

ALASKA STATE LEGISLATURE
SENATE STATE AFFAIRS STANDING COMMITTEE

February 16, 2017

3:30 p.m.

MEMBERS PRESENT

Senator Mike Dunleavy, Chair
Senator David Wilson
Senator Cathy Giessel
Senator John Coghill
Senator Dennis Egan

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

SENATE BILL NO. 21

"An Act relating to appropriations from the income of the Alaska permanent fund; relating to the calculation of permanent fund dividends; and providing for an effective date."

- HEARD & HELD

SENATE BILL NO. 26

"An Act relating to the Alaska Permanent Fund Corporation, the earnings of the Alaska permanent fund, and the earnings reserve account; relating to the mental health trust fund; relating to deposits into the dividend fund; relating to the calculation of permanent fund dividends; relating to unrestricted state revenue available for appropriation; and providing for an effective date."

- HEARD & HELD

DISCUSSION: Angela Rodell~ Executive Director~ Alaska Permanent Fund Corporation.

- HEARD

PREVIOUS COMMITTEE ACTION

BILL: SB 21

SHORT TITLE: PERMANENT FUND: INCOME; POMV; DIVIDENDS
SPONSOR(s): SENATOR(s) STEDMAN

01/18/17 (S) READ THE FIRST TIME - REFERRALS
01/18/17 (S) STA, FIN
02/02/17 (S) STA AT 3:30 PM BUTROVICH 205
02/02/17 (S) Heard & Held
02/02/17 (S) MINUTE(STA)
02/16/17 (S) STA AT 3:30 PM BUTROVICH 205

BILL: SB 26

SHORT TITLE: PERM. FUND: DEPOSITS; DIVIDEND; EARNINGS
SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

01/18/17 (S) READ THE FIRST TIME - REFERRALS
01/18/17 (S) STA, FIN
02/07/17 (S) STA AT 3:30 PM BUTROVICH 205
02/07/17 (S) Heard & Held
02/07/17 (S) MINUTE(STA)
02/16/17 (S) STA AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

SENATOR BERT STEDMAN
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Sponsor of SB 21, provided an overview.

RANDALL HOFFBECK, Commissioner
Alaska Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Reviewed SB 26.

ANGELA RODELL, Executive Director
Alaska Permanent Fund Corporation
Juneau, Alaska

POSITION STATEMENT: Answered question regarding the possible impact on the permanent fund from SB 21 and SB 26.

ACTION NARRATIVE

3:30:44 PM

CHAIR MIKE DUNLEAVY called the Senate State Affairs Standing Committee meeting to order at 3:30 p.m. Present at the call to order were Senators Wilson, Giessel, Coghill, Egan, and Chair Dunleavy.

SB 21-PERMANENT FUND: INCOME; POMV; DIVIDENDS

[3:31:34 PM](#)

CHAIR DUNLEAVY announced the consideration of SB 21.

[3:31:57 PM](#)

SENATOR BERT STEDMAN, Alaska State Legislature, Juneau, Alaska, sponsor of SB 21, stated that the bill is before the committee for the second time and provided an overview as follows:

In essence what this bill does, rather than address a packet solution for the budget deficit is to take a look at the permanent fund or big-earning engine of roughly \$55 billion and take a look at that as far as how much it could produce in payouts that would include dividends or other sources of expenditures, and what percent we can pull out of that and how could we manage that asset to protect if for future generations of Alaskans.

We were fortunate enough to be here when we had the massive wealth oil-bubble run through the state; unlike some of our grandfathers or grandparents who missed it just due to the age cycle or future generations of Alaskans that aren't even born yet, that they can see, especially the future generations, can see that we secured a vast amount of the wealth bubble for their benefit also, that we don't use it over the next dozen year or less on ourselves.

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SENATOR STEDMAN specified what SB 21 does as follows:

This bill what it does it would limit the withdrawal annually to 4.5 percent of the market value and there's an averaging over the last five years that takes place, so you don't take just the last year's ending balance, but you back up six years and take the first five of that, so it makes it very predictable for the budgetary folks to know exactly what revenue they would have.

A 4.5 percent withdrawal on average over time the market should and returns should suffice and there will be other presenters with better backgrounds that

can address that to the committee to ensure that we don't diminish the purchasing power and or spend down the fund. Of that 4.5 percent, 2.25 percent would be, or one half of it would go to dividends automatically, to the citizens, and that would grow over time. The other 2.25 percent of the 4.5 percent, the other 2.25 percent or one half, could be added to the dividends if we are so fortunate as to have robust economies and an easy time balancing the budget, it could also go back to the permanent fund, or could be used, which would happen over the next several years go to the general fund of the state to help us when we have financial difficulties like we have today. So that would ensure that the public gets 50 percent of it in a dividend, the other 50 percent every year would come before the Legislature and the elected body would decide to add it to the dividends, send it back to the permanent fund, or take it to core services like education or health and human services or what have you.

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SENATOR STEDMAN summarized as follows:

In a nutshell, that's what this bill does; again, it's not a one-bill solution to our deficit issue, but it's a protective mechanism to ensure that we have a very valuable asset for future generations to be able to rely on also, that we don't basically, we the Legislature, including myself, all 60 of us, all good intended elected officials, collectively we can be dangerous, don't start taking chunks out, the billions, and hurt the last 40 years of wealth accumulation.

CHAIR DUNLEAVY remarked that during the past several years there have been people trying to sell that using the permanent fund would be immune from market fluctuations versus the volatile oil markets. He asked Senator Stedman to confirm that the permanent fund is not immune from fluctuations.

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SENATOR STEDMAN answered correct. He pointed out that SB 21 uses five years of market values to smooth out volatility. He noted that he worked with the City of Sitka 30 years ago in changing their all-bond portfolio to a percentage of market value that took a five-year average. He noted that unlike SB 21 with a 4.5-

percent payout, Sitka chose a 6-percent payout. He admitted that Sitka's 6-percent payout has shown to be too high and their fund's purchasing power has decreased. He emphasized that the financial markets are not linear and noted that the economy has experienced 3-economic shocks over the past 30 years; however, a withdrawal based on averages from 4 to 6 years smooths out fluctuations and makes things more predictable.

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CHAIR DUNLEAVY asked Senator Stedman to dispel the notion that withdrawing funds from the permanent fund will take care of the state's fiscal issue.

SENATOR STEDMAN concurred with Chair Dunleavy. He noted that SB 21 is a bill for statutory change rather than constitutional change. He admitted that the Legislature could still get around the bill's 4.5 percent withdrawal by spending the earnings reserve which is not protected by the constitution. He disclosed that approximately \$14 billion is available for the Legislature, "To get its hands on." He pointed out that if SB 21 was adopted in the constitution as an amendment, the Legislature would never be able to take more than the 4.5 percent in any given year without the permission of the citizens.

He addressed scenarios on the Legislature sharing the 4.5 percent withdrawal with Alaskans as follows:

That 4.5 percent, if we gave them no dividend out of it and took it all to the general fund we could probably make it work and get out of this hole; I think that's politically not attainable and I personally would not support it. I think if we have a sharing relationship with the dividends, with the people, with the state, there's a balance clearly. If we take it all to the general fund, the whole 4.5 percent, we are going to pretty much fix our problem, make it pretty easy to get out of; but, if we take none of it and it all goes to the dividends, we can't get out of this hole, I don't see any mathematical way we can do it. So somewhere there's a balance and that in lies the 50 percent split and I think hopefully gets the public's support behind it.

CHAIR DUNLEAVY reiterated that the permanent fund will not be a constant flat stream and will not take care of the state's fiscal problems. He pointed out that the state's fiscal problem

is so great that \$1.2 billion to \$1.5 billion draws would be nowhere near the \$2.8 to \$3 billion deficit.

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SENATOR STEDMAN answered correct. He set forth that a withdrawal from the permanent fund would act as a base, but other solutions such as budget reductions and revenue enhancements will be required to fix the budget deficit. He said the state's hole is structural and the quicker the Legislature can dissolve the structural deficit and get back to balanced budgets the better off all of us are.

SENATOR WILSON noted that Senator Stedman's presentation showed the permanent fund's balance growing. He asked Senator Stedman to explain how he came up with the numbers that showed the fund growing.

SENATOR STEDMAN explained as follows:

If the average rate of return is higher than 4.5 percent, it will get larger; if it's higher than 4.5 percent plus the rate of inflation, say the rate of inflation is 2 percent, just as a number, and you made over 6.5 percent, your real purchasing power will start to increase. There will be times I can assure you that the purchasing power will decline in the short run just due to market reductions.

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SENATOR WILSON asked to confirm that the additional earnings would go into the earnings reserve account.

SENATOR STEDMAN specified that the bill does not eliminate the earnings reserve and detailed as follows:

The earnings reserve are trading profits and potentially the unrealized gains. The corpus is what's protected by the constitution, roughly \$40 billion. So we can, we the Legislature, if we adopt this in statute, we still can get around the 4.5 percent and spend the earnings reserve; it would take a constitutional change to block that and limit us just to 4.5 percent and that discussion would come later. I personally support that, but it has to take the will of the people. So you could adopt this statute, pay out 4.5 percent and then have an election of spendthrifts and they decide to come in and say, "We

don't like 4.5 percent, we want \$4 billion or \$5 billion because we want to do this project or we want to build roads or more ferries," or whatever they are going to build and go in and take it out of the earnings reserve. There still needs to be some prudence on sticking with the 4.5 percent to make sure that that does not happen. If and when we take it to a constitutional amendment, the earnings reserve then would be eliminated, it would have no, from what I can see, no value.

SENATOR STEDMAN disclosed that SB 21 does not change the Alaska Permanent Fund Corporation's structure and detailed as follows:

We are not turning the permanent fund on its head and changing its time horizon or its liquidity needs and things of that nature; it pretty much keeps the status quo and it puts them out, kind of silos them off on the side where we clearly would have in front of us a deficit issue. We can't just look over to the permanent fund and grab billions out and not make the hard decisions because we have some tough ones as we all know to make and they are not going to be fun.

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CHAIR DUNLEAVY asked if SB 21 sets an amount for inflation proofing, not passive inflation proofing.

SENATOR STEDMAN answered that SB 21 does not and detailed as follows:

What sets the trigger or the mechanism to allow it to inflation proof itself is the payout rate, and the asset allocation and performance of the fund itself. So given roughly the current allocation and historic performance of all of those asset classes helps derive the payout rate and there's no magic number. I thought 4.5 percent just from my past professional experience is reasonable and attainable, some folks might think it should be 4.75 percent or 5.0 percent and the next guy might think it should be 4.25 percent; I think that should be left up to the discussion and recommendations from the permanent fund and maybe the Department of Revenue and debated in the finance committees or whatever, I just picked that number from professional experience of what I thought would work.

He addressed a scenario where the fund's rate of return was 5 percent over 10 years with a 4.5-percent withdrawal as follows:

We would be going backwards with purchasing power if inflation is 2.0 percent, 2.5 percent, historically it has been 2.5 percent the last century; but you have to have an asset allocation mix that is in balance with your payout. So if you ratchet the payout up, sometimes you could push your performance requirements of your portfolio managers to a point where your risk level gets a little bit too high, in my opinion, and that works with this or a retirement fund or your own personal stuff also.

[3:53:01 PM](#)

CHAIR DUNLEAVY asked if SB 21 would automatically pay a permanent fund dividend (PFD) or if paying a dividend would be optional for the Legislature to appropriate.

SENATOR STEDMAN replied that the dividend would be 2.25 percent of the market value. He noted that there has been a discussion and debate as to whether the PFD is an appropriation, but the bill does not address that. He emphasized that the dividend payout would be a minimum of 2.25 percent. He said there is almost a compact agreement with citizens on the split.

CHAIR DUNLEAVY asked Senator Stedman to address Section 3, line 13, which says, "The Legislature may appropriate." He asked what would happen if the word "may" was changed to "shall."

SENATOR STEDMAN replied that Chair Dunleavy's question would be a good question for the attorneys. He said he understood the difference between "may" and "shall," and would be comfortable with either one of the words.

CHAIR DUNLEAVY replied that the words are very different.

SENATOR STEDMAN responded that he knows the words are very different and detailed as follows:

If I can put on my "elected official hat," it's 2.25 percent. I personally would not care speaking to my constituents if it said "may" or "shall," it would be 2.25 percent and the check should be written and we should deal with our fiscal issues however we need to deal with them.

[3:55:01 PM](#)

CHAIR DUNLEAVY remarked that you would never hear from Alaskans when the dividend was calculated by market outcomes, but they have become suspicious and untrusting when the dividend was vetoed last year. He said the suspicion by Alaskans is the reason why he brought up the concepts of "mays" and "shalls." He pointed out that legislation and appropriations could still be vetoed, but constitutionalization gives Alaskans a little more feeling that they and future generations are being treated as partners.

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CHAIR DUNLEAVY thanked Senator Stedman and held SB 21 in committee.

[3:58:02 PM](#)

At ease.

SB 26-PERMANENT FUND: DEPOSITS; DIVIDEND; EARNINGS

[3:59:06 PM](#)

CHAIR DUNLEAVY called the committee back to order and announced the consideration of SB 26.

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RANDALL HOFFBECK, Commissioner, Alaska Department of Revenue, Juneau, Alaska, addressed the comparison between SB 26, the Permanent Fund Protection Act (PFPA), and SB 21 as follows:

- Rule-based:
 - PFPA: yes;
 - SB 21: yes.
- Stabilizing-investment income:
 - PFPA: partial, 5-year averaging in percentage of market value (POMV);
 - SB 21: Partial, 5-year averaging in POMV.
- Stabilizing-total revenue:
 - PFPA: partial, addressed in a mid-range of oil prices;
 - SB 21: no defined plan.
- Sustainable-protect the dividend:
 - PFPA: yes;
 - SB 21: yes.
- Sustainable-protect the fund's total and corpus:
 - PFPA: yes, maintains value of the fund and corpus over the long term;

- SB 21: partial, the total fund value is maintained but the growth is not protected in the corpus.
- Maximize the earnings reserve account (ERA) use:
 - PFFPA: yes, withdrawing less when oil revenues are high allows higher draws when oil revenues are low;
 - SB 21: partial, withdraws same percent each year regardless of budget need.

COMMISSIONER HOFFBECK said the state is facing a fiscal crisis that requires steps to be taken that are not comfortable but are necessary in order to actually resolve the fiscal situation that the state is in. He emphasized that the permanent fund is the state's largest tool for solving the fiscal crisis and its use maximized. He disclosed that the Department of Revenue did the modeling on what the largest-sustainable draw would be for the permanent fund that would:

- Not put the fund's corpus in jeopardy;
- Allow the fund to grow with inflation over time;
- Allow the fund to maintain its real purchasing power;
- Allow as much money as possible to be used for paying both the dividend and for providing money for funding government services.

He set forth that the Department of Revenue determined that a 5.25 percent draw was aggressive with probabilistic modeling that takes into account anomalies and down markets showed the percentage still survived. He added that McKinsey and Company reviewed the department's modeling and concurred that 5.25 percent was a realistic goal. He disclosed that McKinsey and Company is internationally known on Wall Street and with sovereign wealth funds all over the world.

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At ease.

[4:02:45 PM](#)

CHAIR DUNLEAVY called the committee back to order.

COMMISSIONER HOFFBECK explained that important components were needed to be met when putting together the bill's structure. He set forth that using the permanent fund's earnings must be rules based to avoid overdrawing the fund as well as a draw that could stabilize revenues for the state of Alaska. He noted that the

bill introduced in the previous session originally had a fixed draw, but was rejected as being too constrained, so a POMV approach was adopted which the Senate approved last year. He added that other important components include protecting the dividend and the fund's corpus, and maximizing the use of the fund to generate as much revenue as possible for solving the fiscal problem.

CHAIR DUNLEAVY asked Commissioner Hoffbeck to clarify that when he said "stabilize revenues" he meant stabilizing the revenue stream coming out of the fund, not stabilizing the entire revenue stream.

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COMMISSIONER HOFFBECK replied that the PFPA does more by tying to oil-price revenues that acts as a shutoff valve as oil prices recover and the state gets more revenue from oil rather than the permanent fund. He said PFPA stabilizes the state's major revenue streams. He admitted that annual fluctuations will occur, but five-year averaging will take a lot of the fluctuations out of the equation. He concurred with Chair Dunleavy and Senator Stedman that SB 21 and SB 26 do not get the state to the finish line by itself.

CHAIR DUNLEAVY asked what Commissioner Hoffbeck meant by saying, "Stabilizing the permanent fund."

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COMMISSIONER HOFFBECK clarified that he said, "Protecting the dividend." He explained that the dividend has become a very important part of Alaska's economic base and the administration felt it needed to be protected, but not at the rate over \$2000 a year because it took too much and left the state too far away at closing the gap. He continued as follows:

Essentially the size of the dividend at \$60 oil equates to the size of the deficit and it's not that the dividend creates a deficit, it gives us kind of a way to think in our mind just how big the deficit is with various sizes of dividends. So if you pay a \$2000 dividend, you have about a \$1.3 billion deficit using the 5.25 percent draw. If you pay a \$1000 dividend, you've got about a \$700 million deficit and the difficulty in closing \$700 million is tremendous, but to close \$1.3 billion becomes almost insurmountable; essentially that would require the entire \$750 million in cuts that the Senate has discussed and a full

broad-based tax to close that in order to pay the \$2000 dividend.

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CHAIR DUNLEAVY pointed out that the decades-old calculation for the dividend was determined without interference from government whereas the dividend in the PFPA is determined by the government based upon the deficit or how much the state needs.

COMMISSIONER HOFFBECK confirmed that the entire 5.25 percent draw from the permanent fund goes into the general fund. He explained the formula for the dividend as follows:

Twenty percent of the draw, the 5.25 percent draw, goes to pay the dividend as well as 20 percent of the non-constitutionally deposited mineral royalties, those two together create the dividend; so it's still formula driven, but it goes directly through the general fund and comes out of the general fund. If that becomes a sticking point to getting this to the finish line, we have no problem of just dumping it into a dividend fund similar to how it is done now. We just felt that it was cleaner to run it through the general fund since it's flowing through there anyway, but that is not a critical piece to the plan.

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SENATOR WILSON pointed out that Commissioner Hoffbeck keeps saying, "Protecting the dividend." He asked what the purpose is of protecting the dividend.

COMMISSIONER HOFFBECK replied that that the PFPA protects the earning reserve from being drawn to the point where the state won't be able to pay the dividend. He specified that the idea is to protect the entirety of the permanent fund including the portion that goes to pay the dividend.

SENATOR WILSON said he constantly hears from a lot of bills similar to SB 21 and SB 26 that the permanent fund has to be protected. He asked if the protection was needed because government does not have the discipline to find another solution other than to go the route of SB 26.

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COMMISSIONER HOFFBECK concurred with Senator Stedman when he talked about "wolves." He commented as follows:

It's just kind of the reality of what we face when we bump up against these decisions. If you are sitting there with a \$500 million hole that you need to fill in the budget and that means either you put in a broad-based tax and that fills the committee rooms with angry people, or you put in \$500 million worth of expenditure cuts and that fills the rooms with angry people, or \$500 million you can just take it out of your savings. There's a lot of incentive to just go take it out of your savings and that's why we think that structure needs to be there so that if you go to take it out of your savings, you have to answer to the public why you didn't follow the rules that you set up, it's exactly what the administration is facing right now because of the governor's veto. We believe that the governor had all of the rights and authority to make the veto or he wouldn't have done it; that being said, the people stood up and said why didn't you follow the rules, you've been following that same rule for 30-plus years, why didn't you follow it this time. I think by putting a structure around any restructuring of how we use the dividend and a real framework, we put ourselves in the position that any time that we don't follow the rule, we have to answer to the public why didn't we follow it.

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SENATOR WILSON asked why the government should get more than 50 percent than the people get in terms of the payout from the dividend.

COMMISSIONER HOFFBECK opined that a 50-50 split is easy to explain. He asserted that there is nothing structurally significant about a 50-50 split. He explained that the current dividend formula was the product of political compromise and there was nothing magical with the calculation. He emphasized that a 50-50 split does not get the government to the finish line. He remarked that the administration did not say, "Let's go grab some money from the citizens of the state of Alaska." He asserted that the PFPA squeezes as much out for the dividend while still having a reasonable expectation to be able to close the rest of the fiscal gap.

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CHAIR DUNLEAVY referenced an earlier discussion with Senator Stedman on constitutionalizing SB 21. He admitted that no matter

how much the legislation is ring-fenced in statute, the governor is able to veto or one could change the statute in one session.

COMMISSIONER HOFFBECK replied that Chair Dunleavy's point is well taken and agreed that not only could the administration veto it, but the Legislature could just choose not to appropriate a dividend in any given year as well under the formula. He said the assumption is people are going to follow the rules. He addressed the concern with constitutionalizing the legislation as follows:

The concern with putting in the "constitutional" is exactly what the founders, the ones who wrote the constitution about this whole idea of "siloeing" revenues for set expenditures, they prohibited the dedicated funds within the statutory language specifically in the constitution because they saw the issues that are associated with putting your money in silos that can't be broken and when you put them in silos that can't be broken, now you end up in situations where often times you could have money sitting here that you didn't need that you need to spend over here, but you would have no access to it. So that's the real danger you have by putting it in the constitution is that you would tie it up to say this is exactly where it's going to have to go, you could be in a situation where you couldn't pay your general obligation debt or you couldn't make payroll or some other thing and you would not have access to those funds. So it really ties, not so much the administration's hands, it's the Legislature's hands, you're taking away your own appropriation authority by putting it into the constitution. The administration can't spend what you don't appropriate, so it really is an issue of some of your flexibility, your appropriation authority that would be tied up by moving it into the constitution; but, just as a general statement, it's not good public policy to silo your revenues and lock them up where they can only be spent in a certain fashion and not have the flexibility to move the money around if you need to.

[4:18:00 PM](#)

CHAIR DUNLEAVY pointed out that the state had a rules-based system for decades that changed because it was statutory. He reiterated that the PFFA does not provide protection, it just changes the way the permanent fund is dealt with.

COMMISSIONER HOFFBECK clarified that the PFPA changes the formula and provides no more or no less protection that the old formula had.

CHAIR DUNLEAVY reiterated that the PFPA is still statutory and amounts could be vetoed, and the Legislature could change it in a 90-day session. He commented as follows:

What we are lacking right now from my perspective, just from the feedback I'm getting, is a confidence in the public that we are going to deal with this in a manner that they thoroughly understand and potentially could accept, but they are wading through the terms, the terminology, the nuances, and some of this stuff they are questioning.

[4:19:25 PM](#)

COMMISSIONER HOFFBECK summarized the plans to draw from the permanent fund by addressing the current status quo option, drawing from the permanent-fund-only option, and the differences in using either SB 21 or SB 26 as follows:

- Status quo will eventually deplete the earnings reserve and there won't be a dividend or money for government expenditures.
- Permanent-fund-only plan has the same problems as status quo if there is not a full-fiscal solution. The earnings reserve will eventually be depleted and you won't have money for government services.
- Whatever plan is selected needs the rest of the pieces to solidify either of the plans.
- Both SB 21 and SB 26 are rules based.
- Both SB 21 and SB 26 stabilize the investment-income piece by using the five-year-averaging strategy that will take the wild swings out of it.
- SB 21 does not have the shut-off valve on the percentage of market value (POMV) draw and potentially may result in super-heated spending if oil production or oil prices rebound.
- Total revenue is addressed more within SB 26, but only mid-range oil prices is addressed. Once oil prices move past the mid-range, oil-price volatility could still be present. Other revenues that are part of the total fiscal package would not be addressed in SB 26, the bill only addresses the tie between oil and the permanent fund.

- Both plans are statutory.
- Both plans protect the dividend.
- Both plans have a formula-driven approach for the dividend.
- Both plans protect the fund by at least growing at the rate of inflation.
- Both plans project the fund to have similar balances 24-years out at approximately \$104 billion to \$105 billion.
- SB 21 will have more money in the earnings reserve and SB 26 will have more money in the fund's corpus.
- With money in the corpus at a 5.25 percent draw, SB 26 will generate more revenue for funding government services than the 4.5 percent draw under SB 21.

COMMISSIONER HOFFBECK addressed a final comparison between SB 21 and SB 26 that referenced FY2018 as follows:

- FY2018 unrestricted general fund (UGF): \$4.2 billion;
- FY2018 existing UGF revenues: \$1.4 billion;
- Planned earnings reserve account draws for UGF:
 - Status quo: not available,
 - SB 21: \$1.2 billion,
 - SB 26: \$2.0 billion;
- Additional measures required for a full-fiscal plan:
 - Status quo: \$2.8 billion,
 - SB 21: \$1.6 billion,
 - SB 26: \$0.8 billion.

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SENATOR WILSON addressed the \$1.4 billion in existing UGF revenues in FY2018 and asked Commissioner Hoffbeck to provide additional details.

COMMISSIONER HOFFBECK replied that he believes the \$1.4 billion includes the revenues that the governor proposed from the motor-fuel tax. He opined that the motor-fuel tax is only \$40 million in the first year, so whether the tax is included or not does not change the discussion.

COMMISSIONER HOFFBECK set forth that the \$800 million "hole" that needs to be filled under SB 26 will be a heavy lift; however, the administration does not see a path to fill the \$1.6 billion from SB 21. He opined that an unfunded liability is a larger threat than a too large of a draw. He said a draw can be turned down, but an unfunded liability creates the incentive for

unplanned draws. He asserted that unplanned draws really put the risk and the volatility into the stability of any of the plans.

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SENATOR WILSON pointed out that Commissioner Hoffbeck stated that he did not see another means to "fill the hole." He asked if he thought about "making the hole smaller" by making the size of government smaller instead of looking for revenues to fill the hole.

COMMISSIONER HOFFBECK answered yes. He explained that the governor intentionally did not "fill the hole" when he presented his budget because he thought a discussion was needed regarding how much is going to be revenue and how much is going to be expenditure reductions. He asserted that "everything is on the table." He opined that the \$1.6 billion in additional measures required for a full-fiscal plan from SB 21 would require massive expenditure cuts and massive taxes. He admitted that the \$800 million left from SB 26 is going to be a pretty big task in itself.

CHAIR DUNLEAVY remarked that now is not the time to engage Commissioner Hoffbeck on the philosophy of reductions and the size of government. He opined that continued government spending will be above the \$600 million that is projected in additional measures from SB 26.

COMMISSIONER HOFFBECK said he had no further comment.

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CHAIR DUNLEAVY thanked Commissioner Hoffbeck, and held SB 26 in committee.

[4:29:54 PM](#)

At ease.

DISCUSSION: Angela Rodell, Executive Director, Alaska Permanent Fund Corporation

[4:31:10 PM](#)

CHAIR DUNLEAVY called the committee back to order. He asked Ms. Rodell to address the committee.

[4:31:27 PM](#)

ANGELA RODELL, Executive Director, Alaska Permanent Fund Corporation (APFC), Juneau, Alaska, explained that the APFC's one mission is to manage the Alaska Permanent Fund's assets. She

emphasized that APFC does not: determine spending, manage the dividend, and manage payouts of any kind.

SENATOR COGHILL said one of the questions that continually comes to the forefront is the use of the earnings reserve account because that is something that APFC must manage. He pointed out that continued payouts, including the dividend, presents a liquidity issue for the earnings reserve account. He asked how much was in the earning reserve account.

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MS. RODELL replied that the amount in the earnings reserve account as of December 31, 2016 was approximately \$10.3 billion.

SENATOR COGHILL asked what impact a \$2 billion draw on the earnings reserve account would have.

MS. RODELL cautioned that her answer will not be straight forward because different draws have been proposed and each draw requires different strategies. She explained how the earnings reserve account receives cash as follows:

We routinely get cash every day in some format. We are getting dividends off of stocks, we are getting interest payments off of bonds, we are getting rents from real estate, we are getting payments through the sale of various assets, and then that cash is being reinvested into the entire asset allocation of the fund.

She detailed how the permanent fund is managed as follows:

The way that the corporation has managed the fund to date is that we buy pro rata shares of each asset between the earnings reserve and the corpus of the account, so every asset is owned by both accounts.

She addressed Senator Coghill's question regarding the earnings reserve account's feasibility going forward as follows:

What your question speaks to is whether or not that continues to be feasible going forward if you are now using this fund not as a long-term investment vehicle, but rather a budget-stabilization fund and similar to the restrictions that have been placed on the constitutional budget reserve to recognize its role as a budget stabilization fund and its need to have

principal protection and liquidity. We would want to look long and hard at what the balances are in the earnings reserve account and whether or not it can continue to be invested in all of the same assets that the corpus is currently invested in and continue to take that strategy, and if the earnings reserve account is being drawn down to such levels where it no longer seems prudent to conduct that because we first have a prudent fiduciary responsibility, we are going to have to convert that into a different asset allocation which is going to lower the expected returns overall that you've been assuming in many of these models. That's just the reality of managing the fund and making sure that we have the cash-deliverable that the Legislature and the administration are expecting at the start of the fiscal year.

[4:36:41 PM](#)

SENATOR COGHILL remarked that using the earnings reserve account to stabilize the government as well as payout a dividend is a different process from the way the earnings reserve account is currently used. He asked if the 50-50 allocation process proposed in SB 21 would change the way APFC invested.

MS. RODELL answered no. She pointed out that APFC has never managed to a dividend in the past. She reiterated that each draw percentage is not as clean as everyone would like and opined that modifications may have to be made as a result of what is actually happening both to the fund itself in terms of market performance, but also in terms of what compromises are reached to address the budget issues around it.

[4:38:58 PM](#)

SENATOR COGHILL remarked that the committee has to talk about a philosophy before legislation goes to the Senate Finance Committee. He opined that one approach is to protect a dividend into the future and then get some state benefit. He said the other approach is to get some state benefit and make sure the dividend is guarded. He stated that the two approaches differ in many ways and would deliver different sets of assumptions.

MS. RODELL answered yes. She opined that APFC has had the luxury in managing the permanent fund and the earnings reserve account together as required in statute. She noted that everyone understood the volatility in the market with a dividend payout. She disclosed that APFC's previous executive director told her that he did not receive a single phone call about dividend

payouts because everybody understood what was going on. She opined that the conversation is different when it is a single dividend and budget stabilization payment for the general fund.

[4:40:22 PM](#)

SENATOR WILSON noted that Ms. Rodell referenced "models" when speaking about changing the way APFC would have to manage the earnings account.

MS. RODELL explained that she was talking about pro rata asset allocations between the corpus and earnings reserve account. She noted that APFC prepares a monthly forecast of statutory net income on its website. She specified that if an adjustment has to be made to the earnings reserve account's asset allocation, then the monthly model will have to be adjusted that results in a different total return outcome because \$45 billion invested one way and \$10 billion invested another way will create a different outcome.

SENATOR WILSON remarked that there has been a lot of talks and dialogs upon the need to inflation proof and asked Ms. Rodell to explain what inflation proofing does and does not do in terms of the permanent fund.

[4:42:10 PM](#)

MS. RODELL provided an overview of inflation proofing the permanent fund as follows:

- Inflation proofing was identified as a priority by the permanent fund's Board of Trustees in 1982.
- The dividend program was created in statute and APFC was created to manage the permanent fund in 1982.
- 1982 was a very high inflationary period and there was recognition that a mechanism was needed to generate income for future generations.
- Legislative list of investments that the permanent fund could invest in was removed and allowed for the fund's current diversified asset allocation.
- Many of the fund's assets are considered inflation-proofing investments; e.g., real estate investments go up over time and therefore naturally inflation-proof investments.

MS. RODELL detailed that the fund's real estate investments are sourced to different accounts and explained the process as follows:

If we bought an office building ten years ago for \$100 million with \$20 million coming out of the earnings reserve account and \$80 million coming out of the corpus and we go to sell it today for \$200 million, the earnings reserve account is going to get that \$100 million gain, plus they are going to get the \$20 million that the earnings reserve account originally invested into it and all the corpus is going to get is the \$80 million of its original investment. If hotels now cost \$200 million, not \$100 million and I don't have the earnings reserve account to buy the building, I've now lost the investment power of the corpus and that's why the inflation proofing is so important to protecting the corpus because this is about the value to future generations and the benefit they will receive.

[4:45:47 PM](#)

CHAIR DUNLEAVY asked that Ms. Rodell address inflation proofing for SB 21 and SB 26.

MS. RODELL specified that SB 21 repeals the current statute, so there is no formal or deliberate mechanism to move money into the corpus of the account where it cannot be spent. She detailed that SB 26 has the mechanism where if there's four times the earnings reserve account balance, excess monies will move over into the corpus. She said the challenge is there is not a calculation based on lost earnings power where a mechanism recalculates or recalibrates what the actual loss is due to inflation to the corpus over a certain time period. She admitted that recognizing money should move back into the corpus is good, but SB 26 does not tie money going back into the corpus to inflation or purchase power directly.

SENATOR WILSON asked what the bills do for long-term growth.

[4:48:18 PM](#)

MS. RODELL replied that she cannot answer the question because she does not know what the markets are going to do and what the ultimate draws are going to be.

SENATOR COGHILL commented as follows:

The 4.5 percent as told to us by Senator Stedman is more of a passive inflation in that the historical averages have been over that so that would leave the money available, but it still goes to the earnings

reserve is what you are saying. The earnings reserve can short change you on the purchasing capacity at the corpus level.

MS. RODELL answered correct because money in the earnings reserve is available for appropriation at any time.

[4:49:24 PM](#)

SENATOR COGHILL asked if the money from the earnings reserve has only been drawn for the dividend.

MS. RODELL answered correct.

SENATOR COGHILL commented as follows:

So I think probably what I hear Senator Stedman saying is at this point the public pressure of changing these things is so huge that if that became the structure that that would be a safeguard to itself just like today changing our dividend; that's the philosophical question, changing it has a huge public interest, no doubt about it, but it is available now and people need to know that.

MS. RODELL explained that inflation proofing is currently statutory and appropriations were zeroed-out for FY2016 and FY2017. She said the current statute at least recognizes the importance of inflation proofing.

[4:50:40 PM](#)

CHAIR DUNLEAVY asked what would occur if the earnings reserve account is drawn down and its impact on the corpus.

MS. RODELL explained that two scenarios would occur with a zeroed-out earnings reserve account:

1. Market continues to go up and positive returns continue where unrealized gains continue to build and realized gains are moved over.
2. The earnings reserve acting as a cushion against losses is lost, the corpus would diminish and there would be no dividend.

[4:53:25 PM](#)

CHAIR DUNLEAVY asked that Ms. Rodell address some things that the committee needs to ponder in order to protect the permanent fund. He opined that there are at least a dozen different

approaches to the permanent fund, including the one that is currently in existence. He concurred with Senator Coghill that what's at play is deciding how the fund grows over time, how much the draw should be, and how to deal with the dividend.

He opined that talk has not centered on the dividend. He said one reason why the dividend was put into existence was because of the statehood act and the constitution did not allow folks to claim mineral rights underneath their property. He asserted that the dividend is a way of sharing with Alaskans. He analogized that the dividend was also put into existence to act as the "chain" for the dog that guards the doghouse where a hand gets bit if it is placed in the doghouse.

He disclosed that he has received close to 4,000 communications from concerned Alaskans and attributed their concern to the veto of the dividend as well as where the Legislature may go regarding the permanent fund. He set forth that the permanent fund has been allowed to invest politically-insulated from the Legislature's "wolves." He remarked that the permanent fund does well when politicians are kept as far away as possible from making investment decisions.

[4:56:05 PM](#)

MS. RODELL called attention to APFC and the talent of its 45 members as well as its board of trustees who are dedicated to managing the fund's money. She asked that the committee not lose sight about the fund, the dividend, and that there is an entity that relies on the earnings reserve account to fund its budget.

[4:58:53 PM](#)

CHAIR DUNLEAVY commented as follows:

There is a lot of philosophy and politics at play here; again, the concern for me is I cannot think of an endeavor, an issue, that when politicians touch it or worse, get their arms around it, doesn't muck it up. I know right now there's a sense of some desperation that we need to do something right now, today, yesterday, or we face untold horrors as we move into the future. I for one believe that we could probably get through a year or two and if we had to, craft a really good approach that Alaskans, not just politicians, this is part of the issue here, this isn't just a politician fund, I mean we could spin it that way, but I don't believe it is. Over 4,000 people have contacted my office and they don't believe it is

either, but I think we could craft if we had to an approach that involves the support of Alaskans. I'm very concerned that if we rush this it's not going to have, and Senator Stedman uses this term and I think he's correct, it doesn't imbed stability if the people of Alaska don't support something; at the same time, whatever we do needs to, in my opinion, allow the Permanent Fund Corporation to function as it has and has done the good things that it has for us.

So there's a number of things that need to be discussed and I put forth the concept and it wasn't my concept, it just exists as it is now, that you can use 50 percent of the earnings if you so choose for government and 50 percent that you can put into the dividend, and I still believe at least in the short term you could do that and get some of the money you need for government.

We all agree today that no matter what approach we take it's not a cure-all. I think we've debunked that whole idea that you just do this with the permanent fund and it's like a poultice, you just rub it on yourself and you're all better now, it's not going to work that way. There's going to be some hard decisions that have to happen no matter what approach we take, hard decisions including reductions and it's hard for me to even say, but hard decisions on some other types of revenue enhancement that some of us aren't very fond of; but, guidance and wisdom in crafting this is going to be crucial because we may be back here in a year if whatever we do is not good, if whatever we do is rejected by the people of Alaska, or if it just doesn't function.

I want to thank the corporation for what it's done and I for one would like to continue to allow you folks to do your job in a professional manner and not in a political manner.

[5:02:24 PM](#)

CHAIR DUNLEAVY addressed the committee's upcoming agenda and noted that public testimony would be taken up at the next meeting. He asked members to give thought to potential amendments, changes or questions. He set forth that the committee has lots to think about because SB 21 and SB 26 is legislation that is a dramatic break in the history of the

permanent fund, the dividend, and the relationship with Alaskans.

5:04:20 PM

There being no further business to come before the committee, Chair Dunleavy adjourned the Senate State Affairs Committee at 5:04 p.m.