

**ALASKA STATE LEGISLATURE**  
**BICAMERAL PERMANENT FUND WORKING GROUP**  
**ANCHORAGE LIO**  
June 28, 2019  
10:07 a.m.

**MEMBERS PRESENT**

Representative Jennifer Johnston, Co-Chair  
Senator Shelley Hughes  
Senator Donald Olson  
Representative Adam Wool  
Representative Jonathan Kreiss-Tomkins  
Representative Kelly Merrick

**MEMBERS ABSENT**

Senator Click Bishop, Co-Chair  
Senator Bert Stedman

**OTHER LEGISLATORS PRESENT**

Senator Cathy Gissel  
Senator Chris Birch  
Senator Jesse Kiehl

Representative Matt Claman  
Representative Bryce Edgmon  
Representative Sara Hannan  
Representative Louise Stutes  
Representative Geran Tarr

**COMMITTEE CALENDAR**

**BICAMERAL PERMANENT FUND WORKING GROUP PRESENTATIONS**

- Permanent Fund Corporation Mission and History - Angela Rodell
- Fiscal Models - David Teal
- Revenue Models - Bruce Tangeman

- HEARD

**PREVIOUS COMMITTEE ACTION**

No previous action to record

## **WITNESS REGISTER**

ANGELA RODELL, Executive Director  
Alaska Permanent Fund Corporation  
Department of Revenue (DOR)  
Juneau, Alaska

**POSITION STATEMENT:** Discussed the mission, history, roles and responsibilities of the trustees of the Permanent Fund.

DAVID TEAL, Legislative Fiscal Analyst  
Legislative Finance Division  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Presented fiscal models for the permanent fund.

BRUCE TANGEMAN, Commissioner  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** Presented revenue models for the permanent fund.

## **ACTION NARRATIVE**

[10:07:35 AM](#)

**CO-CHAIR JENNIFER JOHNSTON** called the Bicameral Permanent Fund Working Group meeting to order at 10:07 a.m. Present at the call to order were Senators Olson and Hughes; and Representatives Merrick, Wool, Kreiss-Tomkins, and Co-Chair Johnston. Co-Chair Johnston announced that Co-Chair Bishop had a family emergency and would not be in attendance and Senator Stedman would participate via teleconference.

### **Bicameral Permanent Fund Working Group Presentations**

[10:09:10 AM](#)

**CO-CHAIR JOHNSTON** reviewed the agenda for the Bicameral Permanent Fund Working Group (PFG). She said that Angela Rodell, Executive Director, Alaska Permanent Fund Corporation will give a PowerPoint, followed by fiscal and revenue model presentations by David Teal, Legislative Fiscal Analyst, Legislative Finance Division, and Bruce Tangeman, Commissioner, Department of Revenue. She advised that she had conferred with Co-Chair Bishop and the presentations by the three working group teams would be removed from today's agenda. [The three teams were assigned to

evaluate the impacts of a \$3,000 dividend, a \$1,600 dividend and, a surplus permanent fund dividend amount.]

[10:09:41 AM](#)

SENATOR HUGHES said that a substantial amount of work went into the working group team reports. She asked that the working group reports be published and available even if the teams would continue to work towards reaching agreement.

CO-CHAIR JOHNSTON said she would discuss her request with Co-Chair Bishop. She envisioned the three working group teams would work similar to the legislative conference committee process. She related her understanding that the conference committee process takes considerable time and the committee does a substantial amount of work before it can come to any agreement. Although she offered to speak to Co-Chair Bishop, she anticipated that as co-chairs, they would expect the working group teams to produce reports similar to ones that a conference committee would prepare.

SENATOR HUGHES said that as the Chair of the Senate Judiciary Standing Committee, she would make her report available to the public. The committee heard [SJR 5, proposing amendments to the Constitution of the State of Alaska relating to the Alaska permanent fund and the permanent fund dividend], so she planned on uploading her report and would also make it available electronically.

### **Permanent Fund Corporation Mission and History**

[10:12:15 AM](#)

ANGELA RODELL, Executive Director, Alaska Permanent Fund Corporation, Department of Revenue (DOR), Juneau, stated that she would begin by referring to the Constitution of the State of Alaska, which is how she begins every presentation. She read:

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.

She noted that the Constitution of the State of Alaska has simple, straight-forward language.

[10:13:45 AM](#)

MS. RODELL turned to slide 3, "Legislative Findings 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.

She said that once the decision to establish the permanent fund was passed by initiative, it took another four years before the Alaska Permanent Fund Corporation (PFC) was created. This created the foundation for how the PFC manages and invests the fund. The permanent fund was originally managed in 1977 by the Department of Revenue. In 1980, when the Alaska Permanent Fund Corporation was established, it took over that role.

[10:15:21 AM](#)

MS. RODELL turned to slide 4, "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.*

MS. RODELL said that [the above] statement captures the Alaska Permanent Fund Corporation's mission. It is what the PFC has been set up to do and all that it does. She also included several definitions [shown in italics above.]

MS. RODELL said that it is the job of the Board of Trustees to act in this manner, in the best interest of the principal of the fund.

[10:16:32 AM](#)

MS. RODELL turned to slide 5, "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.

10:17:31 AM

MS. RODELL turned to slide 6, "History" and "Investment Responsibilities." One of the things members will notice as we review the statutory changes is that over the course of the 39 years of the corporation's existence is that the process has been one of allowing the corporation the time to take on more risk, being very prudent in taking on that risk, and having more and more direct management of the fund.

10:18:12 AM

MS. RODELL turned to slide 7, "1980 Original Language AS 27.13.120."

(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.

MS. RODELL said it was interesting to note that the prudent-man rule has been in existence since the [fund's] inception. She noted that some people thought it was a newer version of the investment responsibility. She added that the Permanent Fund Corporation also still complies with the rule to submit quarterly investment reports to the Legislative Budget and Audit Committee.

[10:19:18 AM](#)

REPRESENTATIVE KREISS-TOMKINS referenced her statement that the PFC has taken on more direct management of assets in recent times. He asked her to elaborate on how the percentage of assets managed directly by the PFC has changed in recent years and her goals.

MS. RODELL responded that slide 8 will address that question.

[10:19:51 AM](#)

MS. RODELL turned to slide 8, "1980 Original Investment Vehicles." She said that considering the original investment vehicles at the time, members might notice that it was a very conservative list of vehicles. She reviewed the list.

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

MS. RODELL said that a balance of 60 percent of the portfolio needed to be in obligations that were insured or guaranteed by the United States, Alaska bank CDs and similar items, which was

a very conservative allocation. She noted that this point is the first mention of investing in Alaska.

AS 37.13.120 (1)

- 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.

[10:21:43 AM](#)

REPRESENTATIVE WOOL asked whether the interest rates at the two Alaskan banks were preferential. He recalled reading material in members' binders that Governor Hammond had mentioned one of the incentives to create the permanent fund dividend in the beginning was because only a few people were benefitting from certain loan programs in the state, so he wanted to spread that benefit to the average person who did not receive any loan. He asked whether any of the investments received preferential loans.

MS. RODELL answered no. She said the Permanent Fund Corporation does not believe that any of the investments were subsidized or given preferential treatment. She pointed out that what happened in the banking community at the time with lots of building occurring, resulted in the need for a lot of liquidity. This was an effort to keep a robust banking system in the state, she said.

[10:23:03 AM](#)

REPRESENTATIVE WOOL asked what the balance and average earnings of the Alaska Permanent Fund were at that time.

MS. RODELL answered that in 1980 the balance was about \$1 billion and interest rates were in the high teens.

[10:23:29 AM](#)

SENATOR OLSON, in reviewing the portfolio, recognized that investing in CDs may be safe, but they currently do not bring a significant return. He assumed it was the same in the 1980s. He asked whether the reason the Alaska Permanent Fund balance is so

robust is that the fund was free from the shackles of placing too much emphasis on security.

MS. RODELL responded that he raises a really good point. When the fund was new, the state was focused on ensuring that the permanent fund was going to be available for generations. She referred to the findings, which stated that the permanent fund needed to be present for all future generations of Alaskans. It needed to be available in 2019 and beyond, she said. As with most new things, [the corporation] tended to be risk averse until it got comfortable with how the investments would work. In addition, size matters so once [the fund] reached a certain size [the managers] realized they could afford to take on more risk. Over time, the stability of the fund was maintained in terms of constitutional protection, since annual royalty deposits were made, as required, and the oil continued to flow through the Trans-Alaska Pipeline System (TAPS). This gave comfort to a lot of people that this could continue over time, she said. She said that as she walks through the timeline, members can notice that changes were made on a regular, robust basis, because it was important to Alaskans to make sure that the permanent fund continued to do all the things it needed to do.

[10:25:55 AM](#)

CO-CHAIR JOHNSTON stated that Senator Kiehl had joined the meeting.

REPRESENTATIVE WOOL asked for further clarification on her earlier comment that the permanent fund balance was \$1 billion and the interest rate in 1980 was in the high teens. He asked whether she was speaking to the returns and if the interest rates were in the high teens.

MS. RODELL responded that in 1980 or 1982, the interest rates were in excess of 15 percent due to high inflation.

[10:26:41 AM](#)

MS. RODELL turned to slide 9, "Changes Over Time." She said that the changes came on a fairly regular basis. In 1982, the savings and loan crisis started to work its way through the country. She added that in 1982, the types of stocks that could be invested in are called "value stocks" today rather than "growth stocks" that generate regular payments and income. She reviewed the remaining 1982 statutory changes, adding that there was not a recognition between debt and equity at the time, just exposure to U.S. Corporations, in general.

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

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 and 50% corporate stocks & debt securities (foreign & domestic)

MS. RODELL said that in 1986, there was a recognition that the corporation could take more risk and as a result, increase returns. She turned to 1989.

MS. RODELL said removing the 10 percent limit on foreign equity and the 20 percent for foreign CDs by changing it to 20 percent CDs of U.S. and foreign combined made things much simpler. The Board of Trustees and the PFC would determine the optional mix of foreign and U.S. stocks so long as it did not exceed 50 percent of the fund, she said.

[10:29:38 AM](#)

REPRESENTATIVE WOOL referred to the 1982 allowable investments. He said the asset allocations adds up to 110 percent.

MS. RODELL clarified that these refer to limits and not an allocation pie. The board was still entrusted to create the actual allocation, but limits were placed on specific exposures,

so if the board went in one direction, it would need to cut it from another.

[10:30:15 AM](#)

MS. RODELL turned to slide 10, "Changes Over Time 1992." She said that the changes in statute in 1992 made some bigger changes. She said these changes redefined CDs and also removed the secondary market liquidity requirements, so the corporation no longer had to hold the collateral.

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

She said she mentioned earlier that the corporation could only invest in mortgages on the portion that had federal guarantees, and this removed some of those limits. She emphasized that it added permission for the board to actually establish its own investment guidelines. This was the first time that a real relinquishing of some of the investment responsibilities to the Board of Trustees occurred, she said.

[10:32:05 AM](#)

MS. RODELL turned to slide 10, "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

MS. RODELL said that prior to 1994, the PFC was limited to \$20 million for investment amount and the total value of the investments could not exceed \$150 million. This meant that the PFC could only be a partner in an investment if 33 percent was owned by other institutional investors. This also limited the PFC to a majority owner, but not a 100 percent owner, she said. The rating requirements changed to investment grade, the asset allocation limits changed, and public equities were raised from 50 to 55 percent.

She said that another big change was to add a new category, "other types of investment," which allowed the corporation to invest in other types of investments so long as they were subject to the prudent-investor rule. This meant that as long as other institutional investors of similar type and quality of the permanent fund made investments, that the corporation could also invest. There was the recognition that this other vehicle may look for another type of allocation limit. For example, with a Real Estate Investment Trust (REIT), some institutional investors group those investments with their public equity portfolio because it would be listed in a public equity exchange. In those instances, [the corporation] could exceed the 55 percent limitation on its stocks. There was a recognition that some of those limits might be exceeded, which was fine, so long as the corporation was in compliance with the 55 percent stocks or five percent of "other" investments, she said.

[10:34:18 AM](#)

MS. RODELL reviewed slide 12, "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) nonrecourse to APFC or the Fund
- Increased asset allocation limit for the "Other" category from 5% to 10%

10:35:25 AM

REPRESENTATIVE WOOL asked her to elaborate on the reason the Permanent Fund Corporation (PFC) can borrow money.

MS. RODELL responded that when the Permanent Fund Corporation invests in real estate, it sometimes makes sense to leverage the investment to allow for capital improvements rather than to hold it with cash. For example, the corporation has held some real estate holdings since 1985 but these properties have increased in value. In order to capture some of that value to make additional real estate investments, the PFC can borrow against the value of that property and take cash out of the underlying value. However, the Alaska PFC limits the amount of leverage on its individual real estate to 50 percent of the value. Further, the corporation cannot do multiples of the value, especially in joint venture properties. Sometimes it is important for the PFC to allow its partner to use the value for cash, as well, thereby using it as a partnership tool. It is limited because the vehicle that is buying the property is a "limited special purpose vehicle" that the corporation invests in, which only has rights to the property itself. Thus, the lender can only foreclose on the underlying property and cannot come after the permanent fund or the Permanent Fund Corporation for repayment of any kind.

10:37:33 AM

REPRESENTATIVE KREISS-TOMKINS referred to the 1999 statutory changes [slide 12]. He asked how many wholly owned real estate properties the corporation owned at that point.

MS. RODELL pointed out that the listings are posted to the corporation's website. She did not recall offhand but offered to report back to the group with the figures.

10:38:08 AM

REPRESENTATIVE KREISS-TOMKINS referred to the phrase "nonrecourse to APFC" on the same slide. He asked whether that term was also the one she just explained to Representative Wool, that when leveraging a real estate investment, the lender cannot come after the APFC for repayment.

MS. RODELL said yes.

10:38:45 AM

SENATOR HUGHES asked whether the amendments to statutes [on slides 9-12] were recommended by the board or if some changes were initiated by the legislature.

MS. RODELL offered to double check, but it was her understanding that they came from the Board of Trustees. She reminded members that the board's recommendations also go through the Legislative Budget and Audit Committee, so it was possible that some changes came from the committee. She was unsure of the specifics.

SENATOR HUGHES related her understanding that the Board of Trustees was intimately involved in the process. She asked whether there were any cases in which the board was not comfortable with something that was adopted.

MS. RODELL answered no, not to her knowledge.

10:40:00 AM

MS. RODELL reviewed slide 13, "2005 Current Language Adopted AS 37.13.120." She said this is law the Permanent Fund Corporation currently uses to manage the permanent fund. She said she has included the language in its entirety for the working group's benefit. Members will notice that many of the provisions are very similar to the language adopted in 1980. For example, subsection (a) still has the prudent investor rule. In 1980, it was the prudent man rule, but it has the same meaning and power as the prudent investor rule.

(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.

MS. RODELL referred to subsection (e). She noted that the language is still included, but now the "allowable permissible list" is not used, only the prudent-investor rule. The allowable investments are done through the regulatory process and prior to adoption of a regulation, it goes before the LB&A for review and comment, she said.

[10:41:29 AM](#)

SENATOR OLSON pointed out the U.S. has been enjoying a bull market that has outlasted what many people had anticipated. He asked whether the PFC has any plan in place to protect its assets if a financial crisis occurs, like the one in 2008.

MS. RODELL said she would talk about risk and how the corporation manages its risk later in the presentation, but the diversification of the portfolio helps to protect the fund and the corporation is always monitoring how the market is changing. The PFC works to identify any concerns and makes decisions on where it needs to be more prudent or take measured risk.

[10:42:39 AM](#)

MS. RODELL turned to slide 14, "Historical Asset Allocation," that consists of a series of pie charts based on the actual portfolio, including bonds, stocks, real estate, private equity, absolute return, infrastructure, and asset allocation. She said she included this slide to visually demonstrate how broad the allocation has become since 1980. This allows the corporation to manage its risk through diversification, which Senator Olson asked about earlier.

[10:43:25 AM](#)

REPRESENTATIVE WOOL asked for further clarification on the meaning of "absolute return" and if "infrastructure" differs from real estate.

MS. RODELL answered that "absolute return" relates to hedge funds that use a specific non-correlation in their design to counter what one thinks the market might be in order to provide risk diversification. Infrastructure includes investments in assets that have term contracts or take-or-pay contracts, such as utilities, toll roads, airports, fee-for-service types of large assets.

[10:44:21 AM](#)

REPRESENTATIVE KREISS-TOMKINS asked about the portfolio's current real estate holdings. He wondered which of those asset

classes are predominantly managed in-house by the corporation and those that are primarily managed externally.

MS. RODELL reviewed the list on the left side of slide 14:

Bonds have been almost 100 percent managed internally since 1980, and currently less than five percent is externally managed. The Department of Revenue managed the bond portfolio in house before it was moved over to the corporation.

Stocks are almost exclusively managed externally. The PFC has approximately a \$2 billion portfolio that is being managed internally, she said.

Real estate is internally managed, with the assistance of external managers.

Private Equity has both internal and external management. They make some direct investments but also perform substantial due diligence.

The PFC defines internal management as the responsibility for performing due diligence, by using an investment decision rather than using a fund to make that investment decision.

Absolute Return is externally managed. The PFC selects the funds, but the funds do the investing.

Infrastructure is both internal and external.

Asset Allocation is the treasury function of the funds, so it means managing the daily cash and working with fixed income. The corporation uses a cash overlay program to keep the money invested until cash is needed. It also includes a Risk Parity Program. These are multi assets that invest in the same assets that the PFC does, but differently than the corporation in order to generate a different type of return. They also have a foreign currency overlay program to help manage the foreign currency exposure. She characterized Asset Allocation as a strange catch-all grouping that has a treasury function. It is internally managed, but also has some pieces that are externally managed.

[10:47:54 AM](#)

REPRESENTATIVE KREISS-TOMKINS recapped the asset classes that the PFC internally manages include bonds, real estate, some private equity and infrastructure. The PFC externally manages most of its stocks, some private equity, some infrastructure and hedge funds. He said maybe it is in the quarterly reports of the LB&A, but he recalled that line item in the operating budget for the PFC is approximately \$15 million. He remarked that this is an incredible value given the massive wealth her team has control over. Given the current division of internal and external management, he asked whether she is interested in bringing more assets into internal management and also to identify any limiting factors.

MS. RODELL answered that it continues to be a priority to build up the PFC's internal management capability. The corporation would never want to internally manage 100 percent of its portfolio given the sophistication and change of the assets, but having internal managers touch every asset class, as the PFC currently does, creates a much better alignment of goals with its investments.

She said that in terms of private equity, real estate, or investing in a real estate fund, there is often a need to turn investments on a much tighter timeframe, perhaps a five to seven-year timeframe due to the need for liquidity. However, the PFC can also hold its investments for a longer time period. For example, as previously mentioned, the PFC has owned some of its real estate since 1985, which has allowed the corporation to continue to generate income from those assets. The desire to hold these assets is, in part, because the PFC is not forced to sell its assets when the investors have other demands. However, she acknowledged that creating that alignment is really important to the overall success of the corporation. Secondly, it is less costly to manage internally than externally. If the bond portfolio were externally managed, fees would easily exceed \$15 million per year, which is about the same as the entire PFC's budget of \$17 million for FY2020.

She identified the biggest challenge as the uncertainty of the annual budget and obtaining sufficient salaries for staff. Just like the rest of state government, the PFC's employees do not receive any merit or retention increases. She reported that about 85 percent of public funds in the U.S. pay incentive compensation to their investment personnel. The PFC does not have an incentive compensation program, which is a limiting factor to recruiting and retaining talent. Based on surveys she

has reviewed the number one reason people turn down offers at the PFC is due to inadequate compensation.

[10:51:43 AM](#)

REPRESENTATIVE KREISS-TOMKINS asked how much the PFC pays for external management including net of fee payments.

MS. RODELL answered that including the net of fee arrangements, the cost is in excess of \$350 million on a \$65 billion portfolio.

REPRESENTATIVE KREISS-TOMKINS offered his belief that this represents a huge opportunity for Alaska, given that the PFC has done an incredible job managing the state's assets. He acknowledged that the PFC continues to explore ways to reduce costs in a prudent manner, in consultation with the Board of Trustees, so its assets can be managed in-house. He identified the benefits of in-house management, such that when the payroll stays in Alaska, it also will build a class of sophisticated asset managers.

[10:53:22 AM](#)

REPRESENTATIVE MERRICK asked whether the fees paid to external managers are negotiated fees based on investment returns or if they are based on a flat rate.

MS. RODELL answered that it is both. The contracts that are negotiated with the external managers tend to have a flat management fee, with a fee for performance, as well. They are obviously all different depending on the contract and when it was entered into, but there is generally a performance-based fee component. They must reach certain rates of return in order to earn the fees.

[10:54:12 AM](#)

REPRESENTATIVE MERRICK asked whether external management has ever had negative results.

MS. RODELL answered yes; at one point the PFC had to claw back fees and trying to collect was really painful. The PFC has moved away from that to alternative fee structures. However, during a down market the hope is that the manager does not lose as much as the market loses. However, negative performance will occur, she said.

[10:54:48 AM](#)

REPRESENTATIVE WOOL asked whether all the fees in-house are deducted from the earnings, which would be a pre-dividend calculation.

MS. RODELL answered yes.

REPRESENTATIVE WOOL asked whether the asset allocation changes or is shaped by any incentive, such as offering a bonus.

MS. RODELL answered that it is not affected by the size of the fund.

REPRESENTATIVE WOOL calculated that the \$350 million cost for external managers on \$65 billion results in a little more than a half of one percent. He acknowledged that the retention and recruitment of staff sounds challenging. It seemed to him that people would want to work where they receive performance compensation.

MS. RODELL answered that if the [legislature and the administration] would like to increase in-house asset management, they need to recognize that asset managers and other PFC staff do not fit the traditional state employee definition. The state needs to think about what it will take to recruit and retain that type of talent and be willing to invest in it. Otherwise, the state needs to recognize it is not possible "to have it both ways." It is not possible to build up the talent and expect people to move to Alaska when the market demand for this talent in the Lower 48 and worldwide is high. It is not possible to expect them to provide these services for free, she said.

REPRESENTATIVE WOOL asked whether in-house and external managers have a portion of assets to compare performance.

MS. RODELL answered that typically the decision to have portfolios allocated outside is because the PFC lacks the necessary expertise to manage it in-house.

[10:57:59 AM](#)

SENATOR HUGHES mentioned the comment that "You can't have it both ways." She asked whether the board has considered trying to retain some of the \$350 million in fees by using more in-house managers or if it is better to continue to use external managers. She further asked if any internal managers are based in New York or London or if everyone is located in Juneau.

MS. RODELL answered that the PFC has looked at it. If the corporation is to be successful in making a change, it would take a lot of buy-in by the legislature. It will be difficult to change the recruitment and compensation structure as long as the PFC's budget is subject to the annual legislative budget appropriation process. First, uncertainty as to its overall budget exists. Second, it becomes difficult to distinguish the corporation's staff from those of other state agencies during the budget process.

In 2018, the board worked very hard to build an acceptable incentive compensation structure to bring to the legislature and the governor. Ultimately, given the messages coming from the governor and the legislature, the board decided it was not time to bring that proposal forward. In fact, the FY2020 budget cut salaries to the FY2019 level without including the standard three percent merit increase or cost of living adjustment. In addition, the board had requested four new positions that were not funded.

MS. RODELL stated that its only office and 100 percent of its staff is located in Juneau.

[11:01:00 AM](#)

REPRESENTATIVE KREISS-TOMKINS expressed interested in learning the budget process used by other sovereign wealth funds in the world. He would like to strike a balance and provide the corporation with greater certainty, but still have some degree of public accountability. He said he would defer to the Co-Chairs to decide if considering all aspects of the fund and the dividend is appropriate. He wondered if there was a possibility of pursuing that question.

[11:02:01 AM](#)

MS. RODELL turned to slide 15, 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.

MS. RODELL directed attention to a graph on the right side of the slide. She pointed out two red bars that illustrate that the returns have stayed within 0.0 percent and 15 percent. There were a couple of outliers on the graph in 2008 and 2009, during the financial crisis and the Great Recession. The returns spiked in 1984, she said. She emphasized that this also shows that as the risk profile grew and the PFC was able to take on additional asset classes, it changed limits and took more risks on the portfolio on a measured basis. In doing so the fund was allowed to really grow and it is now at historical highs in excess of \$60 billion in assets under management.

[11:03:12 AM](#)

CO-CHAIR JOHNSTON asked how far out the board projects its investment returns.

MS. RODELL answered that every year Callan Associates, Inc., consultants provide a capital market forecast and review each of the asset classes. The consultants set an expectation for the average return over a ten-year period. They analyze the deviation with a plus or minus variation on the expected ten-year return for the fund. The consultants provide a low case and high case benchmark, in part, at the request of the Department of Revenue for its spring and fall revenue forecast. These figures are on the PFC's projection worksheet on its website. It shows how the fund is projected to grow using a high, middle, and low case scenario. Currently, the fund is projecting an average 10-year return of 6.65 percent. This means looking back that the fund might earn minus 20 percent in some years and a plus 20 percent in other years, but over the ten-year period it will have earned an average of 6.65 percent.

[11:05:12 AM](#)

CO-CHAIR JOHNSTON asked whether 10-year projections are usually the maximum amount or if some projections go to 20 years.

MS. RODELL said that she was not aware of any projections greater than ten years. She said that the PFC watches the markets move and market volatility. She said looking at the months of May and June and observing how much markets have swung, that the farther out the projection goes, the less validity they have. She said that she would caution against using any forecast beyond ten years because it would have little to no value.

[11:06:06 AM](#)

SENATOR HUGHES asked for an estimated timeframe of when to expect the \$65 billion fund would double.

MS. RODELL asked whether this would be based on 6.5 percent return and all things being equal, that the legislature was also not drawing from the fund.

SENATOR HUGHES asked when she thought the fund would reach \$130 billion.

MS. RODELL answered that the chart [on page 15] shows that the fund doubles in value about every ten years. She would expect the fund to double about 20 years from now, but she was not certain.

CO-CHAIR JOHNSTON said she thinks it would put Ms. Rodell at a disadvantage [to provide an accurate projection for the fund balance] due to the structured draw in place.

MS. RODELL responded that her estimate assumed there was not any structured draw since there is not any draw for this time period.

[11:07:57 AM](#)

CO-CHAIR JOHNSTON asked the record to be clear that the assumption was based on no structured draws.

[11:08:13 AM](#)

REPRESENTATIVE KREISS-TOMKINS asked how assets were managed the first few years. He was looking at the period 1977 to 1980.

MS. RODELL answered that the Department of Revenue managed the assets during that time.

[11:08:35 AM](#)

REPRESENTATIVE WOOL said that it was interesting to note that in 1986 and 2014 the fund did really well, but those spikes were also ones in which the Alaska economy had a very tough time. He said it seemed as though the fund does well when oil prices are low.

MS. RODELL said that is correct and it speaks to the global exposure of the portfolio and the non-Alaska concentration of the portfolio. She described it as very counter cyclical to what is happening in the state.

[11:09:49 AM](#)

MS. RODELL said she was not going to read slide 17, "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.

[11:09:59 AM](#)

MS. RODELL reviewed slide 18, "Allocation Structure." She said that the structure that the board currently has in place is basically organized in two ways.

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.

MS. RODELL reviewed the Asset Allocation Structure shown on a table in the slide. She said that within "growth," liquid assets are known as public equities that can be sold very easily. She said that illiquid means it can take between three months and two years to get the full investment back. The portfolio in income has a very liquid allocation in terms of bonds and cash. The illiquid assets include real estate and infrastructure. Each asset class contributes to the total fund return and provides quality and diversity of the portfolio's investments.

[11:12:22 AM](#)

MS. RODELL turned to slide 19, "Diversification: Benefit Reflected in VaR Contribution." The slide contains a graph showing the ratio of "Contribution VaR" to "Stand-alone VaR." She said that she included some slides that the board sees on a quarterly basis. These slides are sent to Legislative Budget and Audit since they get the entire board packet each quarter as part of the reporting. She said this slide relates to an earlier question Senator Olson had.

She said that the easiest way to think about the reason to diversify is not to have all of the eggs in one basket. The PFC wants to ensure that if one asset class is losing, not every asset class is losing. She emphasized that it is important to observe how markets move, either together or apart from each other, which is called correlation. Sometimes asset classes are very tightly correlated. Public equity, stocks, and private equity, which is private investment into companies, is very highly correlated. In other words, the things in the economy that are causing stocks to go up are also causing private equity valuations to go up.

[11:12:57 AM](#)

MS. RODELL said, in converse though, some assets will move in the opposite direction, so holding bonds that are not as

correlated will lose value as growth occurs because interest rates are staying low. One way to measure the portfolio in its entirety is to look at Value at Risk (VaR). VaR is a measure of the risk of loss for investments. It estimates how much a set of investments might lose, with the given probability of 97.5 percent and 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. Total Fund Asset Alloc. Absolute Return FI Plus Infra & Pvt Crdt. Pvt Equity Public Equity Real Estate \$65.7 \$3.7 \$3.7 \$15.5 \$5.2 \$8.4 \$25.1 \$4.0 17.4% 3.4% 4.6% 6.2% 14.3% 45.1% 24.8% 13.5% Asset Allocation \$bn Standalone VaR as % of respective portfolio NAV 40% 50% 60% 70% 80% 90% 100% Ratio of "Contribution VaR" to "Stand-alone VaR" V

MS. RODELL said that sometimes asset classes are highly correlated. She referred to the ratio in the chart on the left that shows the ration of contribution to VaR to Stand-alone-VaR. For example, with public equity the PFC can lose up to 24.8 percent of the value of the public equity portfolio based on the risk it is taking. Private equity has the highest risk association with it, so the PFC could lose up to 45.1 percent of the portfolio with 97.5 confidence in normal market conditions. These are the greatest contributors to risk in the portfolio. That is the reason the PFC has this counter risk, which is fixed income in real estate.

[11:14:33 AM](#)

MS. RODELL turned to slide 20, "Asset allocation & VaR: Breakdowns" depicting two pie charts labeled "Asset Mix" and "VaR Mix," not shown below.

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

She referred to the Asset Mix, shown on the left pie chart, which shows the dollar value of each of the asset classes. For example, with public equity 38 percent of the dollar value of the portfolio is exposed to stocks. However, if one thinks of that same group in terms of risk, the VaR Mix, shown on the pie chart at the right, the public equity is actually contributing 54 percent of overall risk of the portfolio. While the asset mix looks like a highly diversified dollar mix, from a risk perspective it is actually not as diversified as others might want or how other portfolios might look. This is a deliberate choice by the PFC to take on this risk because it delivers returns, and the board is comfortable with the risk this portfolio is generating. This analysis provides a measure to understand exactly where the risk lies and to ensure that the board continues to be comfortable because as markets move, as allocations on the dollar side change, this risk mix will also change.

[11:16:03 AM](#)

MS. RODELL turned to slide, 21, "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.

MS. RODELL reviewed a variety of historical events as if they happen to the portfolio today.

In 2008 and 2009 the market crashed and the S&P was down 20 percent. The fund would lose a little over 20 percent, but that's less than the benchmark that performance is measured against. On the other hand, in a period of slow deflation the fund would lose more than the benchmark. This is due to where the fixed-income portfolio is invested, she said.

MS. RODELL said this gives a sense of the magnitude of losses that the portfolio made with certain market conditions, especially the market crises that occurred and are often discussed.

[11:17:54 AM](#)

MS. RODELL turned to slide 22, "Performance as of March 31, 2019." She reviewed the table.

	FY 19 9 mos.	3 Years	5 Years
Total Fund	3.07%	9.33%	7.24%
Passive Index Benchmark (60 Stocks 20 Bonds  10RE 10 TIPs)	2.39%	7.43%	
Performance Benchmark	3.50%	8.31%	6.03%

Total Fund Return	4.60%	7.20%	6.47%
Objective   CPI+5%			

MS. RODELL reviewed the permanent fund performance. She said that this chart compares the performance based on the first 9 months of FY2019, over three and five-year periods. She pointed out that FY2018 will end on Sunday, June 30, 2019. The FY2019 annual figures will be available in about a month. Thus far, the earnings are 3.07 percent and the passive index benchmark is 2.39 percent. She said the passive benchmark considers earnings without any active management of the fund, as if the fund was invested in a computer-driven index model with 60 percent allocation to stocks, 20 percent to bonds, 10 percent to real estate, and 10 percent to TIPs [Treasury Inflation-Protected Security]. This replicates a passive index benchmark as compared to the PFC's asset allocation mix.

She said that the performance benchmark came in at 3.5 percent, which is a little better than the total fund performance. The [performance benchmark] is for the most part investable indices that managers are held to, such as the S&P 500. She described the calculation. The board has its long-term objective of CPI+5 percent, which is equated to 4.6 percent, she said. She said that right now the PFC is not keeping up with the CPI+5 percent.

[11:19:35 AM](#)

REPRESENTATIVE KREISS-TOMKINS referred to slide 21, "Tail Risk." He asked whether the board or the corporation intentionally made a decision in allocating risk to provide more protection for an event similar to the 2008 market crash versus a Chinese market crash scenario in which the PFC would be more exposed.

MS. RODELL answered that it is intentional in the sense of the board's decision to focus on creating growth. She explained that this allocation dates back to 2016, which explains the directionality into alternatives and private equity, in particular. Further, this is a more U.S. weighted portfolio on a total fund basis. This is countered by the public equity portfolio, which consists of more of an international tilt than the benchmark. These are tactical decisions and active management. The board defines the risk budget and allocation, so when the board indicates it wants 38 percent public equity, it is by definition saying that it wants a 50 percent risk allocation bucket. It is then within this framework that managers are investing. For example, the director of public equities makes the tactical tilt when Brexit happened and the market plummeted, by leaning in to put more money in the

European markets because the director thought the market was overreacting and would be coming back up. She cautioned that the table shows a spot in time on March 31. However, each day will look slightly different based on market conditions.

[11:22:43 AM](#)

REPRESENTATIVE MERRICK asked her to briefly comment on how taxes are paid under the fund and how management takes into consideration any changes to tax structure.

MS. RODELL responded that the permanent fund is not subject to U.S. tax code. The PFC does not pay any taxes on U.S. investments. Further, the corporation is not subject to any corporate tax requirements. However, the corporation does pay foreign taxes to foreign jurisdictions because the PFC is viewed as a taxable entity in some foreign jurisdictions. The PFC relies on the tax treaties that the U.S. negotiates with foreign governments to get tax relief in various jurisdictions, which is done country-by-country.

[11:23:40 AM](#)

REPRESENTATIVE MERRICK asked about taxes paid to foreign entities on the portfolio's foreign assets.

MS. RODELL said that these figures are normally netted out before the PFC sees the returns, and the returns will be net of that payment. She offered to check with the Chief Financial Officer and report back. She said there may be something in the notes of financial statements that she is not recollecting.

[11:24:14 AM](#)

SENATOR OLSON referred to the performance of the fund. He expressed concern over the lag time in changing direction. For example, during a downturn, when it was obvious there would be losses, there was a delay in moving money into safer investments to incur less loss. He asked whether the PFC is still plagued by an inability to move money faster.

MS. RODELL responded that nothing prevents the PFC from moving money if the PFC thinks it is necessary to do so. Currently part of the reason to hold larger cash balances than historically, is the sense that "we're topping up on the market." The PFC wants to have cash available to plow into the market when the market falls, since you want to be able to buy on a downswing. When reviewing 2009, of course we have the perfection of 20-20 hindsight, she said. If the permanent fund had ridden out the downswing, it would be in better shape today. Unfortunately, it

was not possible to know that at the time; the PFC just uses its best judgment and knowledge that a downturn can extend for years. The permanent fund's purpose is to be there in perpetuity.

[11:27:37 AM](#)

CO-CHAIR JOHNSTON commented that former PFC CEO Mike Burns said that the fund is invested for the long term and this was a very long day.

[11:28:10 AM](#)

REPRESENTATIVE WOOL asked for further clarification on the table showing the CPI+5 percent equals 4.60 percent. He asked whether that is because the year is not over.

MS. RODELL confirmed that the figure represents just 9 months.

[11:28:33 AM](#)

MS. RODELL turned to slide 23, "Awards and 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

MS. RODELL characterized this as her "brag page." She said it speaks to the internal management questions raised earlier and the talent that the PFC has been able to retain in Juneau because people who are very good at this and are mission focused, yet want a lifestyle that Alaska offers.

She said it is important for Alaskans to realize that when the PFC wins these awards, they are nice individually, but they also raise the corporation's profile internationally. This creates a "halo effect" and the PFC becomes a preferred partner because the awards demonstrate skill and success. The PFC continues to see a lot of private market flow and offers the corporation the advantage of selecting what it wants and not what it can get. She said the PFC can be really selective, which keeps the returns up.

[11:30:22 AM](#)

MS. RODELL turned to slides 24-25, "Structure of the Fund" and "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.

[11:31:40 AM](#)

MS. RODELL reminded members that when she reviewed the legislative findings and mission of the corporation, she indicated that the PFC is mandated to manage its funds and to manage risk. She reviewed the specific language, including the

permanent fund's goal to maintain safety of principal while maximizing total return and that the fund should be used as a saving device managed to allow the maximum use of disposable income from the fund for the purposes designated by law. There is no liability attached and the corporation is not told to hit a certain bogey of any kind and it never has been told to do so.

MS. RODELL said this explains the mechanics of how money moves through the permanent fund, which is important to the discussion. She said the principal of the fund is constitutionally established and may only be used for income-producing investments. The Earnings Reserve Account (ERA) is statutorily established under AS 37.13.145(a) to hold the income of the fund and may be invested in investments authorized under the same statutes as the principal of the fund. Historically, what the corporation has done is put the accounts side by side and give it a pro rata piece of each investment to the ERA holding.

[11:32:24 AM](#)

MS. RODELL turned to slide 26, "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.

MS. RODELL referred to the principal of the fund. The Constitution of the State of Alaska directs at least 25 percent of all Alaska's mineral royalties be deposited to the principal of the fund. As of May 31, 2019, the PFC has collected \$17.2 billion in royalties over the 42-year period since inception. She said that \$7.1 billion has been added to the principal in the form of inflation proofing. She said the legislature authorized a special appropriation of up to \$9.4 billion in the FY2020 budget from the ERA to the principal of the fund, but she was unsure of the status. Finally, the principal holds a share of its unrealized capital gains and losses of \$4.8 billion. She said that summarizes the principal or corpus of the fund.

[11:34:08 AM](#)

MS. RODELL reviewed the chart on slide 27, "Contributions to Principal in millions." This bar graph gives a sense of the contributions over time. She noted that in 2004, a reclassification of an appropriation is the reason for the negative "out" of the ERA. With that exception, it shows how royalties have been straight-forward throughout the years and how oil prices increased the royalties even though production was less. It also demonstrates the effects of inflation-proofing to the principal of the fund.

[11:35:08 AM](#)

REPRESENTATIVE KREISS-TOMKINS commented that it is a great chart. He offered his belief that the actual transfer in FY2020 is now \$5 billion.

MS. RODELL thanked him for the update. She said that it is really great that a portion of the earnings reserve is being used for future generations of Alaskans. She offered her belief

that the chart shows how important it has been to continue to build the principal of the account over time. It really speaks to the care that has been given to the fund.

11:36:07 AM

MS. RODELL reviewed slide 28, "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

MS. RODELL said the Constitution of the State of Alaska 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.

MS. RODELL, in speaking to statutory net income, stated that it is really hard to spend an unrealized gain "because when the market is moving intra-day and between days - one day you have it, the next you don't - the third day you have three times what you had." She said there is the sense that you can really only spend what you have realized. The net realized gains or the realized gains that have accumulated during the fiscal year minus the realized losses are trued up at the end of the fiscal year. When constitutional language was passed, income was simple income and it was not the fair market value of an investment. In 1997, generally accepted accounting principles changed, and the definition of accounting income was changed to require investments be the value of all of the PFC's investments at fair market value. The change in value year after year would be seen as net income, she said. That is how the concept of having

unrealized losses was embedded in the definition of income, requiring the legislature to back that out and create the definition of statutory net income.

[11:38:00 AM](#)

MS. RODELL reviewed slide 29, "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."

[11:38:51 AM](#)

MS. RODELL reviewed the chart on slide 30, "Net Income and Return [chart not shown]."

MS. RODELL said that looking over the last ten fiscal years as how that income has reflected versus the returns shows that they tend to trend in the same direction, but they can diverge wildly. In 2011, the accounting net income was very big, but statutory net income was not. In 2018, it was just the reverse, with more statutory net income than accounting net income. Statutory net income reflects the investment activity and investment decisions being made by staff and it is not being driven by any particular return objective. She said, "It's really being driven by it's time to sell and if there's a gain we have to recognize it into the Earnings Reserve Account; therefore, it increases statutory net income." Those decisions are investment in nature and not driven by a particular agenda, she said.

[11:39:16 AM](#)

REPRESENTATIVE WOOL related his understanding that statutory net income is the actual realized gains, which determines the value of the permanent fund dividend. He said if the PFC holds on to stocks, but they do not cash them in, there would be no realized gain and it would not affect the statutory net income.

MS. RODELL answered that is correct.

REPRESENTATIVE WOOL asked for further clarification on the returns.

MS. RODELL answered that the return is the percent. She referred to the chart [on slide 22 related to performance], in which 3.07 percent was the 9-month return. This would be the annual return for each of those years shown on the right axis.

[11:40:22 AM](#)

REPRESENTATIVE KREISS-TOMKINS, continuing where Representative Wool was going, said statutory net income does not seem entirely divorced from what the market is doing, but it seems like a quasi-arbitrary metric on which to base dividends.

MS. RODELL answered that the other thing to note about statutory net income is that it is the regularized cash flow, including bond interest payments or rentals from real estate. Asset allocation in 1980 was clipping coupons and collecting rent, which was cash income to be deposited into the ERA. She said that made sense in 1982 because the concept of fair market value did not exist to affect income. Over time the concept of dividend based on earnings never changed but everything around it did since the accounting rules and investments changed.

REPRESENTATIVE KREISS-TOMKINS asked whether it was fair to say that as the permanent fund has invested in more and different assets, including private equities and other conservative and traditional assets in 1982, that it widened the gap or potential gap between how the market is doing, the value of the fund, what savings and interest is, and the size of the PFD.

MS. RODELL answered that is a fair assessment

[11:42:33 AM](#)

REPRESENTATIVE WOOL said she previously mentioned rent and real estate. He asked if rent would be a realized gain, since she previously mentioned rent coming in during the 80s was cash deposited to the ERA. He also asked if rent typically would be

used to pay off the loan. He wondered if the property would be devalued or if the rent coming in would still be a cash gain.

MS. RODELL related a scenario, if she had a real estate mall valued at \$10 million, and collected \$1,000 in rent, net of all the expenses for mall operations, that \$1,000 would be considered income deposited to the ERA. At the end of the year, she receives an annual appraisal and the mall is now appraised at \$11 million. According to GAAP [Generally Accepted Accounting Principles], the \$1 million increase is an unrealized gain and is income. However, since she cannot pay anything on it, it is allocated to the principal and the ERA pro rata as an unrealized gain. If she kept collecting rent and sells the mall for \$11 million, the cost basis was \$10 million so the \$1 million in gain becomes realized gain in its entirety in the ERA.

REPRESENTATIVE WOOL said the owner is always going to get rent on the property even if it not a gain. He was unsure if the rent automatically would go into ...

MS. RODELL interjected that regular cash flow dividends on stocks results in \$1.2 million per year in regularized cash income.

[11:45:08 AM](#)

MS. RODELL turned to slide 31, "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.

MS. RODELL said that in 2018 the legislature passed AS 37.13.140(b).

[11:45:29 AM](#)

SENATOR HUGHES asked if the \$2 billion she said comes in annually is affected by the market since it is from rentals

MS. RODELL responded that the PFC would reinvest that cash rather than sit on it. It is used for new investments, to pay for operating expenses, or to transfer to the state for the draws. She said that it can be affected by the market.

SENATOR HUGHES clarified that the \$2 billion coming in is fairly reliable.

MS. RODELL agreed it was fairly reliable.

[11:46:18 AM](#)

REPRESENTATIVE WOOL clarified that it is \$1.2 billion not \$2 billion.

MS. RODELL agreed.

CO-CHAIR JOHNSTON related her understanding that permanent fund dividends can be affected by the market.

MS. RODELL agreed they can be. She explained that the figure is between \$1.2 and \$1.4 billion, that interest rates go up over time and the market rises, but it is a pretty regularized cash flow.

SENATOR HUGHES asked for further clarification on the amount for rentals. She asked whether that was \$2 billion.

MS. RODELL said the figure was \$1.2 billion. In further response to Senator Hughes, she said she was unsure of what Senator von Imhof had mentioned.

[11:47:30 AM](#)

MS. RODELL reviewed slide 31. She said that the Board of Trustees has supported the percent of market value (POMV) concept since 2003 when the board passed its first set of resolutions. In fact, the board had a resolution dating back to 2000 related to POMV. The board is very supportive because 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.

She said that in 2018, the POMV structure was created in statute that allows for an annual draw from the fund of 5.25 percent, stepping down to 5 percent in FY2022, based on the average market value of the fund for the first five of the preceding six fiscal years. There is a lag in the calculation and a known draw amount prior to the appropriation of this amount and it is not an estimated amount that is to be included in a budget.

MS. RODELL said that in FY2019 the amount was \$2.7 million, for FY2020 it is \$2.9 million, and the PFC is currently estimating a \$3.1 billion draw for FY2021.

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REPRESENTATIVE MERRICK referred to the 5.25 percent and 5 percent POMV, based on market value for five of the preceding fiscal years. She asked whether there would be any benefit to reducing the five years to three years to reduce the lag.

MS. RODELL answered that the reason for the longer timeframe is to smooth out volatility in the market. If the timeframe is shortened it could create more volatility in that time period. She referred to the chart on slide 30, for net income and return, to the three years from 2009 to 2011, versus the five years between 2009 and 2013. The loss would have had a much bigger impact on the draw in three years, but it tends to smooth out with a five year period. She said it would result in much more volatility in the draws by shortening the time period.

[11:50:18 AM](#)

MS. RODELL reviewed the chart on slide 32, "Illustrative POMV Calculation & Distribution" [not shown here].

MS. RODELL said the PFD did a look back to illustrate the two different calculations since they are based on different things. One is based on the percent of market value (POMV) and the other is based on earnings [or net income]. She wondered what that would look like in previous years. She pointed out that in 2009

the permanent fund dividend transfer under the earnings calculation and time period caused the low dividend. She said members may recall an \$800 and \$900 PFD in 2012 and 2013, respectively reflected the reduced earnings in 2009. However, the lag time in the POMV creates a smoother and steadier increase over the time period, she said.

[11:51:34 AM](#)

MS. RODELL reviewed slide 33, "POMV Draws."

	Fund Value	Nominal POMV	Effective POMV
FY 2019	\$64.9B	5.25 percent	4.20 percent
FY 2020	\$66.1	5.25 percent	4.44 percent
FY 2021	\$67.6	5.25 percent	4.57 percent

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.

MS. RODELL said looking forward, the nominal POMV draw of 5.25 percent is an effective draw of 4.20 percent, but it will increase over time due to the slower increase of the total permanent fund value. She said that if fund values are flat or declining, the effective percent of market draw of that is closer to the actual nominal POMV draw, or it could exceed in some years.

[11:52:21 AM](#)

REPRESENTATIVE WOOL related his understanding that the POMV is calculated on the first five of the preceding six fiscal years.

MS. RODELL referred to the chart on slide [32], and said the POMV calculation in 2015, would be based on 2013, 2012, 2011, 2010, and 2009. She clarified that for the FY2021 amount, the PFC will close out FY2019, and will know the fund value by the end of the year. The corporation will consider fiscal years 2019, 2018, 2017, 2016, and 2015 to calculate the amount available for FY2021. When the legislature convenes in January, legislators will know exactly how much is available. The earnings are for five years so the fifth year is an estimated

amount since the final year is not available at the time the appropriation happens for a dividend transfer.

REPRESENTATIVE WOOL asked whether the POMV is calculated differently than the earnings. He asked whether earnings could also be calculated in that way by using a sixth gap year.

MS. RODELL explained that the year gap creates certainty for the PFC. If the state did not need cash from the permanent fund until the last quarter of the fiscal year, arguably it would provide a couple of years to plan and allow investing more fully. But with the earnings you don't know, and it would require a statutory change to remedy it, she said. In 2016, the legislature estimated the amount to be transferred.

[11:55:23 AM](#)

MS. RODELL turned to slide 34, "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.

MS. RODELL said the ERA was established to hold the net realized earnings from the permanent fund's investment portfolio, which includes monthly income. It is posted every month as unaudited monthly financial statements. This gives a sense of how both the principal and ERA are doing. She reviewed the figures as of May 31, 2019, as reported on the slide.

She emphasized that the ERA does not have its own investment mandate or set of trust principles that it has deemed the board to consider when investing the ERA. It is subject to legislative appropriation.

[11:56:52 AM](#)

MS. RODELL reviewed slide 35, "Use of Fund Earnings from ERA Since Inception."

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

MS. RODELL said the capital income transfers of \$367.9 million is money associated with State v. Amerada Hess.

She then reviewed the chart on the right.

Total \$66.1 billion

Paid out to current generations	Transfers to Principal- Saved for Future Generations	Unspent Realized Earnings
Earnings Spent \$30.8 Billion Earnings Saved 35.8 Billion		

[11:57:48 AM](#)

REPRESENTATIVE WOOL asked for the definition of unspent realized earnings since he assumed all of the funds in the ERA were unspent.

MS. RODELL answered that the balance of \$13.7 billion recognizes these transfers that are expected to happen, so the legislature has spent portions of it, the POMV. It also does not include the unrealized earnings, only the realized earnings.

[11:58:51 AM](#)

MS. RODELL reviewed slide 36, "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 Appropriation	FY 2019	FY 2020
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
Department of Law	2,619,100	2,617,700
Department of Natural Resources	6,044,800	6,132,600
Department of Revenue	94,500	97,900

She pointed out that the investment management fees are tied to the performance of the fund, so the corporation has an expectation of fund growth in calculating the class IV management investment fees. The corporation also pays fees to the departments of Law, Natural Resources, and Revenue for services, mostly for collection of royalty on behalf of the fund.

[11:59:47 AM](#)

REPRESENTATIVE WOOL related his understanding that the POMV model would only take a set percentage every year and inflation proofing was not necessary. He recalled the investment management fees were \$350 million, but these figures are about half that amount. He asked if these figures were for in-house investment management fees.

[12:00:08 PM](#)

MS. RODELL said the \$350 million also referred to their net fee arrangements. For example, property managers receive a fee prior to remitting rentals. The \$155 million refers to the PFC actually writing a check and they need an appropriation to write the check. Many of the external public equity managers are paid in this manner for gross performance. In terms of POMV and inflation-proofing, she said so long as there are two accounts exist and the principal account does not get any benefit other than through appropriation from the investments that it makes, it will not keep pace with inflation. This is because there is no way for the principal account to capture that benefit, she said. The corporation still needs inflation-proofing, even under the statutory POMV, in order to ensure that the principal maintains its purchasing power for future generations.

[12:01:33 PM](#)

CO-CHAIR JOHNSTON related her understanding that the investment management fees are negotiated fees for outside management. She asked whether the fund has control of them as they go from FY2019 to FY2020, since this represents an estimate of \$5.3 [million].

MS. RODELL agreed the \$5.3 million is an estimate. She said that in some years, such as in 2017, the PFC requested a supplemental appropriation because the market was really booming, and the PFC needed to be certain it had enough authority to expend these funds.

CO-CHAIR JOHNSTON asked whether the PFC would ask for a supplemental appropriation if the amount in the budget for the next fiscal year does not contain the PFC's estimated amount.

MS. RODELL answered yes.

[12:02:58 PM](#)

REPRESENTATIVE KREISS-TOMKINS referred [to slide 36] to the APFC Operations of \$17,800,400 and asked what percentage of assets in value are managed internally versus externally.

MS. RODELL answered that approximately 40 percent are managed internally, and 60 percent are managed externally.

REPRESENTATIVE KREISS-TOMKINS estimated the ratio is approximately 90/10 or 85/15 in terms of cost of management of corporate investment assets. He asked the reason why external portfolio management is proportionately more expensive as compared to internal management.

MS. RODELL responded that it is important to recognize all of the resources an external manager brings to bear on managing the portfolio. She said that the corporation expects its investment managers to have expertise and to understand the markets. For example, if the PFC has an investment in an emerging market, such as China, the public equity managers must be experts on the Chinese stock market. That expertise has an expense, including the overhead, data, and technology necessary to stay on top of the market, so it requires investment in infrastructure. The external managers' basic compensation structure is commensurate with the expertise being provided, she said.

[12:05:02 PM](#)

REPRESENTATIVE WOOL said outside investment managers handle approximately 60 percent of the assets. He asked for further clarification on the percent of return attributed to outside managers and whether they bring in more than 60 percent of the earnings.

MS. RODELL answered that she did not wish to over or under characterize one group. She offered to research it and report back to the committee.

[12:05:46 PM](#)

MS. RODELL turned to the pie chart on slide 37, "FY 20 Fund Appropriations HB 39 Language." She said that when she left Juneau this morning [prior to Governor Dunleavy's operating budget vetoes], the FY2020 appropriation from the ERA to the general fund was \$2.9 billion based on the POMV. An additional \$27 million was directed to the Capital Income Fund for the Amerada HESS portion, with \$943 million for inflation proofing. She related her understanding that the \$9.4 billion special appropriation post-veto amount is now \$5 billion. She said that the appropriation designated to the principal to meet the constitutional mandate for royalties was \$329.2 million with \$251 million for prepayment for statutory royalties.

MS. RODELL reminded members that by statute, 25 percent of the royalties from leases entered into after 1979 are to go to the principal of the fund. However, that has not been appropriated in the last few years. It has been capped at the constitutional requirement of 25 percent. This year's operating budget tried to restore this difference by depositing an additional \$251 million into the principal.

MS. RODELL said that this allows the PFC to use best practices.

[12:07:28 PM](#)

MS. RODELL turned to slide 38, "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.

She emphasized the importance of the POMV and the rules-based system since it provides structure and predictability, an ability to plan, and allows the corporation to use investment management best practices. She said, "It's quite simple. It's not magic."

[12:08:11 PM](#)

REPRESENTATIVE KREISS-TOMKINS referred to slide 23. He said the Alaska Permanent Fund Corporation is one of the best things Alaska has going for it right now and it's important to set it up for success in the future. He expressed appreciation for Ms. Rodell's work and the corporation employees.

[12:08:43 PM](#)

REPRESENTATIVE WOOL thanked Ms. Rodell for the presentation. He said there is a lot of talk about a \$3,000 PFD, concern about overdrawing the POMV, and if it occurred once or in multiple years. He referred to the statutory PFD. He asked whether this would mean the ERA will be depleted. He surmised that the PFC has modeled this. He wondered if saying the permanent fund dividend is not sustainable means that the ERA gets drawn down.

MS. RODELL said what's important is to recognize there is a limit to how much can be spent. The PFC was encouraged by the POMV because it recognizes that limits were necessary and manageable. It created a rule that the PFC could use as long-term investors and the legislature can use as it looks towards revenue sources for many different types of things. How the legislature wants to use that amount is the reason the group is here today, and it is a really challenging debate. The PFC has talked at length about the 5.25 percent versus stepping down to 5 percent being reasonable. She said the PFC would strongly encourage everyone to maintain those requirements. However, how the legislature spends \$2.9 billion or \$3 billion is the job of the legislature and not the corporation, she said. Further, the corporation believes that the 5.25 percent of POMV stepping down to 5 percent was a reasonable set of rules that everyone could live with, which is why it is so important to maintain it, she said.

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CO-CHAIR JOHNSTON made announcements before the break for lunch.

[12:12:50 PM](#)

CO-CHAIR JOHNSTON recessed the meeting.

### **Fiscal Models**

[12:59:08 PM](#)

CO-CHAIR JOHNSTON reconvened the meeting and announced that Mr. Teal would provide modeling scenarios for the permanent fund dividend (PFD).

[12:59:33 PM](#)

DAVID TEAL, Director, Legislative Fiscal Analyst, Division of Finance, Alaska State Legislature, Juneau, said he was asked to present the long-term projections for the three different scenarios that were assigned to the working group teams.

MR. TEAL explained that Scenario A is the statutory dividend that happens to be \$3,000 this year, Scenario B is a repeat of 2018 for a \$1,600 dividend, and Scenario C is a dividend without deficit, which simply matches the available revenue. He said he would start with the FY2020 fiscal situation and how the cost of dividends is computed.

He directed attention to slide 2, the 6/11/19 Conference Committee calculations for a PFD that maintains a balanced

budget. It shows the traditional revenue, primarily from oil, from the Department of Revenue (DOR) projection for price and production forecasts. That amount is \$2.304 billion. He noted that underneath the revenue forecast is the percentage of market value (POMV) payout, which is \$2.933 billion. The total revenue projected in FY2020 is approximately \$5.2 billion.

He explained that the next calculation is the unrestricted general fund (UGF) appropriations that are operating appropriations from the Conference Committee Budget. The capital budget was funded primarily with constitutional budget reserve (CBR) funds, which failed, so there is very little capital budget in the reserve funds. The capital amount noted in the analysis is primarily mental health funds with some transfers. He said the total spending is approximately \$4.4 billion, leaving a surplus of \$800 million.

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REPRESENTATIVE WOOL asked, if the PFD was funded in a more traditional way through general funds, could the \$4.4 billion go up another \$170 million to \$200 million.

MR. TEAL replied that an additional \$200 million should cover both the fiscal notes that were funded from the Power Cost Equalization (PCE), a little more than \$30 million, and then \$170 million with the capital projects that were funded with the CBR. Add those to the general funds and the surplus drops to \$600 million.

He explained that a surplus of \$800 million can pay a PFD of \$1,178 per person. With an assumed budget surplus, PFDs larger than the affordable \$1,178 will require the budget to be balanced with cuts, new revenue, or by taking money from reserves. Increasing the budget surplus by \$100 million to \$900 million will result in a \$1,334 PFD. A \$1,600 PFD will need new revenue, cuts, or reserves totaling \$270 million. Similarly, to pay the statutory PFD of \$3,000, \$1.1 billion would be required from reserves, budget reduction, or increased revenue.

MR. TEAL explained that the remainder of the chart on slide 2 is a POMV split where the model computation shows how to get to the dividend with cost calculations. The model simply repeats the computations for several years into the future. The computations are not complicated to forecast with various options.

He turned to slide 3, "Scenario A: Current Dividend Statute." It shows the full statutory dividend model using the Department of

Revenue (DOR) spring forecast for price and production. This is about half of the state's revenue. Revenue is the base with limited options for the forecast. The DOR forecast provides the best numbers. If there is concern about how risky the model might be, then a lower price or lower production scenario can be used.

1:08:22 PM

REPRESENTATIVE WOOL asked if the spring forecast means the forecast was made in the spring of 2019 for a future time or that the forecast has already been realized.

MR. TEAL replied these are projected numbers through FY2028. Even the numbers for FY2019 won't be known for another month or two, he said.

SENATOR HUGHES directed attention to the assumptions in the middle column that list a 2.25 inflation rate as well as the population growth rate. She asked if both those assumptions are plugged into the growth of the budget. She offered her understanding that factoring in both those assumptions was one of the reasons the existing constitutional spending cap was too high.

MR. TEAL answered yes, and he would address that later in the presentation.

He explained that the starting point of the operating budget is the 6/11/2019 Conference Committee budget. Now that the vetoes are known, downward adjustments will be made to the model. The growth rate that Senator Hughes noted in Scenario A is inflation. The budget starts with the FY2020 budget and is increased by the rate of inflation. The budget is not increased for population. As previously noted, the population growth rate is used to calculate dividends.

He said the rate of inflation is used in a base scenario. He emphasized that regardless of the scenario, the same assumptions must be used. He described the problems that occur when all scenarios are not run under the same set of assumptions.

He continued with Scenario A noting that the model shows school debt reimbursement at 100 percent. The capital budget in Scenario A is the House budget, except all the CBR appropriations are replaced with unrestricted general funds (UGF). The UGF budget is approximately \$175 million to \$180 million, a calculation that also grows at the rate of inflation.

The model also assumes a \$50 million supplemental budget. He said these budgets are unpredictable but should not be left out because they are an annual fact of life.

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He pointed to the revenue variables in Scenario A and noted that the calculation has no sales taxes, income taxes, and other taxation options. No additional revenue is in the model. The inflation rate is 2.25 percent, which is the number the permanent fund and its advisor, Callan, uses. The model also uses an investment return of 6.55 percent. The population growth rate comes from Department of Labor statistics, which is approximately 0.5 percent per year. CBR earnings are not critical for Scenario A; the minimum CBR balance is just an option within the model. The model does not allow unplanned draws from the earnings reserve account (ERA). He said he would explain why that's so critical in a moment.

MR. TEAL said the plan under Senate Bill 26 (2018) is for a 5.25 percent payout to the general fund through FY2021 with a 5 percent payout thereafter. He said the modeling has nothing to do with statutory net income so that variable will not be used. The calculation for the dividend program is the existing law. It is not based on the POMV and there is no cap on a minimum dividend. The model is inflation proofed and it uses some of the \$5.4 billion that will be appropriated from the earnings reserve to the corpus, which will pay for the inflation proofing a few years in advance.

[1:16:18 PM](#)

He described the output for the dividends. The upper right area for Scenario A shows the graph for dividends. The statutory dividend is roughly \$3,000 that will be increasing under the assumptions in the model. The bar graph in Scenario A shows whether the permanent fund is keeping pace with inflation. The first bar for each fiscal year shows the permanent fund growing at the rate of inflation. The second bar for each fiscal year shows what the permanent fund is doing under the model and the bars show that the permanent fund is basically maintaining its current value. The reason the bar graph shows that the permanent fund does not completely maintain its current value is because the payout is too big. He explained, "We've got 6.5 percent earnings and 2.25 percent goes out, leaving 4.75 percent available for a payout and we are paying out 5.0 percent, or close to it. So, we don't quite keep pace with inflation."

REPRESENTATIVE WOOL referred to the PFD graph on the upper right and asked why the graph shows a dip in the payout between FY2023 and FY2024.

MR. TEAL explained that it reflects the drop in payout from 5.25 percent to 5.0 percent beginning in FY2021. He noted that the dip ultimately recovers.

REPRESENTATIVE WOOL summarized his understanding that the PFD shown in the Scenario A graph is based on the statutory net income, which is independent of POMV, so the decreased draw would keep the permanent fund a little bit larger. He conceded that he does not understand all the factors going into the analysis.

[1:19:06 PM](#)

MR. TEAL explained that FY2018 was big year with returns of some 10.7 percent. That return factors in for 5 years. Going forward that large return fades away and is ultimately replaced with a constant 6.5 percent.

He pointed to the table at the bottom right of Scenario A that shows the dividend payout and what's left for the general fund after the dividend is paid each year. In FY2020 it shows \$1.944 billion, then it goes up \$2 billion, and finally near \$2.3 billion a year. The general fund gets whatever is left after paying dividends. This table also shows what is left for the general fund after the dividend is paid.

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MR. TEAL directed attention to the table at the lower left that shows deficits up to \$1.8 billion a year, noting that the money to fill that gap must come from somewhere. In this version there are no unplanned ERA draws so the CBR is used up rather quickly and will be gone after FY2020. The bar graph on the upper left shows expenditures and revenue with the dark line indicating expenditures without PFDs and the dotted line with PFDs. A balanced budget means the bars must reach the dotted line. The white space means the scenario is not valid because, "You are spending money that you don't have." Having white space means the option cannot be considered, he said. The way the model addresses this situation is to first assume the white spaces are filled from the CBR.

This scenario shows the budget is filled from the CBR through FY2020, but it fails in FY2021 because the balance in the CBR is insufficient. If there isn't any money in the CBR and there are

no taxes, the only alternative is to fill deficits from the ERA. Such ad hoc or unplanned draws are beyond the 5 percent POMV and this causes the ERA balance to decline which results in lower returns and declining dividends in the future. By FY2028 the ERA is almost depleted.

MR. TEAL said the conclusion from Scenario A is that a statutory PFD is unsustainable at projected revenue, expenditures, and earnings. The \$3,000 dividend works if \$1.6 billion is cut from spending or revenue is increased by that amount. It is not possible to continue to pull \$1.6 billion from reserves so there are two options instead of three, he said.

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REPRESENTATIVE WOOL speculated that when the earnings reserve runs out in FY2028, the POMV draw would also go down because the overall value of the permanent fund is depleted. He noted that Ms. Rodell previously said the permanent fund is receiving cash from rent and other realized gains. He asked if the cash could immediately be dispersed in PFDs if nothing else were to change.

MR. TEAL replied that works if earnings are 10 percent as in 2018, but they are unpredictable from year to year. The earnings this year are closer to 3 percent, which means earnings of only \$1.8 billion. A \$3 billion payout is unsustainable with those earnings. Depleting the ERA puts the state in the serious position of not only being unable to pay dividends but also having to cut the budget. This will affect state hiring because career employees can't be expected to accept jobs when there is risk of layoffs every year. He said it's not that the statutory dividend formula is unsustainable, it's that approximately \$1.6 billion will have to be permanently cut from the budget to make the formula sustainable.

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CO-CHAIR JOHNSTON asked if the budget will be static for 10 years if \$1.6 billion is cut from the budget and there isn't inflation.

MR. TEAL agreed that cutting \$1.6 billion and paying a dividend results in a CBR that is relatively steady and an ERA that keeps pace with inflation. He said the Budget Reserve chart on the middle left shows whether or not a scenario is viable. If the budget reserve looks good, the permanent fund also looks good. Deficits of \$200 million to \$300 million turn to surpluses in the out years.

CO-CHAIR JOHNSTON explained that the modeling scenario she requested was suggested by Senator Hughes. She conceded that a couple of large "ifs" would be involved with \$1.6 billion in cuts, and inflation is always changing as well.

SENATOR HUGHES clarified that her intent was to ensure that both inflation and population growth weren't used. She reiterated that is why the existing constitutional spending cap doesn't work; only one or the other is needed.

CO-CHAIR JOHNSTON said population growth is not being used and she would guess that inflation is used.

[1:36:47 PM](#)

MR. TEAL responded that he plugged in the \$400 million UGF vetoes that were made today. The draws are the same and there are still deficits of \$1.5 billion that decline to \$1.3 billion.

CO-CHAIR JOHNSTON remarked that with the current vetoes the state still has deficits.

MR. TEAL answered yes.

REPRESENTATIVE WOOL asked if the assumption is that the current vetoes would be extended to budgets in future years.

MR. TEAL answered yes; there's a \$400 million reduction every year. The assumption is that vetoes are repeatable so that is the new level of spending. He added that dividends start to fall because the ERA is being used at more than a five-percent payout in order to fill the deficits.

SENATOR OLSON asked about the school debt reimbursement.

MR. TEAL explained that the \$400 million in vetoes already includes a veto of some of the school debt. He noted that the school debt reimbursement was used early in the session to create a legislative budget, but the vetoes are done and it should be left at 100 percent. However, there is about \$50 million of the \$400 million that is counted in the school debt reimbursement line.

[1:39:13 PM](#)

SENATOR HUGHES offered her understanding that the governor's plan is to continue reducing the budget next year. She asked if he could show that the \$400 million is left in this year and the additional unknown amount is added for next year.

MR. TEAL replied he could do that but the purpose of this modeling is to look at the scenarios for the \$3,000 dividend, the \$1,600 dividend, and the deficit. He said the easiest way to do that is to use negative 1 percent for a growth rate, which shows that the budget falls. The CBR is not recovering, but it's not as bad and deficits are \$500 million, falling to almost zero. He continued as follows:

With continued cuts you can get there, it doesn't have to happen all in one year. You've got \$400 million this year; you can see that that isn't going to give you a sustainable plan. If there are continued reductions it will, but then you are looking at budgets that are falling - and if that's your intent it works. You can see that while you are using the ERA in an unplanned way for a while, you stop, and that means things will look even better as you extend beyond FY2028.

MR. TEAL said he agrees with Ms. Rodell that the legislature is fooling itself by looking beyond FY2028. He said just projecting three years in advance is hard. He emphasized that the model does projections, not predictions, and projections change when assumptions are changes.

[1:42:15 PM](#)

REPRESENTATIVE WOOL commented that the biggest variables are oil pricing and oil production projections and that is basically two-fifths of the state's income.

MR. TEAL reiterated that the object of the model is not to try to make things look good by making some optimistic assumptions. The object of the model is to look at expectations of what can realistically be achieved. He cited the previous modeling on continued budget reductions as an example. Some people might say the governor is committed to continued budget reductions while others might say that the legislature has been trying to cut the budget for several years and the capital budget cannot be cut further. The question is whether or not additional cuts from the operating budget continue. Once these programs are eliminated, departments will be eliminated at some point. That's fine, it's just a matter of how much goes to dividends and how much goes to government, he said.

MR. TEAL moved to slide 4 titled, "Scenario B: \$1,600 Dividend." He explained that under this scenario there are continued

unplanned ERA draws and the CBR is extended but ultimately vanishes. The \$1,600 dividend is probably workable. The model shows the ERA is growing but there are still deficits on the order of \$400 million to \$600 million. He said a balanced budget will probably occur in the mid-2030s. However, having no CBR is risky because there is no easy place to turn to for balancing the budget if oil prices plummet. The state will have to pull from the ERA which leads to declining real value of the permanent fund.

[1:46:46 PM](#)

REPRESENTATIVE WOOL speculated that because the CBR has a higher threshold, it's more likely that the ERA would be depleted first.

MR. TEAL replied that one option in the model says to not pull from the CBR, but it doesn't make that much difference. That would address the risk factor but the problem has not been fixed. That just provides some time to fix the problem.

CO-CHAIR JOHNSTON asked him to model no draws from the CBR.

MR. TEAL replied that he would model a CBR minimum balance of \$2 billion with draws strictly from the ERA. That shows slightly larger deficits than before. He reiterated the warning that running multiple scenarios tends to get confusing.

[1:49:44 PM](#)

REPRESENTATIVE KREISS-TOMKINS asked how much larger the CBR is getting as a result of the governor's budget not having a reverse sweep.

MR. TEAL answered that he couldn't answer because he does not know precisely what is being swept. He explained that without a reverse sweep, the \$172 million in the Statutory Budget Reserve (SBR) gets swept as well as several hundred million in standard sweepable things like the worker safety and hazard waste funds.

He said the big controversy revolves around the Power Cost Equalization (PCE) Fund and the Education Endowment Fund being swept. If the two funds are swept, then the PCE endowment is gone as of June 30 and there will be no money for PCE benefits in FY2020. He noted that the crime bill was funded with PCE funds so if the PCE fund is swept, the crime bill will not have money to back it. If the Education Endowment Fund is swept, then there would be no funding for things ranging from scholarships; grants to the university; funds for the Washington, Wyoming,

Alaska, Montana, and Idaho (WWAMI) School of Medical Education; and the Homework Help program for libraries.

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He reiterated that until there is a list of actual funds that are swept, he does not know what is going to happen. He said the sweep gets confusing on something like the Vaccine Assessment Fund, a fund established from a bill sponsored by the Senate president. That is a \$21 million fund that essentially consists of voluntary contributions from healthcare and insurance providers. He said if the reverse sweep does not occur for the Vaccine Assessment Fund, chances are low that healthcare and insurance providers will continue to contribute to that program. He remarked that trying to predict what is going to happen in a special session and whether the governor vetoes a reverse sweep is beyond his capabilities.

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MR. TEAL moved to slide 5 titled, "Scenario C: 'Surplus' Dividend," a scenario for what happens if dividends are based on what remains after spending. In this scenario, dividends drop substantially and then go back up as a result of revenue and the POMV payout increasing in the future. As revenue goes up faster than expenditures are climbing, then PFDs will go back up. The CBR grows steadily, meaning there are surpluses. The ERA grows, keeping pace with inflation. There are no deficits because whatever is left after spending on the budget is spend on dividends.

He opined that Scenario C is not as trouble-free as it may appear. On the positive side, if PFDs depend on spending then the people would be interested in what is spent and there would be pressure to move the budget downward. Right now there is no income tax and no link between spending, the dividend, or what people pay for government, but there would be a link in Scenario C. Oil is a very volatile commodity and spending during surplus years will be chaotic without rules governing the dividend. He observed that that wouldn't be any worse than the current situation. He suggested it would be a lot easier to settle the question of the dividend right now with a set of rules to follow that are sustainable and affordable. He acknowledged that the legislature would spend a lot of time and effort to get to that point.

1:59:11 PM

REPRESENTATIVE MERRICK remarked that spending during surplus years requires a conversation about a spending cap. She opined

that government cannot help itself and will spend to the point that there is no surplus and no dividend.

REPRESENTATIVE KREISS-TOMKINS asked him to comment on the spring revenue and production forecasts for North Slope oil.

MR. TEAL suggested he hold his question for Commissioner Tangeman from the Department of Revenue.

REPRESENTATIVE KREISS-TOMKINS asked if the model reflects a production forecast of 499,000 barrels per day.

MR. TEAL answered that the projection for FY2020 is 530,000 barrels per day and that appears to be a little optimistic. A decline is projected and then production goes up to 500,000 by FY2028.

[2:02:44 PM](#)

REPRESENTATIVE WOOL expressed hope that the committee would ultimately look at the underlying PFD formula and figure out a structure, not just pull numbers out of the hat such that the PFD discussion continues to be reargued.

MR. TEAL explained that the model would help legislators see what is sustainable and what is affordable. The model's big advantage is extending things out because deciding whether the state can afford to pay a \$3,000 dividend in FY2020 is a different question than the state being able to afford to pay a \$3,000 dividend every year. Paying a \$3,000 PFD as opposed to a \$1,600 PFD costs an extra \$1 billion. He remarked that he would be willing to pay an extra \$1 billion to, "Just have this problem go away."

REPRESENTATIVE MERRICK said Mr. Teal brought up an important point regarding the goal for the working group. She asked if the working group's goal is to recommend an amount for this year's PFD or to say what is sustainable into the future.

[2:06:41 PM](#)

CO-CHAIR JOHNSTON suggested that she read the resolution of how the working group was created and she will find all of the above. She said a short-term goal has been forced upon the working group for the next special session. The working group will continue to address a project that is not easy and cannot be done quickly because great thought is required.

SENATOR HUGHES said in an ideal world knowing what is affordable and sustainable would be helpful, but whatever is in statute the legislature can choose to follow it or not. Also, the seats in the legislature change over time and new legislators may have different ideas. She opined that the PFD must be settled in the constitution with people on board in a fair way. She pointed out that legislators who thought the PFD should not be put into the constitution, including herself, should reconsider because the dividend matter must be settled. Otherwise, it is going to continue forever.

[2:11:47 PM](#)

At-ease.

### Revenue Models

[2:12:32 PM](#)

CO-CHAIR JOHNSTON reconvened the meeting.

[2:22:19 PM](#)

BRUCE TANGEMAN, Commissioner, Department of Revenue (DOR), Anchorage, said he agrees with almost everything that Mr. Teal just stated. He and Mr. Teal met two days ago to ensure that the inputs to their models were the same and as a result, a lot of the outputs are identical. One difference is that his presentation has a 20-year projection to give a better view of the long term. He reminded the committee that forecasts are just a prediction from a point in time so a 10-year forecast is a bit of a stretch. A 20-year forecast is only meant to provide some parameters.

He said he believes he'll be able to answer members' lingering questions as he goes through his slides. He noted that several members asked what happens if oil prices spike, what happens if production spikes, and what happens when there are new people in office. He said he would not speak to the constitutional amendments but he would address questions associated with the spending limit. If there was a spending limit in place, it would take care of an oil price spike and it would limit what new legislators can and cannot do.

[2:25:38 PM](#)

COMMISSIONER TANGEMAN displayed slide 2, "A Contributing Factor to Why the ERA is Currently at \$19 billion:" He pointed out that a big reason for the \$19 billion ERA relates to the reduced PFD distributions for FY2017, FY2018, and FY2019. The statutory PFD

for those three years totaled about \$4.8 billion and the amount paid was about \$2.5 billion. The \$2.3 billion that was not distributed remained in the ERA and earned about \$400 million in interest. He emphasized that contrary to what some people think, that money was not used for government. He said another factor that contributed to the large ERA balance was that inflation proofing was not paid out for 2016-2018. He estimated that accounted for another \$2 billion.

[2:27:28 PM](#)

SENATOR HUGHES said she knows that in FY2017 and FY2018 the undistributed money was not used for government, but she thought some was used for government in FY2019.

COMMISSIONER TANGEMAN said the POMV started in FY2019 so part of the ERA did go to pay for some government. The undistributed \$886 million that remained in the ERA was part of the pool in the POMV calculation, but it did not go to pay for government. He stressed that there is no direct correlation.

SENATOR HUGHES asked if at least \$886 million from the ERA was used for government.

COMMISSIONER TANGEMAN replied the POMV calculation was \$2.7 billion.

SENATOR HUGHES responded, "So there would have been at least \$886 million that went to pay for government. Correct?"

COMMISSIONER TANGEMAN answered yes.

[2:29:14 PM](#)

CO-CHAIR JOHNSTON asked if the reason for the separation was because of the two distinctly different statutes.

COMMISSIONER TANGEMAN said not necessarily, but that brings up a good point because there has been a lot of discussion about the two competing statutes. He said they're both law, but the concept that surrounds the POMV discussion is different and he believes incomplete. He reminded the committee that the POMV debate centered on how much the draw would be and how it would be spent. The first part is a math equation and the decision was to establish a 5.25 percent draw that steps down to 5 percent over time.

The second part of the equation is how the draw will be split. The administration's perspective is that until the legislature

makes a decision and the governor agrees, the calculation will be the PFD calculation that is on the books. He said he believes that everybody knew at the time that whatever the ERA draw was going to be, there was a hole in the equation.

[2:32:20 PM](#)

CO-CHAIR JOHNSTON said she had to agree with Senator Hughes that it could be easily argued that the undistributed 2019 amount was used for government.

[2:32:33 PM](#)

REPRESENTATIVE MERRICK asked why the old statute wasn't repealed when Senate Bill 26 (2018) was passed.

COMMISSIONER TANGEMAN replied everyone was under the assumption that the split portion of the equation would be addressed the next year. He said he imagines the old formula was left on the books because repealing the calculation in statute would have eliminated the function that was in place to pay the dividend. The idea was that it could be repealed once the legislature came to a conclusion on the calculation going forward.

[2:33:30 PM](#)

REPRESENTATIVE WOOL related his understanding that Senate Bill 26 was a heavy lift and the Senate and the House came to different conclusions on the split. The conference committee solution was to make the draw one year and address the split later. To that point, he said there is nothing that says that the formula has to have anything to do with the POMV because other revenue sources could be used for the PFD.

He referenced the \$2.3 billion that was not distributed over the last three years and said one could argue that the FY2019 5.25 percent POMV draw was used for budgetary purposes. He asked if that was what he said.

COMMISSIONER TANGEMAN said yes, but he didn't want to get wrapped around the axle on the amount that was spent. The point was that if the statutory PFD formula had been followed those three years, there would be \$2.3 billion less in the ERA right now.

[2:35:43 PM](#)

SENATOR HUGHES asked him to comment on Representative Wool's statement that revenue sources other than the POMV could be used to pay the PFD. She offered her perspective that the PFD is supposed to come from the ERA, not from other revenue sources.

COMMISSIONER TANGEMAN said he understands what Representative Wool is saying, but he agrees more with Senator Hughes and the way it's been done for several decades. That is that the statute gives the formula and calculation and says that the money will be drawn from the ERA and go into the permanent fund dividend fund.

REPRESENTATIVE WOOL commented that the way it has been done is not working. He said he suggested other revenue sources because the question of paying a dividend remains if and when oil prices drop to zero. "If there's no oil revenue, do we need all the permanent fund revenue to keep the lights on or is there enough revenue to give out a check?" He suggested everyone think about that before committing to a large check in perpetuity.

[2:38:08 PM](#)

COMMISSIONER TANGEMAN told members that he waited to release his presentation until after the governor's vetoes came out at 11:00 this morning. He noted that Mr. Teal did not have the opportunity to present that scenario.

He continued the presentation reviewing the following assumptions:

- FY20 Budget (UGF Only):
  - Legislature's - \$4.4B Op & \$150mm Cap
  - Governor's - \$4.0B Op & \$150mm Cap
    - \$4B ERA transfer to Corpus (after inflation Proofing and POMV)
- Base Revenue Forecast: Spring 2019 Revenue Sources Book page 10
  - Extrapolated beyond 2028
- Production Scenarios: Fall 2018 RSB page 63
  - Declining at 3% after 2028
- Inflation: 2.25% (from Callan)
  - Agency Operations and Capital Items Grow with Inflation
- Population Growth: 0.5% (Department of Labor)
- Permanent Fund Returns:
  - FY20-FY29: 6.55%
  - FY30+: 5% + inflation
- CBR Balance at End of FY19: \$1.77 billion (Treasury)
- Recommended Minimum CBR Balance: \$1 billion

COMMISSIONER TANGEMAN clarified that for consistency he used the legislature's \$4.4 billion operating budget and \$150 million

capital budget. For the governor's budget he used the \$4 billion operating budget that was released at 11:00 a.m. and the additional \$4 billion ERA transfer to the corpus.

He explained that the fall forecast is the official forecast for the next fiscal year and the price is updated the next spring. The production forecast is made only in the fall. He noted that his graphs go out 20 years and the official forecast is for 10 years. The assumptions he made for the next 10 years include a production decline of 3 percent. He acknowledged that there was no science behind that number; it was that he didn't want to show an overly optimistic number.

COMMISSIONER TANGEMAN referenced an article in the paper today and confirmed that the numbers were coming in under forecast for the year. He highlighted that the Willow and Pikka oil field plays are included in that forecast and those plays have made him more optimistic about what the forecasts will show in the future. That won't be clear until December, but he believes those will come out of the heavily risked evaluation phase into the under development phase. The production forecast for this fall should be very different, he said. He said the forecast shows about a 5 percent decline over 10 years and it wasn't too long ago that the declines were 6-8 percent annually. He opined that flat is a comfortable place for the state to be right now with the other opportunities that are coming along.

[2:42:45 PM](#)

COMMISSIONER TANGEMAN recounted that he used 2.25 percent inflation, 0.5 percent population growth, 6.55 percent permanent fund returns, and 5 percent plus inflation for FY2030 to FY2040. The CBR balance at the end of FY2019 is projected to be \$1.77 billion. He acknowledged that the lack of reverse sweeps will affect that number but the presentation does not take that into account. He said he used the recommended minimum CBR balance of \$1 billion, whereas Mr. Teal did not set a minimum so the CBR disappears in some of his scenarios.

[2:44:04 PM](#)

COMMISSIONER TANGEMAN displayed the bar graph on slide 4 and read the problem statement: "Under the current projections of revenues and investment earnings, there is not enough money to fund the size of budget passed by the legislature and the full PFD for more than 10 years." He said that statement still applies despite the \$400 million the governor cut to the [operating] budget the legislature had passed.

COMMISSIONER TANGEMAN reviewed the graph. He noted that the budget shortfall in 2028 that forces taxes was also reflected in Mr. Teal's slides. However, unlike the CBR, the ERA does regenerate through annual earnings. He calculated that 6.55 percent on \$65 billion yields \$4.5 billion. If the POMV draw is \$3 billion, more is coming in than going out, which is reflected in subsequent years.

[2:46:39 PM](#)

REPRESENTATIVE WOOL questioned whether the ERA would regenerate because the additional draws would reduce the balance upon which to generate returns.

COMMISSIONER TANGEMAN agreed that the additional draws from the ERA, which are over \$1 billion in 2022 and 2023, are not inconsequential. However, the permanent fund balance (light blue background) is not declining. He pointed to the vertical axis on the right of the graph. He said this is despite the 6.55 percent forecast for 10 years, the 5 percent plus inflation draw in the out years, and the annual 5 percent POMV draw. He acknowledged that the draws do keep the fund from reaching triple digits.

[2:48:35 PM](#)

REPRESENTATIVE WOOL requested help interpreting the chart.

COMMISSIONER TANGEMAN explained that the light blue shaded background is the permanent fund itself and the dark blue tringle on the left shows the ERA going to zero [in 2028].

REPRESENTATIVE WOOL asked the value and type of tax that would be needed in 2028.

COMMISSIONER TANGEMAN clarified that he used the word "tax" in a general sense. It's to show that something needs to fill the \$800 million gap when the ERA drops to zero in 2028.

[2:49:58 PM](#)

REPRESENTATIVE KREISS-TOMKINS referenced the assumptions and asked if the 5 percent plus inflation for the permanent fund returns in FY2030 and beyond uses Callan's inflation figure of 2.25 percent.

COMMISSIONER TANGEMAN confirmed that was correct.

REPRESENTATIVE KREISS-TOMKINS said he calculated a 7.25 percent return on a \$70 billion fund for FY2030 and beyond and that assumption equates to \$0.5 billion in extra earnings each year.

He asked the commissioner to speak to the basis for the assumption that returns would increase 0.5 percent in the out years.

COMMISSIONER TANGEMAN responded that the permanent fund is in a position to invest for the long term so it has the opportunity to invest for higher returns. He said he believes that using inflation adjusted 4.3 percent for the next 10 years and inflation adjusted 5 percent for long returns is realistic. He reiterated that he was showing the 10 years beyond the official forecasts and he could have plugged in a different number that would show a different outcome. But if he stayed with a 10 year forecast, he'd be showing the same graph Mr. Teal showed. "I wanted to stretch out what changes now mean over a 20-year period potentially. So we could run it at 4 percent plus inflation or 8 percent plus inflation and it would certainly show different numbers," he said.

REPRESENTATIVE KREISS-TOMKINS said his initial hesitation was the assumption that there will be increased returns starting in FY2030. Second, given what is already known about how assets are managed, it's more likely that returns will go down because the ERA is going to zero. He asked the commissioner to comment.

COMMISSIONER TANGEMAN said returns over the last five years have ranged from 1 percent to 12 percent which is why it's important to rely on history and the experts at the permanent fund to say what they think is a realistic expectation. And 6.65 percent is the number that's projected for the next ten years. He agreed that for the past 30 years the permanent fund has only had to manage for revenue that would be spun off of dividends, but that changed last year when the legislature passed the POMV. A lot of widely ranging scenarios were put forward in 2017 and 2018 and when he puts on his permanent fund trustee hat that makes him very nervous. That is why the POMV legislation was so important. It narrowed the sideboards for potential draws which calmed the concerns of the permanent fund, Wall Street, and the state.

COMMISSIONER TANGEMAN said it's not the job of the permanent fund [corporation] to suggest how to spend the money. Rather, their job is to work with the legislature to establish an appropriate POMV that gives them comfort for investing moving forward. When they heard proposals to draw \$8 billion to fund a budget, they had to stay liquid to meet that potential draw. Now that they know what the POMV looks like, they can draw in those sideboards to a great extent as to what the liquidity needs will be for the next 12 months.

[2:57:22 PM](#)

CO-CHAIR JOHNSTON asked how many years the department looks at in its spring and fall forecasts.

COMMISSIONER TANGEMAN answered 10 years.

CO-CHAIR JOHNSTON asked how many years Callan looks at in its forecasts.

COMMISSIONER TANGEMAN said he wasn't sure but it's probably 10 years.

CO-CHAIR JOHNSTON expressed concern that the model depletes the ERA in the early years. She asked, as a permanent fund trustee, if he would manage differently as the ERA is depleted.

COMMISSIONER TANGEMAN said he labeled slide 4 the problem statement because it demonstrates that it's not possible to give a full dividend and let the full budget grow. He directed attention to the next slide that illustrates the "Surplus PFD" Option. It's the legislature's budget and the POMV draw then whatever is not needed for government is left for dividends. He said that is the first option.

[3:01:47 PM](#)

SENATOR HUGHES asked if the legislature did projections during the years that the budget was growing that might have shown that a future legislature would need to deal with the current situation.

COMMISSIONER TANGEMAN said he assumes there were forecasts but he didn't really know because he wasn't around at the time.

[3:02:32 PM](#)

REPRESENTATIVE WOOL asked how accurate DOR's projections were 10 years ago in forecasting the situation today.

COMMISSIONER TANGEMAN said price and production forecasts have been fairly accurate for the first two years but each subsequent year is less and less accurate. Ten years ago some production forecasts were in the 300s and it's actually 500.

REPRESENTATIVE WOOL observed that predicting the return on a \$60 billion fund might be easier than predicting oil revenues in the next 10 or 20 years. He described predicting total revenue and how it will be dispersed as a guessing game regardless of the

assumptions that are made. He noted that unlike this presentation, Mr. Teal's presentation did not include taxes.

COMMISSIONER TANGEMAN responded that there wasn't a workable spending cap when there were spikes in prices and production was up. The money was spent and therefore was not available for the down years. That is the importance of a spending cap, he said. He noted that there was a spending cap in the constitution right now and the proposal was to fix the problem with the formula which is population and inflation. Since 1982 that has exploded, which is another reason to put a cap in place. He agreed that forecasts are inaccurate as soon as they are printed which is why it's important to have sidebars so you save in the up years to pay for the down years.

REPRESENTATIVE WOOL said the legislature has saved some because it's been using those savings the last few years to balance the budget. "The revenue wasn't there but we pulled it out of CBR savings," he said.

COMMISSIONER TANGEMAN said that's true and he believes that kept people from recognizing that Alaska was in a recession. The budget was not in line with the revenues that were coming in and the legislature relied on savings to balance the budget. That works for the short term but that was done several years in a row and the fund dropped from \$15 billion to where it is today. He said the fact that spending didn't follow revenues down caused a faster bleed on the CBR.

3:06:50 PM

SENATOR OLSON highlighted that he was first elected in 2000 when things were fairly rough and that was followed by spikes and subsequent declines. Mr. Teal worked in Legislative Finance throughout that time and in 2006 he warned the Senate Finance Committee that if the legislature didn't get a handle on things it would get away from them. The problem was that the warning fell on deaf ears because the state was swimming in money at the time.

3:08:08 PM

COMMISSIONER TANGEMAN continued to review slide 5. The legend indicates that black is base revenue, light blue is principal, dark blue is the ERA, and green plus the checkered segment is the POMV draw. Those two and the black represent the base budget. The solid purple is the surplus that is left for dividends. The checkered segment is meant to show the amount of the calculated dividend that goes to government. It shows that

in 2022 the dividend drops to about \$500 and then it starts to grow. He reiterated that this scenario shows the imbalance in the legislature's budget. It uses base revenue plus whatever is needed of the POMV to balance the budget and the leftover is for the dividend. In this scenario, the principal, the ERA, and the CBR all go up. In 2040 it shows about \$120 billion in reserves.

[3:10:25 PM](#)

COMMISSIONER TANGEMAN moved to slide 6 titled, "The Governor's Option (Step 1): Reduce the Budget to \$4.2 billion (\$400 Million in Vetoes)" that shows what the governor introduced this morning. He noted that even with the \$400 million in vetoes above the reductions the legislature passed, it does not solve the problem. The ERA lasts a little longer but it is still depleted by 2028-2029. Dividends could still be paid in the future but the savings in the ERA go away. The POMV draw would rely on annual returns. It shows that for the first couple years there will be extra draws from savings and the ERA. He said this is illustrative but it's just the first of a two-step plan. Step 2 of the governor's plan is to bring revenues in line with expenditures next year.

[3:11:48 PM](#)

COMMISSIONER TANGEMAN moved to slide 7 titled "The Governor's Option (Step #2): Reduce the Budget to \$3.6 billion (Governor's Proposed Budget)." This proposal shows that the ERA starts to stabilize, total reserves are over \$100 billion, and the full PFD is paid under the current formula. He said that even with additional reductions to the FY2021 budget, additional draws from savings and the ERA will be required through FY2027.

[3:12:45 PM](#)

REPRESENTATIVE KREISS-TOMKINS asked if the additional ERA draws are in excess of 5 percent of the market value.

COMMISSIONER TANGEMAN agreed that the draws are in excess of the POMV.

[3:13:24 PM](#)

REPRESENTATIVE KREISS-TOMKINS asked what the administration's position is on draws from the ERA that are in excess of the POMV.

COMMISSIONER TANGEMAN said the governor would have to answer that question. He's said to follow the law but now there are two laws that slightly contradict one another. He offered his perspective that one law has been on the books and working for

40 years, whereas the law that has been on the books for 12 months won't be complete until it addresses how the POMV will be split. Once the split is established, it will be clear how much of the POMV will go to the dividend and how much will be left for government. Under this administration that will balance because this governor says that revenue must match expenditures. He acknowledged that future governors and future legislatures may make different decisions.

3:15:09 PM

REPRESENTATIVE KREISS-TOMKINS said it would be helpful to know what the governor's position is on drawing in excess of the POMV.

COMMISSIONER TANGEMAN said he'd ask and pass the answer along to the group.

3:15:20 PM

REPRESENTATIVE KREISS-TOMKINS highlighted that the governor's budget proposal was released under the pretense that revenues would be in line with expenditures. Theoretically that was the one year plan but those didn't align because that budget used savings from AIDEA and other sources. He asked why the budget proposal the governor released in February did not define revenue.

COMMISSIONER TANGEMAN said he believes it did; the governor presented a balanced budget.

REPRESENTATIVE KREISS-TOMKINS interjected, "Without using savings."

COMMISSIONER TANGEMAN said he'd leave the details to the Office of Management and Budget (OMB) because he didn't know the details. He mentioned petroleum properties.

REPRESENTATIVE KREISS-TOMKINS said, "I'm sorry to interrupt but that's a big detail and you're the commissioner of revenue."

COMMISSIONER TANGEMAN responded, "I'm not the OMB director though so I can only answer to the level that I understand and I know." He said there were large portions that required legislative changes such as petroleum property taxes and AIDEA, but they didn't get traction. Therefore, the budget the legislature passed and the portions the governor vetoed are significantly different than the budget the governor passed in February. The governor's goal to have revenues align with

expenditures hasn't changed, which is why the one-year plan is now a two-year plan.

[3:17:27 PM](#)

REPRESENTATIVE WOOL referenced the statement that the year-old statute only addressed the draw and was therefore incomplete. He asked if the governor would still cut the budget \$1.3 billion in the next two years if the legislature follows all the statutes relevant to the draw and replaces the old formula with a sustainable PFD formula, all of which is within the current revenue stream. Or is the cut only to pay the full PFD, he asked.

COMMISSIONER TANGEMAN said finishing the second part of the POMV is just the revenue part of the equation, not the expenditure side. Base revenue and the POMV that is on the books is a fixed amount and if the budget isn't reduced to that level, there will be a gap that can't be ignored. This administration proposes to address that gap by reducing expenditures to meet whatever revenue come in. If expenditures aren't reduced to that level or the next governor decides to grow the budget beyond the available revenue, that evil red slice (taxes) may perhaps come into play, he said. He said the bottom line is whether revenue minus expenditures balance.

REPRESENTATIVE WOOL commented that a lot of expenditures were cut today and the tension is that the PFD formula is sacrosanct. That's the disagreement between some legislators and the governor and not all legislators agree.

COMMISSIONER TANGEMAN said some people believe the dividend should be paid with the surplus, whereas the governor believes the dividend should be paid first and expenditures should be reduced to balance with revenue.

REPRESENTATIVE WOOL pointed out that the middle ground would change the formula to make the purple bar smaller.

COMMISSIONER TANGEMAN acknowledged the point.

[3:21:54 PM](#)

SENATOR HUGHES referred to an earlier comment that the PFD has not been working the last few years. She offered her belief that it's the budget that has not been working, and that ought to be the focus. Turning back to slide 7 she questioned the need to have a robust ERA up to 2040 if the legislature abided by the 5 percent draw, perhaps because it was in the constitution.

COMMISSIONER TANGEMAN said it's a good point if an endowment model is followed. This shows the current situation, but once things are balanced and the legislature has figured out part 2 of the POMV question, the ERA isn't needed if you stick within those parameters, he said.

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CO-CHAIR JOHNSTON related her understanding that the ERA is necessary to pay out the structured draw.

SENATOR HUGHES highlighted that the governor's option Step 1 shows that the ERA is depleted and the dividend is still paid, whereas the governor's option Step 2 shows that the ERA is extra.

COMMISSIONER TANGEMAN responded that the excess ERA goes away but the annual returns are spinning off revenue to pay for the POMV in the particular year. The ERA is not building, but commitments are being met.

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REPRESENTATIVE MERRICK asked if the administration supports a change to the formula if it goes to a vote of the people.

COMMISSIONER TANGEMAN replied the governor has been very clear that as long as it goes to a vote of the people, he will accept any change the legislature makes.

COMMISSIONER TANGEMAN reviewed the following conclusions:

- There are many ways to address the fiscal issues facing the state
  - Cutting the PFD is the most regressive way to solve the problem

COMMISSIONER TANGEMAN clarified that the next two bullets are his own thoughts. The POMV is a significant change to the revenue stream and in a perfect world it would dictate starting over from a zero-based budget. The question is what should Alaska's budget look like now that the revenue stream is oil plus something else. He emphasized that continued fiscal restraint will be critical moving forward because production is down and there are no forecasts for oil price booms. He opined that is why it's critical to correct the spending limit that's currently on the books.

- Alaska's budgets have been built for decades on one revenue stream
- We have entered a new period in Alaska's history and "picking up where we left off" by merely making tweaks to the existing budget is not sufficient for the long term
- Continued fiscal restraint will be critical moving forward
- The "fiscal crisis" we are trying to solve may not exist
  - There are a lot of good things happening on the North Slope which may help resolve much of the problem. The Legislature & the Governor took an important first step in the right direction on the FY20 budget.
  - We all have more work to do in order to right-size the government for the next generation ["It will require more cuts."]
- We may be trying to solve a temporary problem with a permanent solution
  - It is prudent to gather more information before making drastic changes
  - We are still the envy of most other states
  - Let's keep things in perspective - our financial reserves will allow us to pay the full PFD while we all make prudent decisions for the future of Alaska

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COMMISSIONER TANGEMAN noted that, as requested, he provided additional information on the CBR. He also included a fairly robust synopsis of the CBR including the Sub Account and the investment history.

[3:29:42 PM](#)

CO-CHAIR JOHNSTON asked how the investment policy changed when the legislature started taking draws from the CBR and how that affected the return on investments.

COMMISSIONER TANGEMAN referred to the chart on slide 11 titled, "CBR Return History." He said the gold bars representing the Sub Account show that account was invested at a much more aggressive rate than the main account. When there was up to \$14 billion in the CBR, the fund could afford some longer term investments to earn those returns. However, more liquidity was necessary as the

CBR was drawn down. The need for more liquidity is the primary reason that the Sub Account was zeroed out in 2015.

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CO-CHAIR JOHNSTON asked what the current rate of return is for the CBR.

COMMISSIONER TANGEMAN answered that it's 2.38 percent.

[3:31:24 PM](#)

REPRESENTATIVE KREISS-TOMKINS asked if he would provide charts 5, 6, and 7 with a 6.55 percent assumption for FY2030 and beyond.

COMMISSIONER TANGEMAN asked for clarification that he was asking to have the 6.55 percent assumption that's used in the first 10 years to be mirrored in the second ten years. [Representative Kreiss-Tomkins said yes and Commissioner Tangeman agreed to provide the charts.]

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REPRESENTATIVE KREISS-TOMKINS asked for an explanation of the Sub Account.

COMMISSIONER TANGEMAN explained that it was created because the legislature wanted to invest a portion of the CBR that would earn a higher return than 2.38 percent. He noted that the dates when that took place were in the handout he provided.

REPRESENTATIVE KREISS-TOMKINS asked how the administration plans to invest the cash infusion into the CBR from the sweep that could be in the billions.

COMMISSIONER TANGEMAN said he doubts the CBR will grow by billions because of the sweep, but he would continue to be conservative on the CBR investments until some of the large decisions are made.

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REPRESENTATIVE KREISS-TOMKINS questioned how the sweep would not be in the billions when the power cost equalization endowment is just short of a billion and that is just one of many accounts that will be swept.

COMMISSIONER TANGEMAN said he wasn't part of the discussions when the vetoes took place and so he'll need to catch up on the effects of the accounts that will not be reversed.

CO-CHAIR JOHNSTON asked Ms. Rodell and Commissioner Tangeman to discuss how the management of the ERA will change if the structured draw isn't followed.

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MS. RODELL said the first step is to articulate the purpose of the ERA. In the last couple of years the discussion has been that it has turned from being a receptacle of earnings of the fund to a budget stabilization or reserve fund. While the characterization of how the fund is used has changed, there has been no change to the investment mandate, she said. Secondly, moving \$4 billion from the ERA back to the corpus as a result of the governor's vetoes will leave about \$12 billion in the ERA. When Senate Bill 26 was debated it included discussions about lookbacks to decide whether the draws were sustainable. There was also talk about having a regular sweep of any amounts in excess over 4 years. That is somewhat in line with the creation of the Sub Account and Main Account. The idea of the Sub Account was that a portion of the budget reserve wouldn't be needed for at least 5 years so it could have a longer outlook. If there are 4 years of POMV draws left behind and everything else is swept into the corpus, it looks more like what was envisioned for the CBR as well.

If that is the direction the legislature and the governor are going to take the ERA, she said her recommendation to the board will be about de-risking by investing on a short to medium term basis for the purpose of funding important services of the state. However, before doing that the trustees would like direction from the legislature, she said.

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CO-CHAIR JOHNSTON summarized that the investment profile would change from higher risk, higher yield to something more similar to the original fund.

MS. RODELL said she believes so but depending on the market environment, fixed income assets can do very well. Duration of the investment also makes a difference because you have to time the maturities to the expectation.

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REPRESENTATIVE KREISS-TOMKINS noted that she said she would recommend an adjustment in the way the ERA is invested because of the requirements for greater liquidity. That means less

investments which means all the math in all the slides is that much uglier. He asked if that's wrong.

COMMISSIONER TANGEMAN said it's not wrong at all and that's why it's critical to get on the same page. The first graph shows the ERA will bottom out in 2028, which clearly demonstrates it's not possible to go to that well again and again to support this budget and a full dividend.

[3:43:12 PM](#)

REPRESENTATIVE KREISS-TOMKINS highlighted that even in the governor's ideal vision, there are ERA draws in excess of the POMV. He said per your testimony that would result in management changes, which would mean lower investment returns. Even Step 2 of the governor's option shows ERA overdraws. He said these don't reconcile and increasing investment returns 65 basis points starting in 2030 further fails to reconcile.

COMMISSIONER TANGEMAN said he inserted the extra ten years to demonstrate that the budget eventually balances after Step 2 of the governor's plan. Once things are synced and brought in line, it will be possible to look at the long term in a different light, he said.

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REPRESENTATIVE KREISS-TOMKINS remarked that the talk is about a 10-20 year outlook and the administration has failed to provide a truly balanced budget. He said it's difficult to consider this as a serious fiscal vision when the math doesn't work.

COMMISSIONER TANGEMAN said he respectfully disagreed. When the governor says that revenues will match expenditures, that means there will be a balanced budget for FY2021 on December 15.

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CO-CHAIR JOHNSTON advised that when Alaskans voted for the permanent fund in 1976, revenues went to the general fund. In 1982 after the constitutional challenge of the dividend, 50 percent of those revenues went to the dividend. The rest of the revenues didn't go into the general fund, but a portion of the earnings was reinvested, which grew the fund tremendously. She described it as a partnership in which one partner reinvested earnings to grow the company and the other partner took 50 percent. She said that would change her view of the partnership. While it's not part of the fund's discussion, she said the working group needs to consider the partnership, the original mission, what the 1982 division was, and how the fund has grown.

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CO-CHAIR JOHNSTON asked Mr. Teal to briefly describe how the governor's vetoes affect the dividend and what he's done by taking \$1 billion of the \$2.9 billion out of the structured draw.

MR. TEAL said his response would be based on the first dividend calculator sheet he provided and the assumption that the general fund is used. The calculation shows that with the \$400 million in vetoes, the \$600 million surplus becomes \$1 billion. He said there was also a \$1 billion veto of the POMV payout. As the governor said, the budget is balanced and \$1 billion is left in the ERA. He said that money is available for the 5.25 percent payout and there is enough for a \$1,600 dividend, but he doubts that is what the governor meant given his claims that he wants a \$3,000 dividend. He said he suspects the only solution is to use the \$1 billion that's left in the ERA and then draw an extra \$1 billion, which is unsustainable.

CO-CHAIR JOHNSTON asked if \$1,600 would be available for the next dividend without the additional draw.

MR. TEAL said that's correct.

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CO-CHAIR JOHNSTON noted that about a week ago there was discussion that if Governor Hammond's dividend had gone forward, the inflation adjusted dividend today would be \$3,000. Senator Bishop wanted it on the record that in 1980 the general fund budget was \$1.74 billion. Adjusted for inflation that budget would be \$5.14 billion in 2019.

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SENATOR HUGHES highlighted that part of the reason the PFD was proposed was the worry that the budget was growing so quickly.

CO-CHAIR JOHNSTON pointed out that Governor Hammond's dividend stipulated that it would be paid as funds were available.

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REPRESENTATIVE KREISS-TOMKINS said it's worth noting that a \$1,050 dividend existed in the context of the durational residency formula. Alaskans who had not lived in Alaska for 21 years would receive a dividend that was less than \$1,050.

CO-CHAIR JOHNSTON shared that her dividend would have been \$200.

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MR. TEAL said the 50 percent share made sense when the assumption was that the government would also take its 50 percent. But the government didn't do that. He referenced Ms. Rodell's presentation that looked at the constitutionally mandated portion of the permanent fund, which was some \$17 billion. He said it could be argued that everything in excess of the \$17 billion was royalty deposits, but it was actually money the government put into the fund. It was not royalty at all.

MR. TEAL said that if you were trying to make the argument that the 40-year-old formula is valid, you might also say you should get 50 percent of the earnings on all the royalty deposits. The original concept of the permanent fund was that 25 percent or more of mineral royalties would go into the fund. The situation now is that only about 30 percent of the permanent fund is royalties and the rest was added by the legislature. He said if you follow the formula for 50 percent of earnings and get the \$3,000 dividend and you know that only 30 percent is royalty deposits, you could say the dividend should be just 30 percent of \$3,000, which is about \$900. He said that is arguably what was envisioned when the formula was developed.

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SENATOR HUGHES maintained that the record is very clear that the PFD was to be paid first. Government taking 50 percent was not envisioned but the record does talk about being available when oil revenues went down. She offered her belief that the partnership metaphor didn't resonate, because it wasn't that type of relationship. Rather, it's like grandparents and grandchildren, she said. The grandparents might want to reinvest the money for the next generation, which is what the state was doing. The grandchildren could have some now but the dividends would continue in the future. She reiterated her view that the PFD isn't broken, it's the budget that's broken. She said she also doesn't buy into the concept of living within your means in this context. If oil were to drop to \$10 per barrel, it would be very difficult for the state to provide the most essential services.

She said all eyes have turned to this PFD cookie jar, and she wants all eyes back on the budget to figure out what is a right sized budget in Alaska. She said she feels as though the legislature has been throwing darts in the dark to get to the right number so she asked the Office of Management and Budget (OMB) to tease out the right size when all the factors and

Alaska's unique challenges are taken into consideration. She said she would support a full-scale audit by someone who is nonpartisan to understand where things could be shored up or combined for efficiency, and what isn't meeting statutory or constitutional obligations. She reiterated that it's been very frustrating that the legislature has been going about this all wrong. She maintained that the focus on the PFD has led to a chaotic situation in the legislature the last few years and it really needed to be settled so legislators can focus on the budget.

[4:05:35 PM](#)

REPRESENTATIVE MERRICK asked if there was ever any discussion about dividing the permanent fund and providing a portion for the people and a portion for government.

CO-CHAIR JOHNSTON recalled there were many discussions about doing different things with the permanent fund.

[4:06:06 PM](#)

REPRESENTATIVE KREISS-TOMKINS asked the record to reflect that Cliff Groh was in the audience. He was legislative staff when the permanent fund was established and he shared a 90 or so page private contemporaneous history of how the sausage was made. That blew up some of my assumptions, he said. It doesn't answer Representative Merrick's question but it has rich detail that may be helpful to the working group. He offered to share the document with Mr. Groh's permission

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REPRESENTATIVE WOOL stressed that the original intent of the permanent fund is important, but it is not the defining issue. He said he doesn't entirely agree with Senator Hughes that the budget is the problem. Perhaps spending could be reduced a little less, but per capita and adjusted for inflation it's not the highest it's ever been. There are efforts to keep the budget in check but needs change as the population changes. He highlighted that when about 100,000 Alaskans voted to put the permanent fund in the constitution, the population and composition of the voters was different than it is today. He said most people realized that spending needed to be controlled after the first oil money was spent so quickly. On the other hand, infrastructure in the state at the time needed to catch up. He said the PFD never came to the people for a vote; it just became a statute and that worked well up until 3-4 years ago. He acknowledged that a spending cap was not a bad idea. He said oil has dropped from 90 percent of the state's revenue to just 40

percent and nobody knows where it's going next. He drew a parallel to demonstrate the need to change models when it's prudent to do so. The oil industry is aware of this and they're getting into solar, wind, and other forms of energy, he said. He also noted the changes in northern and western Alaska where the ice is disappearing. He emphasized that the consumption of hydrocarbons may change in the next 10 years because the revenue structure the state has been relying on is changing.

REPRESENTATIVE WOOL said he did not support cutting the budget \$1.3 billion to \$1.6 billion over the next two years because it was too drastic and would cause people to leave the state. He noted that people are already leaving the state because of the cuts to the university. He emphasized the need for the legislature to look at revenue, the revenue projections, the PFD formula, and the priorities of Alaskans today.

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CO-CHAIR JOHNSTON thanked everyone for their hard work and stated that the next meeting would be on July 8 at 9:00 a.m. in Juneau.

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There being no further business to come before the Bicameral Permanent Fund Working Group, Co-Chair Johnston adjourned the meeting at 4:12 p.m.