ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS
April 1, 2021
11:34 a.m.

MEMBERS PRESENT

Representative Ivy Spohnholz, Chair
Representative Adam Wool, Vice Chair
Representative Andy Josephson
Representative Calvin Schrage
Representative Andi Story

MEMBERS ABSENT

Representative Mike Prax
Representative David Eastman

COMMITTEE CALENDAR

PRESENTATION: REVENUE PROJECTIONS

- HEARD

PRESENTATION: ALASKA PERMANENT FUND

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

LUCINDA MAHONEY, Commissioner Designee
Department of Revenue
Anchorage, Alaska
POSITION STATEMENT: Provided introductory remarks to the presentation by Dan Stickel.

DAN STICKEL, Chief Economist
Department of Revenue
Juneau, Alaska
POSITION STATEMENT: Provided a PowerPoint presentation, titled "Spring 2021 Forecast Presentation," dated 4/1/21.

ANGELA RODELL, Chief Executive Officer

Alaska Permanent Fund Corporation
Juneau, Alaska
POSITION STATEMENT: Provided a PowerPoint presentation, titled "Alaska Permanent Fund," dated April 2021.

ACTION NARRATIVE

11:34:39 AM

CHAIR IVY SPOHNHOLZ called the House Special Committee on Ways and Means meeting to order at 11:34 a.m. Representatives Story, Wool, Josephson, Schrage, and Spohnholz were present at the call to order.

PRESENTATION: Revenue Projections

11:36:18 AM

CHAIR SPOHNHOLZ announced that the first order of business would be a presentation on revenue projections by Dan Stickel, Department of Revenue (DOR).

11:36:52 AM

LUCINDA MAHONEY, Commissioner Designee, Department of Revenue, expressed her appreciation to the House for resurrecting the House Special Committee on Ways and Means and offered DOR's support as needed. She conveyed that Mr. Stickel would be sharing an update on the spring forecast, noting that several slides had been updated to provide the most recent data.

11:37:58 AM

DAN STICKEL, Chief Economist, Department of Revenue, introduced a PowerPoint presentation, titled "Spring 2021 Forecast Presentation" [hard copy included in the committee packet]. He directed attention to the agenda on slide 2, which read as follows [original punctuation provided]:

1. Forecast Background and Key Assumptions
2. Spring 2021 Revenue Forecast
•Total State Revenue
•Unrestricted Revenue
3. Petroleum Forecast Assumptions Detail
•Oil Price
•Oil Production

•Oil and Gas Lease Expenditures
•Oil and Gas Credits

MR. STICKEL jumped to slide 4, titled "Background: Spring Revenue Forecast," which read as follows [original punctuation provided]:

1. Historical, current, and estimated future state revenue
2. Updates key data from Fall Revenue Sources Book
3. Official revenue forecast used for final budget process
4. Located at tax.alaska.gov

MR. STICKEL explained that the "Fall Revenue Forecast" is DOR's annual publication by the research group that comes out in December. The publication contains additional tables and important information on the state's revenue sources. Alternatively, the "Spring Revenue Forecast," released in March, updates that fall forecast with a limited selection of tables. Both documents are located on the Tax Division's website.

11:39:31 AM

MR. STICKEL continued to slide 5, titled "Key Alaska Economic Indicators," which read [original punctuation provided]:

1. Real State GDP: $51.6 billion in Q4 2020
•Up 1.4% from Q3 2020, still down 3.4% from Q4 2019

2. Employment: 294,900 in February 2021
•Down 22,400 (-7.1%) compared to February 2020; heaviest impacts in leisure/hospitality, transportation/warehousing, and oil/gas industries

3. Wages & Salaries (seasonally adjusted): $21.3 billion inQ4 2020
•Up 2.1% from Q3 2020, down 2.9% from Q4 2020

4. Alaska Bankruptcies: 313 for calendar year 2020, 39 cumulatively for 2021 (through February)
•Compared to 400 for all of 2019

5. Foreclosures: 98 in Q3 2020, 303 for calendar year 2020 (through Q3)
•Compared to 197 in Q3 2019 and 729 for entire calendar year 2019

6. Housing Starts: January-February: 305 in 2021 vs 304 in 2020
•1,491 for calendar year 2020 vs 1,689 for calendar year 2019

7. Delinquency Rates: 0.7% for mortgages 30-89 days delinquent, .5% for mortgages 90+ days delinquent at end of Q3 2020 (as of September 2020)
•Compared to 1.6% for mortgages 39-89 days delinquent, .7% for mortgages 90+ days delinquent at end September 2019

MR. STICKEL indicated that a combination of factors is driving the decrease in bankruptcies and foreclosures, including government programs that provide temporary aide and limit foreclosures, as well as actions by the financial industry to support individuals in those situations. Regarding the mortgage delinquency rates, he said, between income support, a strong housing market, and lenders working with borrowers, there was not a significant uptick.

11:43:26 AM

REPRESENTATIVE SCHRAGE sought to confirm that the foreclosure moratorium had no effect on these numbers.

MR. STICKEL said these numbers include any moratoriums that had been in place. He added that as foreclosures are down, it would be reasonable to assume that the moratorium was a contributing factor.

CHAIR SPOHNHOLZ noted that there was an expansive housing relief program introduced this year, which may be helping renters catch up on bills.

11:44:22 AM

MR. STICKEL proceeded to slide 6, titled "Spring Forecast Assumptions," which read [original punctuation provided]:

•The economic impacts of COVID-19 are uncertain; DOR has developed a plausible scenario to forecast these impacts.
•Key Assumptions:
o Investments: Stable growth in investment markets.

o Federal: The forecast incorporates stimulus funding through February 2021, it does not include potential new stimulus passed in March 2021.
o Petroleum: Alaska North Slope oil price of $53.05 per barrel for FY 2021 and $61.00 per barrel for FY 2022. No further oil production curtailments.
o Non-Petroleum: Most economic activity will return to baseline levels by FY 2022, except tourism full recovery by summer 2024.

MR. STICKEL indicated that DOR is assuming a 6.75 percent annual return on investments in the Alaska Permanent Fund. He noted that while most economic activity should return to baseline levels by FY 22, the assumption for recovery in the tourism industry was pushed to 2024 because large cruise ships will not be visiting this summer. He reported that the following assumption was incorporated into the forecast: no large cruise ship visits in 2021; 50 percent recovery in 2022; 75 percent recovery in 2023; and return to 1.4 million visitors in summer 2024.

11:46:44 AM

REPRESENTATIVE STORY opined that assumption for the tourism industry is "on the low side." She expressed her hope that the industry would recover sooner than forecasted.

MR. STICKEL explained that while developing the assumption on the tourism industry, the sense from the industry was that with COVID-19 protocols and reluctance to travel, the first year of cruise ships would most likely be under 1.4 million visitors and it would take one or more years to return to that level. He noted that the gradual recovery rate was a planning assumption that incorporated feedback from the industry, as well as discussions with colleagues at the Office of Management & Budget (OMB) and Legislative Finance Division (LFD).

11:48:19 AM

CHAIR SPOHNHOLZ said given CDC [Centers for Disease Control and Prevention] guidelines that cruise ships shouldn't sail in summer 2021, recovery for that sector of the industry would be challenging, as cruise ship passengers account for 55-60 percent of Alaska's tourists.

11:48:50 AM

MR. STICKEL turned to the graphic on slide 7 showing relative contributions to the total state revenue in FY 20 with the largest being from federal revenue, investment earnings, and petroleum. He noted that while other revenue sources - including mining, fisheries, tourism, non-petroleum corporate income, and other - are important to the economic picture, they only amount to slightly over 12 percent of the total state revenue combined.

CHAIR SPOHNHOLZ shared her belief that slide 7 is slightly misleading in regard to the significant role that investment earnings play in the state's current revenue picture. She explained that the slide suggests that investment earnings and petroleum are equal contributors to the state's revenue; however, there was decreased market activity in FY 20. In a more "normal" market, she suggested the ratio would contribute twice as much as petroleum.

11:50:47 AM

MR. STICKEL advanced to slide 9, which showed the total revenue forecast from FY 20 projected through FY 22. He noted that total revenue is grouped into four categories: Unrestricted General Funds (UGF), which are revenues that can be appropriated for any purpose; Designated General Funds (DGF), which are revenues that can be appropriated but are customarily used for a specific purpose; Other Restricted Funds, which are revenues that are dedicated in use and not available for general appropriation; and Federal Revenue, which is restricted revenue.

11:52:58 AM

REPRESENTATIVE STORY questioned how many barrels of oil are produced on federal land and whether the revenue generated from that production could be increased.

MR. STICKEL stated that production on federal land is a relatively small contributor. He reported that in FY 20, oil production from the National Petroleum Reserve - Alaska (NPR-A) amounted to 6,500 barrels per day from the North Slope out of 471,800 total barrels per day. He pointed out that the number would potentially increase with several new developments commencing in the future, including the Greater Moose's Tooth and Willow.

11:54:18 AM

REPRESENTATIVE STORY inquired as to the state's percentage of oil production on federal lands.

MR. STICKEL explained that for production on federal land, state corporate income tax, property tax, and production tax applies. He said royalty from that production goes to either the federal government or private landowners with the state receiving half of any federal royalty; however, there are restrictions on how revenue from the National Petroleum Reserve must be used. Further, for any production attributable to private landowners, the state levies a private landowner royalty tax. He concluded that the state gets some revenue, but because the state is not the landowner, it does not receive as much royalty revenue as production on state land.

11:55:44 AM

REPRESENTATIVE SCHRAGE observed an inverse relationship when comparing the UGF and DGF investment revenue and petroleum revenue forecasts. He asked Mr. Stickel to provide insight on that relationship.

MR. STICKEL said looking at the investment revenue for UGF, the Alaska Permanent Fund is based on the percent of market value (POMV) draw. For FY 21, that draw was based on 5.25 percent of a trailing five-year average, whereas the draw in FY 22 and beyond was based on 5 percent. He added that "the unrestricted piece is reflecting the lower percent of market value draw with the permanent fund." In terms of the other investments, the FY 21 data includes some actual performance for the beginning of the fiscal year combined with a projection for the rest of the fiscal year; consequently, "the actual revenue had come in a little stronger than projected for the remainder of the fiscal year for [FY] 21."

11:57:48 AM

REPRESENTATIVE SCHRAGE asked Mr. Stickel to speak to the petroleum revenue.

MR. STICKEL said it would be discussed on the following slides.

11:58:27 AM

REPRESENTATIVE WOOL calculated that the total earnings for the Alaska Permanent Fund in FY 21 is about $3.9 billion. He asked if that is correct.

MR. STICKEL confirmed that the total earnings of the fund would be the POMV and the unrestricted, plus the other restricted earnings component.

11:59:40 AM

CHAIR SPOHNHOLZ highlighted the loss of $1.2 billion in investment revenue in FY 20. She asked if that represents a loss in revenue at the permanent fund.

MR. STICKEL said the other restricted investment revenue of negative $1.2 billion represents the total permanent fund investment revenue minus the permanent fund draw. He explained that the total return for the fund, which was about 2 percent for FY 20, was a positive number. The 5.25 percent POMV draw represents more money than the total return on the fund; therefore, any residual gain/loss in the fund is shown as other restricted investment revenue. He added that in FY 21 and FY 22, the fund is expected to return slightly more than the draw.

12:01:09 PM

CHAIR SPOHNHOLZ summarized that the revenue was net positive, but more revenue was drawn than was earned from the permanent fund in FY 20.

MR. STICKEL answered that's correct for that particular year.

CHAIR SPOHNHOLZ concluded that's why slide 7 represents an atypical year in many respects. She acknowledged that there would be periodic market declines in the future, but moving forward, investment earnings would contribute more to Alaska's budget than petroleum.

12:03:07 PM

MR. STICKEL moved to slide 10, which pictured the unrestricted revenue forecast from FY 20 to FY 22, featuring investment revenue - Alaska Permanent Fund, investment revenue - other investments, petroleum revenue, and non-petroleum revenue. He reiterated that investment revenue is the largest source of unrestricted revenue to the state, as it contributed nearly $3 billion in FY 20 and is projected to contribute $3.1 billion in FY 21 and FY 22. He noted that the POMV transfer is the main element of that revenue. In FY 20, petroleum generated about $1.1 billion in unrestricted revenue and is forecasted at approximately $1.2 billion in FY 21 and $1.3 billion in FY 22. Lastly, non-petroleum sources are forecasted to contribute under $400 million in unrestricted revenue in both FY 21 and FY 22.

CHAIR SPOHNHOLZ opined that slide 10 is the most important slide of the entire presentation because it illustrates the strategic importance of the permanent fund, as it contributes twice as much revenue as oil to the state.

12:04:43 PM

MR. STICKEL proceeded to slide 11, which summarized some of the changes between the unrestricted revenue forecast from fall 2020 and spring 2021. The average ANS [Alaska North Slope] oil price estimate was increased by $7.73 per barrel for FY 21 and by $13 per barrel for FY 22. He noted that the increase was based on the continued recovery and stabilization in the oil markets. The Alaska Permanent Fund transfer forecast was not changed because the FY 22 forecast is known, as it's based on the average ending market value of the first five of the last six fiscal years. In terms of total unrestricted revenue, the FY 21 forecast was increased by $332 million, and the FY 22 forecast was increased by $460 million, which is a combination of the increased oil price forecast, as well as an increased oil production forecast. He said the production forecast was increased by 4,700 barrels per day for FY 21 and by slightly over 20,000 barrels per day for FY 22.

12:06:32 PM

MR. STICKEL turned to slide 12, which detailed unrestricted investment revenue. The Alaska Permanent Fund transfer is expected to account for two-thirds of unrestricted revenue every year for the foreseeable future. He said that projection speaks to the importance of the permanent fund, as well as the realities of living with oil prices and production that are lower than historic levels. He reminded the committee that the unrestricted revenue forecast featured on slide 12 is the POMV transfer, which is estimated at $3.1 billion in both FY 21 and FY 22. The remaining unrestricted investment revenue is primarily earnings on cash balances in the General Fund.

12:07:34 PM

MR. STICKEL continued to slide 13, which showed a graph of the POMV transfer forecast and read as follows [original punctuation provided]:

- The statutory POMV rate changes to 5% beginning FY 2022.
- For FY 2019 -FY 2021 this rate was 5.25%.
- Forecast assumes Permanent Fund's long-term total return expectation of 6.75%.
- Differing Permanent Fund returns and petroleum deposits could significantly alter actual POMV.

MR. STICKEL explained that the transfer is estimated at over $3 billion for every year going forward, growing to $3.7 billion by FY 30. He noted that this is the baseline forecast and does not account for any proposed additional draws beyond the statutory POMV.

CHAIR SPOHNHOLZ concluded that the revenues would continue to grow if the legislature does not overspend.

MR. STICKEL said assuming the return assumption is correct, yes.

12:08:46 PM

MR. STICKEL advanced to slide 14, which detailed unrestricted petroleum revenue and its four primary sources. He conveyed that property tax is levied on all oil and gas property in the state. He said property tax is a fairly stable revenue source that generates slightly over $100 million per year for the state. Additionally, $400 million is generated for municipalities. Corporate income tax, he continued, is a tax on profit that's levied on qualified corporations doing business in Alaska. In FY 20, the petroleum corporate income tax generated zero in FY 20 and is forecasted at $25 million in both FY 21 and FY 22. The oil and gas production tax is the state's severance tax on petroleum, which consists of a net profit tax with a gross minimum tax floor for ANS oil production. The production tax is expected to bring in $311 million in FY 21 and $376 million in FY 22. The largest source of unrestricted petroleum revenue is royalty revenue. Royalties from oil and gas production on state land are expected to bring in between $700-$800 million in each of the next two years. Additionally, he noted that there is a restricted component to the royalty revenue that's not shown on the slide, which represents the portion deposited into the permanent fund and school fund.

12:11:58 PM

REPRESENTATIVE STORY inquired about the value from tax credits.

MR. STICKEL referred Representative Story to Table 8.4 in the Spring Revenue Forecast publication, which provides information on the tax credits. Additionally, he detailed an upcoming slide that looked at the outstanding balance of transferrable tax credits and how those could be retired over time.

12:13:02 PM

REPRESENTATIVE JOSEPHSON in response to Representative Schrage's question on the slight decrease in petroleum revenue for DGF, pointed out that the 1980 law calls for a 50 percent royalty delivery to the permanent fund. He asked if that is how 30 percent is arrived at when averaging all fields.

MR. STICKEL said that's correct. He explained that the majority of production is from pre-1980 leases.

REPRESENTATIVE JOSEPHSON asked whether the legislature had ever violated that law by not delivering the extra 50 percent.

MR. STICKEL answered yes, there were years where only the 25 percent was deposited.

REPRESENTATIVE JOSEPHSON questioned whether there is recourse or remedy for complaints on that issue. He asked for Mr. Stickel's understanding on its lawfulness.

MR. STICKEL deferred to DOL.

12:14:30 PM

CHAIR SPOHNHOLZ inquired about the difference in revenue from oil extracted on federal lands as opposed to oil extracted on state lands.

MR. STICKEL said the key difference is royalty revenue. He explained that production tax, corporate income tax, and property tax apply regardless of the landowner to any production within the state of Alaska and within the three-mile limit. He conveyed that in terms of royalty revenue, if the production is from state land, state royalty applies. If the production is from the National Petroleum Reserve, which is federally owned, federal royalty applies, meaning 50 percent of those royalties are shared back to the state and must be used for the benefit of local communities. He continued to explain that for private land, a privately negotiated royalty applies, which is not shared with the state; however, the state levies a tax on private landowner royalty interest. The tax is 5 percent for oil or 1.667 percent for gas.

12:16:39 PM

REPRESENTATIVE WOOL asked for an example of private land.

MR. STICKEL replied there are several leases owned by Alaska Native corporations across the North Slope. He said that becomes something to pay attention to in the Western North Slope, as Colville River Unit and the Moose's Tooth Unit have leases that are [on] private land.

REPRESENTATIVE WOOL inquired as to the aggregate average for state land.

MR. STICKEL stated that the typical state royalty is 12.5 percent, whereas the average royalty for state land is slightly below that with royalty relief. He added that there are a variety of different royalty rates. For private land, the royalty rate is privately negotiated so it varies. He continued to explain that the state taxes 5 percent of the private landowner royalty.

REPRESENTATIVE WOOL sought verification that the state is not privy to the royalty negotiations between private landowners and the producers.

MR. STICKEL shared his understanding that information pertaining to some of those royalty rates is available. He deferred to the Department of Natural Resources (DNR).

12:20:16 PM

MR. STICKEL progressed to slide 15, which detailed unrestricted non-petroleum revenue. He relayed that tax revenue is the largest component of that. Typically, he said, corporate income tax is the largest non-petroleum tax type, as it generated over $100 million in FY 20 and forecasted at $55 million for FY 21 and $10 million for FY 22. Several other significant taxes include mining license tax, insurance premium tax, fisheries taxes and excise taxes. He added that when combined with other non-petroleum revenue sources, total non-petroleum unrestricted revenue is expected to be $389 million in FY 21 and $355 million in FY 22.

MR STICKEL proceeded to slide 16, which addresses non-oil and gas corporate income tax (CIT). He emphasized the two major unusual impacts to consider: the 2020 recession and the CARES Act impacts, which is a provision of the federal CARES Act that allows corporations to carry back net operating losses from tax years 2018, 2019, and 2020. Additionally, there is a provision of the CARES Act that allows companies to accelerate certain alternative minimum tax refunds into tax year 2019. He reported that Alaska's CIT works by adopting the federal tax code by reference, so the CARES Act provisions are automatically applied to Alaska's state CIT unless the legislature chooses to decouple or modify those provisions. General CIT is expecting lower revenue for FY 21 and FY 22 even before CARES Act impacts, based on the weak economy. The CARES Act impacts further reduce the revenue forecast down to $55 million in FY 21. In FY 22, $83.6 million of CARES Act related refunds are estimated to bring the net revenue down to $10 million. Once the economy recovers and the CARES Act related issues are worked through, general corporate tax revenue is forecasted to rebound to $130 million in FY 23 and beyond.

12:23:54 PM

REPRESENTATIVE JOSEPHSON returned to slide 15 and asked whether the mining license tax is, effectively, the severance tax.

MR. STICKEL confirmed that the mining license tax is the state severance tax on mining operations.

REPRESENTATIVE JOSEPHSON surmised that when the state was getting $6 billion from oil severance tax in 2009 and 2010, the state was likely receiving a small percentage of that in mining tax.

MR. STICKEL affirmed that mining license tax had been a relatively smaller contributor.

REPRESENTATIVE JOSEPHSON asked whether the refined motor fuel surcharge came from the bill sponsored by Senator Micciche and former Senator Cathy Munoz, which added 95/100 of a penny.

MR. STICKEL replied in the affirmative.

12:25:18 PM

MR. STICKEL resumed the presentation on slide 17, which featured the CARES Act impacts to the oil and gas CIT. He explained that the oil industry, essentially, paid zero corporate income tax in FY 20 after being hit hard by the pandemic. Relatively low revenue was forecasted for FY 21 and FY 22, which is before CARES Act impacts. After those impacts, the forecast is $25 million in net revenue for each year.

12:26:05 PM

MR. STICKEL summarized slide 19, which compared the spring and fall forecasts of oil price. Slide 20 featured a comparison of how DOR's price forecast compares to other forecasts. Slide 21 details how revenue would change with different oil prices. He explained that in FY 22, each dollar change below the forecast of $61 per barrel equates to a $25 million change in unrestricted revenue and each dollar change in oil price above the forecast price equates to $35 million in unrestricted revenue.

CHAIR SPOHNHOLZ pointed out that the price of oil has varied between all of those prices over the last 15 years, indicating that the oil market is incredibly volatile.

MR. STICKEL continued to slide 22, which showed the North Slope oil production forecast. In general, the forecast shows a slight increase to production in FY 21, a slight decrease in FY 22, and an increase in FY 23 and beyond. He noted that production is expected to reach 565,000 barrels per day by FY 30. Slide 23 featured a comparison to the prior fall 2020 forecast. The Spring forecast represents an increase to the production forecast across all years, which is a combination of lower expected decline rates at existing fields, as well an improved outlook for new developments based on the higher oil price forecast. Slide 24 indicated how allowable lease expenditures for the North Slope changed over the past decade, as well as a forecast for the next 10 years. In FY 20, North Slope capital expenditures were $2.6 billion and operating expenditures were $2.9 billion. Looking forward, DOR forecasted increases in spending in FY 22 and FY 23 as companies invest in major new developments and resume drilling at the major fields. Slide 25 showed a similar history and forecast for transportation costs, which are forecasted at $9.72 per barrel in FY 22. On a per barrel basis, the average transportation costs for moving oil from the North Slope to market are forecasted to remain at approximately $10.

12:31:37 PM

MR. STICKEL concluded on slide 26, which highlighted oil tax credits. These tax credits were available to potentially be turned into tax credit certificates prior to 2016; however, in 2016 and 2017, the legislature implemented sunset provisions for earning new credits although there is an outstanding balance of tax credits for activity prior to those sunset dates. The chart features the total estimated balance of credits of $739 million, which would be available for purchase at the end of FY 21 assuming the statutory appropriation for FY 22 and beyond. He noted that the statutory appropriation is a formula based on either 10 or 15 percent of estimated production tax levied. Before subtracting any tax credits, the FY 22 statutory appropriation is calculated at $114 million. Further, if the statutory appropriation were made in FY 22 and beyond, it's estimated that all outstanding tax credits would be paid off by FY 27.

PRESENTATION: Alaska Permanent Fund

12:33:20 PM

CHAIR SPOHNHOLZ announced that the final order of business would be a presentation on the Alaska Permanent Fund by Angela Rodell, Alaska Permanent Fund Corporation (APFC).

12:34:02 PM

ANGELA RODELL, Chief Executive Officer, Alaska Permanent Fund Corporation, introduced a PowerPoint presentation, titled "Alaska Permanent Fund" [hard copy included in the committee packet]. She began on slide 3, which featured an excerpt from the transmittal letter by Governor Jay Hammond for SSHJR 39, which read as follows:

> ...I have introduced this resolution proposing a constitutional amendment because I believe strongly that the revenues from our non-renewable resources belong to future generations of Alaskans as well as ourselves. A permanent fund as I have proposed will set aside a modest portion of the proceeds from the exploitation of our non-renewable resources for investment in our future while leaving sufficient revenues for our present needs.

MS. RODELL continued to slide 4 and reported that Alaskans voted in overwhelming favor to amend the Constitution of the State of Alaska and create the Alaska Permanent Fund. She noted that there is no use of funds discussed anywhere in the constitutional language, nor was it included in the transmittal letter. She advanced to slide 5, titled "The Corporation," which read as follows [original punctuation provided]:

> In 1980, the Alaska State Legislature passed SB 161 establishing the Alaska Permanent Fund Corporation, with the purpose -
>
> *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.
> *Our Vision -*
>
> *to deliver outstanding returns for the benefit of all current and future generations of Alaskans.*

MS. RODELL proceeded to slide 6, titled 1980, which provided excerpts from the free conference committee report on the House Committee Substitute for Senate Bill 161. She noted that Chairs Terry Gardiner and John Sackett addressed "the future" in the report, which read [original punctuation provided]:

> ...this bill addresses only the question of Fund management and leaves the separate question of how to use the Fund earnings to separate legislation. It merely assures that there will be income and does not preclude any options for its use. Unless another determination is made, the Permanent Fund earnings will be deposited in the general fund.

MS. RODELL pointed out that the existence of the Earnings Reserve Account (ERA) currently indicates that another determination was made.

12:38:32 PM

CHAIR SPOHNHOLZ interjected to emphasize the importance of this historical record. She pointed out that the Permanent Fund Dividend (PFD) was not included in the original creation.

12:39:04 PM

MS. RODELL resumed the presentation on slide 8, titled "Renewable Resource," which highlighted the constitutional and statutory mandates, including: The Principal Account (the Principal) for permanent savings; the Prudent Investor Rule; the ERA, which recognizes net realized investment income and makes that available for appropriation. Additionally, prudent rules exist to govern savings, withdrawals, and the growth of the fund. She progressed to slide 9, titled "Board of Trustees' Resolution 18-04," which read [original punctuation provided]:

> In providing guidance on withdrawals for the Fund and to help ensure the long-term sustainability of using Fund earnings for the benefit of all generations of Alaskans, the Board passed Resolution 18-04 at a special meeting on October 17, 2018.
>
> - This resolution affirms the importance of formulaic management of transfers into and out of the ERA to ensure sustainability and long-term growth of the Fund, by identifying four key principles: Adherence –Sustainability –Inflation Proofing –Real Growth
>
> Sustainability … requires annual formulaic withdrawals from the Earnings Reserve Account at an amount that the long-term balance of the account is able to fund. The Board 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 00-13, 03-05 and 04-09).

MS. RODELL turned to slide 10, titled "Asset Allocation - Multi Dimensional Implications," which read [original punctuation provided]:

> Asset allocation should not be driven solely by return considerations; return is just one aspect.
>
> Risk (appetite) should be the other key driver.
>
> In addition to investment/financial risk, operational risks should be considered:
>
> - Adequacy of Resources (operational risk) should be a key sub-consideration.
> - Aspirations and Capabilities should be aligned.

- Capability requirements and infrastructure costs vary based on type of asset class, volume, size and dispersion.

A $1 private asset investment requires a different (possibly higher) resource requirement compared to a $1 public equity investment.

MS. RODELL reported that she was told to "minimize risk of Principal while maximizing returns" during the creation of APFC. She added that recognizing how allocations have both financial risk and operational risk is key to understanding how APFC moves forward as a corporation managing the Alaska Permanent Fund. She addressed asset allocation on slide 11, explaining that that the fund is currently allocated by the APFC Board of Trustees into eight asset classes: bonds, stocks, real estate, private equity, absolute return, private income, risk parity, and cash. She indicated that the fund's allocation has changed over time. In 1980, it was determined that the allocation would be 100 percent in bonds, as they had extremely high interest rates. As legislators and administrations grew more comfortable with the management of the fund, additional asset classes were added over time and in 2005, legislation implemented the Prudent Investor Rule, which exists today.

12:43:24 PM

MS. RODELL advanced to slide 12, titled "Investment Tactics," which read [original punctuation provided]:

Our APFC team is constantly on the hunt for relative value opportunities in the public markets.

- Value vs. growth stocks
- Overweighting attractive sectors and geographies
- Participating in compelling new issue opportunities

In alternatives and private markets, our APFC team focuses on using our reputation in the market place [sic] and long-term investment horizon to source investment opportunities with excess return potential.

- Early stage, high growth technology and life science venture capital opportunities
- Long term cash generative opportunities in Real Estate, Infrastructure, and Private Credit
- Leveraged buyouts of mature businesses

MS. RODELL emphasized the key word, "relative." She explained that in weighing investment opportunities that both make money, it's about determining the best route. She said this is designed to generate positive value within the acceptable risk appetite. She proceeded to slide 13, titled "APFC is in the Business of Taking Risk," which read [original punctuation provided]:

> APFC has to take risks in order to achieve its return objectives.
>
> The goal of risk management is not to avoid risks, it is to:
>
> - know and understand the risks taken,
> - measure, monitor and report these risks, and
> - manage risks to acceptable levels, and review whether returns are commensurate.
>
> The risk management effort is not owned by or the responsibility of a single team or department. It is a collective responsibility, including all staff and trustees.
>
> The risk function primarily aims to:
>
> - provide a different perspective (mostly: what can go wrong? How much can we lose?),
> - constructively challenge assumptions,
> - measure and provide a complete and aggregated ‘risk picture’, including external indicators.

MS. RODELL Progressed to slide 14, titled "ERA: Statutory Net Income," which read [original punctuation provided]:

> AS 37.13.140 (a) directs the net investment earnings of the Fund to the ERA and excludes unrealized gains and losses.
>
> Statutory Net Income is the direct result of investment activity, and includes:
>
> - Monthly cash inflows from stock dividends, bond interest, and real estate
> - Realized Capital Gains/Losses: All the net income (i.e., realized gains minus realized losses) generated by the sale of investments.

FY21 as of February 28, 2021
Statutory Net Income = $4,592,300,000

MS. RODELL explained that Statutory Net Income (SNI) is the mechanism by which money flows into the ERA. The ERA, she said, is invested like the Principal. The ERA owns a share of each investment and is the pot of money that is subject to appropriation. The chart on slide 14 featured Total Return [in gold] and SNI [in black], indicating the volatility of returns compared to the stability of SNI. She noted that as of February 28, 2011, nearly $4.6 billion in SNI had been generated, which was a result of staying disciplined to ACPE's long-term asset allocation goal of maintaining 40 percent of the total fund in stocks. She explained that every time a stock is sold at a gain, SNI is generated. She pointed out that Accounting Net Income is different than SNI because it requires unrealized losses to be included in the calculation. Further, she said gains generated by the Principal's investments only stay in that account if it's unrealized or appropriated back, which is the only way the Principal grows other than the addition of royalties.

12:50:00 PM

REPRESENTATIVE SCHRAGE asked if in addition to unrealized losses, calculating the Accounting Net Income requires the inclusion of unrealized gains, which is not included in SNI.

MS. RODELL replied in the affirmative.

12:50:21 PM

MS. RODELL turned to slide 15, titled "Percent of Market Value - AS 37.13.140(b)," which read [original punctuation provided]:

Based on market value, rather than realized income

Subject to annual appropriation

Predictable

- average market value of the Fund for the first five of the preceding six fiscal years

5.25% -July 1, 2018, FY 19 Effective Rate

- FY19 POMV $2.72 billion4.13%
- FY20 POMV $2.93 billion 4.52%

- FY21 POMV $3.09 billion ~4.68%

5.0% -July 1, 2021, FY22 Effective Rate

- FY22 POMV$3.07 billion ~4.55%
- FY23 POMV~$3.21billion~4.66%
- FY24 POMV~$3.29billion~4.68%

MS. RODELL emphasized the predictability of the POMV structure, indicating that when legislative session begins in January, the legislature knows "to the penny" how much revenue will be received under the POMV structure.

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REPRESENTATIVE JOSEPHSON said the conservative models suggest that 5 percent is too generous. Nonetheless, he asked if the legislature should be comforted by the effective rates.

MS. RODELL answered in the affirmative. She explained that the effective rate would be changed by changes to the fund's value. In considering the ERA, she said, using significant portions above the POMV would significantly drive up the effective rate and affect rates going forward due the smaller market values in the calculation.

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CHAIR SPOHNHOLZ emphasized the importance of the effective rate. She asked whether the 5 percent of market value is sustainable for fund growth or if 5 percent is too high.

MS. RODELL shared her belief that 5 percent is sustainable "all things considered." She expressed concern about what's driving the change in number. She questioned whether it's due to a need to inflate spending or a recognition of other revenue sources. Additionally, pointed out that the percentage "gets caught" in the political discussion because it's subject to appropriation. Further, she questioned how much pressure would be placed on APFC to take actions that are not in the long-term best interest of the fund in an effort to stay in line with the legislature and the administration. She opined that there would always be an inherent conflict of interest.

CHAIR SPOHNHOLZ clarified her question. She asked whether establishing the POMV at 5 percent is truly sustainable over the long-term or if that rate should be more conservative to protect the growth of the fund.

MS. RODELL stated that the 5 percent is effective in that regard. She explained that historically, the 5 percent would have been sustainable had it been included in the original constitutional creation. Nonetheless, she acknowledged that lowering the rate would grow the fund faster because more would be retained.

1:00:19 PM

MS. RODELL resumed the presentation on slide 16, which detailed the use of realized fund earnings from inception through February 28, 2021. She reported that $33.8 billion had been paid out through POMV distributions and dividend appropriations; $26.3 billion had been saved via special appropriations and inflation proofing; and $13 billion is unappropriated, which includes the $3.1 billion set aside in anticipation of the FY 22 POMV.

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MS. RODELL continued to the chart on slide 18 showing fund totals as of February 28, 2021. The data indicated that returns varied; nonetheless, the fund balance grew in excess of $70 billion. She turned to slide 19 and explained that the APFC Board of Trustees adopted three specific benchmarks to measure total fund performance: passive index, performance benchmark, and objective CPI + 5 percent. She noted the importance of measuring fund performance against nationally accepted metrics. She conveyed that passive index viewed the fund if it were only invested in passive index funds; the performance benchmark recognized an investible series of indices that mirror the asset allocation and measure active management; and CPI + 5 percent considered the long-term growth. She highlighted that the total fund is currently returning 17.72 percent, which is one of the highest returning years in history and well above the 5.3 percent [objective CPI + 5 percent] because inflation is low.

CHAIR SPOHNHOLZ asked if that is, in part, because FY 20 ended poorly.

MS. RODELL pointed out that if it were March 31, 2020, the fund would be at $60 billion due to fear associated with the pandemic. She stated that between the fiscal stimulus and other factors, the markets recovered well. She added that the fund benefitted from being able to "plow" cash into the stock market during that time.

1:04:45 PM

MS. RODELL detailed the fund's value on slide 20. She highlighted the slow growth, pointing out that without the $4 billion appropriation [by the legislature] in FY 20, the Principal would only have $42.8 billion. She said the primary growth is from unrealized gains, which have generated $11.3 billion to the Principal and $3.1 billion to the ERA for a total of $14.4 billion.

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CHAIR SPOHNHOLZ noted the recent discussion in the media about paying out the entire $16 billion in the ERA towards dividends. She asked what that would mean in terms of a reduced POMV transfer to the state.

MS. RODELL noted that the $3.1 billion in unrealized gain changes every month because the ERA does not have its own set of investments. She explained that the $3.1 billion is the ERA's proportional gain on the assets. If the entire amount were to be appropriated, she said, the $3.1 could be much higher or lower. Nonetheless, she said if the entire known amount of the ERA were to be appropriated, the account would be at zero. She said in the current slow growth environment, it would not be recouped as quickly. She surmised that there would be several years where the fund would remain around $63 billion. Further, she approximated that it would cost $200 million per year in future revenue to the state.

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CHAIR SPOHNHOLZ surmised that because the POMV is calculated by the first five of the last six years of the fund's value, the impact would be softened, as it would be distributed over years. She concluded that the cost to the state in year-over-year earnings would impact the value of the fund over the long-term as well as the state's revenue in the short-term.

MS. RODELL confirmed.

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REPRESENTATIVE JOSEPHSON pointed out that without the anticipated moneys for government, there would be a deficit of $3 billion. Additionally, he shared his understanding that the

$3.1 billion in unrealized gain does not tangibly exist by definition. He asked if that is correct.

MS. RODELL replied in the affirmative.

REPRESENTATIVE JOSEPHSON asked what slide 20 would look like if the governor hadn't vetoed $5 billion of the $9 billion that the legislature transferred into the corpus several years ago.

MS. RODELL said it wouldn't look much different because the governor's veto didn't move money out of the fund in any way; therefore, the size of the total fund would be the same today, but it would be divvied up differently.

1:12:59 PM

MS. RODELL resumed the presentation on slide 22, titled "Reliance on Corporate Activity," which read [original punctuation provided]:

> The Earnings Reserve Account is subject to legislative appropriation and currently used to:
> - Cover the cost of investing and managing the Alaska Permanent Fund
> - Provide a predictable state revenue stream for current generations
> - Protect the value of the Principal for future generations
> - Support state agencies' collection of royalties

MS. RODELL continued to slide 23, titled "Alignment," which read as follows [original punctuation provided]:

> It is vital to recognize the transformation of the portfolio and align APFC to the future
>
> - Types, complexity and velocity of risks have significantly increased, due to both internal transformation and external factors. The trend is likely to continue, if not accelerate.
> - We should expect the Fund to reach the $90 -$100 billion mark in ~ 10 years
>   - -Mid-Fiscal Year 21 = $71.8 billion
>   - -As of February 28 = $74.2 billion

- The need to expand resources, mature and strengthen control frameworks, in line with growth, is real.

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MS. RODELL advanced to a chart on slide 24 showing the history of UGF revenues. The yellow portion reflected the POMV draw, the blue portion reflected non-petroleum revenue, and the gray section showed total unrestricted petroleum revenue. She highlighted the stability of the POMV revenue. She noted that draws on the state's reserves occurred in FY 15, FY 16, and FY 17; however, those draws are not presented as revenue. The idea that the POMV is now a revenue as opposed to a reserve draw, she said, is "something that's very different." She stressed that the APFC staff take the responsibility of being a revenue stream very seriously.

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MS. RODELL turned to a chart on slide 25 showing actual quarterly returns versus the target. She reported that the target asset allocation would have generated 7.6 [percent], whereas 8.9 percent was actually generated. The difference between the actual and target percentages is the active management of the corporation and the day-to-day investment decisions accompanied by annual work by the APFC Board of Trustees on asset allocation and understanding which levers generate excess returns without taking outsized risk. She proceeded to discuss returns on investment on slide 26, highlighting APFC's FY 22 budget request of $151.8 million. She pointed out that APFC generated nearly $4.6 billion in revenue for the state with an additional $29.1 million going towards the Alaska Capitol Income Fund. She reported that the amount included for royalty collection totals $8.8 million, which is expected to collect $240.6 million in returns.

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CHAIR SPOHNHOLZ inquired about the appropriations from the ERA that support royalty generation.

MS. RODELL said it's the concept that the ERA be used to fund the cost of collecting its entitled royalty and settlements. She explained that appropriations are made to DOL, DNR, and DOR to recognize the work done on behalf of the permanent fund.

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REPRESENTATIVE JOSEPHSON sought verification that Alaska statutes allow for those departments to bill APFC for their efforts at collecting $0.25 billion in royalty. He questioned whether APFC inspects those bills and charges them against its total net income.

MS. RODELL shared her belief that this is all found within the language section of the operating budget bills. She offered to follow up on the specific mechanics.

1:22:04 PM

MS. RODELL resumed the presentation on slide 26, highlighting that there are real profit centers within the state that generate a lot of revenue. She concluded on slide 27, titled "Stewardship," which read as follows [original punctuation provided]:

> APFC is grateful for the support of the Executive Branch, the Legislature and our fellow Alaskans. Given that backing, the influence of our dynamic, Alaskan corporation extends around the world for practices of good governance, transparency, and a long-term investment horizon.
>
> 2021 Awards
> - APFC has once again been named Limited Partner of the Year in North America by the global magazine Private Equity International for our ability to effectively invest in private equity. We also won the award in 2017 and 2018.
> - Capital Finance International (CFI) has named the Alaska Permanent Fund Corporation the Best Sovereign Wealth Fund Investment Team of 2021 (Americas).
>
> In serving Alaska, we provide a - Value Adding & Worthy Purpose Strong Leadership and Culture Passionate & High Caliber Team Board of Trustee Fiduciary Oversight

MS. RODELL stated that Alaskans should be proud of what they've created over the years. She expressed her hope that by highlighting these awards, residents understand that their support is being recognized around the world.

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REPRESENTATIVE STORY said she takes stewardship very seriously. She asked whether inflation proofing occurred last year and whether the governor's budget includes inflation proofing for this year.

MS. RODELL relayed that the governor did not include inflation proofing in his budget proposal. She expounded that when the FY 20 budget was passed that included $4 billion in transfers, there was legislative intent language included, which recognized that as forward funding of inflation proofing. She said that's the mechanism that's being relied upon for the FY 22 budget proposal.

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CHAIR SPOHNHOLZ thanked Ms. Rodell and her team at APFC, adding that the committee is keenly aware of the strategic importance of the Alaska Permanent Fund to the future of Alaska and its fiscal stability.

1:26:33 PM

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at [1:26] p.m.