SCOMM

#18:24

Original sponsors: Kelly, Hohman, Colletta and Sackett

Offered: 5/4/79
Referred: Rules

IN THE SENATE BY THE FINANCE COMMITTEE

HOUSE CS FOR SENATE BILL NO. 161

IN THE LEGISLATURE OF THE STATE OF ALASKA

ELEVENTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to nonrenewable resource revenues; to legislative oversight; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. FINDINGS. The legislature finds that there is a substantial need for oversight of the performance of those agencies of the state which perform lending or investment functions since those functions do not receive the detailed review to which other expenditures of public money are subject, and therefore the knowledge necessary for sound legislation in this area is not readily available. There is a need for legislative oversight which will provide information on the policy and performance of these agencies, the extent to which the agencies conform to statutory intent, and the impact of their performance on the economy and the state treasury.

* Sec. 2. AS 24.20 is amended by adding new sections to read:

Sec. 24.20.156. PURPOSES. The purposes of the Legislative Budget and Audit Committee include

(1) monitoring and reporting

(A) the performance of the agencies of the state which perform lending or investment functions,

(B) the extent to which the performance of these agencies has contributed to the fiscal, financial, economic and social improvement of the state and its citizens,

(C) the extent to which these agencies and the executive have prepared and coordinated short and long term economic, fiscal,

investment and financial planning;

(2) holding these agencies accountable to statutory intent in their performance by recommending, where appropriate, changes in policy to the agencies or changes in legislation to the legislature;

(3) annually reviewing the extent of capitalization of the investment funds of the state and alternative investment policy for the general fund surplus and recommending needed legislation.

Sec. 24.20.206. DUTIES. The Legislative Budget and Audit Committee shall

(1) report to the legislature its recommendations relating to the confirmation of suggested appointees to the Board of Trustees of the Alaska Permanent Fund Corporation and the Board of Trustees of the Alaska Renewable Resources Corporation;

(2) annually review the long-range operating plans of all agencies of the state which perform lending or investment functions;

(3) review periodic reports from all agencies of the state which perform lending or investment functions;

(4) present a complete report of investment programs, plans, performance, and policies of all agencies of the state which perform lending or investment functions to the legislature within 30 days after the convening of each regular session;

(5) present to the legislature within 30 days after the convening of each regular session a review of the report of the governor under AS 37.07.020(d) with recommendations for any needed legislation;

(6) in conjunction with the finance committee of each house recommend annually to the legislature the investment policy for the general fund surplus and for the income from the permanent fund;

(7) provide for an annual post audit and annual operational and performance evaluation of the Alaska Permanent Fund Corporation in-

vestments and investment programs.

Sec. 24.20.209. RECORDS. The Legislative Budget and Audit Committee shall keep a complete file of all reports presented to it and all reports presented by it to the legislature or to a legislative committee.

* Sec. 3. AS 24.20.201(a) is amended by adding new paragraphs to read:

(8) hold public hearings on the confirmation of the members of the Board of Trustees of the Alaska Permanent Fund Corporation, and the members of the Board of Trustees of the Alaska Renewable Resources Corporation;

(9) make recommendations concerning the structure and operating practices of all agencies of the state which perform lending or investment functions;

(10) enter into and enforce all contracts necessary or desirable for the functions of the committee.

* Sec. 4. AS 37.07.020 is amended by adding a new subsection to read:

(d) The governor shall annually, before the convening of the legislature, report to the legislature through the Legislative Budget and Audit Committee the long-range fiscal and economic consequences of

(1) alternate levels of capitalization of the investment funds of the state; and

(2) alternative investment policy for the general fund surplus.

* Sec. 5. AS 37 is amended by adding a new chapter to read:

CHAPTER 13. ALASKA PERMANENT FUND.

Sec. 37.13.010. ALASKA PERMANENT FUND. (a) Under art IX, sec. 15 of the state constitution, there is established as a separate fund the Alaska permanent fund. The Alaska permanent fund consists of

(1) 50 per cent of mineral lease bonuses remaining after

deduction of any amounts allocated

(A) to the Alaska Native Fund under the Alaska Native Claims Settlement Act and implementing state legislation; and

(B) in AS 37.11.020 to the Alaska renewable resources development fund;

(2) 25 per cent of all mineral lease rentals, royalties, royalty sale proceeds, and federal mineral revenue sharing payments received by the state from mineral leases issued on or before July 1, 1979;

(3) 50 per cent of all mineral lease rentals, royalties, royalty sale proceeds, and federal mineral revenue sharing payments received by the state from mineral leases issued after July 1, 1979; and

(4) any other money appropriated or otherwise allocated by law to the Alaska permanent fund.

(b) Payments due the Alaska permanent fund under (a) of this section shall be made to the fund once each month.

(c) The Alaska permanent fund shall be managed by the Alaska Permanent Fund Corporation established in this chapter.

Sec. 37.13.020. FINDINGS. The people of the state, by constitutional amendment, have required the placement of at least 25 per cent of all mineral lease rentals, royalties, royalty sale proceeds, and federal mineral revenue sharing payments and bonuses received by the state into a permanent fund. The legislature finds with respect to the Alaska Permanent Fund Corporation that

(1) the corporation should provide a means of conserving a portion of the state's revenues from mineral resources to benefit all generations of Alaskans;

(2) the corporation's goal should be to maintain safety of principal while maximizing total return;

(3) the corporation should be used as a savings device managed to allow the maximum use of disposable income from the corporation as needed for purposes designated by law.

Sec. 37.13.030. PURPOSE. It is the purpose of this chapter to provide a mechanism for the management and investment of those permanent fund assets allocated to the Alaska Permanent Fund Corporation in a manner consistent with the findings established in AS 37.13.020.

Sec. 37.13.040. ALASKA PERMANENT FUND CORPORATION. There is established the Alaska Permanent Fund Corporation. The corporation is a public corporation and government instrumentality in the Department of Revenue managed by a board of trustees but has a legal existence independent of and separate from the state. The purpose of the board is to manage and invest the assets of the corporation in accordance with this chapter.

Sec. 37.13.050. COMPOSITION OF BOARD OF TRUSTEES. (a) The Board of Trustees of the Alaska Permanent Fund Corporation consists of five members appointed by the governor and confirmed by a majority of the members of the legislature in joint session.

(b) The board shall annually elect a chairman from among its members.

Sec. 37.13.060. TERM OF OFFICE. The members of the board shall be appointed for terms of three years, and they may be reappointed subject to reconfirmation by a majority of the members of the legislature in joint session. Terms shall be staggered. Initial terms shall be two members serving for one year, two members serving for two years, and one member serving for three years.

Sec. 37.13.070. REMOVAL AND VACANCIES. (a) The governor may remove a member of the board from office by and with the consent of a majority of the members of the legislature in joint session. A removal

by the governor shall be in writing and state the reason for removal. If the legislature is not in session, the governor may suspend a member of the board. Upon suspension, a vacancy is not created but the board member may not participate in board business and may not be counted for purposes of establishing a quorum. The joint session shall be held within 30 days from the date of removal if the removal occurs while the legislature is in session or within 30 days of convening of the legislature if the legislature is not in session. If the legislature refuses to consent to his removal, the board member shall be reinstated to his position.

(b) A vacancy on the board shall be promptly filled by appointment by the governor and confirmation by a majority of the members of the legislature in joint session, and an appointee to fill a vacancy shall hold office for the balance of the term for which his predecessor on the board was appointed. If a vacancy arises on the board while the legislature is not in session, the governor may appoint an interim board member who shall exercise all powers of a permanent board member until such time as the legislature in joint session fails to confirm the appointment of the interim board member.

(c) A vacancy on the board does not impair the authority of a quorum of the board to exercise all the powers and perform all the duties of the board.

Sec. 37.13.080. QUALIFICATIONS OF BOARD OF TRUSTEES. (a) No individual may be appointed to the board who has not been a resident of the state for at least three years.

(b) No member of the board may hold any other state or federal office, position or employment, either elective or appointive, except as a member of the armed forces of the United States or of this state.

(c) At least three members of the board shall have recognized

competence and wide experience in finance, investments, or other business management-related field.

Sec. 37.13.090. QUORUM. Three members of the board constitute a quorum for the transaction of business and the exercise of the powers and duties of the board.

Sec. 37.13.100. COMPENSATION OF TRUSTEES. Members of the board receive an honorarium of $250 for each meeting day if they attend the meeting and are entitled to per diem and travel allowances as provided by law for members of state boards and commissions.

Sec. 37.13.110. EMPLOYMENT OF PERSONNEL. The board may employ and determine the salary of an executive director. The executive director may, with the approval of the board, select and employ additional staff as necessary. No employee of the corporation, including the executive director, may be a member of the board. The executive director and all other employees of the board are in the exempt service under AS 39.25.

Sec. 37.13.120. CONFLICTS OF INTEREST. (a) Members of the board and the executive director are subject to the provisions of AS 39.50.

(b) If a member or employee acquires, owns or controls an interest, direct or indirect, in an entity or project in which corporation assets are invested, he shall immediately disclose the interest to the board. The disclosure is a matter of public record and shall be included in the minutes of the board meeting next following the disclosure.

Sec. 37.13.130. POWERS AND DUTIES. (a) The prudent-man rule shall be applied by the board in the management and investment of 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 intel-

ligence 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 corporation 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 fund the obligations of others.

(f) The board may enter into and enforce all contracts necessary, convenient or desirable for purposes of the corporation.

(g) Subject to the limitations in (h) and (i) of this section, the board may invest corporation assets in

(1) obligations of, or obligations insured by or guaranteed by, the United States or agencies or instrumentalities of the United States;

(2) obligations secured by reserves paid in by the United States or agencies or instrumentalities of the United States or obligations of corporations in which the United States is a shareholder or member;

(3) certificates of deposit issued by United States domestic banks which are members of the Federal Deposit Insurance Corporation and which are secured as to the payment of principal and interest in accordance with Alaska law and for which a generally recognized secondary market exists;

(4) corporate debt securities which are rated AA or better by a nationally recognized rating service;

(5) short-term corporate promissory notes of the highest rating assigned by a nationally recognized rating service;

(6) bankers' acceptances drawn on and accepted by United States banks each of which have a combined capital and surplus aggregating at least $200,000,000;

(7) repurchase agreements, the securities underlying the agreements being any of the items in (1) - (5) of this subsection;

(8) the guaranteed portion of Federal Small Business Administration loans;

(9) the portion of first lien real estate mortgages guaranteed by the Federal Veterans Administration;

(10) the portions of business and industrial loans made under the Rural Development Act of 1972 which are guaranteed by the Farmer's Home Administration;

(11) the guaranteed portion of Farmer's Home Administration loans.

(h) Investments under (g)(4) of this section may not exceed 25 per cent of the total investments of the fund. Investments under (g)(8) - (11) of this section may not exceed in the aggregate 25 per cent of the total investments of the fund.

(i) No portion of the assets of the fund may be used for the purchase of bonds of a corporation, upon which any regular interest payment has been defaulted within five years before purchase, except bonds never in default but which have been outstanding for less than five years.

(j) The board shall establish and from time to time as necessary modify guidelines for the investment of the assets of the corporation. Before adoption of any guidelines the guidelines shall be reported to

the Legislative Budget and Audit Committee for review and comment.

(k) The board may invest corporation assets in in-state investments 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.

Sec. 37.13.140. GAINS AND LOSSES. At the end of each fiscal year, the total amount of losses on the sales of securities, not offset by gains on the sales of securities during that year, shall be computed, with a portion of these losses to be deducted each fiscal year from the income and the resulting amount of income added to the principal of the fund. Losses taken on the sales of securities shall be accumulated over a period equal to the average remaining life of the securities sold, unless these losses are offset by gains on future sales of securities. In any fiscal year in which the gains on the sales of securities exceed the losses on the sales of securities, the excess shall be added to the principal of the fund.

Sec. 37.13.150. INCOME. The interest received in a year is the income of the corporation for that year. The income available for disbursement shall be determined on an averaging basis. For the first five years, income will be the simple averaging of the annual current return at cost. Subsequently, there will be a moving average current return, in which the latest fiscal year will replace the oldest year. The income available for disbursement will be the lesser of the latest fiscal year's income, or the average annual current income for the past five fiscal years of the fund at cost, and after adjustment for capital losses charged to that fiscal year.

Sec. 37.13.160. BOARD BUDGET. The board's operating budget is

from the general fund and is subject to the Executive Budget Act (AS 37.07).

Sec. 37.13.170. AUDITS. The Legislative Budget and Audit Committee shall provide for an annual post audit and annual operational and performance evaluations of the corporation's investments and investment programs.

Sec. 37.13.180. REPORTS AND PUBLICATIONS. No later than September 30 of each year, the board shall publish a report of the corporation for distribution to the governor, legislature, and the public. The report shall be written in easily understandable language. The report must include financial statements audited by independent outside auditors, a statement of the amount of money received by the permanent fund from each investment during the period covered, a statement of corporation investments including an appraisal at market value, a description of corporation investment activity during the period covered by the report, a comparison of the corporation performance with the intended goals contained in AS 37.13.020, an examination of the impact of the investment criteria of this chapter on the corporation portfolio with recommendations of any needed changes and any other information the board believes would be of interest to the governor, the legislature, and the public. The annual income statement and balance sheet of the corporation shall be published in at least one newspaper in each judicial district. The income statement and balance sheet for the two fiscal years preceding the publication of the election pamphlet under AS 15.57 shall be included in that pamphlet. The board may also publish other reports it considers desirable to carry out its purpose.

Sec. 37.13.190. TAX EXEMPTION. The corporation is exempt from all taxes and assessments in the state. All security instruments issued by the corporation, their transfer, and their income are exempt from all

taxes and assessments in the state.

Sec. 37.13.200. POLITICAL ACTIVITIES. The resources of the corporation may not be used to finance or influence any political activities.

Sec. 37.13.210. PUBLIC ACCESS TO INFORMATION. Information in the possession of the corporation is a public record, except that information which discloses the particulars of the business or affairs of a private enterprise or investor is confidential and is not a public record. Confidential information may be disclosed only for the purposes of an official law enforcement investigation or when its production is required in a court proceeding. These restrictions do not prohibit the publication of statistics presented in a manner that prevents the identification of particular reports, items, persons, or enterprises.

Sec. 37.13.220. DEFINITIONS. In this chapter,

(1) "board" means the Board of Trustees of the Alaska Permanent Fund Corporation;

(2) "corporation" means the Alaska Permanent Fund Corporation.

* Sec. 6. AS 39.25.110 is amended by adding a new paragraph to read:

(22) members of the board of trustees, the executive director, and staff of the Alaska Permanent Fund Corporation.

* Sec. 7. AS 39.50.200(9) is amended by adding a new subparagraph to read:

(QQ) Board of Trustees and executive director of the Alaska Permanent Fund Corporation.

* Sec. 8. TRANSITION. The commissioner of revenue shall transfer all funds of the Alaska permanent fund to the Alaska Permanent Fund Corporation established by this Act after request for transfer is made by the board of trustees of the corporation.

* Sec. 9. AS 37.10.065(c) is repealed.

* Sec. 10. AS 37.10.065(a) and (b) are repealed.

* Sec. 11. Section 10 of this Act takes effect upon transfer of the funds of the Alaska permanent fund to the Alaska Permanent Fund Corporation as provided in sec. 8 of this Act. The remainder of this Act takes effect July 1, 1979.

1st FCC

PERMANENT FUND FREE CONFERENCE COMMITTEE

Revised Schedule

March 17, Monday topic: CAPITAL NEEDS

Dr. Fry - University of Hawaii
Dr. Coffman - Washington State University

March 18, Tuesday topic: FINANCIAL AND CREDIT ISSUES

Mr. Theodore Swick and Mr. Samuel Plaia - Bache Halsey

March 19, Wednesday topics: INVESTMENT OF FUNDS AND BONDING ASPECTS OF SB 1

Mr. Bob Greely
Mr. Tony Dean - Nuveen and Co.

March 20, Thursday topics: LEGAL IMPLICATIONS AND INVESTMENT STRATEGY

Mr. George Wolf - Orrick, Herrington
Mr. Bob Richards - Alaska Pacific Bank

March 21, Friday topic: MANAGEMENT POLICY

Mr. Peter McDowell - Homan-McDowell Associates

All meetings will begin at 1:30 p.m. in the Senate Finance Committee Room.

#18:24

AlaskaPacificBank

A Subsidiary of Alaska Pacific Bancorporation

MANAGEMENT PLAN

For

THE ALASKA PERMANENT FUND

Testimony Before

Senate Special Committee on the Permanent Fund
House Special Committee on the Permanent Fund
Alaska State Legislature

By

Robert R. Richards
President
Alaska Pacific Bank

March 17, 1980

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The overriding consideration in determining the proper management of the State of Alaska's Permanent Fund is achieving and maintaining an effective level of government services for Alaskans in the future. Therefore, it is imperative that Alaska's current fiscal surplus be managed to ensure long-run sustainable growth of revenues. Expanding revenues permit improvements in both the quality and quantity of public services to overcome inflation effects and the demands of a growing population as well as to meet the rising social expectations of a maturing society.

This overriding consideration of ensuring a reasonable expansion of Alaska government services in the future leads to two conclusions regarding disposition of today's surplus funds. First, as close as possible to 100% of the surplus funds of the State of Alaska should be placed in the Permanent Fund, rather than used for over-expansion of current operations which intensifies the expected future deficit. Second, the Permanent Fund should be divided into two parts: an endowment fund and a development bank. Of the total quarterly surplus each calendar year, at least 50% but no more than 80% should be placed in an endowment fund which focuses on the preservation of capital. Hence, the State of Alaska would have a basic fund from which to generate earnings to finance future government expenditures. However, for the first ten years, earnings from the endowment fund should be reinvested directly bank into the fund. Likewise, at least 20% but no more than 50% of the total quarterly surplus each year should

be managed as a development bank which would invest in large projects designed to expand the industrial base of Alaska which would expand the State's tax base, and which, thereby, would expand the ability of the State to provide public goods and services. Depending on the surplus total, prevailing economic conditions, and the quality of particular projects, the board of directors of the Permanent Fund would have the discretion to shift between the 80%/20% and 50%/50% investment mix.

Before discussing our specific recommendations concerning the endowment fund and the development bank, perhaps it would be most appropriate to present our recommendations regarding the administrative structure of the Permanent Fund.

Administration

In our opinion, the administration of the Permanent Fund should remain relatively independent from political pressures. A suitable governing body for the Permanent Fund would be patterned after the Federal Reserve Board or the World Bank, with the members being appointed by the Governor subject to approval by the Legislature, serving staggared terms to avoid affiliations with any particular administration. For example, a nine-member, blue ribbon board of directors could include as permanent members the positions of the President of the Senate, the Speaker of the House of Representatives, and the Commissioners of Commerce and Revenue, with five gubernatorial

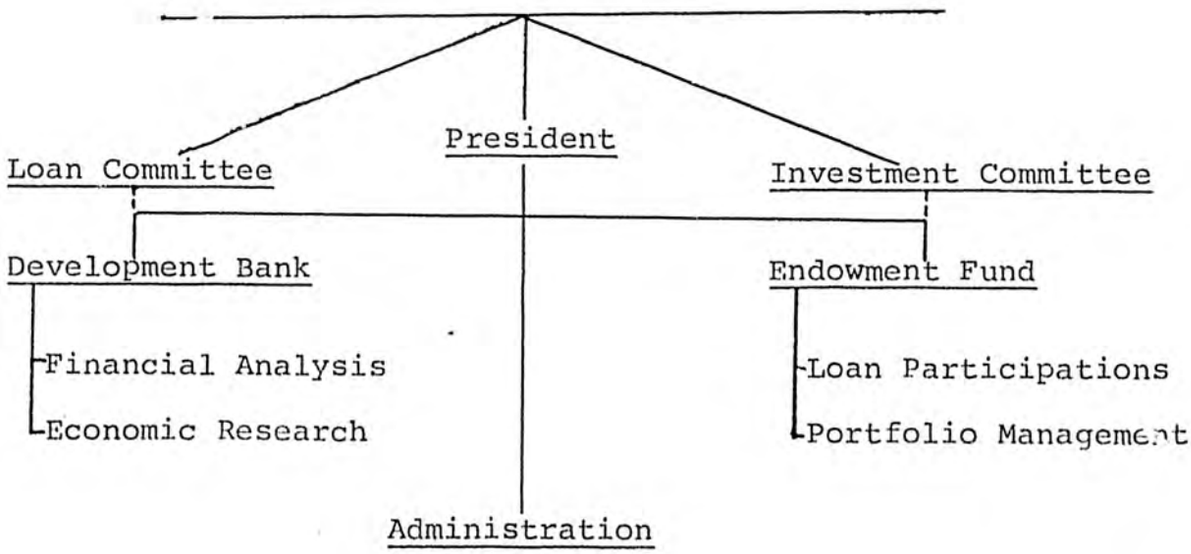
appointments from the private sector subject to legislative approval. The private sector members would be appointed for terms of ten years, so arranged that one term would expire every two years. The members could elect one of the private sector members as Chairman for a five-year term. The objective of the board in a broad sense would be to maintain prudent management of the Permanent Fund. The board would develop an investment plan for the endowment fund and a list of specific projects for the development bank, submitting the entire package annually to the Legislature for approval.

The management of the Fund would be delegated to a president hired by the board. Obviously this person should be an individual with outstanding credentials in banking or finance. The Permanent Fund structure should be composed of three segments: development bank, endowment fund, and administration as indicated on the following page.

THE ALASKA PERMANENT FUND

BOARD OF DIRECTORS

Commissioner of Revenue
Commissioner of Commerce and Economic Development
President of the Senate
Speaker of the House of Representatives
Private member
Private member
Private member } appointed by Governor
Private member
Private member



Endowment Fund

The primary objective for the endowment fund should be capital preservation in the form of risk-free and low-risk investments.

The endowment fund should have a well-defined investment policy which provides the framework for managing the fund's resources in the most efficient manner to take advantage of rapidly moving money markets and changing economic conditions while maintaining adequate liquidity at maximum yields. The investment policy should be reviewed regularly and revised accordingly to accommodate the investment objectives of the endowment fund. The fund should diversity its investments to some degree.

Liquidity items in the fund's investment portfolio should be well-defined and maintained at an amount sufficient for the specified needs of the endowment fund. Likewise, the maturity schedule of the fund's investment portfolio should coincide with anticipated seasonal and cyclical requirements of the other investments of the endowment fund. Maturities of all investments should be well-defined with a specified average life.

The size of the securities portfolio within the endowment fund's array of investments should be maintained at a sufficient level to meet the investment objectives of the fund, but the

securities portfolio size should be allowed to fluctuate above these requirements depending on the other sources of funds within the endowment fund.

An excellent example of risk-free investments for the endowment fund would be U.S. government and agency securities to provide the fund with liquidity, safety, and quality.

Clearly, certificates of deposit with Alaska banks quality are appropriate low-risk investments. We recommend a combination of investments with staggered maturities for a series of variable rate CD's with the rate subject to review every six months. Such an investment in Alaska bank CD's will enable Alaska banks to make more funds available for term loans, the most difficult loans for Alaskans to obtain. It is our recommendation that the amount of State of Alaska investment in Alaska bank CD's each quarter be limited to an amount that causes total public funds in Alaska's banking industry to be at least 30% but not more than 35% of total statewide deposits at the end of the previous quarter. This formula is based on an analysis of the table on the following page which outlines the Alaska commercial banking system's rising liquidity pressures. We also suggest that the State relax its collateralization requirements to permit Alaska banks to place these funds into a broader range of loans. Alaska financial institutions have historically made funds available to Alaska borrowers at a greater rate than their deposit base has increased. The table on the following page indicated that since 1970, Alaska commercial bank loans have quadrupled while

Alaska Commercial Banks
Loan and Deposit History
($ Millions)

12/31	Loans	Deposits	Loan/Deposit Ratio	Public Deposits	Public as % of Total
1970	336.3	637.6	0.53	225.7	35.4%
1971	401.0	722.6	0.56	250.3	34.6%
1972	476.5	824.0	0.58	278.1	33.8%
1973	541.3	883.9	0.61	277.9	31.4%
1974	648.3	1097.8	0.59	298.8	27.2%
1975	809.4	1376.7	0.59	297.5	21.6%
1976	937.4	1531.7	0.63	264.1	17.2%
1977	1228.7	1684.3	0.73	372.3	22.1%
1978	1327.7	1747.3	0.76	389.4	22.3%
1979*	1439.6	1896.9	0.76	479.0	25.3%

*September 30

deposits have tripled. Obviously, in order to reach a more prudent loan to deposit ratio, either loans must be decreased or deposits increased. There can be no increase in loans without a corresponding increase in deposits.

Following the surge experienced during trans-Alaska pipeline construction, private demand deposits as a percent of total deposits has been decreasing. Likewise, public deposits as a percent of total deposits has declined from 35% in 1970 to 25% in 1979. Therefore, it has been necessary to purchase a growing portion of Alaska bank deposits from nonpublic sources. In many cases, these purchased funds are priced in national markets, transferring upward pressure to Alaska interest rates.

Further, there has always been a high degree of participation by outside financial institutions in Alaska credits, due in part to the relatively small size of the Alaska banking system as a whole. While this importation of capital into Alaska enables local banks to make more loans, it also contributes to interest rates for Alaska loans being tied directly to national markets.

Therefore, it seems appropriate that the State of Alaska, given its unique situation of a projected budget surplus, assist Alaska borrowers in two ways. First, by increasing the level of Alaska public deposits as previously described, and second by buying loans.

In our opinion, purchasing Alaska loans also qualifies as an appropriate investment for the endowment fund, at rates commensurate with current money market conditions.

It is our recommendation that the State of Alaska use the Alaska banking industry as a conduit for all endowment fund loan programs, with the endowment fund itself making no direct loans. The Alaska banking community has the expertise to service all such loans effectively, and, thereby, such programs would require no additional state government personnel. We also recommend that the State of Alaska participation rate be 90% in these loan programs, which would place the Alaska banks at sufficient risk but enable them to make additional loans through traditional outside capital markets. Because of its excellent reputation and efficiency, we futher recommend that the Alaska Housing Finance Corporation be the State agency used to purchase all housing-related loans. We feel that the existing State Department of Commerce business loan program should either continue to work through the Alaska banking system with limits increased from $500,000 to $1,000,000 for any one project, independent of the individual borrower, or that these programs be transferred to the Alaska Industrial Development Authority under expanded powers.

The social and economic benefits derived from investing in Alaska home mortgages are particularly attractive because of the . multiplier effect. We recommend, therefore, that up to $300 million of the principal from the endowment fund be invested annually in Alaska single family, owner occupied real estate mortgages in years when there is a net population increase. An ongoing investment of principal from the endowment fund into Alaska real estate mortgages appropriately leaves social decisions concerning disposition of general funds in the legislature and minimizes the discretion of the board of governors of the permanent fund.

In summary, the attractive aspect of the endowment fund concept to manage 80% of the state budget surplus is that it can be invested in a manner that simultaneously achieves the two important objectives of capital preservation and the allocation of funds to Alaska families and businesses. Further, through utilizing existing financial institutions both for deposits and as a conduit for the purchasing of loans, these objectives can be satisfied with virtually no increase in state bureaucracy or operating expenditures.

Development Bank

The development bank should invest in large projects which expand Alaska's industrial base and increase the State revenue generating capacity beyond the extent to which they also increase the demand for government services. Excess earnings from development bank lending activities and the sale of loans should be returned to the endowment fund for reinvestment. Development bank investments should be structured primarily as debt instruments in projects which advance the sustainability of the Alaska economy with reasonable economic viability over the long-term.

The development bank should not participate in projects which can obtain total financing from the private sector. However, development bank loans should be made to qualifying projects in both the public and private sectors. Public projects include those typically engaged in by the public sector - dams and other power projects, ports, transportation facilities, etc., which expand the infrastructure and which, thereby, make it easier and more feasible for the private sector to pursue its own objectives. Private projects suitable for development bank participation are those of such a nature and size that public

participation is substantial - oil and gas pipelines, petrochemical facilities, fish processing plants, mineral refineries, sawmills, etc. Due to the very size and nature of such projects, we are recommending that the development bank in this case make direct loans with appropriate participation levels made available to Alaska and outside banks. This contrasts with our philosophy that the endowment fund, on the other hand, purchase Alaska loans, using the Alaska banking system for origination and servicing. We are recommending also that the floor level for development bank loans be $5 million, with the exception of a $1 million floor imposed for qualifying projects in rural areas where a lower amount clearly would safeguard the intention of the development bank.

We also recommend that another function of the development bank be to guarantee the bonds, capital notes, or other types of debt utilized to finance large private projects, and that the development bank serve as a conduit for the issuance of revenue bonds which have the effect of reducing the debt service burden of private projects. A successful vehicle for the implementation of this function of the development bank would be the existing Alaska Industrial Development Authority.

It is vital to refrain from making the development bank a political tool or engulfing it in bureaucratic inefficiencies. It is also important that the development bank lending activity be allocated both on a regional basis and by industrial diversification. It is not the intent of the development bank to subsidize industry, but rather to take more than normal risk in causing projects to happen which have demonstrated feasibility. We, therefore, recommend a seven-member, high caliber executive committee responsible for approving all direct loans of the development bank.

Some Conceptual and Policy Considerations

Each year the Board of Directors should present for approval by the Legislature a general ten year plan, a somewhat more specific five year plan, and a highly specific one year plan and budget. This is to insure that the general management of the development bank is in accord with the objectives of the Alaska people. However, the Permanent Fund should be free to function without the handicap of short run, individual political pressures. To permit this the Board of Directors should be granted relatively broad powers.

As stated at the outset of this testimony, the objective of the Permanent Fund is singular: to generate sustainable revenue to the State of Alaska over the long run. Other objectives should not be allowed to cloud and confuse the effective management of the Permanent Fund. Therefore, the pursuit of certain social objectives such as income redistribution, interest rate subsidization, rural welfare improvement, and so forth should be kept out of the Permanent Fund and within the exclusive jurisdiction of the Legislature where it belongs. That is, the State's social goals should be pursued through the normal legislative and administrative processes. (It can be noted, however, that certain investments by the Permanent Fund can have the secondary effect of being conducive to pursuit of certain of the State's social goals.)

Finally, it must be acknowledged that a portion of the Permanent Fund likely will be invested outside the State of Alaska as

a result, simply, of the expected future immensity of the Fund. This reflects two considerations. First, Alaska has the ability to absorb only so much capital. (For example, the total deposits of the entire Alaska banking system are only approximately $2 billion.) Secondly, "the prudent man rule" of investment management suggests that the Fund's investments should be diversified, and a portion of the Fund's capital should be placed in low risk, highly liquid securities such as instruments of the U.S. government.

Summary

The objective of the management of the Permanent Fund is to generate future revenue to state government in two ways: (1) from earnings on the endowment fund and (2) through increased revenues from an expanded industrial base through investments by the development bank.

To achieve these objectives the administration of the Fund should be relatively independent from though ultimately and generally responsible to political considerations.