

HB

317

HFIN

FILE

HOUSE COMMITTEE REPORT

(11)

Date Referred to Committee: January 13, 1998

FURTHER REFERRALS:

Date of Committee Action: 3/19/98

The FINANCE Committee considered:

HB 317

HOUSE BILL NO. 317

PERMANENT FUND CORP. INVESTMENTS

"An Act relating to investments of the Alaska Permanent Fund Corporation."

recommends it be replaced with the following committee substitute _____ the same title a new title

additional referral to _____ Committee
 attached amendment(s)

ADOPTS: _____ Letter of Intent

ATTACHES NEW FISCAL NOTE(S): (Dept) _____ APPROVES PREVIOUS: (Dept/Date) _____
 fiscal note(s) Revenue fiscal note(s) _____

zero fiscal note(s) _____ zero fiscal note(s) _____

SIGNING WITH RECOMMENDATIONS		DP	DNP	NR	AM
	Theriault	X			
	Hanley	X			
	Mulder	X			
	Martin	X			
	Kohring	X			
	J. Davies	X			
	Grussendorf	X			
	Moses	X			
	G. Davis	X			
	Foster	X			

CO CHAIR'S SIGNATURE
 Theriault Hanley

Revision Date: _____ Dept. Affected: Revenue
 Title: Alaska Permanent Fund Corporation Investments BRU: Alaska Permanent Fund Corporation
 Component: Alaska Permanent Fund Corporation
 Sponsor: (H) Rules/LB&A
 Requestor: (H) FIN COMPONENT SERIAL NO. 109

Expenditures/Revenues: (Thousands of Dollars)

OPERATING EXPENDITURES	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL	4,265.0	4,986.0	6,118.0	7,278.0	8,508.0	9,863.0
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	4,265.0	4,986.0	6,118.0	7,278.0	8,508.0	9,863.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ()	72,000.0	75,384.0	78,927.0	82,636.6	86,520.5	90,587.0

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other	4,265.0	4,986.0	6,118.0	7,278.0	8,508.0	9,863.0
TOTAL	4,265.0	4,986.0	6,118.0	7,278.0	8,508.0	9,863.0

Estimate of any current year (FY98) cost \$ 0.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

HB 317 as proposed amends AS 37.13.120(l) which established the Alaska Permanent Fund Corporation's legal investment classes and their respective level of authorization. HB 317 increases the percentage level of domestic and non-domestic corporate stocks to 60% of the total investments of the Permanent Fund.

The projected costs above are calculated based on a 60% exposure to domestic and non-domestic stocks with 35% invested in passive manager accounts and the remaining in active portfolios. The projected change in revenues is based upon an assumed increased earnings rate of 30 basis points applied to the asset value of the Permanent Fund. Growth in the asset value is at the long-term Callan projection of 8.7%, less dividend distributions of 4%.

Prepared by: Byron I. Mallott Phone: 465-2047
 Division: Alaska Permanent Fund Corporation Date: March 24, 1998
 Approved by Commissioner: Wilson L. Condon Date: March 24, 1998
 Agency: Revenue

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE

For further distribution information call the Governor's Legislative Office

Revision Date: _____ Dept. Affected: Revenue
 Title: Permanent Fund Corporation Investments BRU: Alaska Permanent Fund Corporation
 Component: Alaska Permanent Fund Corporation
 Sponsor: Rules / LBA
 Requestor: (H) FIN COMPONENT SERIAL NO. 109

Expenditures/Revenues: (Thousands of Dollars)

OPERATING EXPENDITURES	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL	4,265.0	4,986.0	6,118.0	7,278.0	8,508.0	9,863.0
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	4,265.0	4,986.0	6,118.0	7,278.0	8,508.0	9,863.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ()						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1001 CBRF						
1048 University of AK receipts						
Other	4,265.0	4,986.0	6,118.0	7,278.0	8,308.0	8,763.0
TOTAL	4,265.0	4,986.0	6,118.0	7,278.0	8,308.0	8,763.0

Estimate of any current year cost \$ 586.0

POSITIONS:

FULL-TIME			
PART-TIME			
TEMPORARY			

waiting for revised F.N.

ANALYSIS: (Attach a separate page if necessary)

HB 317 as proposed amends AS 37.13.120(l) which established the Alaska Permanent Fund Corporation's legal investment classes and their respective level of authorization. HB 317 increases the percentage level of domestic and non-domestic corporate stocks to 60% of the total investments of the Fund.

The projected costs above are calculated based on a 60% exposure to domestic and non-domestic stocks with 35% invested in passive manager accounts and the remaining in active portfolios.

Prepared by: Byron I. Mallott
 Division: Alaska Permanent Fund Corporation
 Approved by Commissioner: Wilson L. Condon
 Agency: Revenue

Phone: 465-2047
 Date: March 17, 1998
 Date: March 17, 1998

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For further distribution information call the Governor's Legislative Office

Revision Date: _____ Dept. Affected: Revenue
 Title: Alaska Permanent Fund Corporation Investments BRU: Alaska Permanent Fund Corporation
 Component: Alaska Permanent Fund Corporation
 Sponsor: (H) Rules/LB&A
 Requestor: (H) FIN COMPONENT SERIAL NO. 109

Expenditures/Revenues: (Thousands of Dollars)

OPERATING EXPENDITURES	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL	4,265.0	4,986.0	6,118.0	7,278.0	8,508.0	9,863.0
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	4,265.0	4,986.0	6,118.0	7,278.0	8,508.0	9,863.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()	72,000.0	75,384.0	78,927.0	82,636.6	86,520.5	90,587.0
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
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1005 GF/Program Receipts						
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Other	4,265.0	4,986.0	6,118.0	7,278.0	8,508.0	9,863.0
TOTAL	4,265.0	4,986.0	6,118.0	7,278.0	8,508.0	9,863.0

Estimate of any current year (FY97) cost \$ 586.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

HB 317 as proposed amends AS 37.13.120(l) which established the Alaska Permanent Fund Corporation's legal investment classes and their respective level of authorization. HB 317 increases the percentage level of domestic and non-domestic corporate stocks to 60% of the total investments of the

The projected costs above are calculated based on a 60% exposure to domestic and non-domestic stocks with 35% invested in passive manager accounts and the remaining in active portfolios. The projected change in revenues is based upon an assumed increased earnings rate of 30 basis points applied to the asset value of the Permanent Fund. Growth in the asset value is at the long-term Callan projection of 8.7%, less dividend distributions of 4%.

Prepared by: Byron I. Mallott Phone: 465-2047
 Division: Alaska Permanent Fund Corporation Date: March 20, 1998
 Approved by Commissioner: Wilson L. Condon Date: March 20, 1998
 Agency: Revenue

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE

For further distribution information call the Governor's Legislative Office

3/19/98 pm



Alaska Permanent Fund Corporation

P.O. Box 25500 Juneau, Alaska 99802-5500

(907) 465-2047

March 12, 1998

Representative Gene Therriault
Co-Chair, House Finance Committee
Capitol Room 511
Juneau, Alaska 99811

Dear Representative Therriault:

I am writing to request that you schedule House Bill No. 317 in the House Finance Committee at your earliest convenience. This bill, which is supported unanimously by the APFC Board of Trustees, would increase from 50% to 60% the Board's authorization to invest in common stocks.

Virtually all the literature on capital markets theory and practice indicates that equities provide a vastly superior long-term rate of return compared to other financial assets, albeit with increased short- and intermediate-term volatility. HB 317 would give the Board of Trustees the flexibility to increase the Fund's investments in equities to a level comparable to its peers. Currently, the Permanent Fund has a smaller allocation to equities than most other large institutional funds, including the State of Alaska's retirement funds.

We look forward to testifying in support of this bill at your earliest convenience. Attached is back-up material to accompany the fiscal note which is presently enroute to you via the Commissioner of the Department of Revenue. Thank you.

With warm regards,

A handwritten signature in black ink, appearing to read "Byron I. Mallott".

Byron I. Mallott
Executive Director

C: Board of Trustees

Alaska Permanent Fund Corporation



The Case for HB 317

To grant the Trustees
the authority and flexibility
to invest up to 60% of the Permanent Fund
in stocks



Arguments in Favor of HB 317

- ◆ **Equities significantly outperform other asset classes over the long term.**
- ◆ **The Fund would produce more net income for use by both current and future generations.**
- ◆ **The Fund's principal would be better protected against the effects of inflation.**
- ◆ **The Fund's asset allocation would become more comparable to that of other large institutional funds, and its performance more competitive.**
- ◆ **Moving from 50% to 60% equities, there is four times as much upside potential as downside risk -- over a 5-year period, the best-case investment environment increases returns by 120 bps, the worst-case decreases returns by only 30 basis points.**



Equities Outperform -- 46 times better than bonds over the long term

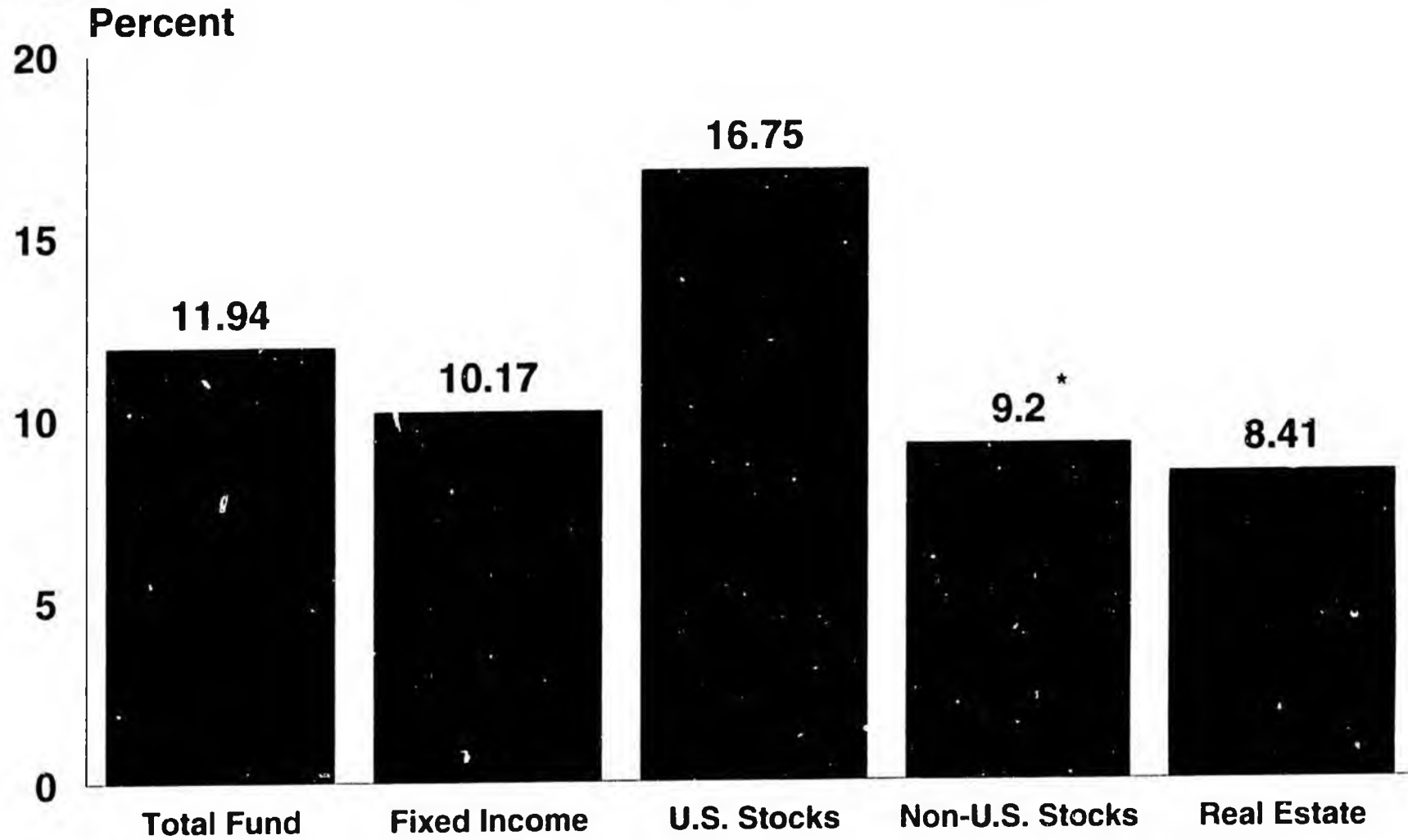
**Consider the growth of \$1.00 invested in
various U.S. asset classes from Dec. 31, 1925
to Dec. 31, 1997:**

◆ Inflation	\$	9.02
◆ Treasury bills		14.25
◆ Treasury bonds		39.07
◆ Common stocks		1,828.33



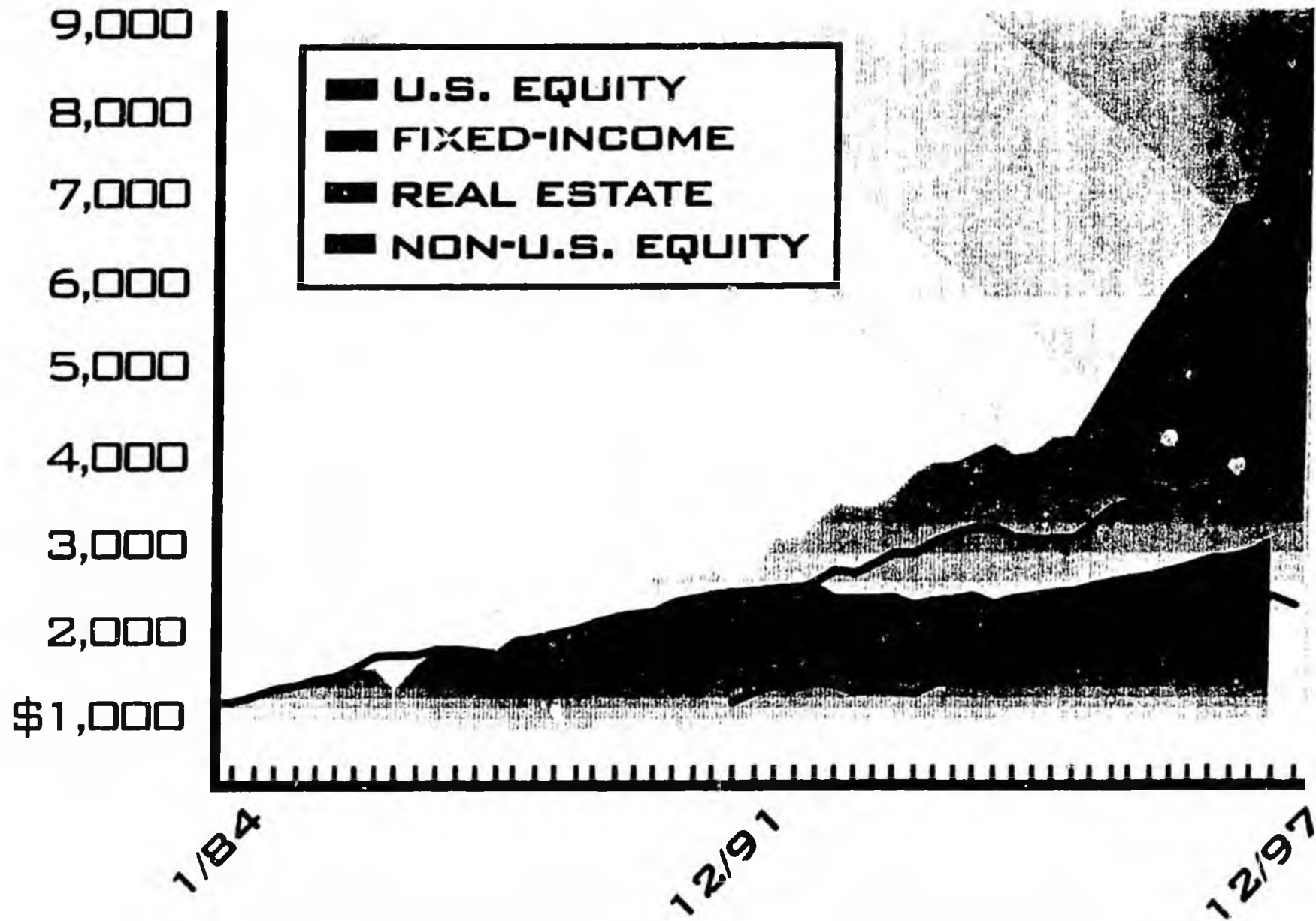
Long-Term Total Returns

14 Years Ending December 31, 1997



* Last 7 Years

Permanent Fund's 14-Year Performance





Other Large Institutional Funds Invest More in Stocks

According to Pensions and Investments Age, these are the average allocations to equities of the top 200 largest U.S. defined benefit pension funds as of September 30, 1997:

◆ Corporate	67%
◆ Public	60%
◆ Alaska PERS	58%
<hr/>	
◆ Alaska Permanent Fund	48%

Equities Allocations of Other Large Institutional Funds

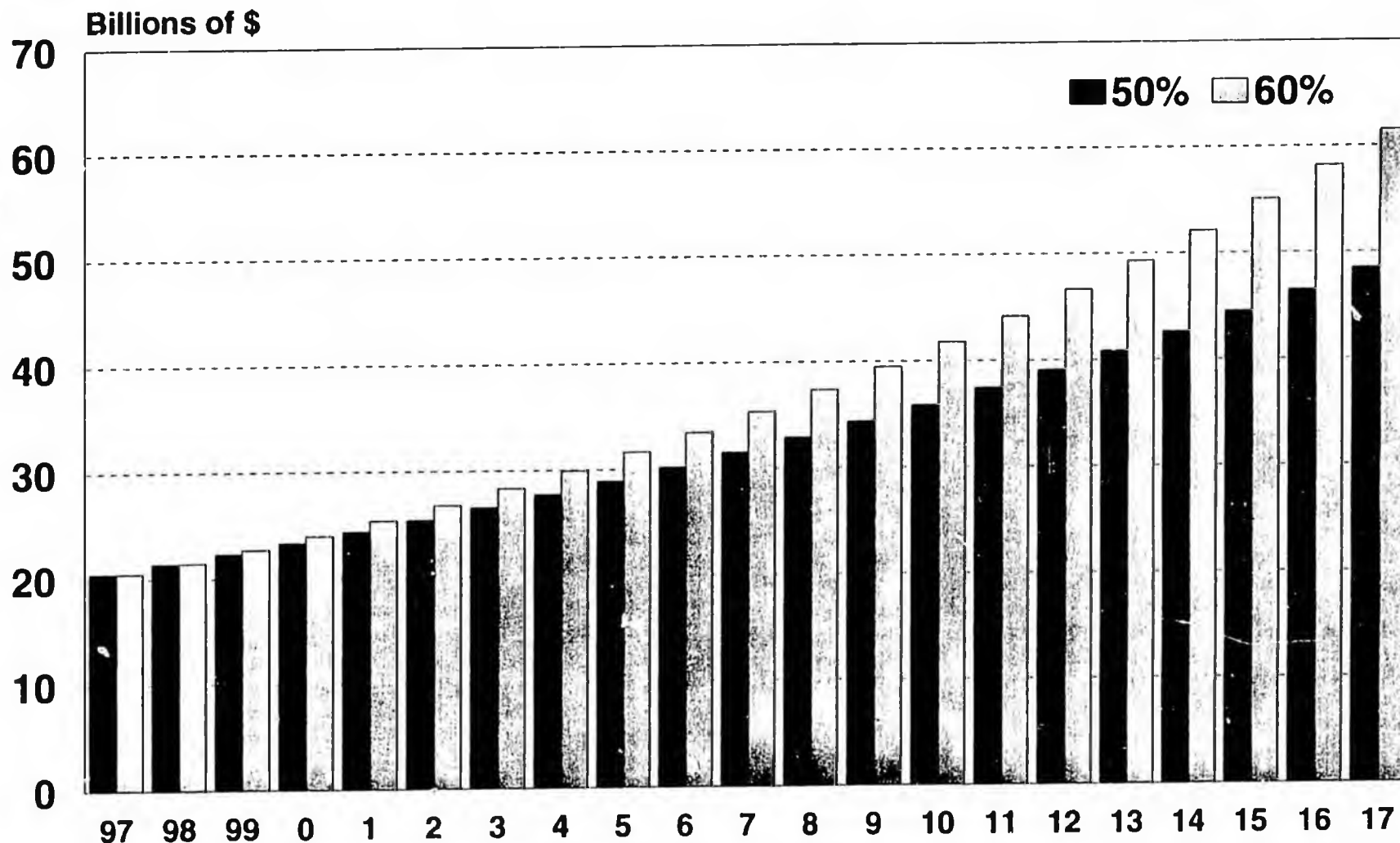
according to a recent issue of *Pensions & Investment Age*

Fund	Market Value (billions of \$)	Asset Allocations (%)		
		Domestic Equities	International Equities	Combination
New York St Teachers	65,200	63.1	9.4	72.5
New York City Tvar A	10,910	70.6		70.6
New York City ERS	32,439	59.8	10.5	70.3
Minnesota St. Bl	30,100	51.6	16.2	67.8
Virginia RS	26,834	53.0	13.0	66.0
Massachusetts PRIM	20,451	49.3	15.4	64.7
Texas Teachers RS	60,621	55.6	8.6	64.2
California PERS	127,599	45.0	19.1	64.1
New York City Teachers	20,332	52.0	12.0	64.0
New Jersey	56,400	49.6	12.6	62.2
Connecticut St.	16,824	48.0	14.0	62.0
Oregon PERF	27,886	40.8	20.3	61.1
Mississippi PERS	11,790	50.4	9.4	59.8
Alaska State Pension Investment Board	10,658	42.0	17.0	59.0
New York City Police	13,055	57.4		57.4
Illinois Teachers RS	18,022	43.3	11.0	54.3
Missouri Public Schools	14,729	38.3	15.3	53.6
Ohio St Teachers'	40,708	43.0	10.0	53.0
California STRS	64,803	32.3	20.3	52.6
New York Common RF	82,507	45.2	7.1	52.3
Pennsylvania School	35,633	47.0	3.0	50.0
Alaska Permanent Fund Corporation	20,900	37.2	11.0	48.2



A \$14 Billion Difference

\$48 billion vs. \$62 billion in 2017



✦ Assumptions: Fund with 50% equities earns 8.4%, Fund with 60% equities earns 8.7%
Growth is net of a 4% annual income distribution



Impact on the Permanent Fund of a 20% Stock Market Correction

Total Fund value as of Dec. 31, 1997: \$23.0 billion

Stocks market value:	\$10.1 billion
Stocks cost value:	<u>7.6 billion</u>
Unrealized gains:	2.5 billion

After a 20% global stock market correction:

Stocks market value	\$8.1 billion
Stocks cost value:	<u>7.6 billion</u>
Unrealized gains	.5 billion

Expected Permanent Fund total return with 60% in equities:	8.7%
Expected Permanent Fund total return with 50% in equities:	8.4%

\$23.0 billion Permanent Fund	x 8.7%	= \$2.00 billion
\$23.0 billion Permanent Fund	x 8.4%	= \$1.93 billion

A 20% reduction in earnings rate	8.7%	x 80%	= 7.0%
A 20% reduction in earnings rate	8.4%	x 80%	= 6.7%

\$23.0 billion Permanent Fund	x 7.0%	= \$1.61 billion
\$23.0 billion Permanent Fund	x 6.7%	= \$1.54 billion

The annual total return difference between a Permanent Fund at a 50% equities level and a 60% level, without the correction, is \$70 million, with the correction, the difference is \$70 million.



50% vs 60% Equities: Best Case vs Worst-Case

Five-Year Impact Based on Callan Capital Market Assumptions

Total Fund value as of Dec. 31, 1997: \$23.0 billion

	BEST-CASE RETURN	WORST-CASE RETURN
Fund with 60% in equities:	16.1%	1.9%
Fund with 50% in equities:	14.9%	2.2%

\$23.0 billion Permanent Fund	x 16.1%	=	\$3.703 billion
\$23.0 billion Permanent Fund	x 14.9%	=	<u>3.427 billion</u>
Difference			276 million

\$23.0 billion Permanent Fund	x 1.9%	=	\$437 million
\$23.0 billion Permanent Fund	x 2.2%	=	<u>506 million</u>
Difference			- 69 million

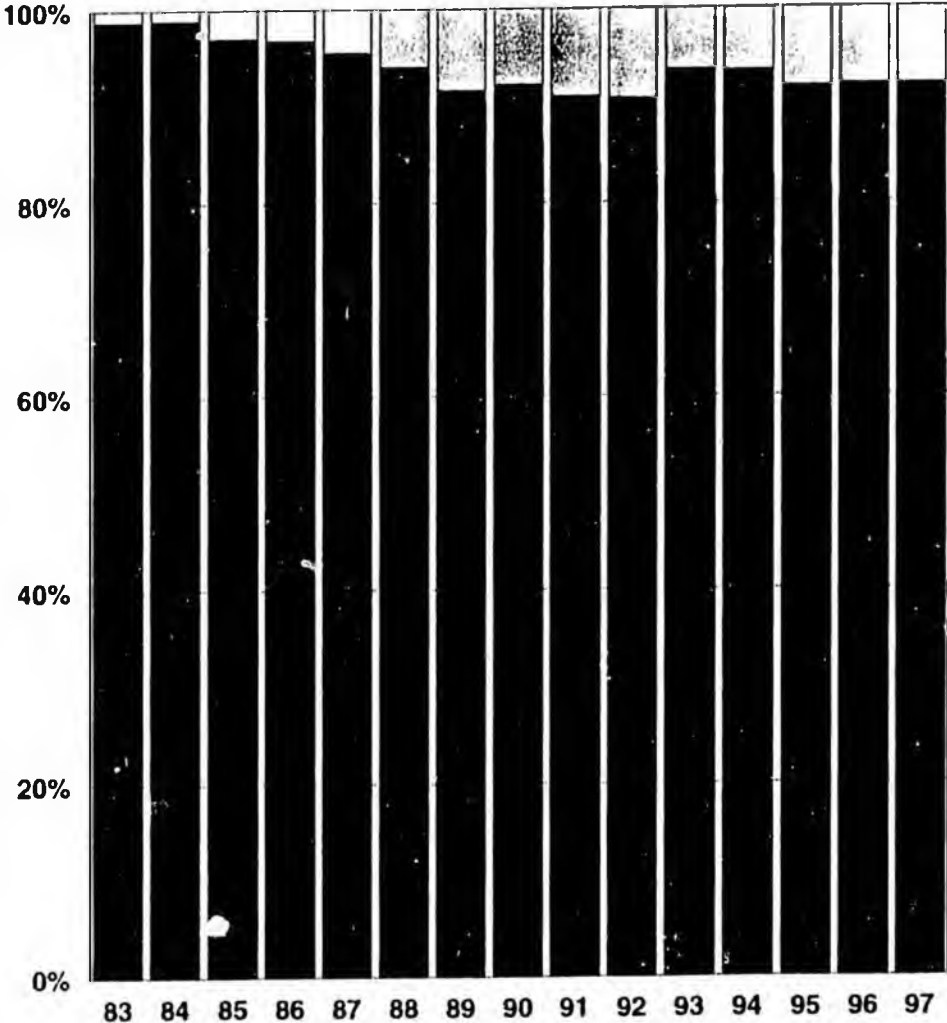
NOTE: The upside potential (best case) from a shift to 60% equities from 50% is \$276 million per year for each of the five years in the period -- a total of \$1.380 billion. The downside risk (worst-case) is \$69 million in reduced earnings -- a total of \$345 million for the five years. The best and worst cases represent the 95th percentile and 5th percentile probabilities respectively.

Permanent Fund Asset Allocation

Incremental Change

Since
1983

Current





House Finance Committee

SUBJECT OF MEETING:
HB 317

DATE: **March 19, 98**

PLACE: **Cap 519**

NAME	REPRESENTING	BUSINESS/PERSONAL MAILING ADDRESS	ZIP	(H) PHONE	(W) PHONE	DO YOU WANT TO TESTIFY?	WHAT SUBJECT/ WHICH BILL?	
Byron Malott / Kim Kelly	APEC				2047	<input checked="" type="radio"/> Y <input type="radio"/> N	HR 317	
① CLIFF STONE	Rep AUSTIN					<input type="radio"/> Y <input type="radio"/> N	411	
R. Austerman						<input type="radio"/> Y <input type="radio"/> N		
Mary Gore staff	Minimally					<input type="radio"/> Y <input type="radio"/> N		
Doug Griffin (3194) 277-8638 3pm Alcohol Bus cur Bone						<input type="radio"/> Y <input type="radio"/> N		
						<input type="radio"/> Y <input type="radio"/> N		
							<input type="radio"/> Y <input type="radio"/> N	
							<input type="radio"/> Y <input type="radio"/> N	
							<input type="radio"/> Y <input type="radio"/> N	