

SCOMM

101:18

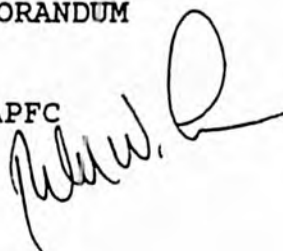
ATTORNEYS AT LAW
SIMPSON, TILLINGHAST, SORESENSEN & LORENSSEN
A PROFESSIONAL CORPORATION

LESLIE LONGENBAUGH
RONALD W. LORENSSEN
L. MERRILL LOWDEN
E. BUDD SIMPSON
STEPHEN F. SORESENSEN
JON K. TILLINGHAST

ONE SEALASKA PLAZA, SUITE 300
JUNEAU, ALASKA 99801
PHONE (907) 586-1400
FAX (907) 586-3065

MEMORANDUM

To: Byron I. Mallott
Executive Director, APFC

From: Ron Lorensen, STS&L 

Date: December 2, 1995

Re: Need for Proposed Constitutional Amendment to Permanent
Fund Provision to Implement Endowment Concept
Our File No.: 846.2

You recently asked me to address the question raised by Trustee Clark Gruening (November 17, 1995 memorandum) of whether an amendment to the constitutional provision dealing with the Permanent Fund (Art. IX, sec. 15, Alaska Constitution¹) was necessary to implement the endowment concept recommended by the State Long Range Financial Planning Commission ("the Commission") in its Final Report. Subject to one important qualifier, I think the answer is that a constitutional amendment is not legally necessary.²

¹ Art. IX, sec. 15 provides as follows:

SECTION 15. ALASKA PERMANENT FUND. At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payment and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.

² Whether it might be desirable, as a matter of policy (or politics), to present the proposed shift to an endowment concept for the Permanent Fund to the voters, be it in the form of a

Byron I. Mallott

Page 2

December 2, 1995

Under Art. IX, sec. 15, the Fund's principal (i.e., receipts placed in the Fund, plus any additional monies appropriated to the Fund by the Legislature) may not be drawn upon for any reason--ever. The income of the Fund, on the other hand, is all available for transfer to the general fund, unless the Legislature provides otherwise by law.³ This distinction between principal and income under the constitution provides a clear dividing line in determining what part of the Fund may be paid out by the Legislature to be used for various governmental and other public purposes.⁴

This principal/income distinction does not play a specific role (or serve a particular function) under the endowment approach recommended by the Commission. The goal of endowment-type funds is to establish a rate of withdrawal of assets from the fund that, over the longer term, will maximize the amount available for expenditure while maintaining the purchasing power of the fund. This withdrawal or "payout"⁵ rate for a particular year is typically determined as a percentage of the fund's average market value over a specified number of preceding years. Once established, the payout rate remains constant from year to year, although subsequent experience with a fund's actual performance may lead to later adjustments or "fine-tuning" of the rate. The annual payout rate proposed by the Commission is four percent, applied to the Fund's average market value in the immediately preceding five years.

By looking at the Fund's market value as the basis for computing the annual payout, the distinction between principal and income becomes essentially irrelevant. This is because market value depicts the total value of the Fund's assets, whether they derive from principal or the income generated by it. The fact that the principal/income distinction would become irrelevant does not mean, though, that Art. IX, sec. 15 must be changed. Unless the constitutional provision as it now reads would preclude or otherwise interfere with implementation of the endowment concept

constitutional amendment, an advisory vote, or otherwise, is a question that is beyond the scope of this memorandum.

³ Which it has done, both by general law (e.g. the Permanent Fund Dividend Program under AS 43.23 and "inflation-proofing" under AS 37.13.145(c)) and by special appropriation.

⁴ To date, the principal uses of Fund income by the Legislature have been to "inflation-proof" the Fund and to pay annual Permanent Fund dividends to Alaskans.

⁵ This is the term used by the Commission.

Byron I. Mallott

Page 3

December 2, 1995

recommended by the Commission, there would be no legal need to amend it.

Certainly, the Legislature could enact a general law that provided both that all income of the Fund was to be retained in the Fund⁶ and that there would be an annual payout from the Fund to the general fund based on application of a fixed payout rate to the Fund's market value, averaged over a specific period. Nothing in the constitution would have to be changed in order for the Legislature to be able to do either of these things. However, there is at least a theoretical possibility that the computed payout amount for a particular year would exceed available income, necessitating an "invasion" of principal, which is not allowed under Art. IX, sec. 15.

In point of fact, this theoretical possibility is probably just that. Given that the payout is based on a five year average and that the Fund continues to grow each year through additional receipts, the actual payout in a year, expressed as a percentage of the Fund's market value in that same year, will almost certainly be less than four percent.⁷ At the same time, the Fund's historical earnings rate is substantially above four percent. Under the endowment approach, the excess earnings would be left with the Fund, quickly accumulating a substantial cushion of "retained earnings"⁸ from which the payout could be satisfied if necessary.⁹

Rather than amend the constitution to deal with this theoretical conflict, the Legislature could address it as part of

⁶ This provision would be necessary to reverse the effect of Art. IX, sec. 15 that all income of the Fund is to be deposited in the general fund, unless otherwise provided by law.

⁷ The only time this would not be true would be when the market value of the Fund had declined to or below its average value over the previous five years. The Fund has never experienced such a significant loss in value.

⁸ In retaining all income in the Fund by general law, the Legislature might wish to create a separate retainage account in the Fund into which the income would be deposited in order to provide for this cushion, rather than automatically convert retained income into "principal."

⁹ In this regard, it would probably be instructive to perform a historical analysis of the Fund's performance to evaluate whether and how the constitution's proscription against using principal would have been implicated if the endowment concept had been applied to the Fund since its inception.

SIMPSON, TILLINGHAST, SORENSEN & LORENSEN, P.C.

Byron I. Mallott

Page 4

December 2, 1995

an enactment implementing the endowment/annual payout concept. This could be done by a provision saying that the payout for a year would be either the amount computed by applying the payout rate to the Fund's average market value for the specified number of preceding years or the amount of income available for distribution (i.e. without "invading" principal), whichever is less. If this kind of safeguard were incorporated into legislation utilizing the Permanent Fund as an endowment, the potential conflict with the present constitutional provision would be avoided, and there would be no legal need to amend it.

I hope this memorandum has been responsive to your inquiry. If you or any of the Fund's Trustees have any questions about it or would like to discuss the issue further, please do not hesitate to contact me.

cc: Jim Baldwin, AAG
Department of Law

9-LS1319A ✓

Cook

10/20/95

JOINT RESOLUTION NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

BY THE _____ RULES COMMITTEE BY REQUEST OF THE LONG RANGE FINANCIAL
PLANNING COMMISSION

Introduced:

Referred:

A RESOLUTION

1 Proposing amendments to the Constitution of the State of Alaska relating to the
2 permanent fund and the budget reserve fund.

3 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

4 * Section 1. Article IX, sec. 15, Constitution of the State of Alaska, is amended to read:

5 SECTION 15. ALASKA PERMANENT FUND. At least fifty [TWENTY-
6 FIVE] percent of all mineral lease rentals, royalties, royalty sale proceeds, federal
7 mineral revenue sharing payments and bonuses received by the State shall be placed
8 in a permanent fund, ~~THE PRINCIPAL OF~~ which shall be used ~~ONLY~~ for those
9 income-producing investments specifically designated by law as eligible for permanent
10 fund investments. Income [ALL INCOME] from the permanent fund shall be
11 retained in the permanent fund, ^{except that} Appropriations may only be made from the
12 INCOME permanent fund to [DEPOSITED IN] the general fund [UNLESS OTHERWISE
13 PROVIDED BY LAW]. ^{ANNUAL} ~~The total amount of appropriations from the permanent~~
14 ~~fund that takes effect during a calendar year may not exceed an amount equal to~~
15 ~~four percent of the average market value of the permanent fund during the~~
16 ~~immediately preceding five calendar years.~~

unintegrated
or
imposed?

LEGISLATURE may
Implement
by law

Institutional
Initiation
proceeding

WORK DRAFT

WORK DRAFT

WORK DRAFT

1 * Sec. 2. Article IX, sec. 17(a), Constitution of the State of Alaska, is amended to read:

2 (a) There is established as a separate fund in the State treasury the budget
3 reserve fund. The purpose of the budget reserve fund is to help stabilize State
4 spending from year to year. Except for money deposited into the permanent fund
5 under Section 15 of this article, all money received by the State after July 1, 1990, as
6 a result of the termination, through settlement or otherwise, of an administrative
7 proceeding or of litigation in a State or federal court involving mineral lease bonuses,
8 rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or
9 bonuses, or involving taxes imposed on mineral income, production, or property, shall
10 be deposited in the budget reserve fund. Money in the budget reserve fund shall be
11 invested so as to yield competitive market rates to the fund. Income of the fund shall
12 be retained in the fund. Section 7 of this article does not apply to deposits made to
13 the fund under this subsection. Money may be appropriated from the fund only as
14 authorized under (b) or (c) of this section.

15 * Sec. 3. Article IX, sec. 17(b), Constitution of the State of Alaska, is amended to read:

16 (b) If the amount of unrestricted revenue available [FOR APPROPRIATION]
17 for a fiscal year is less than the combined amount of unrestricted revenue and
18 money from the budget reserve fund appropriated for the previous fiscal year, an
19 appropriation may be made from the [BUDGET RESERVE] fund. However, the
20 amount appropriated from the fund under this subsection may not exceed the amount
21 necessary [, WHEN ADDED TO OTHER FUNDS AVAILABLE FOR
22 APPROPRIATION,] to provide for total appropriations of unrestricted revenue and
23 money from the fund equal to the amount of appropriations made from these sources
24 [IN THE PREVIOUS CALENDAR YEAR] for the previous fiscal year. The
25 legislature shall implement this subsection by law. [For purposes of this
26 subsection, "unrestricted revenue" means all money received by the State during
27 a fiscal year except money held in trust, received from the federal government for
28 a particular purpose, or dedicated for a particular purpose as permitted by this
29 constitution.]

30 * Sec. 4. Article IX, sec. 17(d), Constitution of the State of Alaska, is repealed.

31 * Sec. 5. The amendments proposed by this resolution shall be placed before the voters of



WORK DRAFT

WORK DRAFT

WORK DRAFT

- 1 the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the
- 2 State of Alaska, and the election laws of the state.

MEMORANDUM**State of Alaska**
Department of Law

TO: Deborah Behr
Assistant Attorney General
and Regulations Attorney

DATE: November 2, 1995

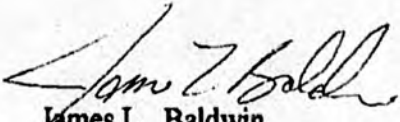
FILE NO: 465-2129

TEL. NO.:

SUBJECT:

Comments concerning constitutional
amendments recommended by Long
Range Fiscal Planning Commission

FROM:


James L. Baldwin
Assistant Attorney General
Governmental Affairs - Juneau

We have reviewed the draft joint resolutions prepared by the Legislative Affairs Agency for the Long Range Fiscal Planning Commission proposing amendments to Article IX, Sections 15 and 17 relating to the Alaska Permanent Fund and the Budget Reserve Fund, respectively. The following comments are offered for consideration by the commission:

Alaska Permanent Fund

(1) It is not clear that appropriations from the fund are intended to be from principal and interest. See, page 1, lines 11 and 12. The sentence could be construed to mean that appropriations are made only from income. The existing wording provides that deposits "shall be used" for investment. While it is true that the word "only", appearing on line 8, would be deleted, the wording remains mandatory and expressly covers use of the deposits. It would be clearer to state that deposits shall be "invested in" and delete "used only for."

(2) Under the proposed amendment, market value must be calculated on a calendar year basis. We are uncertain whether this would present a problem for the APFC. At present, earnings are computed on a fiscal year basis. Further, the endowment payment is limited by an amount determined on a calendar year basis. It may be difficult to make the availability of endowment payments coincide with the budget cycle which is based on a fiscal year. The concept of a five year rolling average market value for determining the endowment payment should be carefully considered in light of the history of permanent fund investments and projections made by consultants to APFC. A longer period may provide a more rational approach to meet the intent of the commission.

(3) The wording of the limit on the amount of the endowment payment may not convey the idea that four percent is a cap amount, not a stipulated amount for the payment. The wording is clumsy in that it provides "may not exceed an amount equal to four percent." This sounds like it could not be less than four percent. In any case, the present wording is ambiguous. Perhaps the provision should be worded positively as follows: "may be an amount not more than four percent"

2. *The Constitutional Budget Reserve Fund.*

The proposed Constitutional amendment changes when a draw can be made from the fund with a simple majority. The inquiry changes from how much is "available for appropriation" to how much "unrestricted revenue" is received. This approach is consistent with much of the history concerning the original intent of the fund. One could argue that this language puts budget surpluses in a higher priority than the budget reserve fund--i.e., the legislature could spend the budget reserve before it would have to spend a budget surplus carry-forward. This does not seem like a major flaw, however--the legislature is free to appropriate the carry-forward first, and in all likelihood, will.

MEMORANDUM

State of Alaska

Office of the Governor
Office of Management and Budget

November 22, 1995

TO: Annalee McConnell
Director

FROM: Brad Pierce
Senior Policy Analyst

SUBJECT: PF Constitutional Amendment Work Group Meeting

Per your request, a staff working group met on Friday November 17 to discuss the practical aspects of a constitutional amendment drafted by the Long Range Financial Planning Commission (LRFPC) that would change the Permanent Fund to an endowment and make changes to the Constitutional Budget Reserve. Our purpose was to think through the mechanics of how these proposals would work and identify any problems that might be encountered in their implementation.

Issues discussed and conclusions arrived at included:

- The effective date on the PF endowment amendment is currently unspecified, meaning that it would go into effect 90 days after voter approval or February 1997. For ease of accounting and administration the effective date should be July 1, 1997 to conform with the state fiscal year.
- There was agreement that the PF amendment language should be clear on how the endowment payout is to be calculated (e.g., 4% of the average of preceding five calendar year's market value). As drafted, the present language is perhaps overly specific and risks legal complications similar to that of the current CBR. "The total amount of appropriations from the permanent fund that takes effect during a calendar year may not exceed an amount equal to four percent of the average market value of the permanent fund during the immediately preceding five calendar years." The intent of the commission was that the legislature would know

*Finance
insert
appr. language
of effective date*

exactly how much revenue it had from the endowment prior to making appropriations for the upcoming fiscal year.

- The payout schedule, repeal of inflation proofing and the earnings reserve, and PFD calculation should be addressed in implementation statutes. A monthly payout schedule would probably work best from the state's cash flow perspective and could allow PF trustees maximum flexibility in liquidating whatever assets necessary to meet the payout obligation. If implementing statutes were not passed, these issues would need to be addressed in the front sections of the annual appropriations bill. *Agree*
- One idea not addressed by the commission but brought up by Jim Baldwin was whether the amendment should provide for the PF to expand its authority to invest according to the prudent investor rule rather than its currently specified list of allowable investments. He felt that this might allow the trustees the same discretion enjoyed by other endowments. *Agree*
- There was general agreement that the amendment language relating to the CBR fixed its problems. Implementation statutes should specify that the state can borrow from the CBR during cash flow shortages and repeal the debt currently owed from previous years, otherwise these issues will need to be annually addressed in the front sections of the appropriations bill. *Not quite*
- Finally, the LRFPC spreadsheet shows a \$607 million transfer from the CBR to PF principal in FY 96 and another \$207 transfer in FY 97. These should probably be moved to FY 98 when the endowment would go into effect as it is unlikely that the governor or legislature would want to significantly reduce liquid reserves absent a comprehensive fiscal gap solution.

TO:

**COMMISSIONERS LONG RANGE FINANCIAL PLANNING
COMMISSION**

FROM:

**MELISSA FOUSE
STAFF, LONG RANGE FINANCIAL PLANNING COMMISSION
FAX: 258-9869
PHONE: 258-8165**

FOLLOWING ARE:

1. DRAFT JOINT RESOLUTION TO AMEND THE CONSTITUTION
 - :ALLOW FOR A 4% PAYOUT FROM THE INCOME OF THE PERMANENT FUND
 - CLARIFY THE PURPOSE OF THE BUDGET RESERVE FUND
 - CHANGE THE TRIGGER FOR APPROPRIATIONS FROM THE CBR
2. COMMENTS BY ATTORNEY GENERAL JIM BALDWIN
3. BRAD PIERCE REPORT OF AN ADMINISTRATIVE BRANCH STAFFERS' MEETING RE: CONSTITUTIONAL AMENDMENT

8 pages

MORE BILL DRAFTS WILL FOLLOW

9-LS1319A

Cook

10/20/95

_____ **JOINT RESOLUTION NO.**

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

**BY THE _____ RULES COMMITTEE BY REQUEST OF THE LONG RANGE FINANCIAL
PLANNING COMMISSION**

Introduced:

Referred:

A RESOLUTION

1 **Proposing amendments to the Constitution of the State of Alaska relating to the**
2 **permanent fund and the budget reserve fund.**

3 **BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

4 *** Section 1.** Article IX, sec. 15, Constitution of the State of Alaska, is amended to read:

5 **SECTION 15. ALASKA PERMANENT FUND.** At least fifty [TWENTY-
6 FIVE] percent of all mineral lease rentals, royalties, royalty sale proceeds, federal
7 mineral revenue sharing payments and bonuses received by the State shall be placed
8 in a permanent fund, [THE PRINCIPAL OF] which shall be used [ONLY] for those
9 income-producing investments specifically designated by law as eligible for permanent
10 fund investments. Income [ALL INCOME] from the permanent fund shall be
11 retained in the permanent fund. Appropriations may only be made from the
12 permanent fund to [DEPOSITED IN] the general fund [UNLESS OTHERWISE
13 PROVIDED BY LAW]. The total amount of appropriations from the permanent
14 fund that takes effect during a calendar year may not exceed an amount equal to
15 four percent of the average market value of the permanent fund during the
16 immediately preceding five calendar years.

1 * **Sec. 2.** Article IX, sec. 17(a), Constitution of the State of Alaska, is amended to read:

2 (a) There is established as a separate fund in the State treasury the budget
3 reserve fund. The purpose of the budget reserve fund is to help stabilize State
4 spending from year to year. Except for money deposited into the permanent fund
5 under Section 15 of this article, all money received by the State after July 1, 1990, as
6 a result of the termination, through settlement or otherwise, of an administrative
7 proceeding or of litigation in a State or federal court involving mineral lease bonuses,
8 rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or
9 bonuses, or involving taxes imposed on mineral income, production, or property, shall
10 be deposited in the budget reserve fund. Money in the budget reserve fund shall be
11 invested so as to yield competitive market rates to the fund. Income of the fund shall
12 be retained in the fund. Section 7 of this article does not apply to deposits made to
13 the fund under this subsection. Money may be appropriated from the fund only as
14 authorized under (b) or (c) of this section.

15 * **Sec. 3.** Article IX, sec. 17(b), Constitution of the State of Alaska, is amended to read:

16 (b) If the amount of unrestricted revenue available [FOR APPROPRIATION]
17 for a fiscal year is less than the combined amount of unrestricted revenue and
18 money from the budget reserve fund appropriated for the previous fiscal year, an
19 appropriation may be made from the [BUDGET RESERVE] fund. However, the
20 amount appropriated from the fund under this subsection may not exceed the amount
21 necessary [, WHEN ADDED TO OTHER FUNDS AVAILABLE FOR
22 APPROPRIATION.] to provide for total appropriations of unrestricted revenue and
23 money from the fund equal to the amount of appropriations made from these sources
24 [IN THE PREVIOUS CALENDAR YEAR] for the previous fiscal year. The
25 legislature shall implement this subsection by law. For purposes of this
26 subsection, "unrestricted revenue" means all money received by the State during
27 a fiscal year except money held in trust, received from the federal government for
28 a particular purpose, or dedicated for a particular purpose as permitted by this
29 constitution.

30 * **Sec. 4.** Article IX, sec. 17(d), Constitution of the State of Alaska, is repealed.

31 * **Sec. 5.** The amendments proposed by this resolution shall be placed before the voters of

- 1 the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the
- 2 State of Alaska, and the election laws of the state.



FAX COVER SHEET

FAX (907) 465-2029

Mail Stop 3101

**LEGAL SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA**

130 Seward Street, Suite 409

Juneau, Alaska 99801-2105

(907) 465-3867 or 465-2450

WARNING: THE INFORMATION CONTAINED IN THIS FAX IS CONFIDENTIAL. IT IS INTENDED TO BE REVIEWED ONLY BY THE INDIVIDUAL NAMED BELOW. IF THE READER OF THIS TRANSMITTAL PAGE IS NOT THE INTENDED RECIPIENT OR A REPRESENTATIVE OF THE INTENDED RECIPIENT, YOU ARE HEREBY NOTIFIED THAT ANY REVIEW, DISSEMINATION OR COPYING OF THIS FAX OR THE INFORMATION CONTAINED HEREIN IS PROHIBITED. IF YOU HAVE RECEIVED THIS FAX IN ERROR, PLEASE IMMEDIATELY NOTIFY THE SENDER BY TELEPHONE AND RETURN THIS FAX TO THE SENDER AT THE ABOVE ADDRESS. THANK YOU.

TO: Melissa Fouse, LRFPFAX: 258-9869 PHONE: _____**NUMBER OF PAGES**(including cover sheet): 4 DATE SENT 10-20-95 TIME 7:50 SENT BY MLDISPOSAL OF ORIGINAL: MAIL ☒ FILE ☐ THROW AWAY ☐ HOLD FOR PICKUP ☐**NOTES/INSTRUCTIONS:**

4652150

FAX COVER

TO:
LEGAL SERVICES,
LAA

FROM:
MELISSA FOUSE
STAFF, LONG RANGE FINANCIAL PLANNING
COMMISSION

PHONE: 258-8165
FAX: 258-9869

ATTACHED IS A ROUGH DRAFT OF A CONSTITUTIONAL
AMENDMENT. THE PURPOSE OF THIS AMENDMENT IS TO
TURN THE PERMANENT FUND INTO AN ENDOWMENT THAT
ALLOWS UP TO FOUR PERCENT OF THE AVERAGE MARKET
VALUE OF THE PRIOR FIVE YEARS TO BE USED FOR
GENERAL FUND SERVICES AND FOR DIVIDENDS.

OF THE FUND

THIS AMENDMENT ALSO INTENDS TO AMEND SEC. 17 TO
CLARIFY THE PURPOSE OF THE BUDGET RESERVE FUND, TO
REPEAL THE SWEEP PROVISION AND TO LIMIT SPENDING.

IN ADDITION, THERE IS A STATEMENT IN OUR FINAL
REPORT THAT SAYS THE COMMISSION RECOMMENDS
THAT THE GENERAL FUND BE ALLOWED TO BORROW FROM
THE BUDGET RESERVE FUND TO MEET CASH FLOW
REQUIREMENTS. IS THAT PERMISSABLE WHEN AN
ACCOUNT IS ESTABLISHED (AND PRESUMABLY LIMITED) BY
CONSTITUTIONAL PROVISIONS?

I WILL CALL AFTER SENDING THIS FAX TO SEE IF YOU HAVE
ANY QUESTIONS.

Deborah Behr

November 2, 1995

Page 2

(4) The proposed amendment adds a new provision that is intended to convey the idea that amounts from the permanent fund are to be exclusively used as a revenue source for the state general fund. However, the wording at page 1, lines 11 and 12, appears to limit the power of the legislature to appropriate amounts into the fund. The report of the commission appears to state a contrary intent.

(5) The proposed amendment leaves untouched the existing provision that authorizes the legislature to set the types of investments that the APFC may make. If the APFC is to become the centerpiece for providing revenue available for appropriation, consideration should be given to moving the APFC away from an investment strategy set by law to one based on standards applicable to a fiduciary which is set out in the constitution. The constitutional basis could be the prudent investor standard. This standard is in existing law applicable to the Alaska State Pension Investment Board and appears to be operating smoothly. To achieve this end, delete [SPECIFICALLY DESIGNATED BY LAW AS ELIGIBLE FOR PERMANENT FUND INVESTMENTS] and insert in which a prudent investor may invest when managing large trust investments.

Budget Reserve Fund

(1) The proposed amendment of the formula for how much may be appropriated from the budget reserve fund needs explaining. The amount is determined by available unrestricted revenue and the amount appropriated from the budget reserve fund for the prior fiscal year. If we have learned anything from our legal battles over the meaning of the existing section 17, it is that a detailed legislative history of the intent of the drafters of the provision is extremely valuable. If the commission is not going to make such a record, it will be incumbent on the legislature to make such a record. Our review of the report of the commission does not disclose any statement of intent to justify the approach used in the draft resolution.

(2) The definition of "unrestricted revenue" set out on page 2 lines 25 - 29 must be carefully considered. It might be better to delete the definition and leave that for the legislature to enact by law.

(3) The draft resolution does not contain a provision that would expressly allow the legislature to appropriate from other sources to the budget reserve fund. The commission's report recommends that amounts attributable to unforeseen oil price increases be deposited in the budget reserve. The legislature may have the implied power to appropriate to any fund it desires. However, it would be better to remove all doubt by authorizing appropriations from other sources.

JLB:clh

2. *The Constitutional Budget Reserve Fund.*

The proposed Constitutional amendment changes when a draw can be made from the fund with a simple majority. The inquiry changes from how much is "available for appropriation" to how much "unrestricted revenue" is received. This approach is consistent with much of the history concerning the original intent of the fund. One could argue that this language puts budget surpluses in a higher priority than the budget reserve fund--i.e., the legislature could spend the budget reserve before it would have to spend a budget surplus carry-forward. This does not seem like a major flaw, however--the legislature is free to appropriate the carry-forward first, and in all likelihood, will.

MEMORANDUM

State of Alaska
Office of the Governor
Office of Management and Budget

November 22, 1995

TO: Annalee McConnell
Director

FROM: Brad Pierce
Senior Policy Analyst

SUBJECT: PF Constitutional Amendment Work Group Meeting

Per your request, a staff working group met on Friday November 17 to discuss the practical aspects of a constitutional amendment drafted by the Long Range Financial Planning Commission (LRFPC) that would change the Permanent Fund to an endowment and make changes to the Constitutional Budget Reserve. Our purpose was to think through the mechanics of how these proposals would work and identify any problems that might be encountered in their implementation.

Issues discussed and conclusions arrived at included:

- The effective date on the PF endowment amendment is currently unspecified, meaning that it would go into effect 90 days after voter approval or February 1997. For ease of accounting and administration the effective date should be July 1, 1997 to conform with the state fiscal year.
- There was agreement that the PF amendment language should be clear on how the endowment payout is to be calculated (e.g., 4% of the average of preceding five calendar year's market value). As drafted, the present language is perhaps overly specific and risks legal complications similar to that of the current CBR. "The total amount of appropriations from the permanent fund that takes effect during a calendar year may not exceed an amount equal to four percent of the average market value of the permanent fund during the immediately preceding five calendar years." The intent of the commission was that the legislature would know

exactly how much revenue it had from the endowment prior to making appropriations for the upcoming fiscal year.

- The payout schedule, repeal of inflation proofing and the earnings reserve, and PFD calculation should be addressed in implementation statutes. A monthly payout schedule would probably work best from the state's cash flow perspective and could allow PF trustees maximum flexibility in liquidating whatever assets necessary to meet the payout obligation. If implementing statutes were not passed, these issues would need to be addressed in the front sections of the annual appropriations bill.**
- One idea not addressed by the commission but brought up by Jim Baldwin was whether the amendment should provide for the PF to expand its authority to invest according to the prudent investor rule rather than its currently specified list of allowable investments. He felt that this might allow the trustees the same discretion enjoyed by other endowments.**
- There was general agreement that the amendment language relating to the CBR fixed its problems. Implementation statutes should specify that the state can borrow from the CBR during cash flow shortages and repeal the debt currently owed from previous years, otherwise these issues will need to be annually addressed in the front sections of the appropriations bill.**
- Finally, the LRFPC spreadsheet shows a \$607 million transfer from the CBR to PF principal in FY 96 and another \$207 transfer in FY 97. These should probably be moved to FY 98 when the endowment would go into effect as it is unlikely that the governor or legislature would want to significantly reduce liquid reserves absent a comprehensive fiscal gap solution.**

WORK DRAFT

WORK DRAFT

WORK DRAFT

9-LS1319A ✓

Cook

10/20/95

_____ JOINT RESOLUTION NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

BY THE _____ RULES COMMITTEE BY REQUEST OF THE LONG RANGE FINANCIAL
PLANNING COMMISSION

Introduced:

Referred:

A RESOLUTION

1 Proposing amendments to the Constitution of the State of Alaska relating to the
2 permanent fund and the budget reserve fund.

3 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

4 * Section 1. Article IX, sec. 15, Constitution of the State of Alaska, is amended to read:

5 SECTION 15. ALASKA PERMANENT FUND. At least fifty [TWENTY-

6 FIVE] percent of all mineral lease rentals, royalties, royalty sale proceeds, federal

7 mineral revenue sharing payments and bonuses received by the State shall be placed

8 in a permanent fund, [THE PRINCIPAL OF] which shall be used ^{invested consistently} [ONLY] for those ✓

9 ^{with prudent investor practices of long institutional funds} income-producing investments specifically designated by law as eligible for permanent ✓

10 ~~fund investments~~ Income [ALL INCOME] from the permanent fund shall be

11 retained in the permanent fund. ^{except for} Appropriations ~~may only be made from the~~ ✓

12 permanent fund to [DEPOSITED IN] the general fund [UNLESS OTHERWISE

13 PROVIDED BY LAW]. The total amount of appropriations from the permanent

14 fund that takes effect during a calendar year may not exceed an amount equal to ^{the total fiscal be an not more than}

15 four percent of the average market value of the permanent fund during the

16 immediately preceding five calendar years.

WORK DRAFT

WORK DRAFT

WORK DRAFT

1 * Sec. 2. Article IX, sec. 17(a), Constitution of the State of Alaska, is amended to read:

2 (a) There is established as a separate fund in the State treasury the budget
3 reserve fund. The purpose of the budget reserve fund is to help stabilize
4 State revenue volatility. ~~Except for money deposited into the permanent fund~~
5 under Section 15 of this article, all money received by the State after July 1, 1990, as
6 a result of the termination, through settlement or otherwise, of an administrative
7 proceeding or of litigation in a State or federal court involving mineral lease bonuses,
8 rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or
9 bonuses, or involving taxes imposed on mineral income, production, or property, shall
10 ~~be deposited in the budget reserve fund.~~ appropriations from other sources Money in the budget reserve fund shall be
11 invested so as to yield competitive market rates to the fund. Income of the fund shall
12 be retained in the fund. Section 7 of this article does not apply to deposits made to
13 the fund under this subsection. Money may be appropriated from the fund only as
14 authorized under (b) or (c) of this section.

15 * Sec. 3. Article IX, sec. 17(b), Constitution of the State of Alaska, is amended to read:

16 (b) If the amount of unrestricted revenue available [FOR APPROPRIATION]
17 for a fiscal year is less than the combined amount of unrestricted revenue ~~and~~
18 including money from the budget reserve fund ~~appropriated for the previous fiscal year,~~ an
19 appropriation may be made from the [BUDGET RESERVE] fund. However, the
20 amount appropriated from the fund under this subsection may not exceed the amount
21 necessary [, WHEN ADDED TO OTHER FUNDS AVAILABLE FOR
22 APPROPRIATION,] to provide for total appropriations of unrestricted revenue and
23 money from the fund equal to the amount of appropriations made from these sources
24 [IN THE PREVIOUS CALENDAR YEAR] for the previous fiscal year. The
25 legislature shall implement this subsection by law. For purposes of this
26 subsection, "unrestricted revenue" means all money received by the State during
27 a fiscal year except money held in trust, received from the federal government for
28 a particular purpose, or dedicated for a particular purpose as permitted by this
29 constitution.

30 * Sec. 4. Article IX, sec. 17(d), Constitution of the State of Alaska, is repealed.

31 * Sec. 5. The amendments proposed by this resolution shall be placed before the voters of

What happened to language 12

Amounts IN THE CBR which exceeds the previous years annual oil and gas
revenues are automatically deposited into the AFF at the end of each state
fiscal year.

(As a note, it is the intent ~~that~~ the Commission that the legislature will ^{necessary}
maintain a ~~balance~~ balance in the CBR via voluntary contributions of GP ~~Sub~~ Sub

is this
language
adequate?
does it
include or
exclude
existing
state assets
eg. AFFC,
H. 1007, ASTF
etc.?

WORK DRAFT

WORK DRAFT

WORK DRAFT

- 1 the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the
- 2 State of Alaska, and the election laws of the state.

MEMORANDUM

State of Alaska Department of Law

TO: Deborah Behr
Assistant Attorney General
and Regulations Attorney

DATE: November 2, 1995

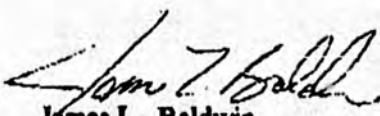
FILE NO: 465-2129

TEL NO.

SUBJECT:

Comments concerning constitutional
amendments recommended by Long
Range Fiscal Planning Commission

FROM:


James L. Baldwin
Assistant Attorney General
Governmental Affairs - Juneau

We have reviewed the draft joint resolutions prepared by the Legislative Affairs Agency for the Long Range Fiscal Planning Commission proposing amendments to Article IX, Sections 15 and 17 relating to the Alaska Permanent Fund and the Budget Reserve Fund, respectively. The following comments are offered for consideration by the commission.

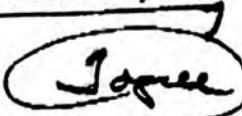
Alaska Permanent Fund

(1) It is not clear that appropriations from the fund are intended to be from principal and interest. See, page 1, lines 11 and 12. The sentence could be construed to mean that appropriations are made only from income. The existing wording provides that deposits "shall be used" for investment. While it is true that the word "only", appearing on line 8, would be deleted, the wording remains mandatory and expressly covers use of the deposits. It would be clearer to state that deposits shall be "invested in" and delete "used only for."

(2) Under the proposed amendment, market value must be calculated on a calendar year basis. We are uncertain whether this would present a problem for the APFC. At present, earnings are computed on a fiscal year basis. Further, the endowment payment is limited by an amount determined on a calendar year basis. It may be difficult to make the availability of endowment payments coincide with the budget cycle which is based on a fiscal year. The concept of a five year rolling average market value for determining the endowment payment should be carefully considered in light of the history of permanent fund investments and projections made by consultants to APFC. A longer period may provide a more rational approach to meet the intent of the commission.

(3) The wording of the limit on the amount of the endowment payment may not convey the idea that four percent is a cap amount, not a stipulated amount for the payment. The wording is clumsy in that it provides "may not exceed an amount equal to four percent." This sounds like it could not be less than four percent. In any case, the present wording is ambiguous. Perhaps the provision should be worded positively as follows: "may be an amount not more than four percent"

*Callahan
said 3 yrs
would be
adequate
more than
5 is
excessive.*



Deborah Behr

November 2, 1995
Page 2

(4) The proposed amendment adds a new provision that is intended to convey the idea that amounts from the permanent fund are to be exclusively used as a revenue source for the state general fund. However, the wording at page 1, lines 11 and 12, appears to limit the power of the legislature to appropriate amounts into the fund. The report of the commission appears to state a contrary intent.

See my revision

(5) The proposed amendment leaves untouched the existing provision that authorizes the legislature to set the types of investments that the APFC may make. If the APFC is to become the centerpiece for providing revenue available for appropriation, consideration should be given to moving the APFC away from an investment strategy set by law to one based on standards applicable to a fiduciary which is set out in the constitution. The constitutional basis could be the prudent investor standard. This standard is in existing law applicable to the Alaska State Pension Investment Board and appears to be operating smoothly. To achieve this end, delete [SPECIFICALLY DESIGNATED BY LAW AS ELIGIBLE FOR PERMANENT FUND INVESTMENTS] and insert in which a prudent investor may invest when managing large trust investments.

Budget Reserve Fund

(1) The proposed amendment of the formula for how much may be appropriated from the budget reserve fund needs explaining. The amount is determined by available unrestricted revenue and the amount appropriated from the budget reserve fund for the prior fiscal year. If we have learned anything from our legal battles over the meaning of the existing section 17, it is that a detailed legislative history of the intent of the drafters of the provision is extremely valuable. If the commission is not going to make such a record, it will be incumbent on the legislature to make such a record. Our review of the report of the commission does not disclose any statement of intent to justify the approach used in the draft resolution. *I suggest Brian prepare a draft or Brad.*

(2) The definition of "unrestricted revenue" set out on page 2 lines 25 - 29 must be carefully considered. It might be better to delete the definition and leave that for the legislature to enact by law. *This would invite year to year manipulations of the definition to suit whoever is in the majority. Nonetheless, I agree that a sound definition is needed.*

(3) The draft resolution does not contain a provision that would expressly allow the legislature to appropriate from other sources to the budget reserve fund. The commission's report recommends that amounts attributable to unforeseen oil price increases be deposited in the budget reserve. The legislature may have the implied power to appropriate to any fund it desires. However, it would be better to remove all doubt by authorizing appropriations from other sources.

JLB:clh

See revised language

Have drafted

Section 15 — Alaska Permanent Fund

At least **fifty** [TWENTY-FIVE] per cent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the state shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. **Income from the permanent fund shall be deposited in the permanent fund. Up to four percent of the average market value of the permanent fund for the preceeding five calendar years may** [ALL INCOME FROM THE PERMANENT FUND SHALL] be deposited in the general fund **at the beginning of the next fiscal year** [UNLESS OTHERWISE PROVIDED BY LAW].

Section 17 — Budget Reserve Fund

(a) There is established as a separate fund in the State treasury the budget reserve fund. **The purpose of the budget reserve fund is to help stabilize State spending from year to year.** Except for money deposited into the permanent fund under Section 15 of this article, all money received by the state after July 1, 1990, as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation in a State or federal court involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments of bonuses, or involving taxes imposed on mineral income, production, or property, shall be deposited in the budget reserve fund. Money in the budget reserve fund shall be invested so as to yield competitive market rates to the fund. Income of the fund shall be retained in the fund. Section 7 of this article does not apply to deposits made to the fund under this subsection. Money may be appropriated from the fund only as authorized under (b) or (c) of this section.

(b) If the amount **of unrestricted revenue** available [FOR APPROPRIATION] for a fiscal year is less than the **combined** amount **of unrestricted revenue and money from the fund** appropriated for the previous fiscal year, an appropriation may be made from the budget reserve fund. However, the amount appropriated from the fund under this subsection may not exceed the amount necessary[, WHEN ADDED TO OTHER FUNDS AVAILABLE FOR APPROPRIATION,] to provide for total appropriations **from unrestricted revenue and from the fund** equal to the amount of appropriations made **from these sources** [IN THE PREVIOUS CALENDAR YEAR]

for the previous fiscal year. The legislature shall implement this subsection by law. For purposes of this subsection, "unrestricted revenue" means all money received by the State during a fiscal year except money held in trust, received from the federal government for a particular purpose, or dedicated to a particular purpose as permitted by this constitution.

(c) An appropriation from the budget reserve fund may be made for any public purpose upon affirmative vote of three-fourths of the members of each house of the legislature.

[(D) IF AN APPROPRIATION IS MADE FROM THE BUDGET RESERVE FUND, UNTIL THE AMOUNT APPROPRIATED IS REPAYED, THE AMOUNT OF MONEY IN THE GENERAL FUND AVAILABLE FOR APPROPRIATION AT THE END OF EACH SUCCEEDING FISCAL YEAR SHALL BE DEPOSITED IN THE BUDGET RESERVE FUND.]

HP OfficeJet
Personal Printer/Fax/Copier

Fax Log Report

Oct-12-95 10:05 AM

<u>Identification</u>	<u>Result</u>	<u>Pages</u>	<u>Type</u>	<u>Date</u>	<u>Time</u>	<u>Duration</u>	<u>Diagnostic</u>
19074652029	OK	03	Sent	Oct-12	10:03A	00:01:58	002485030022

7.0.0