarily be private pension funds; APFC was not a pension, but The Median Public Fund generally was comprised of state, large county, and city pension funds.

Vice-Chair Micciche asked whether the Public Median Fund was heavy on equities.

Mr. Burns reiterated that APFC maintained lower equity exposure. He said that there was a significant difference between the Alaska Retirement System and APFC over that last year in equities. He stated that he could not offer numbers over the past 5-10 years. He added that the APFC was historically on the more aggressive side investment-wise, but had not been the past 18 months. He relayed that the fiscal climate on the national level over the past few years had made the corporation more conservative in its investments. He asserted that the APFC investments and portfolio was performing well, and there was a strong belief in the corporation in reversion to the mean. He shared that APFC's real estate portfolio was performing successfully and that for the first time the APFC had purchased real estate internationally.

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Mr. Burns recalled that on March 9th, 2009; when the market was so incredibly cheap that the corporation was compelled to invest APFC put \$800 million into an S&P Index account, which was worth approximately \$3 billion in 2015. He offered that value could sometimes be found in "running toward the fire."

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Senator Bishop asked whether the corporation was "running toward the fire" when choosing current energy investments.

Mr. Burns responded in the affirmative. He said that APFC had made substantial commitments over the past year to

carbon. He added that APFC had money already committed, but as of yet uninvested, in the energy sector.

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Mr. Burns presented Slide 5, "\$52.4 billion as of 12/31/14": He pointed out the unrealized gains, represented by the smallest yellow triangle on the pie chart. He explained that should the legislature want to appropriate money from the fund, the small yellow triangle was not available. The slide included "assigned earnings reserve", \$7.8 billion; and "nonspendable principal", \$44.6 billion.

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Mr. Burns moved to Slide 6, "Target asset allocation":

- Stocks - 36 percent
- Bonds - 20 percent
- Real Estate - 12 percent
- Other - 12 percent
- Absolute return - 6 percent
- Private Equity - 6 percent
- Infrastructure - 4 percent
- P/P credit - 2 percent
- Cash - 2 percent

He noted that many of the smaller pieces of the pie chart had equity-like returns. He pointed out that the states investment stocks was not really as low as 36 percent once exposure to equity was considered.

[9:20:31 AM](#)

Mr. Burns presented Slide 7, "The effect of diversification." He explained that the yellow line was what the total fund had done over the years.

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Vice-Chair Micciche stated that he would like to see Fund returns by asset class over the past 10 years.

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LAURA ACHEE, DIRECTOR OF COMMUNICATIONS AND ADMINISTRATION, ALASKA PERMANENT FUND CORPORATION, DEPARTMENT OF REVENUE interjected that the information was accessible on the APFC website. She returned to Slide 6 to discuss how the investment policy had changed over time. She explained that in 1980 the Fund was invested entirely in bonds and in the

early 1980's U.S. stocks and real estate were added to the mix. She continued saying that in early 1990, APFC moved into non U.S. stocks and bonds. She relayed that in 2005, shortly after APFC began adding alternative assets, the legislature removed the statutory list, which gave the board authority to pass regulations that defined the corporation's investments. In 2013 the corporation added the first direct investments to private assets, made by the staff and not through gatekeepers, and in 2014 investments in non U.S. directly head real estate was added to the portfolio.

[9:22:38 AM](#)

Mr. Burns turned to Slide 8, "Fund advantages":

Size - Access to investments  
Ability to negotiate fee savings

Time Horizon - No set liability

He stated the APFC had access to all of the best investments and investment advisors in the world and were a preferred client, which gave them the ability to negotiate better fees. He noted providers were much more attuned to customers wants than in the past. He said that there was no set liability because the Fund was not a pension fund, did not have monthly draws to accommodate, and had the ability to take a long term view while investing. He believed that the state, like the corporation, should take a long term view when making future investments.

[9:24:19 AM](#)

Mr. Burns moved to Slide 9, "Fund Challenges":

Location - Business travel to financial centers  
Recruitment from financial centers

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

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

Mr. Burns relayed that attracting and retaining talent to the state was a challenge. He shared that people self-selected into the market and once they arrived in the state they wanted to stay, but the challenge existed. He furthered that the resource resourcing of the corporation was difficult through the slow budget process; the investment world moved faster than the political world.

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Senator Bishop commented that he would be interested in a cost benefit analysis on the three Fund challenges of location, flexibility, and staff size.

Mr. Burns noted that, contrary to popular opinion, outsourcing was not cost effective. He added that when the corporation paid someone out-of-state to manage its money, the cost was "gargantuan." He clarified that the corporation would not pay for mediocrity simply to insource, but that outsourcing was very expensive.

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Vice-Chair Micciche asked whether it was appropriate to purposely look to hire from outside of the state.

Mr. Burns responded that APFC frequently look outside the state for new hire, and at least half of the current 37 employees were from out of state, 80 to 90 percent of which were on the investment side.

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Co-Chair MacKinnon announced that she had been involved in putting together a tour of the APFC operations center. She encouraged members to take the tour.

Mr. Burns turned to Slide 10, "Stock Portfolio," which boasted \$20.4 billion as of June 30, 2014. The slide listed the breakdown of the stock portfolio; by country or region; by mandate: U.S., Global, Non-U.S.; by management: Active, Passive, Quasi-passive.

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Mr. Burns stated that in 2014 the U.S. portfolio returned 27 percent, non-U.S. returned 20 percent, and the global portfolio returned 25 percent.

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Mr. Burns moved to Slide 11, "Top 5 stocks as of 12/31/2014," and noted that Apple was at \$195 million.

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Mr. Burns continued to Slide 12, "Bond portfolio composition. The portfolio showed \$12.0 billion as of June 30, 2014, comprised of:

- U.S. Corporate - 45 percent

- U.S. Treasuries - 20 percent
- Non-U.S. Corporate - 16 percent
- Non-U.S. Government - 10 percent
- Mortgage-backed - 7 percent
- CMBS - 3 percent

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Mr. Burns spoke to Slide 13, "Bond Portfolio management," and highlighted that the corporation had increased internal management, this was due to the legislature giving APFC the resources to bring international fixed income in-house.

Ms. Achee interjected that the total cost for the change had been under \$300,000.

Mr. Burns said that the move had saved APFC approximately \$1 million in fees.

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Senator Dunleavy asked whether APFC invested in Alaska.

Mr. Burns responded infrequently due to lack of opportunity. He said that the scale in-state was too small.

Senator Dunleavy inquired whether regulations had prohibited the APFC from investing in large-scale projects, for example, the Alaska Gas Pipeline.

Mr. Burns replied that regulations would not prohibit the corporation from investing, but that it might be prudent to invest too much money.

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Ms. Achee added that there was a statute that directed the corporation that if two investments were equal in risk and return profiles, the in-state project must be chosen. She relayed that the Funds investments in infrastructure had come from discussions at the board level regarding investing in a gas pipeline. The investment size would depend on the scope of the Fund.

[9:34:21 AM](#)

Mr. Burns turned to Slide 14, which was a map of APFC real estate holdings.

[9:34:37 AM](#)

Mr. Burns moved to Slide 15, "Real estate," which was a pie chart detailing various real estate investments properties:

- Office - 27 percent
- Retail - 26 percent
- Multifamily - 23 percent
- REITs - 20 percent
- Industrial - 5 percent
- \$5.9 billion as of June 30, 2014
- 5 U.S. direct equity managers
- 1 Real Estate Investment Trust manager(REIT)

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Mr. Burns moved to Slide 16, "Tysons Corner Center." The project was near completion. The slide illustrated a 400 plus unit apartment building that would begin leasing in April 2015. The building in the center was a 550,000 square foot office building, which was 80 percent leased. The smallest building on the page was a 340 room Hyatt-Regency hotel. The slide also showed the new plaza at the entrance of Tysons Corner Mall and the new walkway out to the metro. The structures \$600 million addition to the property.

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Co-Chair MacKinnon asked where the property was located.

Mr. Burns clarified that it was at Tysons Corner Shopping Center in Fairfax, Virginia. He added that the center was referred to as a "fortress mall" because there was nowhere to build another mall near it, stifling competition.

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Senator Hoffman asked for the percentage of investment APFC had in the center.

Mr. Burns replied 50 percent. He said that the corporation's partner was a publicly traded, real estate investment trust that managed malls.

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Mr. Burns presented Slide 17, "Simpson Housing LLLP," and explained that the corporation was 50/50 partners with the

state of Michigan in the ownership of 20,000 apartment units across the country. He highlighted that the corporations share was valued at \$992 million as of June 30, 2014.

[9:37:42 AM](#)

Mr. Burns noted that Slide 18 and 19 pictured several of the properties housed under Simpson Housing LLLP.

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Mr. Burns showed Slide 20, "American Homes 4 Rent." He said that the corporation's special opportunities were divided into two categories: generating excess returns or reducing risk. He shared that the balance had been heavily toward reducing risk, but more was currently being done to generate excess returns. He stated that America Homes 4 Rent had begun as a partnership with friends in California, buying single family homes in foreclosure. He furthered that a private real estate investment trust was formed, all of the real estate was put into one company, the company went public, and APFC now owned 24 percent of the public company. He relayed that the corporation currently had approximately \$800 million in market value shares.

[9:39:55 AM](#)

Mr. Burns presented slide 21, "CityCentre II, III and IV," which illustrated an office and retail, 400,000 square foot building in Huston, TX.

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Mr. Burns continued to Slide 22, "Parc Huron," which showed the 221 unit, residential, Parc Huron building in Chicago, IL.

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Mr. Burns spoke to Slide 23, "The Shops at North Bridge," which was in Chicago on the corners of Michigan and Rush Streets. He clarified that the state and its partners owned the retail spaces and expected to expand.

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Mr. Burns continued to Slide 24, "Non-U.S. real estate," which consisted of the Golden Square Shopping Center in Warrington, UK and Zenia Boulevard Shopping Center in Alicante, Spain. He shared that the corporation was looking into two centers in Portugal and one in Poland.

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Co-Chair MacKinnon asked about the investments in retail real estate. She wondered how online shopping played into the corporation's future.

Mr. Burns replied that all successful retail currently went through three channels: the traditional brick and mortar center, online, and discount retailers, such as Nordstrom Rack. He assured the committee that APFC was mindful of the channels when making investments. He added that adding the hotel, offices and apartments to the Tyson Corner Center created live, work, play environment, complete with mass transit.

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Senator Bishop understood that Nordstrom Rack was where one could find good deals on merchandise.

Mr. Burns replied in the affirmative.

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Co-Chair MacKinnon interjected that the discount retailers included outlet malls and other areas where people brought in a low price on designer items.

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Mr. Burns moved to Slide 25, "Real estate management," and noted that the APFC had had no additional staff since 1998. He pointed out to the committee that in 1998 the value of the portfolio was \$1.2 billion, with a 32 percent controlling ownership percent of the portfolio. He said that in 2015, the APFC had \$5.9 billion in real estate and an 80 percent controlling ownership.

Ms. Achee states that the rise in percentage created a different workload for their investment staff; minority

owners were waiting primarily for reports to come in, majority owners were dealing with things more hands-on.

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Vice-Chair Micciche understood that the APFC had a lower percentage of real estate holdings in 2015, than in 1998.

Ms. Achee responded that in 1998 the corporation portfolio was approximately 10 percent in real estate and now the target was 12 percent.

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Co-Chair MacKinnon surmised that the APFC board had been established in state statute in order to keep politics out of investment decisions.

Mr. Burns replied yes. He felt that the balance was working well.

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Mr. Burns turned to Slide 27, "Infrastructure holdings," which illustrated that assets valued \$1.1 billion as of June 30, 2014; the corporation had properties in the U.S., U.K., India, Argentina and Canada and had implemented a co-investment program in FY 14. The circle graph on the slide showed 45 percent holdings in transportation, 41 percent in energy and 14 percent in water and waste management. He spoke to the details of the co-investment program and noted that the corporation needed more staff to manage the program.

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Vice-Chair Micciche asked if the legislature moved forward with Percent of Market Value (POMV), how would asset allocations, investment policies and fund managers specialties change. He wondered whether the fund would be managed differently if it were to be drawn from to help balance the budget.

Mr. Burns replied that management of the fund would remain the same. He said that the fund was currently managed for total return, and would manage it the same as if it were a

POMV. He said that it would be similar to drawing funds to pay out the dividend.

Vice-Chair Micciche expressed concern that reducing risk significantly would also reduce returns and that a draw could drive the board to be more conservative in future investments.

Ms. Achee interjected that the POMV concept brought forward by the board did not mandate a draw from the fund, it would change the accounting of what would be available from the fund if the legislature chose to appropriate it.

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Co-Chair MacKinnon thought that the public would be concerned that their permanent fund dividends could be affected. She asked whether a POMV in 2009 would have resulted in higher dividends over the years, or would the destabilization of the market lowered and averaged it out to current numbers.

Mr. Burns believed that it would average out the same.

Co-Chair MacKinnon felt that the issue warranted further discussion. She noted that time was short and hoped that the committee could invite the presenters back to finish their presentation.

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Mr. Burns offered that approximately fifteen months ago, APFC formed several partnerships and put funds into forming a company called Juneau Therapeutics, which had gone public. He said that APFC owned one-third of the company, totaling 25 million shares at \$40 per share. He expressed excitement at the long-term possibilities of the company and its success at fighting cancer.

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ADJOURNMENT

[9:55:13 AM](#)

The meeting was adjourned at 9:55 a.m.

