

SENATE FINANCE COMMITTEE
April 14, 2023
9:05 a.m.

9:05:01 AM

CALL TO ORDER

Senator Bishop called the Senate Finance Committee meeting to order at 9:05 a.m.

MEMBERS PRESENT

Senator Donny Olson, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Click Bishop
Senator Jesse Kiehl
Senator Kelly Merrick
Senator David Wilson

MEMBERS ABSENT

Senator Lyman Hoffman, Co-Chair

ALSO PRESENT

Senator Cathy Giessel; Tim Grussendorf, Staff, Senator Lyman Hoffman; Deven Mitchell, Executive Director, Alaska Permanent Fund Corporation; Marcus Frampton, Chief Investment Officer, Alaska Permanent Fund Corporation.

SUMMARY

SB 41 APPROP: CAPITAL/SUPPLEMENTAL

SB 41 was HEARD and HELD in committee for further consideration.

EARNINGS RESERVE ACCOUNT

#sb41

SENATE BILL NO. 41

"An Act making appropriations, including capital appropriations and other appropriations; making supplemental appropriations; making appropriations to

capitalize funds; and providing for an effective date."

[9:06:02 AM](#)

Senator Kiehl MOVED to ADOPT the committee substitute for SB 41, Work Draft 33-GS1348\S (Dunmire, 4\13\23).

Senator Bishop OBJECTED for discussion.

[9:06:24 AM](#)

TIM GRUSSENDORF, STAFF, SENATOR LYMAN HOFFMAN, explained the committee substitute. He stated that the committee substitute would be referred to as "CS One." He stated that the bill combined the capital and supplemental budgets. He shared that it was a "bare bones" capital budgets with all the discretionary and capital appropriations removed from the original. He stated that it set the base budget of federal and matching funds; and other funds only. He stated that the categories included Village Safe Water; Alaska Housing Finance Corporation (AHFC) programs; the Airport Improvement program; and the Department of Transportation and Public Facilities (DOT/PF) program. He noted that on page 27, there was the total of the base budget. He remarked that the budget was \$177.881 million.

Co-Chair Olson wondered whether there was a copy of the reappropriation list in the packet.

Mr. Grussendorf replied in the affirmative.

Co-Chair Stedman surmised that the match money was included for federal highways and airports.

Mr. Grussendorf replied in the affirmative.

Senator Bishop REMOVED the OBJECTION. There being NO OBJECTION, it was so ordered.

[9:10:49 AM](#)

Co-Chair Stedman noted that there had been a concentration in years past on major maintenance. He wondered about the major maintenance in the current version.

Mr. Grussendorf replied that the committee would make the determination on maintenance.

SB 41 was HEARD and HELD in committee for further consideration.

Senator Bishop HANDED the GAVEL to Co-Chair Stedman.

9:12:13 AM

AT EASE

9:13:37 AM

RECONVENED

^EARNINGS RESERVE ACCOUNT

9:15:02 AM

DEVEN MITCHELL, EXECUTIVE DIRECTOR, ALASKA PERMANENT FUND CORPORATION, introduced himself. He discussed the presentation, "Senate Finance Committee, Portfolio Gains - Realized and Unrealized, April 14, 2023" (copy on file). He discussed slide 2, "Alaska Constitution Article IX, Section 15":

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.

Intergenerational

Since its establishment, every Alaskan has forgone some present-day support to benefit future generations.

Mr. Mitchell addressed slide 3. He noted that the way that money became available to expend under the Permanent Fund umbrella was the focal point of the presentation.

Mr. Mitchell pointed to slide 4. He remarked that the slide showed the unrealized gains within the component.

[9:21:39 AM](#)

Mr. Mitchell looked at slide 5, "Inflation Proofing":

Per AS 37.13.145 (c)

FY23 Inflation-Proofing Calculation

The monthly index value, CPI, is averaged for the current and prior calendar year

o CY2021 = 811.7

o CY2022 = 876.7

The percent change from the previous year is the inflation percent used for the calculation

o 8.0 percent for CY2021 to CY2022

The percentage is then applied to the permanent Principal deposits (royalties, inflation proofing, special appropriations), not including unrealized gains.

As of February 28, 2023

FY23 YTD Principal deposits = \$52,095,180,000

Statutory Inflation Rate = x 8.00 percent

FY23 YTD Inflation Proofing = \$4,167,614,000

Given the two-account structure of the Fund, all realized earnings flow to the Earnings Reserve Account.

The Principal of the Fund is grown from

- Royalty Deposits \$19.0 billion
- Inflation Proofing \$18.0 billion
- Special Appropriations \$15.1 billion

An annual appropriation from the ERA to the Principal sufficient to offset the effects of inflation as enshrined in statute is essential to protect intergenerational purchasing power.

The FY23 inflation-proofing appropriation will transfer at the end of the fiscal year based on deposits into the Principal and the statutory inflation rate.

Mr. Mitchell looked at slide 6, "Earnings Reserve Account (ERA)":

Deposits - Statutory Net Income

- Cash Inflows: stock dividends, bond interest, real estate leases, annually \$1.8 billion

• Realized Capital Gains/Losses: net income generated by the sale of investments Annually market-driven

Withdrawals -

- Maintain Principal Purchasing Power
Inflation Proofing
- Real Growth of Principal
Special Appropriations
- Annual Draws
Government Services and the PFD
- Amerada Hess Earnings
Alaska Capital Income Account

[9:25:04 AM](#)

Mr. Mitchell highlighted slide 7, "Statutory Net Income":

Comprised of receipts from interest on fixed income, real estate rentals, stock dividends, and all realized gains and losses on the sales of invested assets, less AK Capital Income Fund committed amounts and operating expenses.

Mr. Mitchell pointed to slide 8, "Constitutionalize Annual Fund Draw":

Board Resolutions 03-05, 04-09
Supporting a constitutional amendment to limit the annual Fund payout to not more than a 5 percent POMV averaged over a period of 5 years.
Implementation of a constitutional POMV spending limit for the Fund has the accompanying benefit of assuring permanent inflation-proofing of the Fund.

Mr. Mitchell addressed slide 9. He noted that the slide was a simplification of the process of moving from two accounts to one account.

[9:27:49 AM](#)

MARCUS FRAMPTON, CHIEF INVESTMENT OFFICER, ALASKA PERMANENT FUND CORPORATION, looked at slide 11, "Summary":

- There are high unrealized balances in the portfolio, but an unusually high percentage are in less liquid private markets.
- Private distributions are down 52 percent year over year, introducing statutory net income uncertainty.
- Baseline statutory net income (SNI) is the only amount one can "take to the bank" on short-term

horizon (or long-term, assuming a flat market with limited private exits).

- Callan's forecast of \$5 billion per year of SNI is predicated on a return to a world where equities return at least 6 - 7 percent per annum.

- APFC does not manage towards SNI as a key metric, nor do unrealized gains factor into any investment decisions; therefore, we share these purely as observations.

[9:31:15 AM](#)

Mr. Frampton discussed slide 12, "Current Unrealized Gains by Asset Class." He noted that the stock portfolio had \$2.6 billion of gains, with a 35 percent turnover per year. He stated that anticipating a zero percent flat stock market would generate about \$700 to \$800 million of gains out of the stock portfolio in the upcoming twelve months. He stated that fixed income showed a \$1 billion loss as a result of the increased interest rates.

Co-Chair Olson asked for more information about the negative \$1 billion in fixed income.

Mr. Frampton replied that the fixed income portfolio had a duration of approximately six or seven years. He stated that increased rates caused the lower interest bonds to be worth approximately \$1 billion less than they were in years prior.

[9:35:08 AM](#)

Co-Chair Olson surmised that the plan was to wait it out in the market for interest rates to decrease.

Mr. Frampton replied that the strategy was not to "wait it out", but the fixed income team would be managing that portfolio against the benchmark.

Co-Chair Olson wondered how the investment strategy might be adjusting based on current various market impacts.

Mr. Frampton replied that there was current caution, because market indicators showed a good possibility of heading into a recession.

Co-Chair Olson wondered whether a new Federal Reserve chairman would alter the assumption that there would be a recession.

Mr. Frampton replied that the current chairman was very aggressive about raising rates with the rhetoric to get inflation under control, but the market "does not always listen." He stated that the current chairman was as focused on a tight monetary position as any of his peers.

Co-Chair Stedman queried a rough total of the nonliquid assets within the \$11 billion.

Mr. Frampton responded that it was approximately 85 percent nonliquid and 15 percent stocks and bonds.

Co-Chair Stedman surmised that it was approximately \$1.8 billion in liquidity.

Mr. Frampton agreed.

Co-Chair Stedman wondered whether that was "tight" on the liquidity portion.

Mr. Mitchell replied that the portfolio was not managed for liquidity, but was managed based on maximum returns. He stated that it was a function of the current market that resulted in decreased liquidity.

[9:40:36 AM](#)

Co-Chair Stedman stressed that there should be an focus on the Earnings Reserve Account (ERA) liquidity in case there was a need to use those funds.

Mr. Frampton stressed that the fund had substantial liquidity and the investment in the ERA. He highlighted that the location of the unrealized gains was largely in private equities, but the fund at over \$80 billion could be liquidated by half if needed.

Co-Chair Stedman stressed that the principle of the fund would not be spent, or even an overdraw of 5 percent of the ERA. He wanted to understand the constraints dealing with the ERA.

Mr. Frampton pointed to slide 13, "Realized Gains: Drivers by Asset Class":

- Public Equity Trading activities
- Fixed Income Trading activities
- Real Estate Property dispositions (irregular)
- Private Equity Manager exit activity
- Private Income Manager exit activity
- Absolute Return Redemptions from managers

[9:45:08 AM](#)

Senator Bishop wondered where the gold exchange be located within the fund.

Mr. Frampton stated that there were some gold holdings in the cash account and the absolute return investment area.

Mr. Frampton addressed slide 14, "Statutory Net Income by Fiscal Year: 1986 - 2022." He outlined each portion of the graph, and noted some correlation between investment returns and the statutory net income.

Co-Chair Stedman surmised that the statutory net income led to increased calculation on the statutory Permanent Fund Dividend (PFD).

Mr. Mitchell agreed.

Co-Chair Stedman stated that it was the "driver" of the statutory PFD.

Mr. Mitchell replied in the affirmative.

Co-Chair Stedman concluded that the likelihood of the statutory PFD calculation had a higher probability of decreasing than increasing.

Mr. Mitchell replied that the current fiscal years' anticipated statutory net income was \$2 billion.

Co-Chair Stedman queried the number needed for next year's anticipated dividend.

Mr. Mitchell replied that there was a midpoint anticipation of \$2.86 billion.

[9:51:40 AM](#)

Mr. Frampton looked at slide 15, "Unrealized Gains by Asset Class (2012 - Present)." He stated that the number was currently high, but was overall low.

Mr. Frampton pointed to slide 16, "Realized Gains by Asset Class (2012 - Present)." He detailed the specific lines on the slide.

Co-Chair Stedman asked about the expectation of a 7 percent return, and then using that return of \$5 billion in portfolio profits. He noted that FY 21 was an anomaly, but felt that \$5 billion was too high.

[9:54:57 AM](#)

Mr. Frampton addressed slide 17, "How Available Unrealized Gains Were Realized":

- Portfolio Turnover Rate = Statutory Net Income from Trading / Unrealized Gains Available for Statutory Net Income

How Available Unrealized Gains Were Realized

- Historical average when cumulative unrealized gains are less than 7 percent of the Fund is 60 percent (only occurred in Fiscal Years '08, '09, and '10)
- Historical average when cumulative unrealized gains are greater than 7 percent of the Fund is 22 percent

Mr. Frampton discussed slide 18, "Private Markets - Realized Gains Have Slowed." He stated the private markets had seen a sudden decrease.

Mr. Frampton addressed slide 19, "Baseline Statutory Net Income." He noted that the slide showed the baseline statutory net income number over time.

[10:00:02 AM](#)

Co-Chair Stedman wondered whether the slide showed the data used to determine the baseline net income.

Mr. Frampton replied in the affirmative.

Co-Chair Stedman recalled to slide 16 and the realized gains of \$4.6 billion per year, and felt that there would be that number required to determine a 50/50 dividend. He surmised that there was reasonable uncertainty about getting that number.

Mr. Mitchell stated that the long-term might see an aversion to the mean, but the cycles showed the fund exceeding the target, and sometimes did not exceed the target. He felt that sometimes there were moments of less income.

Co-Chair Stedman felt that the direction and magnitude was needed for policy calls.

Senator Bishop wondered whether there had been an investment strategy change since the percent of market value (POMV) draw as put into statute.

Mr. Mitchell replied in the negative.

Senator Bishop inferred that putting the PFD into the constitution would not result in changing investment strategies.

[10:05:46 AM](#)

Mr. Mitchell agreed.

Mr. Frampton displayed slide 20, "Conclusions":

- Baseline SNI (\$991 million for FY 2023 to date through February or \$1,486 million annualized) is recurring in nature and reliable.
- The realized gains portion of SNI is less reliable, not entirely under APFC's control, and subject to market vagaries.
- SNI is further exposed to additional declines in equity markets.
- 86 percent of current unrealized gains sit in illiquid asset classes - these gains are either difficult to harvest or outside our control.

Co-Chair Stedman wanted to discuss inflation proofing. He wondered whether there would be a problem with inflation proofing, and felt that it would not be included in the

budget and the concerns with the ERA. He asked that the board be notified about the issue.

Mr. Mitchell agreed.

[10:11:27 AM](#)

Senator Merrick asked about the downside to constitutionalizing the POMV, and combining the ERA and corpus.

Mr. Mitchell replied that he did not see any downside.

Co-Chair Stedman stated that the legislature had the capability to do a partial combination.

Mr. Mitchell agreed that inflation proofing was a top priority, and hoped that there could be intent language if there was no money included for that in the current budget.

[10:15:11 AM](#)

Co-Chair Stedman asked about the resolution to the state program.

Mr. Mitchell replied that there were some concerns about the small board that could have conflicts. He stated that there were some concerns about the use of the investment.

[10:17:06 AM](#)

AT EASE

[10:17:49 AM](#)

RECONVENED

[10:17:55 AM](#)

Co-Chair Stedman discussed committee business and the schedule for the following week.

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ADJOURNMENT

[10:19:18 AM](#)

The meeting was adjourned at 10:19 a.m.