HOUSE
COMMITTEE REPORT

(11)
Date referred: 2/24/86

FURTHER REFERRALS:

DATE: 5-2-86

The FINANCE Committee has considered CSSB 346(Fin)

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

and recommends:

[ ] do pass
[ ] do not pass
[ ] do pass with attached amendment(s)
[ ] no recommendation
[X] replace with HCS CSSB 346(FIN) [X] same title
[ ] new title

and recommends do pass

[ ] further referral to the ______ Committee

and attaches:
[ ] letter of intent
[ ] first fiscal note
[ ] new fiscal note
[X] zero fiscal note

SIGNING DO PASS:

Albert P. Adams
Jim Duncan
Ronald L. Larson
[illegible]
Pat Pourchot
Mike Miller
Steve Frank
Sam Cotten

SIGNING OTHER RECOMMENDATIONS:

[illegible] no REC
[illegible] No Rec
Rich Uehling (NO REC)

Albert P. Adams
Chairman

STATE OF ALASKA 1986 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date :

REQUEST

Bill/Resolution No. : HCS CSSB 346(FIN)
Title : Act relating to income of the permanent fund

Sponsor : Senator Halford
Requestor : House Finance Committee
Date of Request : 5/2/86

FISCAL DETAIL

Agency Affected : Revenue
BRU :

Components :

EXPENDITURES/REVENUES : (Thousands of Dollars)

OPERATING	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
PERSONAL SERVICES		0	0	0	0	0
TRAVEL		0	0	0	0	0
CONTRACTUAL		0	0	0	0	0
SUPPLIES		0	0	0	0	0
EQUIPMENT		0	0	0	0	0
LAND & STRUCTURES		0	0	0	0	0
GRANTS, CLAIMS		0	0	0	0	0
MISCELLANEOUS		0	0	0	0	0
TOTAL OPERATING		0	0	0	0	0

CAPITAL		0	0	0	0	0

REVENUE		0	0	0	0	0

FUNDING : (Thousands of Dollars)

GENERAL FUND		0	0	0	0	0
FEDERAL FUNDS		0	0	0	0	0
OTHER		0	0	0	0	0
TOTAL		0	0	0	0	0

POSITIONS :

FULL-TIME		0	0	0	0	0
PART-TIME		0	0	0	0	0
TEMPORARY		0	0	0	0	0

ANALYSIS : Attach a separate page if necessary

AA

Prepared by : Al Adams, Chair
Phone : 465-3706
Division : House Finance Committee
Date : 5/2/86

Approved by Commissioner :
Date :
Agency :

Distribution (by Agency preparing fiscal note) :
- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

10/25/85

Original sponsors: Halford, Kerttula,
Faiks, et al

IN THE SENATE BY THE FINANCE COMMITTEE

HOUSE CS FOR CS FOR SENATE BILL NO. 346 (Finance)

IN THE LEGISLATURE OF THE STATE OF ALASKA

FOURTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to the income of the Alaska permanent fund; and providing for an effective date."

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

* Section 1. AS 37.13.140 is amended to read:

Sec. 37.13.140. INCOME. Net income of the corporation shall [MUST] be computed annually as of the last day of the fiscal year in accordance with generally accepted accounting principles, excluding any unrealized gains or losses. Income available for distribution equals 21 percent of the [AVERAGE] net income of the corporation for the last five fiscal years, including the fiscal year just ended, but may not exceed net income of the corporation for the fiscal year just ended plus the balance in the earnings reserve [UNDISTRIBUTED INCOME] account described in AS 37.13.145.

* Sec. 2. AS 37.13.145 is amended to read:

Sec. 37.13.145. DISPOSITION OF INCOME. At the end of each fiscal year, an amount sufficient to offset the effect of inflation on principal of the Alaska permanent fund during that year, as measured by the change in the calendar year average United States consumer price index for all urban consumers [A NATIONALLY RECOGNIZED INDEX,] shall be transferred from net income as defined in AS 37.13.140, excluding income on the earnings reserve [UNDISTRIBUTED INCOME] account in the Alaska Permanent Fund, to the principal of the Alaska permanent fund for reinvestment. The balance of the [NET] income available for distribution under [AS DEFINED IN] AS 37.13.140 shall be transferred to the earnings reserve [UNDISTRIBUTED INCOME] account in the Alaska permanent fund. Money in the earnings reserve [UNDISTRIBUTED INCOME] account shall be invested in investments authorized under AS 37.13.120. Income from the investment of the earnings reserve [UNDISTRIBUTED INCOME] account shall be treated as an addition to that account.

* Sec. 3. This Act takes effect July 1, 1986.

STATE OF ALASKA 1986 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date : ________

REQUEST

Bill/Resolution No. : CSSB 346 (Fin)
Title : Act relating to income of Alaska permanent fund

Sponsor : Senator Halford
Requestor :
Date of Request :

FISCAL DETAIL

Agency Affected : Department of Revenue
BRU :

Components :

EXPENDITURES/REVENUES : (Thousands of Dollars)

OPERATING	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		0	0	0	0	0

CAPITAL		0	0	0	0	0

REVENUE		0	0	0	0	0

FUNDING : (Thousands of Dollars)

GENERAL FUND		0	0	0	0	0
FEDERAL FUNDS						
OTHER						
TOTAL		0	0	0	0	0

POSITIONS :

FULL-TIME		0	0	0	0	0
PART-TIME						
TEMPORARY						

ANALYSIS : Attach a separate page if necessary

Prepared by : Jan Faiks, Co-chairman
Division : Senate Finance Committee
Phone : 465-4523
Date : 2/19/86

Approved by Commissioner : ________ Date : ________
Agency : ________

Distribution (by Agency preparing fiscal note) :
- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

page ___ of ___

10/25/85

MEMORANDUM

TO: All Members
House of Representatives

FROM: Senator Rick Halford

Rick Halford

DATE: February 27, 1986

RE: Permanent Fund Deposit and Legislation - SB 346, HB 28

SB 346 and HB 28 currently in the House propose the following actions.

1. The deposit of approximately one billion dollars in the principal of the permanent fund.
2. The increase in annual earnings from the principal of the Permanent Fund of approximately 100 million dollars each year thereafter (1 billion x 10% = 100 million).
3. An increase in the amount available for dividends to individuals (and the Alaskan economy) of over 40 million dollars per year.
4. Repeal of the five-year averaging provisions for computation of dividend amounts which currently reduces dividends from a true 50% of earnings.
5. Repeal of the provisions relating to the Undistributed Income Account.

WHY MAKE THE DEPOSIT?

Political realities and our own human frailties provide substantial limitations to the options before us. The questions are not do we deposit the additional one billion to the principal of the Permanent Fund now, or should we deposit it to the principal between now and 2003 as needed for inflation proofing, but simply do we save it or spend it? Few of us can really believe that any legislature would leave a multi-million dollar account available for appropriations alone for the next fifteen years.

Two current practices of the Permanent Fund Corporation must be understood to evaluate HB 28 and SB 346.

1. Two thirds of all future returns are needed for inflation according to Permanent Fund Corporation computer runs which assume a very conservative rate of return of only 9% with an inflation rate of 6% for a real rate of return of only 3%. This is a lower rate of return and a higher inflation rate than is projected by our own Department of Revenue. This very conservative projection, desirable from a management standpoint, makes all of the long-range analysis of the effects of any proposal highly speculative. As we have found in other areas, short-term predictions are difficult and projections beyond the next ten years almost impossible. Long-term energy prices are a major factor in determining inflation.

2. Permanent Fund Corporation computer runs treat the Undistributed Income Account as a part of the principal of the fund and assume that it remain intact until it is all deposited in the principal by the year 2003. Therefore P.F. corporate projections don't show the approximately 100 million per year increase in P.F. earnings resulting from the deposit of the one billion to the principal. Instead the withdrawal of the Undistributed Income Account reduces the figures by one billion and 100 million annually.

WHY DELETE THE UNDISTRIBUTED INCOME ACCOUNT AND FIVE-YEAR AVERAGING?

Assuming that the deposit is desirable at this time, while we have over a billion dollars in other windfalls and accounts, why is it then necessary or desirable to repeal the current provisions in law which created the Undistributed Income Account and reduce dividends to the five-year average net income of the fund?

To address potential changes necessitated by a deposit of the entire Undistributed Income Account to the principal of the Permanent Fund we must review how the current law works and where potential conflicts may exist.

1. The existence of the Undistributed Income Account, only puts off the problem in existing law, dividends and inflation-proofing are in direct conflict. It is obvious that the obligation to pay 1/2 of the average income of the fund to dividends cannot be met when 2/3 of the income is required for inflation-proofing at current Corporation projections.

a. AS 37.13.140 provides that

"Income available for distribution equals the average net income of the corporation for the last five fiscal years but may not exceed net income of the corporation for the fiscal year just ended plus the balance in the Undistributed Income Account."

By law without the balance in the Undistributed Income Account averaging can only reduce but never increase the amount available for dividends above the income of the immediately prior year.

b. AS 37.13.145 provides that

"At the end of each fiscal year, an amount sufficient to offset the effect of inflation on principal of the Alaska Permanent Fund during that year, as measured by a nationally recognized index, shall be transferred from net income as defined in AS 37.13.140, excluding income on the Undistributed Income Account in the Alaska Permanent Fund, to the principal of the Alaska Permanent Fund for reinvestment."

When the two proceeding provisions are combined with the Permanent Fund Corporation's own projections of 9% return with a 6% requirement for inflation, the conflict is obvious. In simplest terms it is impossible use to 2/3 of a given sum to one purpose while paying 1/2 of the same sum to another purpose. Averaging only conceals the mathematical impossibility while the Fund is growing at a large rate and while the Undistributed Income Account exists to make up the shortfall.

Statutory requirements for dividends and inflation-proofing cannot be met under current law if the Undistributed Income Account is deposited to the principal.

2. In recognition of the existing problem, the Permanent Fund Board supported legislation last year to give a clear priority to inflation-proofing over dividends. SB 196 or the original HB 28, if passed, in the form supported by the Permanent Fund Corporation last year had a potentially devastating effect on the political support of the Fund provided through dividends. Progress of that approach was stopped by former Governor Hammond and many others who recognize that while inflation-proofing is important and should be provided for, the first defense of the Fund is the political support created and enhanced by a viable continuing dividend program.

SB 346 deals with the existing conflict positively, recognizing the need for both dividends and inflation-proofing by dividing the income in half on an annual basis.

The Permanent Fund Corporation has provided an analysis of the advantages and disadvantages of the proposal now adopted by the Senate (Attachment A). The advantages listed are self-explanatory. The only advantage I would add is that the increase in dividends under SB 346 exceeds 40 million dollars per year. The disadvantages listed seem to be in two categories - incentives for mis-management and potential volatility in dividends. The existing management law, board policies, and accounting system are all designed to avoid these problems. In fact the current accounting system clearly indicates both realized and unrealized gains in stock market investments. Any manipulation designed to realize gains while holding losses would be clearly evident, and in any case could only effect a small portion of the Fund as the overwhelming majority of the investments are in stable and long-term issues (See Attachment B). In any case under existing law, without an Undistributed Income Account balance, dividends cannot exceed the current year's income. So the potential for dividend reduction without a balance in the Undistributed Income Account is equal under existing law or SB 346/HB 28. Averaging without the Undistributed Income Account balance provides that the public bear the entire risk of income reductions without realizing the full gain of income increases.

In extensive research I have found no better way to add the billion dollars to the principal of the Permanent Fund and protect both dividends and inflation-proofing than that which is contained in SB 346 and HB 28. Together these bills provide substantial benefit to Alaskans in the near future and in the long term. I will be glad to work with anyone who can find a better direct way to accomplish this than simply depositing the Undistributed Income Account to the principal of the Permanent Fund and splitting future income equally between dividends and inflation-proofing.

PROJECTIONS ATTACHED

I have added as attachments C,D, E, and F four projections indicating long-term effects of the alternatives before us. Attachment C shows the current law under the improbable assumption that the Undistributed Income Account remains untouched for the next fifteen years and is deposited over time into the Fund - there is a substantial shortfall with dividends and inflation-proofing in conflict once the Undistributed Income Account is depleted. Attachment D shows the effect if the Undistributed Income Account is transferred to the General Fund, a buffer account or any other use - there is a substantial shortfall with dividends and inflation-proofing in conflict as soon as the Undistributed Income Account balance is zero. Attachment E shows the effect of HB 28 and SB 346 - note that when the real political alternatives are considered (Spend Attachment D vs. Save Attachment E), the Permanent Fund balance in the year 2005 is approximately the same (within 1/10 of 1% difference in assumption for inflation rate or rate of return). In fact if an inflation rate of 4% instead of 6% is assumed, Attachment F shows that under SB 346/HB 28, the principal balance in 2005 is substantially increased, because of increased inflation-proofing over current law, in spite of the fact that hundreds of millions more has been paid out to Alaskans in dividends. It is interesting to note that the average rate of inflation from 1940 to date has been 3.75% according to the U.S. Bureau of Labor Statistics.

ATTACHMENT A

Alaska Permanent Fund Corporation
Pouch 4-1000 Juneau, Alaska 99802
(907) 465-2047 Telex 099-46-323

EFFECT OF ELIMINATING FIVE YEAR AVERAGING UNDER THE HALFORD PROPOSAL

ADVANTAGES

Eliminates a pool of money which becomes a target for legislative appropriation for purposes other than deposit in the fund.

Pays an actual 50% of net income for dividends each year rather than 50% of averaged (five year) earnings.

Provides incentive to fund managers to perform well since the other 50% of all net earnings go to principal.

Heightens public scrutiny of fund management.

Heightens public scrutiny of legislative proposals to change investment criteria to meet social and political rather than economic goals.

DISADVANTAGES

Changes focus of fund performance from long to short term.

1. May invite management decisions to take gains prematurely to keep profitability up in any given year.

2. May invite management decisions not to realize losses in order to preclude a drop in profitability.

3. In falling markets, may invite management to engage in higher risk investments to maintain or increase profitability. While higher risk can produce higher income, it can also produce significant losses.

Will subject fund to market volatility each year. This may result in widely (up and down) fluctuation in dividends.

If income is eventually to be used as a supplement to state revenue, the supplement will fluctuate widely and a steady, stable revenue stream could not be guaranteed.

STATEMENT OF ASSETS, LIABILITIES AND FUND EQUITY

ASSETS	%	June 30, 1985	June 30, 1984
Cash	0.01	$ 878,000	$ 259,000
Receivables and prepaid expenses	2.8	188,592,000	171,250,000
Investments:			
Marketable debt securities —			
Repurchase agreements		7,300,000	124,600,000
Short-term issues		54,493,000	329,605,000
Intermediate and long-term issues		5,438,792,000	4,564,080,000
Total marketable debt securities	81.8	5,500,585,000	5,018,285,000
Real estate —			
Equity pools		43,898,000	7,500,000
Participating mortgage		8,000,000	8,000,000
Limited partnership		25,648,000	
General partnerships		52,104,000	
Total real estate	1.9	129,650,000	15,500,000
Preferred and common stock, net of valuation allowance (1984)	11.1	747,303,000	290,835,000
Conventional mortgages	0.7	47,985,000	34,549,000
Alaska certificates of deposit	1.5	107,500,000	
Total investments		6,533,023,000	5,359,169,000
Property and equipment, net of accumulated depreciation		359,000	121,000
Total assets		$ 6,722,852,000	$ 5,530,799,000
LIABILITIES			
Accounts payable		$ 1,372,000	$ 849,000
Income distributable to the State of Alaska		217,274,000	155,130,000
Total liabilities		218,646,000	155,979,000
EQUITY			
Contributed equity		5,740,942,000	4,838,344,000
Reserve for inflation and dividends		763,264,000	557,347,000
Unrealized loss on common stock			(20,871,000)
Total equity		6,504,206,000	5,374,820,000
Total liabilities and equity		$ 6,722,852,000	$ 5,530,799,000

ALASKA PERMANENT FUND CORPORATION

FINANCIAL PROJECTIONS AS OF 12/31/85
(in millions)

	PRINCIPAL						INCOME					ASSETS	
								Distributions		Reserves			
FY	FY Begin Balance	Appro-priations	Dedicated State Revenues*	Inflation Proofing	FY End Balance	Divid/ Inflation Proofing Shortfall	Net Income	Dividends	Inflation Proofing	Add (Delete)	FY End Balance	FY End Balance	FY
78			54.4		54.4		1.8					55.0	78
79	54.4		84.1		138.5		8.0					140.5	79
80	138.5		344.4	.3	483.2		32.4	11.8	.3			502.9	80
81	483.2	900.0	385.1	.2	1,768.5		149.9	27.5	.2	58.7	58.7	1,874.6	81
82	1,768.5	800.0	400.5		2,969.0		368.4	71.1		195.1	243.8	3,301.7	82
83	2,969.0	400.0	421.0	231.2	4,021.2		471.1	107.9	231.2	110.0	353.8	4,593.0	83
84	4,021.2	300.0	365.2	150.9	4,838.3		529.5	175.0	150.9	203.6	557.4	5,530.8	84
85	4,838.3	300.0	368.0	234.6	5,740.9		557.8	217.0	234.6	205.9	763.3	5,722.9	85
86	5,740.9		356.7	219.5	6,317.1		751.4	277.8	219.5	254.1	1,017.4	7,512.3	86
87	6,317.1		295.4	395.8	7,010.3		705.2	311.5	395.8	(3.1)	1,014.3	8,335.1	87
88	7,010.3		271.5	436.9	7,718.3		759.0	341.3	436.9	(9.2)	1,005.1	9,065.2	88
89	7,718.3		265.2	479.1	8,464.1		834.7	371.3	479.1	(16.2)	988.9	9,824.3	89
90	8,464.1		255.9	523.2	9,243.2		903.5	395.3	523.2	(15.6)	972.3	10,611.3	90
91	9,243.2		251.0	569.7	10,063.9		974.5	428.5	569.7	(13.8)	958.5	11,441.0	91
92	10,063.9		249.5	618.8	10,932.3		1,050.5	453.2	618.8	(21.5)	937.0	12,322.5	92
93	10,932.3		251.6	671.0	11,854.9		1,132.4	483.3	671.0	(19.9)	917.1	13,251.3	93
94	11,854.9		249.9	726.3	12,831.1		1,214.5	527.3	726.3	(39.1)	878.0	14,226.4	94
95	12,831.1		247.7	784.7	13,863.5		1,302.7	557.5	784.7	(49.3)	828.7	15,249.5	95
96	13,863.5		237.9	846.1	14,947.5		1,394.9	609.3	846.1	(60.5)	768.2	16,315.0	96
97	14,947.5		235.6	911.0	16,094.1		1,491.2	653.4	911.0	(73.2)	695.0	17,432.5	97
98	16,094.1		224.9	979.1	17,298.1		1,591.8	699.5	979.1	(86.7)	608.3	18,595.9	98
99	17,298.1		157.3	1,047.3	18,502.7		1,694.0	747.5	1,047.3	(100.3)	497.5	19,747.7	99
0	18,502.7		89.0	1,115.4	19,706.1		1,794.7	796.7	1,115.4	(117.4)	380.1	20,932.9	0
1	19,706.1		48.3	1,185.3	20,939.7		1,895.2	846.7	1,185.3	(136.8)	243.3	22,029.7	1
2	20,939.7		54.0	1,259.6	22,253.3		1,993.9	897.5	1,259.6	(158.2)	85.1	23,235.9	2
3	22,253.3		59.7	1,244.0	23,557.0	94.8	2,103.0	949.1	1,244.0	(85.1)		24,506.1	3
4	23,557.0		63.9	1,221.0	24,841.9	196.3	2,223.0	1,002.0	1,221.0			25,843.9	4
5	24,841.9		71.2	1,287.5	26,200.6	207.3	2,344.5	1,057.0	1,287.5			27,257.6	5

ASSUMPTIONS

- 30% Case Forecast - December 1985
- 25% Pre-1980 Contribution Rate
- 50% Post-1979 Contribution Rate
- 3.60% Inflation FY86
- 10.65% Return FY86
- 6% Average Inflation FY87-FY05
- 9% Average Return FY87-FY05

*SOURCE: Alaska Department of Revenue

CURRENT LAW

ATTACHMENT D

ALASKA PERMANENT FUND CORPORATION

FINANCIAL PROJECTIONS 12/31/85
(in millions)

	PRINCIPAL						INCOME						ASSETS
								Distributions			Reserves		
FY	FY Begin Balance	Appropriations	Dedicated State Revenues*	Inflation Proofing	FY End Balance	Inflation Proofing Shortfall	Net Income	Dividends	Inflation Proofing	General Fund	Add (Delete)	FY End Balance	FY End Balance
78	-		54.4		54.4		1.8			1.3	.5	.5	55.3
79	54.4		84.1		138.5		8.0			6.6	1.4	1.9	140.5
80	138.5		344.4	.3	483.2		32.4	11.3	.3	11.8	8.5	10.4	502.3
81	483.2	900.0	385.1	.2	1,768.5		149.9	27.5	.2	27.5	94.7	105.1	1,874.6
82	1,768.5	800.0	400.5		2,969.0		368.4	71.1		71.1	226.2	331.3	3,301.7
83	2,969.0	400.0	421.0	231.2	4,021.2		471.1	107.9	231.2	109.5	22.5	353.8	4,593.0
84	4,021.2	300.0	366.2	150.9	4,838.3		529.5	175.0	150.9		203.6	557.4	5,530.8
85	4,838.3	300.0	358.0	234.6	5,740.9		557.3	217.3	234.6		205.9	763.3	6,722.9
86	5,740.9		356.7	213.5	6,317.1		751.4	277.3	213.5	1,017.1	254.1		6,594.9
87	6,317.1		296.4	334.1	6,947.6	62.7	639.0	304.9	334.1				7,252.5
88	6,947.6		271.6	370.2	7,589.4	63.0	697.8	327.6	370.2				7,917.0
89	7,589.4		266.2	409.0	8,264.6	62.3	759.6	350.6	409.0				8,615.2
90	8,264.6		255.9	457.3	8,977.8	53.9	824.5	367.2	457.3				9,345.0
91	8,977.8		251.0	512.4	9,741.2	41.3	893.9	381.5	512.4				10,122.7
92	9,741.2		249.6	553.3	10,544.1	46.1	967.6	414.3	553.3				10,958.4
93	10,544.1		251.6	596.4	11,392.1	51.3	1,045.5	449.1	596.4				11,841.2
94	11,392.1		249.9	641.5	12,283.5	57.0	1,127.4	485.9	641.5				12,769.4
95	12,283.5		247.7	688.6	13,219.8	63.3	1,213.4	524.8	688.6				13,744.6
96	13,219.8		237.9	737.3	14,195.0	70.2	1,303.0	565.7	737.3				14,760.7
97	14,195.0		235.6	788.5	15,219.1	77.3	1,397.1	608.6	788.5				15,827.7
98	15,219.1		224.9	841.5	16,285.5	85.1	1,495.1	653.6	841.5				16,939.1
99	16,285.5		157.3	891.6	17,334.4	95.0	1,591.6	700.0	891.6				18,034.4
0	17,334.4		83.0	938.8	18,361.2	106.5	1,686.1	747.3	938.8				19,103.5
1	18,361.2		43.3	986.3	19,395.8	118.3	1,781.4	795.1	986.3				20,190.9
2	19,395.8		54.0	1,038.3	20,488.1	128.7	1,881.9	843.6	1,038.3				21,331.7
3	20,488.1		59.7	1,095.1	21,642.9	137.8	1,988.0	892.9	1,095.1				22,535.8
4	21,642.9		63.9	1,156.4	22,863.2	146.0	2,100.2	943.8	1,156.4				23,807.0
5	22,863.2		71.2	1,221.9	24,156.3	154.2	2,218.9	997.0	1,221.9				25,153.3

ASSUMPTIONS

- 30% Case Forecast - December 1985
- 25% Pre-1980 Contribution Rate
- 50% Post-1979 Contribution Rate
- 3.60% Inflation FY86
- 10.65% Return FY86
- [illegible]% Average Inflation FY87-FY05
- [illegible]% Average Return FY87-FY05

*SOURCE: Alaska Department of Revenue

CURRENT LAW
WITH APPROPRIATION
OF [illegible] TO G.F.
[illegible]/30/86

ATTACHMENT E

ALASKA PERMANENT FUND CORPORATION

FINANCIAL PROJECTIONS AS OF 12/31/85
(in millions)

	PRINCIPAL						INCOME					ASSETS	
							Distributions			Reserves			
FY	FY Begin Balance	Appropriations	Dedicated State Revenues'	Inflation Proofing	FY End Balance	Inflation Proofing Shortfall	Net Income	Dividends	Inflation Proofing	Add (Delete)	FY End Balance	FY End Balance	FY
78			54.4		54.4		[illegible]					55.0	78
79	54.4		84.1		138.5		3.0					140.5	79
80	138.5		344.4	.3	483.2		32.4	11.3	.3			502.9	80
81	483.2	900.0	385.1	.2	1,768.5		149.9	27.5	.2	58.7	58.7	1,874.6	81
82	1,768.5	800.0	400.5		2,969.0		[illegible]	71.1		185.1	243.8	3,201.7	82
83	[illegible]	400.0	[illegible]	201.2	4,021.2		[illegible]	[illegible]	201.2	110.0	353.8	4,593.0	83
84	4,021.2	300.0	355.2	150.9	4,838.3		[illegible]	175.0	150.9	203.6	557.4	5,330.3	84
85	4,838.3	300.0	[illegible]	234.6	5,740.9		[illegible]	237.5	234.6	205.9	763.3	6,722.9	85
86	5,740.9		356.7	219.5	6,317.1		[illegible]	277.2	219.5	254.1	1,017.4	7,612.3	86
87	6,317.1	1,017.4	336.4	352.6	7,993.5	195.3	[illegible]	352.5	352.6			8,336.1	87
88	7,993.5		271.6	382.6	8,637.7	112.7	745.2	382.6	382.6			9,020.3	88
89	8,637.7		265.2	413.3	9,317.2	123.9	[illegible]	413.3	413.3			9,730.5	89
90	9,317.2		255.9	445.0	10,018.1	129.4	[illegible]	445.1	445.0			10,463.2	90
91	10,018.1		[illegible]	477.9	10,747.0	130.2	[illegible]	478.0	477.9			11,225.0	91
92	10,747.0		249.4	512.3	11,508.9	147.5	[illegible]	512.3	512.3			12,021.2	92
93	11,508.9		251.1	549.2	12,308.7	157.4	[illegible]	549.3	549.2			12,857.0	93
94	12,308.7		249.3	585.9	13,144.5	167.6	[illegible]	585.9	585.9			13,730.4	94
95	13,144.5		247.7	625.2	14,017.4	178.2	[illegible]	625.2	625.2			14,642.6	95
96	14,017.4		237.9	666.1	14,921.4	189.2	1,332.2	666.1	666.1			15,587.5	96
97	14,921.4		235.6	708.6	15,865.6	200.3	[illegible]	708.7	708.6			16,574.3	97
98	15,865.6		224.9	752.9	16,843.4	212.5	1,505.8	752.9	752.9			17,596.3	98
99	16,843.4		157.3	797.3	17,798.0	222.7	[illegible]	797.4	797.3			18,595.4	99
0	17,798.0		88.0	840.7	18,726.7	232.5	[illegible]	840.7	840.7			19,567.4	0
1	18,726.7		48.3	883.5	19,658.5	243.0	[illegible]	883.5	883.5			20,542.1	1
2	19,658.5		54.0	927.6	20,640.1	255.2	[illegible]	927.5	927.6			21,567.7	2
3	20,640.1		59.7	974.0	21,673.8	263.0	1,948.0	974.0	974.0			22,647.8	3
4	21,673.8		63.9	1,022.3	22,760.5	281.5	[illegible]	1,022.3	1,022.3			23,783.3	4
5	22,760.5		71.2	1,074.1	23,905.8	295.3	[illegible]	1,074.2	1,074.1			24,980.0	5

ASSUMPTIONS

[illegible] Case Forecast - December 1985
25% Pre-1980 Contribution Rate
50% Post-1980 Contribution Rate
3.60% Inflation FY86
13.65% Return FY86
5% Average Inflation FY87-FY05
9% Average Return FY87-FY05

SOURCE: Alaska Department of Revenue

SCSCS HB28
SENATE BILL NO. 346

ATTACHMENT E

FY	FY BEGIN BALANCE	APPRO- PRIATION	STATE REVENUES	NET INCOME	DIVIDENDS	INFLATION PROOFING	ACTUAL INFLATION	PAID INFLATION SURPLUS	FY END BALANCE
78			54.4	1.8					54.4
79	54.4		84.1	8.0					138.5
80	138.5		344.4	32.4	11.8	.3			483.2
81	483.2	900.0	385.1	149.9	27.5	.2			1,768.5
82	1,768.5	800.0	400.5	368.4	71.1				2,969.0
83	2,969.0	400.0	421.0	471.1	107.9	231.2			4,021.2
84	4,021.2	300.0	366.2	529.5	175.0	150.9			4,838.3
85	4,868.3	300.0	368.0	657.8	217.3	234.6			5,740.9
86	5,740.9		356.7	751.4	277.8	219.5			6,317.1
87	6,317.1	1,017.4	296.4	705.2	352.6	352.6	279.0	73.6	8,057.1
88	8,057.1		271.6	765.2	332.6	382.6	327.7	54.9	8,766.2
89	8,766.2		266.2	826.6	413.3	413.3	356.0	57.3	9,503.0
90	9,503.0		255.9	890.1	445.1	445.1	385.2	59.8	10,263.8
91	10,263.8		251.0	955.9	478.0	478.0	415.6	62.4	11,055.1
92	11,055.1		249.6	1,024.6	512.3	512.3	447.2	65.1	11,882.1
93	11,882.1		251.6	1,096.5	548.3	548.3	480.3	67.9	12,749.9
94	12,749.9		249.9	1,171.8	585.9	585.9	515.0	70.9	13,656.6
95	13,656.6		247.7	1,250.4	625.2	625.2	551.2	74.0	14,603.5
96	14,603.5		237.9	1,332.2	666.1	666.1	588.9	77.2	15,584.7
97	15,584.7		235.6	1,417.3	708.7	708.7	628.1	80.5	16,609.5
98	16,609.5		224.9	1,505.8	752.9	752.9	668.9	84.0	17,671.3
99	17,671.3		157.3	1,594.7	797.4	797.4	710.0	87.4	18,713.3
00	18,713.3		88.0	1,681.4	840.7	840.7	750.3	90.4	19,732.4
01	19,732.4		48.3	1,767.1	883.6	883.6	790.3	93.3	20,757.6
02	20,757.6		54.0	1,855.2	927.6	927.6	831.4	96.2	21,835.4
03	21,835.4		59.7	1,948.0	974.0	974.0	874.6	99.4	22,968.5
04	22,968.5		63.9	2,045.6	1,022.8	1,022.8	920.0	102.8	24,158.0
05	24,158.0		71.2	2,148.3	1,074.2	1,074.2	967.7	106.4	25,409.7

ASSUMPTIONS

30% Case Forecast Dec. 1985
25% Pre 1980 Contribution Rate
50% Post- 1979 Contribution Rate
3.6% Inflation FY86
10.65 Return FY 86
9% Average Return FY87-05
4% Average Inflation Rate FY87-05

SCSCS HB28
SB 346

Alaska Permanent Fund Corporation
Pouch 4-1000 Juneau, Alaska 99802
(907) 465-2047 Telex 099-46-323

TESTIMONY BEFORE THE HOUSE FINANCE COMMITTEE: MARCH 12, 1986

Mr. Chairman and Members of the Committee, I appreciate you giving me this opportunity to testify today on Senate Bill No. 346, and its companion piece of legislation, House Bill No. 28.

The counsel of the board of trustees is first, that you maintain the five-year averaging provision in existing law as regards distributable income, and second, that you consider the appropriation of the balance of the undistributed income account to the principal of the Fund as an issue separate from any proposed changes to the Permanent Fund management act.

On this latter point, I understand that, at present, the passage of HB 28 depends on passage of the changes embodied in SB 346. I simply wish to state that there is no structural flaw in existing statutes which requires "fixing" before the appropriation can be made. The issues are linked as a matter of political preference, not necessity.

The following information is provided to make clear the justification for continuation of five-year averaging, and to provide you with factual information about the status quo and the changes proposed by SB 346 so that you can then make an informed decision about the relative merits of each.

FIVE-YEAR AVERAGING: There is no compelling reason to eliminate five-year averaging.

One argument given for elimination of this particular provision of law has been that "you can't income average without an undistributed income account," and SB 346 would eliminate that account. Well, as a practical matter, there is no connection between the two. Let me explain.

As you know, existing law gives the dividend program first priority on the use of the annual earnings of the Alaska Permanent Fund. This derives from the language in AS 43.23.045 which states:

> "Notwithstanding any contrary provision of law, each year the commissioner shall transfer to the dividend fund 50 percent of the income of the Alaska permanent fund earned during the fiscal year ending on June 30 of the current year and available for distribution."

This view of the priority of claims on Fund income is substantiated in an opinion by legislative legal services dated March 18, 1983 (see attachment #1).

"Income available for distribution" is defined by AS 37.13.140 to be "the average net income of the corporation for the last five fiscal years, including the fiscal year just ended..." This is the language of five-year averaging.

Because existing law provides that only one-half of distributable income is paid out as dividends, Fund earnings would have to decline 25% or more, for at least two consecutive years, before current year net income would be insufficient to pay the full amount of the dividends. As long as this dramatic decline in income does not occur, income averaging will not require a draw-down of the undistributed income account for dividends - and it is extremely unlikely that Permanent Fund income will experience such a drop, at least for the foreseeable future.

What then, is the purpose of the undistributed income account? Under current law, the undistributed income account is designated by the board of trustees as a reserve from which to draw-down undistributed income, as necessary, in years of low earnings or high inflation to fully protect the purchasing or investment power of Permanent Fund principal.

As you can see by looking at the projections sheet which accompanies our latest Monthly Financial Report (see attachment #2), any year in which the Fund earns 9% and experiences 6% inflation, there will be a need to draw-down a portion of the reserve to transfer to principal for inflation-proofing.

It is because of this relationship between inflation-proofing and the undistributed income account that the trustees are so protective of undistributed income. It is also the reason why the trustees, as fiduciaries, supported the original version of HB 28 which would have reversed the order of priority of claims on income.

Nonetheless, appropriation of the unexpended and unobligated balance of the undistributed income account on July 1, 1986 to the principal of the Fund, as contemplated in the present version of HB 28, is encouraged by the trustees. Even though the Fund would lose its reserve for future inflation-proofing, there is some consolation in the fact that the money which was projected to be deposited in the principal over the next 16 years anyway, has instead been deposited immediately.

In addition, in light of the new asset allocation adopted by the board of trustees on Monday of this week, it appears that there will be additional undistributed income to re-establish the reserve next year. (See attachment #3 for the new Permanent Fund long-term investment policy, and attachment #4 for the asset allocation memorandum which describes its probable effects.)

Attachment #5 is the revised projections sheet which reflects the new policy. Please note that the projections now include a more realistic assumption about the FY 87 rate of return (9.25%) and inflation rate (4.1%). As you can see, under these assumptions, though income will decline slightly next year, dividends will continue to grow, inflation-proofing will be completely funded, and there will be $141.1 million left for deposit in the undistributed income account.

But, let's assume for a moment that our assumptions are wrong, and that instead of having enough income to re-establish the reserve next year, the Fund does not produce enough to fully inflation-proof the principal, and - because of this year's HB 28 appropriation - there is no money in reserve. Is there a statutory crisis? No. There is simply a shortfall in inflation-proofing. Dividends are still paid, and the Fund is inflation-proofed to the extent possible.

That is how the disposition of income takes place under the status quo.

I have said there is no compelling reason to eliminate five-year averaging. Now, I would like to tell you why I think you ought to keep it.

1) The averaging of income for dividend distributions reduces the deleterious effects of market volatility on Fund beneficiaries and virtually insures that dividends will continue to grow through bad times as well as good times.

2) Five-year averaging is a stabilizing technique used to even out the ups and downs caused by market volatility. At the same time the legislature and the governor are attempting to create a similar mechanism to buffer the state budget from these de-stabilizing effects, does it make any sense to do away with the one which protects dividend recipients?

3) Five-year averaging is part of a management system which was adopted only after years of deliberation and consideration of alternatives. To quote from the Free Conference Committee Report for the 1980 bill which established existing law:

> "It was the aim of the Committee to establish a management system for the Alaska Permanent Fund which would be protected from political influences but, at the same time, responsive to changes in state policy and accountable to the people through their elected officials. In short, the goal was insulation without isolation."

I would like to say at this point, that if you choose to ignore the advice of the trustees and eliminate five-year averaging, as executive director, I will do everything in my power to insure that the management system retains its integrity and independence from undue political influences. I will continue to favor the long-term best interests of the Fund over short-term performance. However, that won't change the fact that you will have increased the institutional risk of political manipulation.

In conclusion, let me reiterate our support for the appropriation and for continuation of the status quo as regards the management act.

You have the opportunity here to substantially increase the size of the principal of the Permanent Fund, and thereby insure that future earnings will be substantially increased.

You have the opportunity here to insure that dividends will continue to grow, regardless of the downward trend of state revenues.

You have the opportunity here to hold the line against premature changes to a Fund which is going to be here for a long, long time. The system works fine right now, just the way it is. There has been no public outcry of dissatisfaction. Nothing is broken.

Thank you. Are there any questions?

#1

STATE OF ALASKA
THE LEGISLATURE

POUCH Y - STATE CAPITOL
JUNEAU ALASKA 99811
907-465-3800

LEGISLATIVE AFFAIRS AGENCY

M E M O R A N D U M March 18, 1983

SUBJECT: Priority of claims on Alaska permanent fund income (SB 142)

TO: Senator Bob Mulcahy

FROM: Linn H. Asper
Legislative Counsel

You have asked whether a transfer of permanent fund income to the dividend fund (AS 43.23.045), takes precedence over the "inflation-proofing" transfer required by AS 37.13.145, under existing law, and you have also asked how proposed CSSB 142 (Finance) would affect the answer to your first question.

In considering disposition of permanent fund income some confusion is caused by the fact that the dividend distribution program provisions and the inflation-proofing provisions occur in different titles and use different methods of calculating the amount of permanent fund income that is drawn on for their respective purposes. AS 43.23.045 states that 50 percent of permanent fund income "available for distribution" will be transferred to the dividend fund annually. Permanent fund income that is "available for distribution" is determined under AS 37.13.140 by averaging the net income of the permanent fund corporation for the preceding five years. The averaged amount is the amount available for distribution if that amount does not exceed the limits that are stated in that section. The inflation-proofing amount, on the other hand, is a variable annual percentage of the principal of the permanent fund that is drawn from the annual net income of the permanent fund corporation, without averaging. Even though the two claims on the income of the permanent fund are computed differently, they both draw on the same pool of annual permanent fund income. If the amount required for inflation-proofing is large enough, and that amount can vary upward without limit, depending on the rate of inflation that is being experienced, it may be that there will not be enough permanent fund income in a given year to satisfy the requirements of both inflation-proofing and the dividend fund. If this situation arises as the law is now written, it is my opinion that the transfer to the dividend fund must take precedence over the inflation-proofing because AS 43.23.045(b) states that

> Notwithstanding any contrary provision of law, each year the commissioner shall transfer to the dividend fund 50 percent of the income of the Alaska permanent fund earned during the fiscal year ending on June 30 of the current year and available for distribution. (Emphasis added)

The "notwithstanding" clause gives the dividend fund transfer priority over the inflation-proofing transfer.

The proposed CSSB 142 (Finance) (draft of March 16, 1983), that you have made reference to, has been written to reverse the order of priority of claims to permanent fund income. AS 37.13.145 is amended to state that the inflation-proofing transfer is to be made before any other transfer or distribution from permanent fund income, and AS 43.23.045 is amended to delete the "notwithstanding" clause and to state that the inflation-proofing transfer must take place before the dividend fund transfer.

LHA:ljb
10/017

Alaska State Legislature
Senate

Official Business

Pouch V
State Capitol
Juneau, Alaska 99811

To: Representative Al Adams

From: Sally Bibb
Legislative Analyst
Rural Research Agency

Date: March 12, 1986

Re: Analysis of SB 346 and HB 28: Amendments to Permanent Fund Statute

You have requested that we analyze how the passage of CS SB 346 (Finance) and Senate CS for CS HB 28 (Finance) will change the calculation and distribution of Permanent Fund earnings and how management of the Fund's assets may be affected.

SB 346 repeals the five year averaging procedure currently used to determine Permanent Fund income available for distribution (AS 37.13.140). This change eliminates accumulation of excess earnings in the Undistributed Income Account (UIA). The bill also proposes amendments to AS 37.13.145 which provides for the distribution of Permanent Fund earnings. If the amendments are adopted, 50% of annual net income will be transferred to the Dividend Fund and 50% will be reinvested in the principal to "help offset the impact of inflation". HB 28 provides for the deposit of the UIA balance to the principal only if the amendments proposed in SB 346 are approved. The effective date is July 1, 1986 and, therefore, the new procedures would not effect the FY 1986 calculation and distribution of income.

<u>History of the Five Year Averaging Procedure</u>

The 1980 Permanent Fund legislation defined "income available for disbursement" as the greater of the fiscal year net income or the five year average net income. As long as net income was increasing, the average income would be greater, and would determine the amount distributed. The averaging procedure was intended to provide a "relatively steady income flow".[1] From FY 1980 through FY 1982, the

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[1]Alaska State Legislature. Joint Committee Report on
(Footnote Continued)

Dividend Fund and the General Fund each received half of the income disbursed. Excess income was retained in the UIA. Rapid growth of the principal was primarily responsible for the dramatic increases in net income in FY 1981 and 1982 (360% and 146% respectively).

The 1982 amendments retained the five year averaging procedure and more clearly defined the use of the UIA as a supplement if average income exceeded income earned that year. As the UIA balance grew, it become evident that the averaging procedure practically guaranteed that income distributed would be less than each year's net income. However, if the UIA were to be appropriated (to the General Fund or the principal), it would no longer be available to make up differences between annual earnings and the amount of income distributed. Thus, income averaging can smooth out the effects of decreasing or fluctuating income only if the UIA balance is available to supplement annual income.

Results of the Averaging Procedure

The unexpected growth of the UIA was due to the circumstances under which the averaging procedure was applied. Large deposits to the principal combined with usually good return rates resulted in dramatic increases in net income from year to year. Average annual net income was usually much larger than net income for that year. If the Permanent Fund had distributed net income each year, past appropriations to the Dividend Fund and the General Fund would have been much larger. However, because Permanent Fund management policy was in its development stages and investment returns were very unpredictable, the account provided an important buffer for possible income fluctuations. It also increased the assets and net income of the Fund while remaining available for appropriation.

Averaging does not result in less income being paid out, but rather the distribution of payments is spread over five years. In FY 1985, the income available for distribution was 20% of net income from FY 1981 through FY 1985. By FY 1985 50% of the FY 1981 net income of $149.9 million had been transferred to the Dividend Fund in annual increments of about $15.0 million. Similarily, the full 50% of FY 1985 net income will be transferred to the Dividend Fund in the next four years. As long as net income is increasing (the case to date), the averaging procedure results in dividend recipients waiting longer to receive the benefits of any one year's net income. Although money received in the future has a decreased real value, the excess income retained in the Permanent Fund continues to earn income thus contributing to future earnings and dividends. If net income does decrease,

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(Footnote Continued)
LCS SB 161 (Finance), Permanent Fund Management. House Journal Supplement No. 50. May 4, 1979.

the averaging procedure would only allow 20% of this decrease to effect the distribution of income in that year. Of course, the decrease would also effect net income in the next four years.

The projected FY 1986 Dividend Fund transfer can be used as an example of the effect of averaging. The FY 1986 net income would have to decrease 80%, from $751 million to about $150 million, in order for the FY 1986 individual dividend amount to be less than $404 (the amount of FY 1985 dividend). Because deposits of dedicated revenues and inflation proofing amounts increase the principal balance, it would require a significant decrease in the investment earnings rate for net income to actually decrease.

Effect of Structural Changes

Under SB 346, future Permanent Fund earnings will be totally committed. Depositing the UIA balance and eliminating future accumulations of earnings in this account results in (1) over $1 billion no longer being available for appropriation and (2) future legislatures having to amend the statute in order to appropriate Permanent Fund earnings for purposes other than dividends and reinvestment to principal.

Currently, income earned on investment of the Permanent Fund principal and the UIA is distributed to the Dividend Fund, the Permanent Fund principal and the UIA. Although these structural changes will not effect the FY 1986 balances (because of a July 1, 1986 effective date), Table 1 illustrates the effects of the proposed amendments using the projected FY 1986 income distribution.

Table 1. Distribution of Projected FY 1986 Net Income Under Current Law and SB 346.

	Current Law	SB 346
Dividend Fund	$277.8 million	$375.7 million
Inflation Proofing	$219.5 million	$375.7 million
UIA Addition	$254.1 million	0
Total Projected Net Income	$751.4 million	$751.4 million
Per Capita Dividend Amount[2]	$530	$720

Source: APFC

[2]Assuming 521,320 Permanent Fund Dividend recipients.

<u>Undistributed Income Account</u>: The amount of dedicated revenue deposits is expected to start decreasing this fiscal year and, inflation proofing deposits will fluctuate with the inflation rate. As long as the principal does not receive large appropriations from the legislature, there should be a more stable income stream with less difference between annual net income and average income. Under these conditions, the UIA would not experience such large growth rates as it has in the past.

The UIA is projected to amount to over $1.1 billion by the end of FY 1986. Although this money is available for appropriation, the APFC Trustees have designated it as a reserve account to be used if future income is not sufficient to cover both dividends and inflation proofing. HB 28 proposes to deposit the UIA balance to the Fund principal so, although the account will be eliminated, this money will continue to earn income for the Permanent Fund. Changes to the income distribution scheme results in net income being distributed at the end of each fiscal year. There is no accumulation of earnings and the UIA is no longer required as a reserve account.

<u>Dividend Fund Transfer:</u> In FY 1985, the Dividend Fund received 50% of the five year average net income which represented about 33% of the current year's net income. Dividends paid out in the fall of 1987 will be the first affected by the amendments proposed in SB 346. Assuming that FY 1987 net income is greater than that of FY 1986, the per capita amount of the dividend should increase substantially.[3] In the future, the difference between the dividends under the current law and dividends under CS SB 346 will depend on net income trends. The APFC financial projections assume that net income does increase each year and they project that, in the long run, the Dividend Fund transfer will be about 45% of annual net income. If net income does continue to increase, annual dividend amounts, based on the current income distribution scheme, will be less than dividends based on the proposed legislation. If net income decreases in one year, or over a period of years, then the averaging procedure would result in higher dividend amounts.

<u>Inflation Proofing Amount:</u> Currently, inflation proofing deposits are determined by a national index to inflation. If the inflation rate makes up the largest component of the nominal return rate (inflation rate is greater than the real rate of return) then income cannot cover both dividends and inflation proofing. If the reverse is true, or the real rate of return is the largest component of the nominal return rate, then inflation proofing

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[3] The increased dividend amount should not affect public assistance eligibility or the amount of money required to fund the Permanent Fund Dividend Hold Harmless program.

requirements will be less than 50% of income and both distribution schemes will be covered.

APFC financial projections predict a conflict between the two uses for Permanent Fund income. Under the assumed 6% inflation rate and 9% nominal rate of return, about 66% of annual net income will be required for inflation proofing . Therefore, a Dividend Fund transfer of 45% of net income will result in inflation proofing shortfalls. In reality, the relationship between the real rate of return and the inflation rates has varied since the creation of the Permanent Fund. From 1977 through 1982, inflation rates were high, causing the inflation rate component of nominal returns to exceed 50%. If the current income distribution scheme had been in place during these years, annual income would not have covered both the Dividend Fund transfer and inflation proofing. Since FY 1983, inflation rates have been lower, and less than 50% of income has been required for inflation proofing.

SB 346 amends the statute so that the amount reinvested in the principal has nothing to do with the impact of inflation on the principal. The purchasing power of the Permanent Fund principal would no longer be protected because, regardless of the inflation rate, the amount reinvested will be 50% of net income.

Financial Projection Models

The debate about the effects of this legislation on future Fund balances and income distribution is primarily based on financial projection models. The APFC assumptions of constant investment return (9%) and inflation rates (6%) in the future determine the outcome of these projections. Based on historical information, it is unrealistic to assume that either inflation or return rates will be constant over time. Figure 1 illustrates the difference between the return and inflation rates experienced and those assumed in the projections. The assumptions, and therefore the models, are used for long range planning. Over time, the objective of the APFC is to achieve a 3% real rate of return. They do not, however, expect that return rates or inflation rates will be consistently 9% and 6% each year after FY 1986.

Financial projections under a scenario of cycling return and inflation rates have not been presented in the debate over these bills nor are they for this analysis. There are many possible return and inflation rates that could be combined to a multitude of projections. Although long term trends may be identified, annual fluctuations are difficult to predict. Models such as that developed by the APFC should not be used to predict account balances in a particular year, but rather to illustrate the impacts of long term trends.

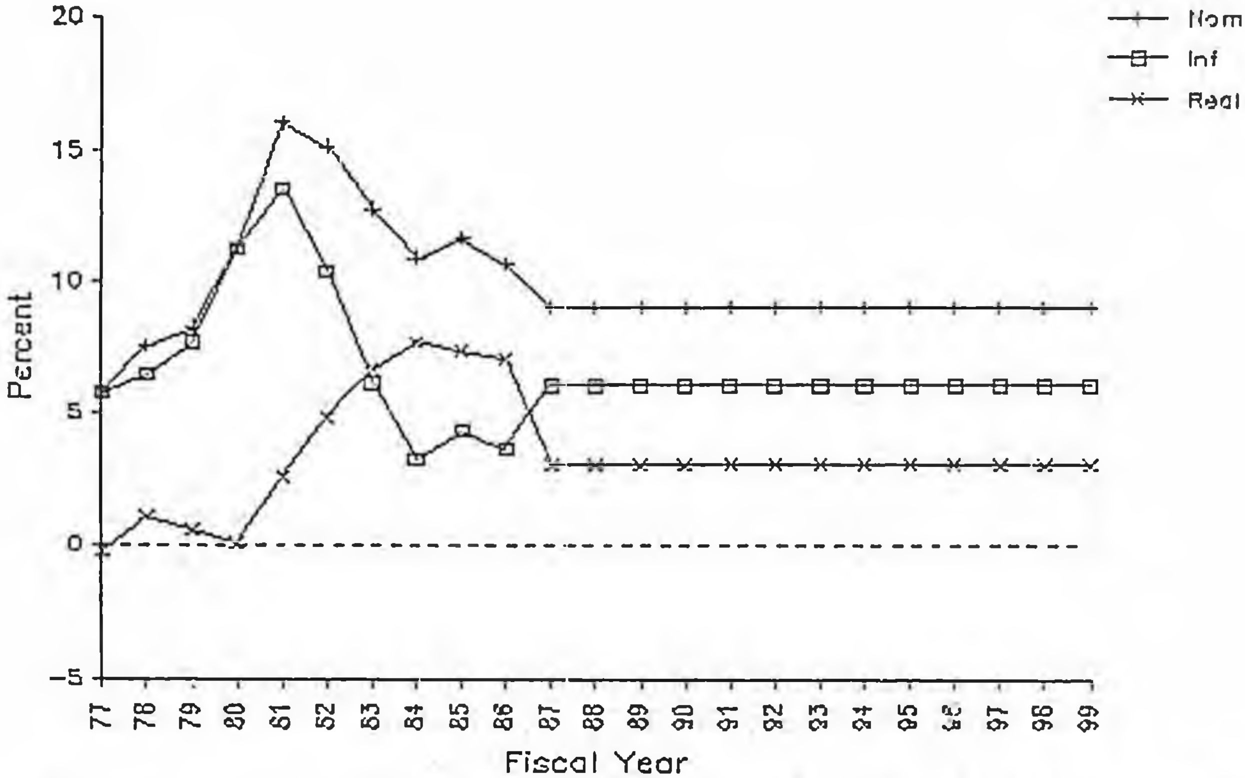

Figure 1. Actual (FY 1977-1985) and Projected (FY 1986 and later) Nominal and Real Rates of Return and Inflation Rates. Alaska Permanent Fund

Management Concerns

In addition to the structural changes in the Permanent Fund, the APFC staff and trustees fear that this legislation will result in changes to Fund management and investment strategies.

Public Accountability: The Permanent Fund Corporation has prepared a list of advantages and disadvantages of eliminating the five year average procedure. "Heightened public scrutiny of fund management...and of legislative proposals to change investment criteria" were among the several advantages. If dividend amounts are tied only to net income in the previous year, the public will be more aware of Fund performance. If dividends are higher than the previous fiscal year, many recipients will assume the Fund is being managed well. If the dividend amount drops, the public may question the prior year's management decisions.

Management of the assets of a Fund this size is not a year to year undertaking. Most Permanent Fund assets are invested in long term instruments. The average life to maturity of the fixed income investments, about 80% of the current portfolio, is eight years. Investments in the stock and real estate market are intended to provide diversification of the portfolio and reduce overall risk. The APFC Trustees direct allocation of assets to these investment types with a long term investment strategy in mind. Clearly, investment decisions made in one year affect earnings in future years.

Per capita dividend amounts can increase for reasons other than good Fund management and, similarly, dividends may decrease even under the most prudent management. Deposits to the principal from mineral resource revenues and prior year's inflation proofing could offset the impact of a decreased earnings rate. Future population trends, or the number of persons applying for the dividend, will also effect dividend amounts.

Investment Strategy: If SB 346 passes, the Trustees believe that Permanent Fund managers will be under increased pressure from the public which could result in (1) the Trustees adopting a more conservative investment strategy to prevent volatility in earnings or (2) managers making investment decisions aimed at either avoiding short term losses or realizing short term gains. Whether the public will actually pressure APFC or the Legislature to provide increased dividends each year, regardless of market conditions, is unknown. However, the Trustees perceive that this will occur and therefore they may adopt a more conservative investment strategy in anticipation.

The Trustess may decide to decrease assets allocated to more risky investments such as those in stock and real estate markets. Although these two asset classes have not accounted for a large proportion of earnings in the past, they play a very important role in the diversification of the Fund's portfolio. As the Trustees consider the risk associated with these investment types, they may become less willing to diversify.

The advantages offered by CS SB 346/HB 28 may appeal to a wide range of interests because they provide for a large deposit to the principal and eliminate continued debate about the disposition of the UIA balance. However, the legislation also limits options available to the Legislature, makes future disposition of income more difficult, fails to tie reinvestment in the principal to the impact of inflation, and may encourage significant changes in management and investment strategies.

#5

Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS
(in millions)

as of March 10, 1986

	PRINCIPAL						INCOME					ASSETS	
								Distributions		Reserves			
FY	FY Begin Balance	Appro- priations	Dedicated State Revenues*	Inflation Proofing	FY End Balance	Inflation Proofing Shortfall	Net Income	Dividends	Inflation Proofing	Add (Delete)	FY End Balance	FY End Balance	FY
78			54.4		54.4		1.8					55.0	78
79	54.4		84.1		138.5		8.0					140.5	79
80	138.5		344.4	.3	483.2		32.4	11.8	.3			502.9	80
81	483.2	900.0	385.1	.2	1,768.5		149.9	27.5	.2	58.7	58.7	1,874.6	81
82	1,768.5	800.0	400.5		2,969.0		368.4	71.1		185.1	243.8	3,301.7	82
83	2,969.0	400.0	421.0	231.2	4,021.2		471.1	107.9	231.2	110.0	353.8	4,593.0	83
84	4,021.2	300.0	366.2	150.9	4,838.3		529.5	175.0	150.9	203.6	557.4	5,530.8	84
85	4,838.3	300.0	368.0	234.6	5,740.9		657.8	217.3	234.6	205.9	763.3	6,722.9	85
86	5,740.9		356.7	217.7	6,315.3		750.9	277.8	217.7	255.4	1,018.7	7,611.8	86
87	6,315.3		296.4	271.1	6,882.8		725.7	313.5	271.1	141.1	1,159.8	8,356.1	87
88	6,882.8		271.6	429.3	7,583.7		770.7	343.5	429.3	(2.1)	1,157.7	9,084.9	88
89	7,583.7		266.2	471.0	8,320.9		836.3	374.1	471.0	(8.8)	1,148.9	9,843.9	89
90	8,320.9		255.9	514.6	9,091.4		904.5	398.8	514.6	(8.9)	1,140.0	10,630.2	90
91	9,091.4		251.0	560.5	9,902.9		976.0	421.3	560.5	(5.8)	1,134.2	11,458.4	91
92	9,902.9		249.6	609.2	10,761.7		1,051.9	453.9	609.2	(11.2)	1,123.0	12,338.6	92
93	10,761.7		251.6	660.8	11,674.1		1,131.9	490.1	660.8	(19.0)	1,104.0	13,268.2	93
94	11,674.1		249.9	715.4	12,639.4		1,216.0	528.0	715.4	(27.4)	1,076.6	14,244.0	94
95	12,639.4		247.7	773.2	13,660.3		1,304.3	568.0	773.2	(36.9)	1,039.7	15,268.0	95
96	13,660.3		237.9	833.9	14,732.1		1,396.5	610.1	833.9	(47.5)	992.2	16,334.4	96
97	14,732.1		235.6	898.1	15,865.8		1,493.0	654.2	898.1	(59.3)	932.9	17,452.9	97
98	15,865.8		224.9	965.4	17,056.1		1,593.7	700.4	965.4	(72.1)	860.8	18,617.3	98
99	17,056.1		157.3	1,032.8	18,246.2		1,695.9	748.3	1,032.8	(85.2)	775.6	19,770.1	99
0	18,246.2		88.0	1,100.1	19,434.3		1,796.8	797.6	1,100.1	(100.9)	674.7	20,906.6	0
1	19,434.3		48.3	1,169.0	20,651.6		1,897.4	847.7	1,169.0	(119.3)	555.4	22,054.7	1
2	20,651.6		54.0	1,242.3	21,947.9		2,001.1	898.5	1,242.3	(139.7)	415.7	23,262.1	2
3	21,947.9		59.7	1,320.5	23,328.1		2,110.4	950.2	1,320.5	(160.3)	255.4	24,533.7	3
4	23,328.1		63.9	1,403.5	24,795.5		2,225.5	1,003.1	1,403.5	(181.1)	74.3	25,872.9	4
5	24,795.5		71.2	1,363.2	26,229.9	128.8	2,347.1	1,058.2	1,363.2	(74.3)		27,288.1	5

ASSUMPTIONS

3.57% Inflation FY 86
10.64% Return FY 86
4.10% Inflation FY 87
9.25% Return FY 87
6% Average Inflation FY 83-05
9% Average Return FY 88-05

* SOURCE: Alaska Department of Revenue
30% Case Forecast - December 1985
25% Pre-1980 Contribution Rate
50% Post-1979 Contribution Rate

CURRENT LAW

#3

RESOLUTION OF THE BOARD OF TRUSTEES,
THE ALASKA PERMANENT FUND CORPORATION, REGARDING
TARGET RATE OF RETURN AND
ALLOCATION OF ASSETS TO BE INVESTED

RESOLUTION NO. 86-2

WHEREAS, the Trustees deem it appropriate to establish a target real rate of return (actual realized return less the rate of inflation); and

WHEREAS, the Trustees wish to establish a long term investment policy embodying a diversified allocation of assets for investment,

NOW THEREFORE BE IT RESOLVED that the Trustees adopt the target rate of return and a policy for the allocation of assets as set forth on Appendix A hereto.

PASSED AND APPROVED by the Board of Trustees of the Alaska Permanent Fund Corporation, this 10th day of March, 1986.

Byron I. Mallott, Chairman
Board of Trustees
Alaska Permanent Fund Corporation

ATTEST:

David A. Rose, Executive Director

ALASKA PERMANENT FUND CORPORATION
BOARD OF TRUSTEES

APPENDIX A TO RESOLUTION 86-2
LONG TERM INVESTMENT POLICY

The Trustees adopt a three percent (3%) real rate of return, over and above inflation, as the average long term goal for a good, consistent investment result. This is to be measured against the average calendar year rate of change in the national consumer price index for urban consumers as the Fund is competing nationally, and the CPI is the most widely understood index of inflation.

The Trustees adopt the policy of incremental additional investments in common stock up to seventeen and a half percent (17.5%), at cost, of the Fund by June 30, 1987, market conditions permitting. The Fund balance shall be deemed to be the estimated value, at cost, of the Fund at the end of the fiscal year in which the investment is made. This would be done to maintain sixty-six and two-thirds percent (66 and 2/3%), at cost, of the stock portfolio on the basis of the Standard & Poor's 500 or closely related index and thirty-three and one-third percent (33 and 1/3%), at cost, of the stock portfolio with specialty, external managers. The latter firms, of which there are currently three, have been selected to pursue areas having prospects of growth and earnings that substantially exceed those of the market average.

The Trustees adopt the policy of placing up to six and a half percent (6.5%) of the Fund into real estate mortgages, pools, participating mortgages and equity. Funds will be invested in accordance with the real estate investment policy adopted by the Trustees. The Fund will actively seek to include Alaskan properties as part of a properly diversified portfolio.

The Trustees adopt the policy of placing the remainder of the Fund which is seventy-six percent (76%) into fixed income security investments. Funds not utilized to meet common stock and real estate allocations shall also be placed into fixed income security investments. The pattern of investment in terms of maturity shall be established quarterly by motion of the Trustees. Of this allocation, $200.0 million is designated for use in connection with the Alaska Bank Certificates of Deposit Program and $80.0 million is designated for use in connection with the Alaska Home Mortgage Program.

The Trustees continue to be sensitive to the desire for more Alaskan investment as long as that is consistent with adequate geographic diversity for the Fund as a whole and offers yields and investment quality comparable with that available elsewhere.

#4

Alaska Permanent Fund Corporation
Pouch 4-1000 Juneau, Alaska 99802
(907) 465-2047 Telex 099-46-323

M E M O R A N D U M

DATE: March 10, 1986

TO: Trustees

FROM: David A. Rose
Executive Director

SUBJECT: Asset Allocation

On an annual basis, the Trustees review overall investment plans and determine the optimum mix of investment vehicles. In determining this mix (or allocation of investment assets) several elements are considered. These are:

a. The long term average rate of return being sought;

b. The amount of risk the portfolio should be exposed to;

c. The probability of preserving principal;

d. The probability of earning enough to offset inflation;

e. The probability of earning -- in the coming year -- the average rate of return being sought.

On February 10, 1986, the Trustees met in worksession to discuss various asset allocation mixes and their respective probabilities of achieving certain goals. The Trustees were joined by Advisors Rogers, and Greeley; by consultants Paul St. Pierre (Pension Realty Advisors) and Dennis J. Grether (SEI), and by staff.

There was consensus on the following points:

a. The goal to achieve a three percent realized real rate of return, over time, is realistic;

b. The Fund should be managed on a risk-averse basis in such a manner that the investment process should preserve principal assets as its highest priority;

c. However, the Fund should not be so risk-averse as to preclude: 1) a high probability of earning a positive real rate of return and 2) an acceptable probability of earning the target rate, over time, of three percent.

Six asset allocation schemes were explored in depth. Each is described below:

I

THE PRESENT, ACTUAL PORTFOLIO MIX

This mix is the most risk averse with a standard deviation of 8.1 percent. It provides for:

Stock	15 percent
Real estate	2 percent
Bonds	83 percent

Under historical conditions it has a fifty percent probability of earning a 2.7 percent rate of return and under current market conditions it has a fifty percent probability of earning a 4.7 percent rate of return.

II

THE PRESENT TARGET MIX

This target mix, adopted by the Trustees, provides for a better probability of returns with little added risk. The mix is:

Stock	15 percent
Real estate	5 percent
Bonds	80 percent

The standard deviation is 8.2 percent with a fifty percent probability of earning a 4.8 percent real rate of return under current market conditions.

III

MIX FOR TYPICAL GOVERNMENTAL PENSION FUND

This mix was examined in order to view the type of risks and rewards inherent in the asset allocation currently used by large public pension funds. This mix is:

Stock	37 percent
Real estate	2 percent
Bonds	47 percent
Cash	14 percent

By comparison to the Alaska Permanent Fund, the standard deviation risk is substantially higher (10.2 percent). This is due to the high dedication of the portfolio to common stock. Additionally, while many large public funds are constrained to protect principal, they are primarily driven toward earning returns for benefit payment within an actuarily sound scheme. Employer contributions are generally available to guarantee actuarial soundness if a poor earnings record occurs. Under current market conditions, there is a fifty percent probability that a real rate of return of 5.5 percent will be attained under this allocation mix.

IV

MIX FOR TYPICAL CORPORATE PENSION FUND

This mix has the most risk. With a standard deviation of 13.4 percent, there is a:

5% probability that a 17.3% return will be realized;
25% probability that a 10.6% return will be realized;
50% probability that a 6.2% return will be realized;
75% probability that a 2.0% return will be realized;
95% probability that a -3.8% or better return will be realized.

To the degree that a corporate fund can consistently earn high returns, fewer dollars must be expended for employee benefits. The risk/reward engendered offers the prospect of substantial gains (or losses) which the private sector generally has more willingness to accept than the public sector.

This mix is set forth as follows:

Stock	54 percent
Real estate	3 percent
Bonds	30 percent
Cash	13 percent

Note the substantial dedication to stock which is the cause of the higher risk.

V

HIGH PROBABILITY OF EARNING A THREE PERCENT REAL RATE OF RETURN AT LEAST RISK

The Trustees examined a scenario which would involve a high probability (70 percent) of attaining a three percent real rate of return under current market conditions while minimizing risk. The standard deviation is 8.3 percent. That mix is:

Stock	15 percent
Real estate	10 percent
Bonds	75 percent

VI

STRONGEST CANDIDATE SCENARIO

Following extensive inquiry and discussion, the Trustees asked that the following scenario be presented for further exploration at the March 10, 1986 meeting. The mix is:

Stock	20 percent
Real estate	10 percent
Bonds	70 percent

The standard deviation (risk) is 8.8 percent which is higher than the current target of 8.2 percent and slightly higher than the standard deviation for the asset allocation mix under scenario V.

With a slight increase in risk under typical market conditions (target standard deviation rises from 8.2 to 8.8), there is a 50 percent probability of exceeding a rate of return of 3.2 percent as opposed to 2.8 percent.

Common stock investment at 20 percent of portfolio remains conservative, but it is significant enough to have a marked effect on the rate of return. The amount of new funds dedicated to the stock market will be slightly less than the amount currently being provided.

This scenario, under current market conditions, provides for a:

99% probability that principal will be preserved;
91% probability that purchasing power will be preserved;
71% probability that a 3% real rate of return will be achieved.

Additionally, it provides that there is a:

5% probability that a 12.2% return will be realized;
25% probability that a 8.0% return will be realized;
50% probability that a 5.2% return will be realized;
75% probability that a 2.4% return will be realized;
95% probability that a -1.4% or better return will be realized.

Since the current value of the stock portfolio at market is approximately 20 percent of the Permanent Fund and since the rate of fill implied by raising the target for real estate to 10% is impracticable, somewhat lower targets for common stock and real estate are suggested for FY 1987.

The following asset allocation mix targets are suggested for FY 1987.

	From	To
Stock	15 percent	17.5 percent
Real estate	5 percent	6.5 percent
Bonds*	80 percent	76.0 percent

*Including:
Mortgages @ $80 million
Alaska C.D's @ $200 million

The standard deviation (risk) for this allocation mix is 8.5. The expected real rate of return under current market conditions is 5.15 percent based on an expected nominal return of 9.25 percent and an expected inflation rate of 4.1 percent.

DAR:ep

ASSET ALLOCATION

Comparisons*

	June 30, 1986 $7.5 Billion		June 30, 1987 $8.3 Billion	
	%	Amount	%	Amount
Stock	15	$1,125 million	17.5	$1,453 million
Real estate	5	375 million	6.5	540 million
Fixed-income*	80	6,000 million	76	6,308 million
*Including:				
Mortgages		80 million		80 million
Alaska C.D.s		200 million		200 million

Amounts are at cost.
Value of stock portfolio at market approximates 20% of the market value of the Permanent Fund.

STOCK RATE OF FILL

	Present Fill $30.0 million/mo.*		Proposed Fill Beginning July 1986 $27.5 million/mo.
Passive Management	2/3	$20 million/mo.	$11.67 million/mo.**
Active Management	1/3	10 million/mo.	15.83 million/mo.**
Total		$30 million/mo.*	$27.50 million/mo.

*Plus $84 million Batterymarch adjustment.

**Maintains 2/3 - 1/3 balance by adjusting for Batterymarch transfer to passive management.

Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS
(in millions)

as of January 31, 1986

	PRINCIPAL						INCOME					ASSETS	
								Distributions		Reserves			
FY	FY Begin Balance	Appro-priations	Dedicated State Revenues*	Inflation Proofing	FY End Balance	Inflation Proofing Shortfall	Net Income	Dividends	Inflation Proofing	Add (Delete)	FY End Balance	FY End Balance	FY
78			54.4		54.4		1.8					55.0	78
79	54.4		84.1		138.5		8.0					140.5	79
80	138.5		344.4	.3	483.2		32.4	11.8	.3			502.9	80
81	483.2	900.0	385.1	.2	1,768.5		149.9	27.5	.2	58.7	58.7	1,874.6	81
82	1,768.5	800.0	400.5		2,969.0		368.4	71.1		185.1	243.8	3,301.7	82
83	2,969.0	400.0	421.0	231.2	4,021.2		471.1	107.9	231.2	110.0	353.8	4,593.0	83
84	4,021.2	300.0	366.2	150.9	4,838.3		529.5	175.0	150.9	203.6	557.4	5,530.8	84
85	4,838.3	300.0	368.0	234.6	5,740.9		657.8	217.3	234.6	205.9	763.3	6,7[illegible].9	85
86	5,740.9		356.7	217.7	6,315.3		750.9	277.8	217.7	255.4	1,018.7	7,611.8	86
87	6,315.3		296.4	396.7	7,008.4		705.1	311.4	396.7	(3.0)	1,015.7	8,335.5	87
88	7,008.4		271.6	436.8	7,716.8		769.0	341.2	436.8	(9.0)	1,006.7	9,064.7	88
89	7,716.8		266.2	479.0	8,462.0		834.7	371.7	479.0	(16.0)	990.7	9,824.4	89
90	8,462.0		255.9	523.1	9,241.0		902.9	396.3	523.1	(16.5)	974.2	10,611.5	90
91	9,241.0		251.0	569.5	10,061.5		974.5	418.6	569.5	(13.6)	960.6	11,440.7	91
92	10,061.5		249.6	618.7	10,929.8		1,050.5	453.2	618.7	(21.4)	[illegible]	12,322.2	92
93	10,929.8		251.6	670.9	11,852.3		1,130.4	489.3	670.9	(29.8)	[illegible]	13,251.0	93
94	11,852.3		249.9	726.1	12,828.3		1,214.4	527.3	726.1	(39.0)	870.4	14,226.0	94
95	12,828.3		247.7	784.6	13,860.6		1,302.6	567.2	784.6	(49.2)	821.2	15,249.0	95
96	13,860.6		237.9	845.9	14,944.4		1,394.8	609.3	845.9	(60.4)	760.8	16,314.5	96
97	14,944.4		235.6	910.8	16,090.8		1,491.2	653.3	910.8	(72.9)	687.9	17,432.0	97
98	16,090.8		224.9	978.9	17,294.6		1,591.8	699.5	978.9	(86.6)	601.3	18,595.4	98
99	17,294.6		157.3	1,047.1	18,499.0		1,693.9	747.4	1,047.1	(100.6)	500.7	19,747.1	99
0	18,499.0		83.0	1,115.2	19,702.2		1,794.7	796.6	1,115.2	(117.1)	383.6	20,882.4	0
1	19,702.2		48.3	1,185.0	20,935.5		1,895.2	846.7	1,185.0	(136.5)	247.1	22,029.3	1
2	20,935.5		54.0	1,259.4	22,248.9		1,998.8	897.4	1,259.4	(158.0)	89.1	23,235.4	2
3	22,248.9		59.7	1,248.0	23,556.6	90.5	2,108.0	949.1	1,248.0	(89.1)		24,505.7	3
4	23,556.6		63.9	1,221.0	24,841.5	196.2	2,223.0	1,002.0	1,221.0			25,343.5	4
5	24,841.5		71.2	1,287.5	26,200.2	207.3	2,344.4	1,056.9	1,287.5			27,257.1	5

ASSUMPTIONS

* SOURCE: Alaska Department of Revenue
30% Case Forecast - December 1985
25% Pre-1980 Contribution Rate
50% Post-1979 Contribution Rate

3.57% Inflation FY 86
10.64% Return FY 86
6% Average Inflation FY 87-05
9% Average Return FY 87-05

ALASKA PERMANENT FUND CORPORATION

A Public Trust Investing For Alaska's Future

Alaska Permanent Fund Corporation Established 1980

Monthly Financial Report
January 1986

Alaska Permanent Fund Corporation
Pouch 4-1000 Juneau, Alaska 99802
TEL 907/465-2047 TLX 099-46-323

M E M O R A N D U M

DATE: March 4, 1985

TO: Recipients of January 1986 Financial Statements

FROM: David A. Rose
Executive Director

SUBJECT: Report Highlights

Attached please find the Corporation's financial statements for the month of January 1986 and for the first seven months of the fiscal year.

During January, Fund assets climbed by almost $100 million. This can be attributed to net earnings of $60,516,000 and the receipt of dedicated State revenues of $38,900,000.

On January 31, 1986, the equity of the Alaska Permanent Fund, at cost, was $7,173,604,000. This is broken down into four elements as follows:

Fund principal	$5,961,725,000
Seven-month reserve for 1986 dividends	160,974,000
Seven-month reserve for 1986 inflation-proofing	128,050,000
Undistributed income	922,855,000
	$7,173,604,000

We currently project that the Fund will earn realized net income of $750,900,000 this fiscal year. Earnings rates are projected as follows:

Nominal rate of return	10.64 percent
Inflation rate	3.57 percent
Real rate of return	7.07 percent

Additionally, the Fund has substantial unrealized gains (paper profits) on its investments. Currently, these unrealized gains exceed $625 million (see notes to the financial statements #4 and #5).

At its meeting on February 10, 1986, the Corporation's Board of Trustees discussed legislation recently introduced and under debate. In this regard, the Trustees have encouraged passage of a bill which would appropriate the balance of the Undistributed Income Account at June 30, 1986 (estimated to be $1.01 billion) to the principal of the Fund. This appropriation is encouraged as a "stand-alone" action and should not be contingent on adoption of any other legislation which fundamentally changes disposition of Fund earnings. Currently, the appropriation <u>is</u> contingent upon passage of a bill which changes the inflation-proofing calculation, changes the dividend calculation, abolishes the undistributed income account and eliminates five-year averaging. The Trustees have counseled that such action erroneously places focus on short-term performance rather than on long-term investment. In the Trustees' view, this legislation creates volatility and instability at the very point in Alaska's history when stability is greatly needed and should be aggressively pursued.

The inflation rate used , calculate the fiscal year 1986 inflation-proofing has been established at 3.57%. This is in accordance with (i) AS 37.13.145, which directs that an amount sufficient to offset the impact of inflation, as measured by a nationally recognized index, be transferred from net income to principal at the end of each fiscal year, and (ii) Board of Trustees Resolution 83-7, which establishes the previous calendar year average of the United State Consumer Price Index for all urban consumers as the nationally recognized index to be used at the end of each fiscal year. This rate of percentage change in the calendar year average from 1984 to 1985 has been calculated as follows:

MONTH	1984	1985
JAN	305.2	316.1
FEB	306.6	317.4
MAR	307.3	318.8
APR	308.8	320.1
MAY	309.7	321.3
JUN	310.7	322.3
JUL	311.7	322.8
AUG	313.0	323.5
SEP	314.5	324.5
OCT	315.3	325.5
NOV	315.3	326.6
DEC	315.5	327.4
AVERAGE:	311.1	322.2

$$\frac{322.2 - 311.1}{311.1} = 3.57\%$$

The Trustees ill convene their next meeting in Juneau on Monday, March 10, 1986 at 8:0C a.m., at the offices of the Fund at 801 W. 10th Street. The meeting will focus upon changes in investment policy, the allocation of investment assets, goals, levels of risk and expected returns. Operations reports will also be presented.

DAR:bm

ALASKA PERMANENT FUND CORPORATION
STATEMENT OF PORTFOLIO ASSETS, LIABILITIES AND FUND EQUITY

JANUARY 31, 1986

	%	AMOUNT
ASSETS		
Cash		$ 376,000
Receivables	3	196,902,000
Investments:		
Marketable debt securities-		
Repurchase agreements		38,900,000
Short-term issues	1	40,733,000
Intermediate and long-term issues	77	5,523,148,000
Total marketable debt securities	78	5,602,781,000
Real Estate-		
Equity pools	1	50,627,000
Participating mortgages		47,102,000
General partnership	1	58,446,000
Limited partnership	---	25,553,000
Total real estate	2	181,728,000
Preferred & common stock	14	993,050,000
Conventional mortgages	1	50,274,000
Alaska certificates of deposit	2	148,525,000
Total investments	97	6,976,359,000
Property and equipment, net of accumulated depreciation	---	494,000
Total assets	100	$ 7,174,130,000
LIABILITIES		
Accounts payable		$ 526,000
EQUITY		
Contributed equity	83	5,961,725,000
Reserve for inflation and dividends	17	1,211,879,000
Total equity	100	7,173,604,000
Total liabilities & equity	100	$ 7,174,130,000

ALASKA PERMANENT FUND CORPORATION

STATEMENT OF REVENUES AND OPERATING EXPENSES
JANUARY 31, 1986

	CURRENT MONTH	YEAR-TO-DATE
REVENUES:		
Interest	$ 54,479,000	$377,632,000
Fees earned on loaned securities	264,000	2,165,000
Dividends	2,251,000	22,783,000
Real estate cash flow	332,000	2,691,000
Realized gains (losses) on the sale of-		
Marketable debt securities	(225,000)	24,895,000
Common stock	3,132,000	19,372,000
Total gains	2,907,000	44,267,000
Unrealized gain on real estate	895,000	1,455,000
Gross revenues	61,128,000	450,993,000
EXPENSES:		
Salaries and benefits	68,000	439,000
Travel	5,000	39,000
Trustee honoraria	2,000	8,000
Communications	12,000	67,000
Consulting and studies, advisors	8,000	170,000
Printing and advertising		8,000
Rentals	13,000	76,000
Custody and safekeeping fees	73,000	269,000
Common stock and real estate mgmt. fees	400,000	1,109,000
Mortgage service fees	15,000	99,000
Public information and education program	5,000	33,000
Depreciation	6,000	37,000
Other	5,000	24,000
Total Operating Expenses	612,000	2,378,000
Net Income	$ 60,516,000	$448,615,000

ALASKA PERMANENT FUND CORPORATION

STATEMENT OF CHANGES IN FUND EQUITY
JANUARY 31, 1986

Current Month	Total	Contributed Equity	Reserve for Inflation and Dividends	Undistributed Income
Balance, December 31, 1985	$ 7,074,187,000	$ 5,922,825,000	$1,151,363,000	
Net income from operations	60,516,000			60,516,000
Dedicated state revenues	38,900,000	38,900,000		
Provision for 1986 dividends			22,432,000	(22,432,000)
Provision for 1986 inflation proofing			18,943,000	(18,943,000)
Provision for future inflation and dividends			19,141,000	(19,141,000)
Balance, January 31, 1986	$ 7,173,604,000	$ 5,961,725,000	$1,211,879,000	$

Year-to-Date	Total	Contributed Equity	Reserve for Inflation and Dividends	Undistributed Income
Balance, June 30, 1985	$ 6,504,206,000	$ 5,740,942,000	$ 763,264,000	
Net income from operations	448,615,000			448,615,000
Dedicated state revenues	220,782,000	220,782,000		
Citizen contribution	1,000	1,000		
Provision for 1986 dividends			160,974,000	(160,974,000)
Provision for 1986 inflation proofing			128,050,000	(128,050,000)
Provision for future inflation and dividends			159,591,000	(159,591,000)
Balance, January 31, 1986	$ 7,173,604,000	$ 5,961,725,000	$1,211,879,000	$

ALASKA PERMANENT FUND CORPORATION
STATEMENT OF CHANGES IN CONDITION
JANUARY 31, 1986

	CURRENT MONTH	YEAR-TO-DATE
FUNDS WERE PROVIDED BY:		
Investment operations-		
Net income	$ 60,516,000	$ 448,615,000
Items not affecting funds-		
Amortization	(199,000)	(1,234,000)
Depreciation	6,000	37,000
Increase in receivables & prepaid expenses	(49,490,000)	(8,310,000)
Increase (Decrease) in accounts payable	67,000	(846,000)
Undistributed real estate cash flow	(35,000)	(152,000)
Unrealized gain on real estate	(895,000)	(1,455,000)
Total provided by operations	9,970,000	436,655,000
Sales-		
Marketable securities	245,368,000	2,938,113,000
Common stock	13,226,000	98,877,000
Total sales	258,594,000	3,036,990,000
Maturities of debt obligations	34,562,000	497,498,000
Conventional mortgage repayments	362,000	3,559,000
Citizen contribution		1,000
Contributions from the State of Alaska	38,900,000	220,782,000
Total funds provided	342,388,000	4,195,485,000
FUNDS WERE USED FOR:		
Purchases-		
Marketable securities	252,498,000	3,504,973,000
Conventional mortgages	1,155,000	5,848,000
Common stock	42,560,000	344,624,000
Real estate equity	5,000,000	50,471,000
Property & equipment		172,000
Alaska certificates of deposit	16,525,000	41,025,000
Total purchases	317,738,000	3,947,113,000
Payments to the State of Alaska		217,274,000
Total funds used	317,738,000	4,164,387,000
Net change in funds	$ 24,650,000	$ 31,098,000

ALASKA PERMANENT FUND CORPORATION
STATEMENT OF CHANGES IN CONDITION

(continued)

	CURRENT MONTH	YEAR-TO-DATE
SUMMARY OF CHANGES		
Decrease in cash	$ (250,000)	$ (502,000)
Increase in repurchase agreements	24,900,000)	31,600,000
Net Change in Funds	$ 24,650,000	$ 31,098,000

ALASKA PERMANENT FUND CORPORATION

NOTES TO THE FINANCIAL STATEMENTS

JANUARY 31, 1986

1. ENTITY:

The Constitution of the State of Alaska was amended by public referendum in 1976 to provide for the automatic segregation of a portion of certain natural resource revenues which are dedicated to the Permanent Fund. The principal of the Permanent Fund is to be invested in perpetuity. The State Legislature created the Alaska Permanent Fund Corporation (the "Corporation"), a public corporation separate from the agencies of State government and governed by a Board of Trustees, to manage the investments of the Permanent Fund. By law, a portion of the annual earnings is made available to the State for the payment of dividends, and a portion of the annual earnings is contributed to the principal of the Permanent Fund sufficient to offset the impact of inflation. The balance is retained by the Corporation in a reserve for future inflation and dividends account.

2. SIGNIFICANT ACCOUNTING POLICIES:

Contributions -

Contributions by operation of statute are recorded when they become due from the State, i.e., when certain revenues are received by the State Department of Natural Resources.

Contributions by appropriation are recorded when they are received.

Depreciation -

Furniture and equipment is depreciated on a straight-line basis over a three year useful life. Other property is depreciated on a straight-line basis over a five year useful life.

Dividend appropriations -

Current law directs that one-half of a five year moving average of the net income of the Corporation, excluding unrealized gains and losses, be made available for the payment of dividends each year.

Funds -

For purposes of the Statement of Changes in Financial Position, the term "Funds" has been defined as cash and repurchase agreements.

Inflation Impact -

The impact of inflation is measured by the United States Consumer Price Index calendar year average for all urban consumers applied against the balance of contributed equity at the end of the fiscal year.

Interest Income -

Interest income on all securities is accrued monthly as earned.

Interest income is shown net of amortization of premiums and accretion of discounts.

Investments -

In accordance with the American Institute of Certified Public Accountants' Statement of Position of the Accounting Standards Division No. 78-10, investments in the aggregate are valued as follows:

Type	Basis
Marketable debt securities	Cost adjusted for amortization of premiums and accretion of discounts
Preferred and common stock	Lower of cost or market
Real estate	Market
Conventional mortgages	Cost
Alaska certificates of deposit	Cost

Real estate investments are carried at cost until independent appraisals are made. The carrying value is then adjusted to reflect market value as determined by the independent appraisals.

Realized gains or losses on the sale of investments are determined by specific identification.

3. RECEIVABLES AND PREPAID EXPENSES

Receivables and prepaid expenses consisted of the following as of January 31, 1986:

State of Alaska dedicated revenues	$ 10,946,000
Purchased interest receivable	11,538,000
Accrued interest receivable	171,151,000
Dividends receivable	3,208,000
Commitment fees, real estate	1,000
Prepaid expenses	58,000
	$196,902,000

4. MARKETABLE DEBT SECURITIES

The estimated market values, versus amortized cost, of debt securities at January 31, 1986 are as follows:

	COST	MARKET	UNREALIZED GAIN (LOSS)	YIELD
Repurchase Agreements	$ 38,900,000	$ 38,900,000	$	7.93
Short Term Issues	40,734,000	40,734,000		7.54
Intermediate and Long Term Issues	5,523,148,000	5,965,476,000	442,328,000	11.16
	$5,602,782,000	$6,045,110,000	$442,328,000	11.11

All of the Corporation's investment securities are held by commercial lending institutions pursuant to custodial agreements.

The average weighted life of debt securities at January 31, 1986 is: 8 years, 0 months.

5. COMMON STOCK

At January 31, 1986, the investment in preferred and common stock was valued at a cost of $993,050,000, which was less than the aggregate market value of $1,180,165,000 on that date. This results in an unrealized gain of $187,115,000. The dividend yield on preferred and common stock amounted to 4.43 percent.

6. REAL ESTATE:

The Corporation has purchased certain real estate investments. The underlying properties constituting these investments include, but are not limited to, office buildings and shopping malls. Certain terms unique to these investments are as follows:

Equity Pools -

At January 31, 1986, the investment in CPI was valued at market as determined by an independent appraisal at December 31, 1984; and the investment in JMB II was valued at market as determined by an independent appraisal at December 31, 1985.

Participating Real Estate Mortgages -

The investment in participating real estate mortgages conveys an undivided interest in real properties acquired in connection with loans made on and collateralized by certain real estate. Future adjustments to market value will be determined by the combined total of (i) independent appraisals of the real properties, and (ii) the difference between the present value of the mortgages and the outstanding principal balance of the notes at year end. Terms of the mortgage notes provide for interest and service fees at certain rates per annum. In addition, the Corporation will participate to the extent of its percentage of ownership in future net cash flows derived from leasing the properties. The total amount of interest and net cash flow each year is limited to the maximum rate for interest allowed under applicable state or federal law.

Limited Partnership -

An independent appraisal of the properties of the limited partnership was completed on June 30, 1985. The appraisal indicated a 2.24% increase in net asset value. The total unrealized gain for the Corporation amounted to $560,000. At January 31, 1986, the investment was valued at market as determined at June 30, 1985, and adjusted for subsequent cash flows and distributions.

The Corporation will participate to the extent of its percentage of ownership in future net cash flow derived from leasing the properties. The general partner may call for an additional one-time capital contribution from the Corporation of up to $1,250,000.

General Partnerships -

The Corporation will participate to the extent of its percentage of ownership in future net cash flow derived from leasing the properties. Additional contributions to capital shall only be made by agreement of all the partners and in proportion to their respective partnership interests. Responsibility for property and investment management of the partnerships is vested in real estate advisors under contract to the Corporation. Investment management fees are shown as period expenses of the Corporation.

7. CONTRIBUTED EQUITY

The principal balance of the Alaska Permanent Fund at January 31, 1986 was composed of the following elements:

Dedicated state revenues	$ 2,645,026,000
Appropriations from the State	2,700,000,000
Provision for inflation	616,697,000
Citizen contribution	2,000
	$ 5,961,725.000

8. RESERVE FOR INFLATION AND DIVIDENDS

The Trustees of the Permanent Fund have designated the balance of the undistributed income account to be continuously reserved for future inflation impact and dividend payments. Although the State Legislature could legally appropriate this amount for other purposes, in the opinion of the Trustees, this designation is in accordance with the stated purpose of undistributed income, i.e., to provide a reserve for the current statutory uses of Corporation income against the possibility of future declines in that income. Such a reserve is intended to enable the Corporation to fully offset the impact of inflation and still maintain a constant level of dividends in years when Permanent Fund earnings are not enough to do both.

* * * * * *

The Board of Trustees
Alaska Permanent Fund Corporation

Gentlemen:

The financial report and statements presented herein were prepared from the books of account without audit, and no independent opinion on the fairness of these statements has been rendered.

Sincerely,

Peter A. Bushre

Peter A. Bushre
Comptroller

Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS
(in millions)

as of January 31, 1986

	PRINCIPAL						INCOME					ASSETS	
								Distributions		Reserves			
FY	FY Begin Balance	Appro-priations	Dedicated State Revenues*	Inflation Proofing	FY End Balance	Inflation Proofing Shortfall	Net Income	Dividends	Inflation Proofing	Add (Delete)	FY End Balance	FY End Balance	FY
78			54.4		54.4		1.8					55.0	78
79	54.4		84.1		138.5		8.0					140.5	79
80	138.5		344.4	.3	483.2		32.4	11.8	.3			502.9	80
81	483.2	900.0	385.1	.2	1,768.5		149.9	27.5	.2	58.7	58.7	1,874.6	81
82	1,768.5	800.0	400.5		2,969.0		368.4	71.1		185.1	243.8	3,301.7	82
83	2,969.0	400.0	421.0	231.2	4,021.2		471.1	107.9	231.2	110.0	353.8	4,593.0	83
84	4,021.2	300.0	366.2	150.9	4,838.3		529.5	175.0	150.9	203.6	557.4	5,530.8	84
85	4,838.3	300.0	368.0	234.6	5,740.9		657.8	217.3	234.6	205.9	763.3	6,722.9	85
86	5,740.9		356.7	217.7	6,315.3		750.9	277.8	217.7	255.4	1,018.7	7,611.8	86
87	6,315.3		296.4	396.7	7,008.4		705.1	311.4	396.7	(3.0)	1,015.7	8,335.5	87
88	7,003.4		271.6	436.8	7,716.8		769.0	341.2	436.8	(9.0)	1,006.7	9,064.7	88
89	7,716.8		266.2	479.0	8,462.0		834.7	371.7	479.0	(16.0)	990.7	9,824.4	89
90	8,462.0		255.9	523.1	9,241.0		902.9	396.3	523.1	(16.5)	974.2	10,611.5	90
91	9,241.0		251.0	569.5	10,061.5		974.5	418.6	569.5	(13.6)	960.6	11,440.7	91
92	10,061.5		249.6	618.7	10,929.8		1,050.5	453.2	618.7	(21.4)	939.7	12,322.2	92
93	10,929.8		251.6	670.9	11,852.3		1,130.4	489.3	670.9	(29.8)	909.4	13,251.0	93
94	11,852.3		249.9	726.1	12,828.3		1,214.4	527.3	726.1	(39.0)	870.4	14,226.0	94
95	12,828.3		247.7	784.6	13,860.6		1,302.6	567.2	784.6	(49.2)	821.2	15,249.0	95
96	13,860.6		237.9	845.9	14,944.4		1,394.8	609.3	845.9	(60.4)	760.8	16,314.5	96
97	14,944.4		235.6	910.8	16,090.8		1,491.2	653.3	910.8	(72.9)	687.9	17,432.0	97
98	16,090.8		224.9	978.9	17,294.6		1,591.8	699.5	978.9	(86.6)	601.3	18,595.4	98
99	17,294.6		157.3	1,047.1	18,499.0		1,693.9	747.4	1,047.1	(100.6)	500.7	19,747.1	99
0	18,499.0		88.0	1,115.2	19,702.2		1,794.7	795.6	1,115.2	(117.1)	383.6	20,882.4	0
1	19,702.2		48.3	1,185.0	20,935.5		1,895.2	846.7	1,185.0	(136.5)	247.1	22,029.3	1
2	20,935.5		54.0	1,259.4	22,248.9		1,998.3	897.4	1,259.4	(158.0)	89.1	23,235.4	2
3	22,248.9		59.7	1,248.0	23,556.6	90.5	2,108.0	949.1	1,248.0	(89.1)		24,505.7	3
4	23,556.6		63.9	1,221.0	24,841.5	196.2	2,223.0	1,002.0	1,221.0			25,843.5	4
5	24,841.5		71.2	1,287.5	26,200.2	207.3	2,344.4	1,056.9	1,287.5			27,257.1	5

ASSUMPTIONS

* SOURCE: Alaska Department of Revenue
30% Case Forecast - December 1985
25% Pre-1980 Contribution Rate
50% Post-1979 Contribution Rate

3.57% Inflation FY 86
10.64% Return FY 86
6% Average Inflation FY 87-05
9% Average Return FY 87-05

Offered: 2/19/86
Referred: Rules

Original sponsors: Halford, Kerttula, Faiks, et al

IN THE SENATE BY THE FINANCE COMMITTEE

CS FOR SENATE BILL NO. 346 (Finance)

IN THE LEGISLATURE OF THE STATE OF ALASKA

FOURTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to the income of the Alaska permanent fund; and providing for an effective date."

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

* Section 1. AS 37.13.140 is amended to read:

Sec. 37.13.140. INCOME. Net income of the corporation <u>shall</u> [MUST] be computed annually as of the last day of the fiscal year in accordance with generally accepted accounting principles, excluding any unrealized gains or losses. Income available for distribution equals the [AVERAGE] net income of the corporation for the [LAST FIVE FISCAL YEARS, INCLUDING THE] fiscal year just ended [, BUT MAY NOT EXCEED NET INCOME OF THE CORPORATION FOR THE FISCAL YEAR JUST ENDED PLUS THE BALANCE IN THE UNDISTRIBUTED INCOME ACCOUNT DESCRIBED IN AS 37.13.145].

* Sec. 2. AS 37.13.145 is amended to read:

Sec. 37.13.145. DISPOSITION OF INCOME. At the end of each fiscal year, <u>in order</u> [AN AMOUNT SUFFICIENT] to <u>help</u> offset the effect of inflation on principal of the Alaska permanent fund during that year, <u>50 percent of the income available for distribution under AS 37.13.140</u> [AS MEASURED BY A NATIONALLY RECOGNIZED INDEX,] shall be transferred [FROM NET INCOME AS DEFINED IN AS 37.13.140, EXCLUDING INCOME ON THE UNDISTRIBUTED INCOME ACCOUNT IN THE ALASKA PERMANENT FUND,] to the principal of the Alaska permanent fund for reinvestment. The balance of the [NET] income <u>available for distribution under</u> [AS DEFINED IN] AS 37.13.140 shall be transferred to the <u>dividend fund</u>

established under AS 43.23.045 [UNDISTRIBUTED INCOME ACCOUNT IN THE ALASKA PERMANENT FUND. MONEY IN THE UNDISTRIBUTED INCOME ACCOUNT SHALL BE INVESTED IN INVESTMENTS AUTHORIZED UNDER AS 37.13.120. INCOME FROM THE INVESTMENT OF THE UNDISTRIBUTED INCOME ACCOUNT SHALL BE TREATED AS AN ADDITION TO THAT ACCOUNT].

* Sec. 3. This Act takes effect July 1, 1986.

Introduced: 1/16/86
Referred: Finance

BY HALFORD, KERTTULA, FAIKS, STURGULEWSKI, V. FISCHER, ELIASON AND BENNETT

IN THE SENATE

SENATE BILL NO. 346

IN THE LEGISLATURE OF THE STATE OF ALASKA

FOURTEENTH LEGISLATURE - SECOND SESSION

A BILL

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* Sec. 2. AS 37.13.145 is amended to read:

Sec. 37.13.145. DISPOSITION OF INCOME. At the end of each fiscal year, in order [AN AMOUNT SUFFICIENT] to help offset the effect of inflation on principal of the Alaska permanent fund during that year, 50 percent of the income available for distribution under AS 37.13.140 [AS MEASURED BY A NATIONALLY RECOGNIZED INDEX,] shall be transferred [FROM NET INCOME AS DEFINED IN AS 37.13.140, EXCLUDING INCOME ON THE UNDISTRIBUTED INCOME ACCOUNT IN THE ALASKA PERMANENT FUND,] to the principal of the Alaska permanent fund for reinvestment. The balance of the [NET] income available for distribution under [AS DEFINED IN] AS 37.13.140 shall be transferred to the dividend fund established under AS 43.23.045 [UNDISTRIBUTED INCOME ACCOUNT IN THE ALASKA PERMANENT FUND. MONEY IN THE UNDISTRIBUTED INCOME ACCOUNT SHALL BE INVESTED IN INVESTMENTS AUTHORIZED UNDER AS 37.13.120. INCOME FROM THE INVESTMENT OF THE UNDISTRIBUTED INCOME ACCOUNT SHALL BE TREATED AS AN ADDITION TO THAT ACCOUNT].

* Sec. 3. This Act takes effect on the effective date of an Act appropriating the unexpended and unobligated balance of the undistributed income account in the Alaska permanent fund to the principal of the Alaska permanent fund.