

**HJR**

**25**

# FISCAL NOTE

STATE OF ALASKA  
1997 LEGISLATIVE SESSION

BILL NO. HJR 25

Revision Date _____	Dept Affected _____	Office of the Governor _____
Title <u>Const. Amdt.: Regarding the Permanent Fund</u>	BRU _____	Elective Operations _____
Interest and Dividend _____	Component _____	General and Primary Elections _____
Sponsor <u>Representative Austerman</u>	Component Serial No. <u>#22</u>	
Requester <u>House State Affairs</u>	_____	

**Expenditures/Revenues**

(Thousands of Dollars)

OPERATING EXPENDITURES	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
Personal Services						
Travel						
Contractual		30				
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	0.0	3.0	0.0	0.0	0.0	0.0

**CAPITAL EXPENDITURES**

**CHANGE IN REVENUES [ ]**

**FUND SOURCE**

(Thousands of Dollars)

FUND SOURCE	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
1002 Federal Receipts						
1003 GF Match						
1004 GF		30				
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other						
<b>TOTAL</b>	0.0	3.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY97) cost: none

**POSITIONS**

POSITIONS	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
Full-time		0				
Part-time		0				
Temporary		0				

**ANALYSIS:** *(Attach a separate page if necessary)*

This figure includes the cost of providing information about this issue in the Official Election Pamphlet as required by AS 15.58, and the programming costs for counting votes cast on the measure. However, only four measures can be printed on a single ballot card. If this measure requires printing an additional ballot card, the costs will increase by \$56.0.

Prepared by Dana LaTour  
 Division Division of Elections  
 Approved by Co Lt. Governor Fran Ulmer  
 Agency Office of the Lieutenant Governor

Phone 465-5347  
 Date 3/7/97  
 Date 3/7/97

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**Alaska Permanent Fund Corporation**

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

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**MEMORANDUM**

**DATE:** April 30, 1997

**TO:** Representative Joe Green  
Chairman, House Judiciary Committee

**FROM:** Byron I. Mallott *Byron I. Mallott*  
Executive Director

**SUBJECT:** **Permanent Fund Legal Issues**

I am herewith forwarding to you, for information purposes only, copies of two legal opinions we received this week from our legal counsel, Ron Lorensen of Simpson, Tillinghast, Sorensen and Lorensen. Although the issues raised in these two memoranda relate directly to SB 161, they are issues which also bear, in a broad context, on the subject discussed earlier this week in your committee regarding HJR 25.

I understand that House Judiciary voted to table HJR 25. On behalf of myself and the APFC staff who appeared before your committee, we appreciated the frank discussion and would be pleased to discuss any Permanent Fund issues with you or your committee anytime at your convenience in the future.

Attachments

ATTORNEYS AT LAW  
SIMPSON, TILLINGHAST, SORENSEN & LORENSEN  
A PROFESSIONAL CORPORATION

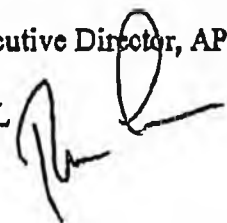
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DANIEL H. INOUIYE  
KATHRYN L. KURTZ  
L. MARRILL LOWDEN

MEMORANDUM

To: Byron I. Mallott, Executive Director, APFC

From: Ron Lorensen, STS&L 

Date: April 29, 1997

Re: Liability issues associated with SB 161, Relating to management of certain municipal assets by the Alaska Permanent Fund Corporation  
Our File No.: 846.1

---

The provisions of proposed AS 37.13.310 (set out in SB 161) call for the Alaska Permanent Fund Corporation ("APFC") to manage certain assets of Alaskan municipalities on their behalf. You have asked whether and under what circumstances a municipality whose assets were managed by the APFC might be able to assert a claim against the corporation based on its investment policies or decisions.

As very general rules of thumb, liability would not arise where a loss is the result of external market forces over which the APFC had no control. The circumstances under which liability might arise are those in which the decision or action of the APFC (or its own investment managers) vary from those that a "prudent investment manager" would exercise under similar circumstances. Unfortunately, because of the myriad factual situations that could develop in the course of the APFC's investment activities, it is difficult to give a more specific or definitive answer to the question without developing a very comprehensive and lengthy opinion addressing the issues.

To the extent that it may seem advisable to the APFC and the Legislature to protect the corporation against these kinds of claims by municipalities, it may make sense for the Legislature

## SIMPSON, TILLINGHAST, SORENSEN &amp; LORENSEN, P. C.

Byron I. Mallott  
April 29, 1997  
Page 2

amend SB 161 by adding a provision to AS 37.13.310 that expressly limits the APFC's liability to municipalities whose assets it manages. The following is possible language to accomplish that result:

1. Re-designate present subsection (d) as (e).
2. Insert a new subsection (d) to read:

(d) A municipality that directs the corporation to manage its assets under this section accepts the investment policies and decisions of the corporation and has no right or authority to instruct the corporation with respect to the investment of all or any part of those assets. The corporation's liability to a municipality for which it manages the municipality's assets under this section is limited to claims of gross negligence or of conduct that is willful, wanton, or reckless in the handling or investment of those assets.

cc: Jim Baldwin, Assistant Attorney General

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MEMORANDUM

To: Byron I. Mallott, Executive Director, APFC

From: Ron Lorensen, STS&L 

Date: April 29, 1997

Re: SB 161, Relating to management of certain municipal assets by the Alaska Permanent Fund Corporation

Our File No.: 846.1

---

At your request, I have looked into the question of whether enactment of SB 161 to provide for management of certain municipal assets by the Alaska Permanent Fund Corporation ("APFC") might cause the APFC to be treated as an "investment advisor" under the federal Investment Advisors Act of 1940 (as amended). The answer is that it would not.

The Act is found at 15 U.S.C. §80b-1 et seq. Under 15 U.S.C. §80b-2(b), States and "any agency, authority, or instrumentality of [a State]" and "any officer, agent, or employee of the foregoing acting as such in the course of his official duty" are excluded from coverage of the Act unless a specific provision of the Act expressly applies. I have reviewed the entire Act and there are no provisions that attempt to regulate the investment activities of States or their officers, etc.<sup>1</sup>

cc: Jim Baldwin, Assistant Attorney General

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<sup>1</sup> I also looked at the related question of whether the APFC might be subject to federal regulation under the separate Investment Company Act of 1940 (15 U.S.C. §80a-1 et seq.). The answer is the same; that Act also expressly excludes States and their agencies and officers, etc.



**Alaska Permanent Fund Corporation**


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

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**MEMORANDUM**

**DATE:** April 28, 1997

**TO:** Representative Joe Green  
Chairman, House Judiciary Committee

**FROM:** Jim Kelly   
Director of Communications

**SUBJECT:** **Permanent Fund Information**

Per your request, attached please find two sets of analysis performed for the Alaska Permanent Fund Corporation (APFC) by our investment consultant, Michael O'Leary, executive vice-president of Callan Associates, Inc.

The first attachment, "APFC Asset Allocation Stress Test," examines the impact on Permanent Fund total return and net income – assuming a variety of different asset allocations – during a period of an extended bear market.

The second attachment, "APFC Board Workshop" provides a primer on endowment management which outlines the investment policy questions faced by investment boards like the APFC Board of Trustees; and compares the impact of different distribution policies on Fund growth and spending.

If you would like to discuss any of the findings contained in this material or need additional information, please let me know. I hope this is responsive.

Post-it® Fax Note	7671	Date	11/29/95	# of pages	9
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November 27, 1995

Alaska Permanent Fund Corporation  
Board Workshop

Prepared by

Callan Associates Inc.  
550 East 8th Avenue  
Denver, CO 80203  
(303) 861-1900

Michael J. O'Leary, Jr., CFA  
Executive Vice President

Alaska Permanent Fund Corporation  
Board Workshop

November 27, 1995

Callan Associates Inc.  
550 East 8th Avenue  
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## Endowment Management A Primer

Our objective in this segment of the report is to outline the investment policy questions confronting overseers of endowment assets. We will briefly describe key management issues, basic investment concepts and modern endowment management practices and trends.

### Purpose

Endowments typically represent the permanent funds of an educational or other institution. They are designed to provide revenues that will support the institution forever. Conceptually, most would argue that the level of support should be neutral from an intergenerational perspective. In other words, the support provided current operations should be maintained in perpetuity.

### Goals

The goals implicit in an endowment's basic purpose are to preserve principal and to provide a meaningful and stable flow of revenue to help fund operations. These two basic goals inherently conflict. It also is obvious that both presume attainment in inflation adjusted terms. Preservation of principal is actually preservation of purchasing power. Maintaining a meaningful and stable contribution to operations dictates a revenue stream that grows with inflation.

The table below illustrates the effect of inflation on purchasing power.

<u>Inflation Rate</u>	<u>Time to Half Purchasing Power</u>
2%	36 Years
3%	24 Years
4%	18 Years
5%	14 Years
6%	12 Years

Mr. David Swensen, Chief Investment Officer of Yale University, illustrates the conflict between the dual endowment goals by contrasting two extreme distribution (spending) policies: "On one hand, if the institution could spend only the real returns generated by the portfolio, asset purchasing power could be maintained perfectly. Assume investment returns are 10% in one year and inflation is 4%. If the 6% real return on endowment value is distributed to the operating units and the 4% attributable to inflation is reinvested in the endowment fund to maintain purchasing power, all constituents are satisfied. In the following year, assume that investment returns are only 2% and inflation is 7%. Now the institution faces a serious problem. Compensation for inflation requires a 7% reinvestment in the endowment, but the fund only generated a return of

2%. The endowment manager cannot go to the operating units and ask for 5% rebates to maintain the purchasing power of assets. Thus, a policy that seeks to maintain asset purchasing power without exception is not feasible.

The other policy extreme, pursuing the goal of providing a completely stable flow of resources to the operating budget could be accomplished by spending a fixed amount that is increased each year by the amount of inflation. In the short-term, the flow of resources from the endowment to the operating budget will be perfectly stable and quite predictable. Under normal market conditions, such a policy might not be harmful. In a period of sustained declines in endowment market value, however, spending at a level independent of the value of assets could cause a loss of capital that would permanently damage the endowment fund.

A spending policy must be devised that addresses the conflicting objectives of preserving purchasing power and providing a stable flow of resources to the operating budget. Most institutions achieve the balance by determining a sensible long-term target rate of spending and applying that rate to a moving average of endowment market values."<sup>1</sup>

### Historical Perspective

Managing an endowment portfolio provides a fiduciary challenge similar to that of managing a trust in which there are distinct income beneficiaries and remaindermen. Taking actions to enhance the income beneficiary's return works to the disadvantage of the remaindermen and the converse, emphasizing growth penalizes the income beneficiaries. Prior to 1970, many, if not most, endowments had spending policies that were linked to income. Managers attempted to balance conflicting interests by investing a portion of the fund's assets for growth and a portion for income generation. The Ford Foundation, in 1972, published a study that strongly advocated the use of a "total return" investment approach and a market linked spending policy. While the timing of the study was unfortunate and many of its conclusions criticized, the basic principles have achieved wide spread acceptance among major endowments and foundations.

A 1992 Survey of Educational Endowments conducted by NACUBO found the following spending policies:

<u>Spending Rule</u>	<u>Percentage</u>
Spend all Current Income	17.4%
Spend a Percent of a Moving Average Market Value	48.4%
Spend a Percent of Prior Year Spending	5.7%
Determine Spending Rate Each Year	13.8%
Other Spending Rule	<u>14.7%</u>
Total	100.0%

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<sup>1</sup> References throughout to Mr. Swensen are to: David F. Swensen, *AIMR Seminar Proceedings Investment Policy: Endowment Management*, Association for Investment Management and Research, 1994, Pgs. 30-40.

The extensive reliance on a spending policy that is independent of income is consistent with the heavy reliance that private educational endowments and foundations have placed on equity oriented investments and a "total return" investment philosophy.

It, however, should be noted that public sector funds, of which there are comparatively few, tend to employ spending policies that are linked to income (or realized return). There have been attempts to shift toward market linked approaches but they have not achieved notable success. Some opine that a primary factor slowing acceptance in the public arena is the heavy historic emphasis placed on fixed income assets. Movement away from an income based distribution approach might result in lower current distributions, a frequently unacceptable consequence.

Callan assisted the New Mexico State Investment Board evaluate the implications of a proposed constitutional change that was unsuccessful, but which may provide useful insight. Realized return from the State's Tax Severance Fund is added to the State's General Fund. Realized return from the State's Permanent Fund is used to support education. The proposed constitutional change would have changed spending from a realized return basis to a percent of moving average market value approach. Since current distributions exceeded the proposed moving average percentage, the proposed change also included a transitional element that stipulated that each year's spending had to, at a minimum, be 102% of the prior year level. The consequence of this feature was that perceived benefits of the change (in terms of inflation protection) were not likely to be realized for more than a decade. The proposed change also included provisions that would have liberalized the current legal list investment approach. Some opponents felt that limitation on spending was unnecessarily inflexible, that it would tie the hands of future state legislatures and administrations. Others were concerned that the 102% of prior year spending rule would result in an invasion of principal. Still others were concerned with the broadening of permissible investments. Supporters of the change felt that the current "realized return" distribution policy resulted in too heavy an emphasis on fixed income securities. They also argued that pressure to increase current earnings increased in periods of low interest rates. Some supporters of the change felt that achievement of a strategic asset allocation policy that would be consistent with maintenance of purchasing power could not be accomplished with the current spending approach. They noted that in the 1960's and 1970's, the funds failed to keep pace with inflation and, in fact, were distributing corpus. They viewed the 1980's and early 1990's as an extraordinary investment environment.

In the final analysis, proponents argued that something like a 50/50 asset mix policy was essential for attainment of long-term goals and that such a policy could best be implemented and maintained if distribution levels were determined independently from short-term earnings (i.e., a percentage of market value related approach). Opponents, while agreeing with the heavier than historic equity targets, argued that there was not need to change the constitution to implement the strategic asset mix target.

### Essential Conclusion

Regardless of the approach utilized to determine distributions, it is obvious that inflation is the primary obstacle to achievement of long-term objectives. It is, therefore, apparent that some

portion of average current earnings must be retained to preserve purchasing power. For example, presume an all bond portfolio, steady inflation of 4% and a coupon return of 7%. If all earnings were distributed, the fund would, in effect, be distributing 4% of principal each year. If 5% of year-end market value were distributed, there would be a 2% average erosion of purchasing power corpus.

To achieve the dual long-term goals, the distribution policy must be reasonable and consistent with the fund's investment policy. For example, either an income based distribution policy or a market value linked spending policy combined with a risk averse short-term fixed income investment policy, will fail to preserve purchasing power. An income based spending approach combined with an 80% equity related investment policy probably would result in a comparatively low and volatile distribution stream.

As the survey of spending policies noted earlier demonstrates, comparatively few endowments and foundations rely on an income based spending approach.

### Endowment Investment Practices

Major endowments and foundations tend to be comparatively aggressive investors. The 1995 Money Market Directory found that less than 35% of endowment and foundation assets were allocated to fixed investments. Public pension funds typically had 40-45% allocation to comparable investments. It also should be noted that the endowment and foundation universe is comparatively small and can be dominated by the investment practices of the larger entities. The Money Market Directory included the following:

	<u>Number</u>	<u>Assets</u>
Corporate Plans	45,554	\$1,698 billion
Union	1,520	240 billion
Government	1,1678	1,239 billion
Endowment	816	116 billion
Total	49,057	3,293 billion

Mr. Swensen, of Yale, explains the comparatively high equity orientation by opining: "The tension between the goals of an endowment can be relaxed by investing for high rates of return. Hence, investment with an equity bias is the first tenet of endowment investment philosophy."

He, however, also emphasized the importance of diversification. For example, he notes the dismal performance of equities in the early 1930's and expresses a view that a heavy equity policy probably would not have survived. He rationalizes Yale's very heavy equity orientation by stating that: "Diversification without the opportunity costs of investing in fixed income can be achieved by identifying high-return asset classes that are not highly correlated with domestic marketable securities."

According to Mr. Swensen, Yale's Asset Allocation and Expected After Inflation Return Targets were:

<u>Asset Class</u>	<u>Target Weight</u>	<u>Expected After-Inflation Return</u>
U.S. Bonds	15.0%	2.0%
U.S. Stocks	22.5%	6.0%
Non-U.S. Stocks	12.5%	6.0%
Private Equity	20.0%	14.0%
Absolute Return	20.0%	7.0%
Real Estate	<u>10.0%</u>	<u>6.0%</u>
Total	100.0%	7.2%

Yale's spending rate was recently raised from 4.5% to 4.75%.

Yale's investment policy, based on Callan's experience, is significantly more aggressive than most. However, other major educational endowments such as Harvard and Stanford also employ comparatively aggressive strategies.

Major endowments have been particularly receptive to the use of "private equity" (including leveraged buyout, management buyout, and venture capital funds). Many have been receptive to non-traditional investment strategies such as "merger" arbitrage, investment in distressed securities, and "market neutral" investment approaches.

Obviously APFC cannot currently pursue investment approaches utilized by these educational endowments. Current law limits overall equity exposure and precludes the types of arrangements that are the norm for investing in private equity. Statute also precludes the use of many of the instruments and techniques that are employed in the absolute return category (e.g., short selling, futures, options, and derivatives).

## Comparison of the Impact of Distribution Policies on Growth and Spending

The long-term returns achieved from equity and high quality fixed investments are well known and documented. In sum, equity investments have far outpaced fixed investments, albeit with greater volatility.

What is less well documented but critically important is the impact of alternative distribution policies on long run growth.

To examine this question, in conjunction with staff, we developed two alternative distribution rules. They were:

1. 1/2 of average five year total return is distributed.
2. 4% of average five year market value is distributed.

Using Ibbotson Associates return data, we then modeled three alternative investment policies. The policies were:

1. 50% equity (S&P 500) and 50% bonds (Salomon Brothers High Grade Long-Term Corporate)
2. An aggressive policy (70% equity), and
3. A conservative policy (30% equity).

For each of the three investment policies, we calculated market values and annual distributions (spending). For each, we used data from 1926, for the past 40, 30, 20, and 10 year periods. We considered the multiple timeframes to minimize the risk of drawing conclusion that had a particular time period bias.

The distribution rule based on 1/2 of five year average earnings is similar to, but different from, APFC's actual distribution pattern. Your distributions are based on "realized" return not total return. Thus, the distributions associated with our model are more volatile than those that you have actually observed. However, in a true economic sense, the total return approach utilized is very meaningful.

Data limitations precluded the use of international equities, real estate and broader measures of the bond market. Inclusion of these additional asset categories should dampen overall observed volatility but not distort the conclusions of the analysis.

Graphs portraying the results of the analysis for the 50/50 policy follow this text. Results for the aggressive and conservative policies are presented in the Appendix.

Review of the output demonstrates the following conclusions:

1. The policy of distributing half of average return erodes the growth in assets relative to the market value based distribution policy when returns are high. As should be expected, the greater spending in these periods does not allow as much reinvestment to take advantage of subsequent market returns.
2. The second conclusion is that the return based distribution policy leads to more volatile cash flows than the market value policy.
3. Whichever policy produces lower initial spending produces greater subsequent market values (growth). On balance, the 4% spending policy produced lower spending than the half return policy, and, therefore, fund growth was greater with the market value spending approach.

Several other points pertaining to the historic analysis are noteworthy. Regardless of spending policy, the asset growth and long-term spending are greater with higher equity commitments. At the 50/50 investment policy, there were extended periods where the half return policy produced higher market values. However, for the entire period and for the 40, 30, 20, and 10 year periods, the market value distribution approach resulted in higher ending market values. Market value differences were greater with the more aggressive policy and mixed with the more conservative investment policy.

Technical Note: In order to develop spending comparisons in the initial five years for each comparison, we used averages of increasing duration. Spending in the initial year was based on the first year market value, in the second year on the average of the first and second year market values, and so forth. In order to make the comparison apples-to-apples, we followed the same procedure for calculating the average returns. These assumptions have the greatest impact on shorter timeframes by introducing additional time period bias.

#### Other Conclusions

While not apparent from the analysis, we believe the following additional observations are important:

1. Long run returns have been positive, thus, lengthening the period used for averaging (e.g., from 5 to 7) tends to reduce the effective distribution. Lower distributions result in more rapid asset growth. Conversely, shortening the averaging period would result in larger distributions, thereby retarding asset growth.
2. The magnitude of the impact on asset growth would vary significantly with the investment policy and the time period considered.

ALASKA PERMANENT FUND CORPORATION

ASSET ALLOCATION "STRESS TEST"

MARCH 1997

# ALASKA PERMANENT FUND CORPORATION

## ASSET ALLOCATION "STRESS TEST"

### Introduction and Overview

In recent years, APFC's equity allocation has been increased. The increase has contributed importantly to the Fund's growth because stocks have significantly outperformed fixed income investments. At present, the Fund's equity allocation is essentially at current statutory limits. As an important part of the Board's regular asset allocation policy review, Callan has been asked to examine how the current policy and two alternative policies, with even greater equity exposure, would have fared in a weak market environment.

We believe that this is a particularly useful exercise since investors, over the past 10-15 years, a period that corresponds to APFC's entire experience in equity investing, have enjoyed exceptional returns.

To complete the assignment, we examined two five-year periods. The first, 1973-1977, was a five-year period which includes a severe bear market (1973 and 1974) and a strong subsequent recovery.

The second five-year span is the most recent five-year period ended 12/31/96. It illustrates the potential rewards associated with the current policy and two alternatives with heavier equity commitments.

### Simulation Process

In order to evaluate the alternatives, we had to make certain important simplifying assumptions. First, owing to limited market index history, we had to exclude international bonds from the analysis. Second, we had to approximate the income and appreciation components of real estate index returns.

The three policies considered for both time periods are presented in Table 1 below. The S&P 500 Stock Index was used as the proxy for domestic equities, the Lehman Government/Corporate Bond Index as the proxy for the bond market, the Morgan Stanley Capital Index - Europe, Australia and Far East Index (EAFE) as the proxy for international stocks, and the Callan Real Estate Index for real estate.

TABLE 1  
ASSET MIX ALTERNATIVES EVALUATED

*Asset Mix Alternatives Evaluated*

Asset Class	Current Mix	Mix A	Mix B
Domestic Equity	36%	38%	41%
International Equity	12%	14%	16%
Domestic Fixed-Income	42%	37%	30%
Real Estate	10%	11%	13%
	100%	100%	100%

**Decision Rules**

A hypothetical portfolio was constructed at the beginning of each period. Each asset category was presumed to achieve market returns. At the end of each calendar quarter, the total equity allocation (sum of domestic and international) was examined. If it exceeded a limit, rebalancing to the policy was conducted at no cost. At the end of each calendar year, the portfolio was rebalanced to the policy target. The maximum equity commitment for the current policy was set at 50%; 55% for Mix A and 60% for Mix B.

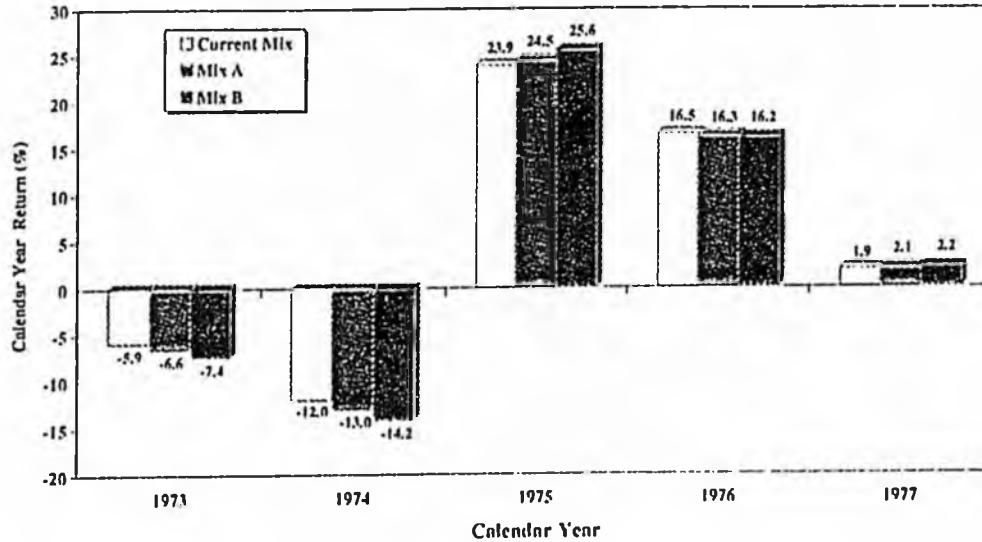
52.7

57.7

**1973-1977 Results**

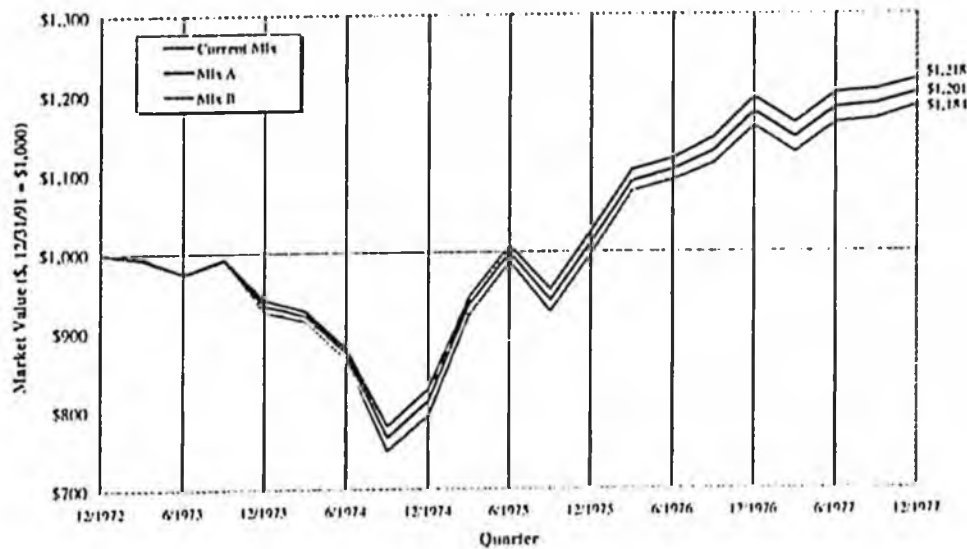
Graph 1 below depicts the total return for each of the three alternative policies. As one would expect, the current policy, owing to its lower equity commitment, had the best returns in the two bear market years (1973 and 1974). Over this two year span, the current policy had a negative cumulative return of 17.2%. A dollar of value at the beginning of 1973 had declined to 82.8 cents by the end of 1974. Policy B, total equity exposure of 57%, declined 20.55% over the same span.

**GRAPH 1**  
*Calendar Year Total Returns*  
*(1973 - 1977)*



Graph 2 depicts the cumulative return for each policy over the full five-year period. The most conservative policy achieved the highest cumulative return. Over this span, \$1,000 invested in the current policy would have grown to \$1,218, an annualized compound return of 4.02%. The most aggressive policy (Mix C) would have produced an ending value of \$1,184 for a compound annual return of 3.44%.

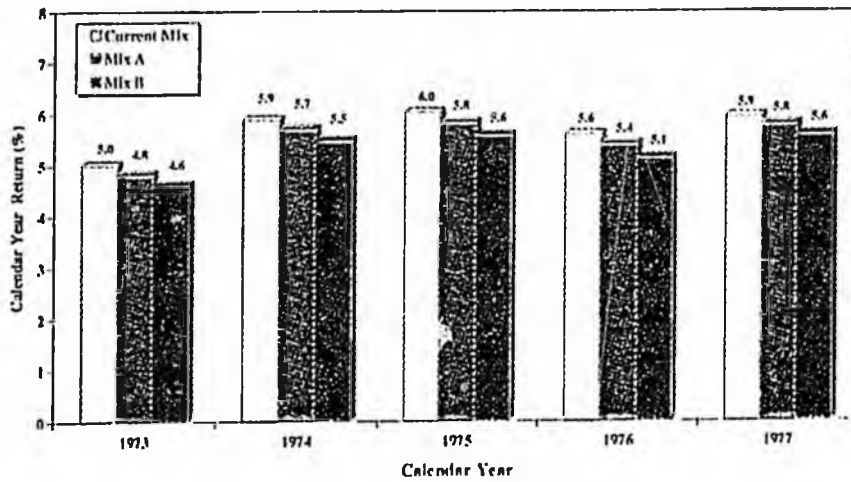
**GRAPH 2**  
*Cumulative Portfolio Growth*  
*(1973 - 1977)*



**Income Return**

The current mix total return was positively affected by its greater income component. Graph 3 depicts the income return by calendar year for each policy.

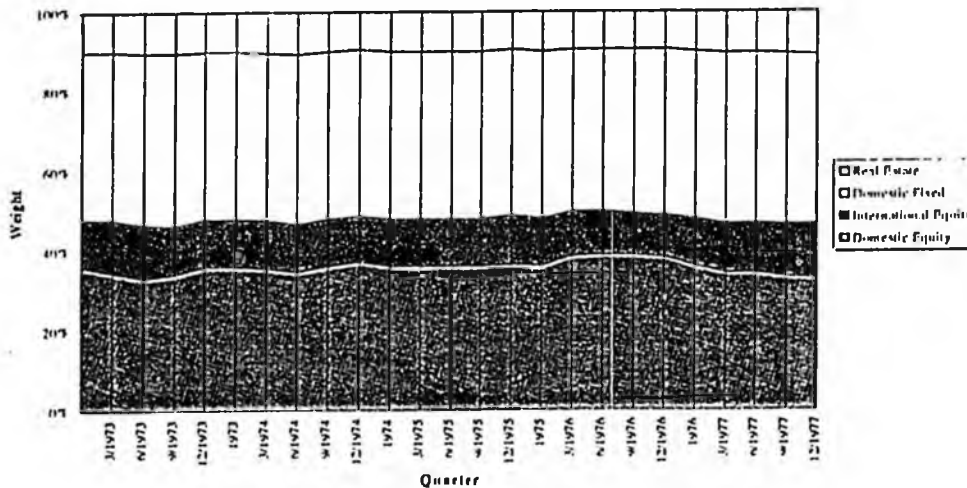
**GRAPH 3**  
*Calendar Year Income Returns*  
(1973 - 1977)



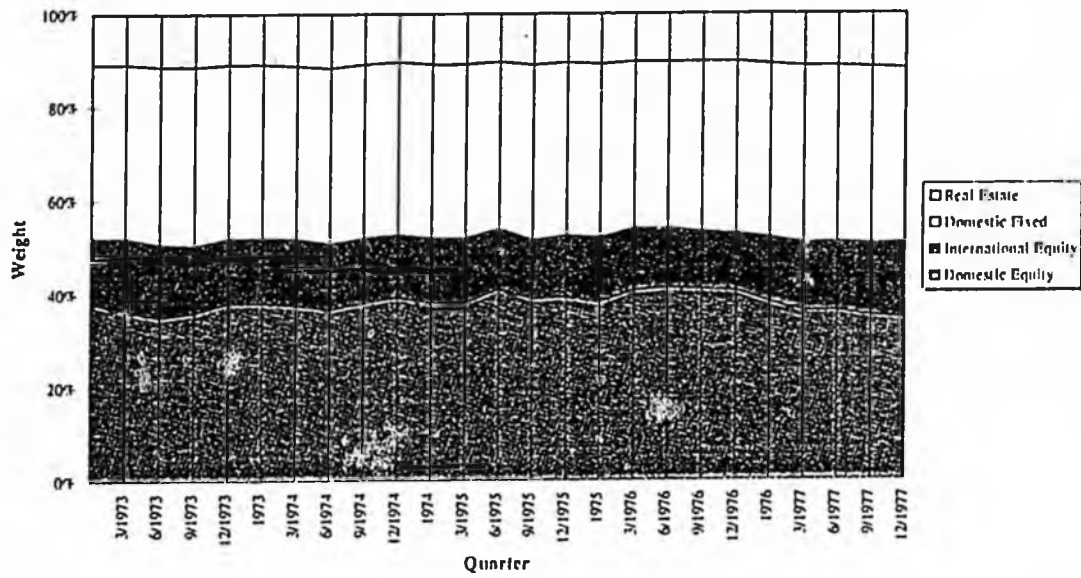
**Portfolio Composition**

Details of portfolio composition and return for each policy by calendar quarter are presented in the Appendix. The graphs below illustrate the composition of the three hypothetical portfolios throughout the five-year period. It is clear that each policy's broad diversification and the rebalancing rules resulted in only minor shifts in portfolio composition throughout the period.

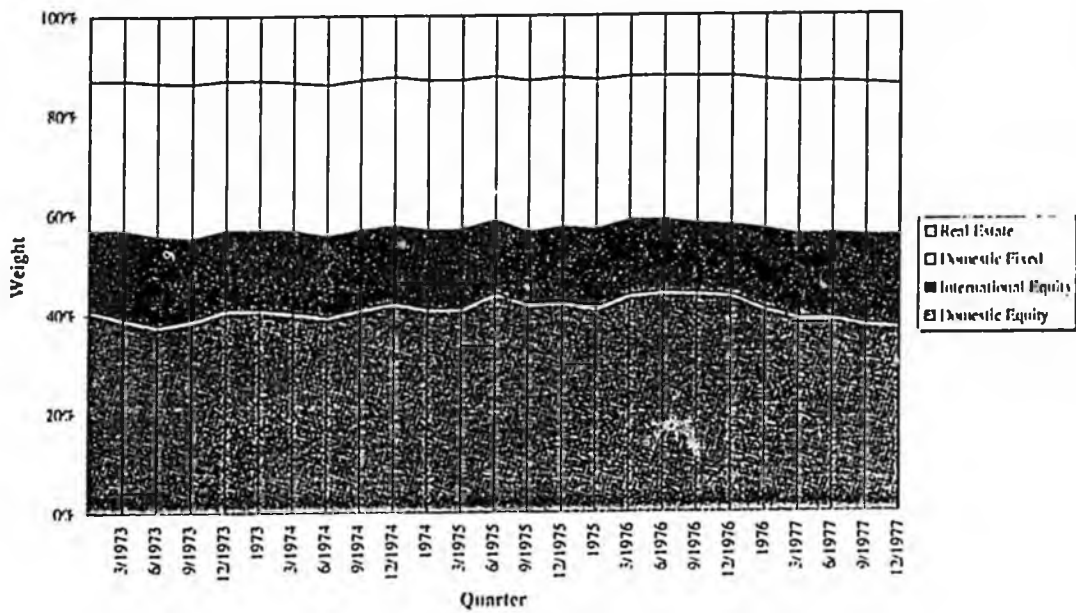
**GRAPH 4**  
*Asset Class Weights - Current Mix*  
(1973 - 1977)



**GRAPH 5**  
*Asset Class Weights - Mix A*  
 (1973 - 1977)



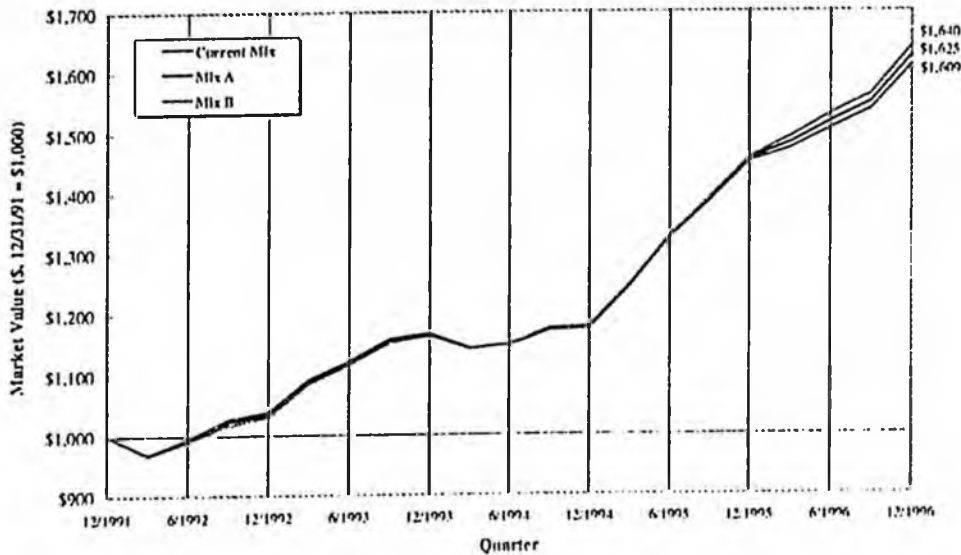
**GRAPH 6**  
*Asset Class Weights - Mix B*  
 (1973 - 1977)



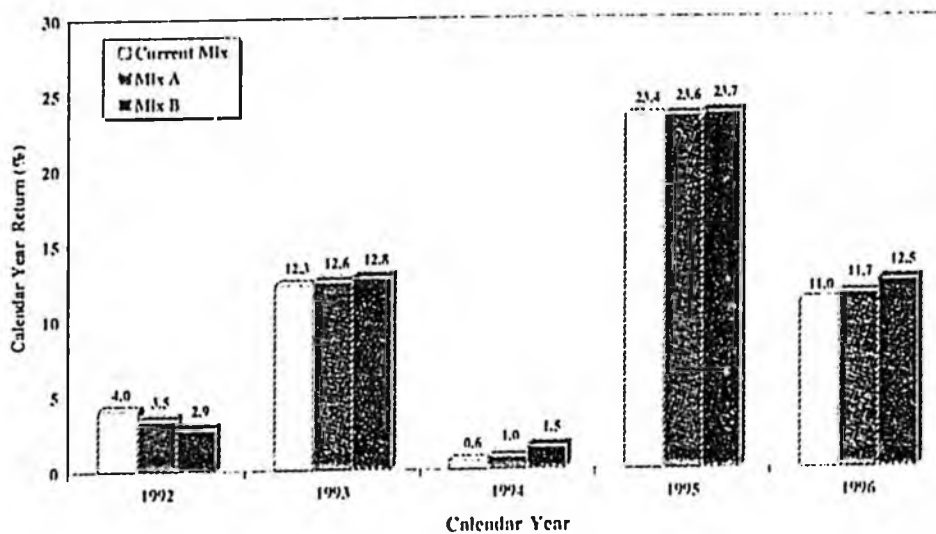
1992-1996

As one should expect, the results for the 1992-1996 period were the mirror image of the 1973-1977 analysis. The most aggressive policy produced the highest return. Graphs 7 and 8 depict the cumulative and calendar period performance for the three policies. Policy B produced a compound annualized return of 10.4% while the current policy returned 9.98%.

**GRAPH 7**  
*Cumulative Portfolio Growth*  
(1992 - 1996)

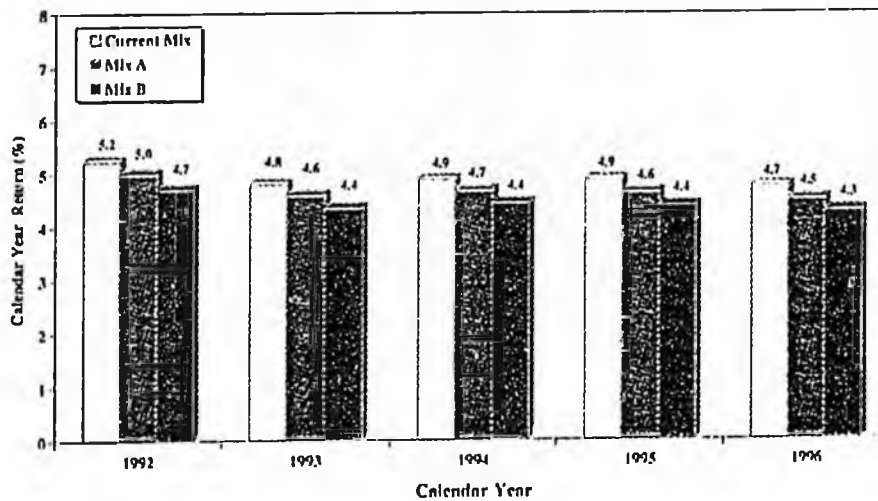


**GRAPH 8**  
*Calendar Year Total Returns*  
(1992 - 1996)



The income return pattern was as expected; the most conservative policy had the highest income. It is, however, important to note that for all three policies, the income component of overall return was less than half of the total return. In contrast, during the 1973-1977 span, the income component of return was actually greater than the total return (i.e., losses detracted from the income return).

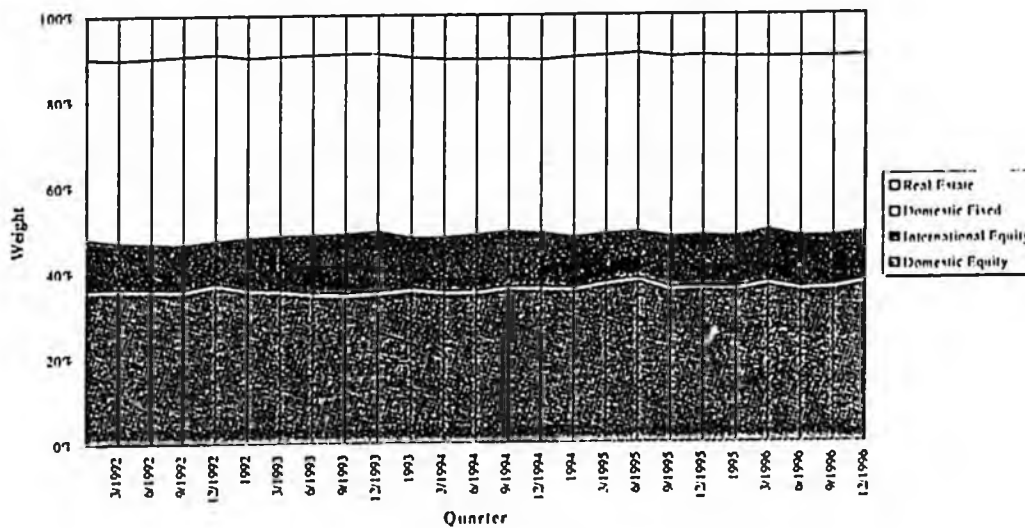
**GRAPH 9**  
*Calendar Year Income Returns*  
 (1992 - 1996)



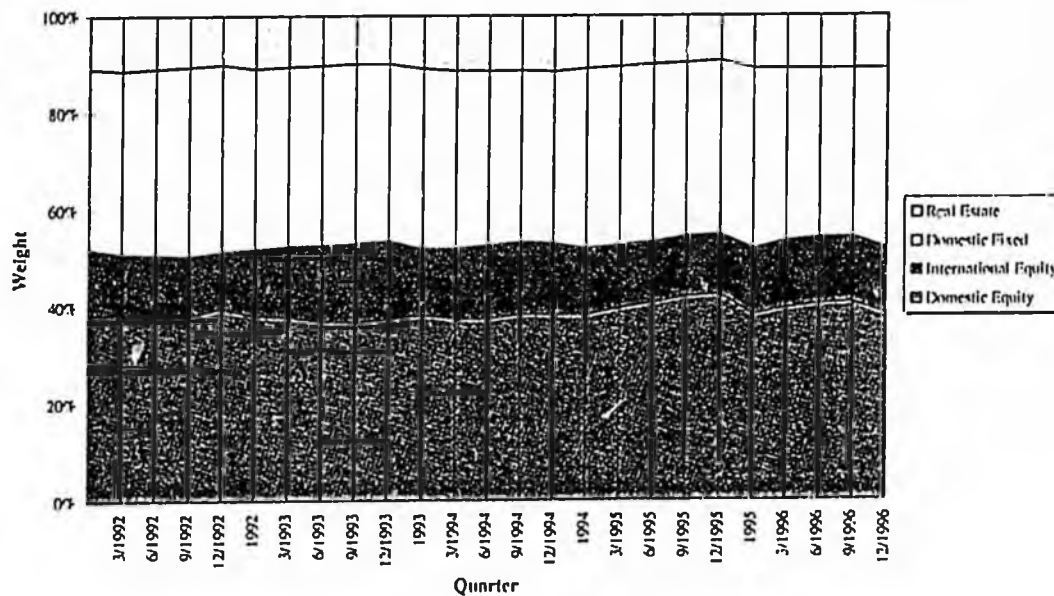
\*  
 dividends since 1982 have never been based on a yr of realized return of less than 8.75%; these #'s (also mix 3) are not 1/2 of what it would be reduced further by realized losses; the effect would likely be no \$ available for i-p

Graphs 10-12 illustrate the asset mix composition throughout the five-year period. Owing to the strong equity market, the maximum equity limitation forced more frequent rebalancings.

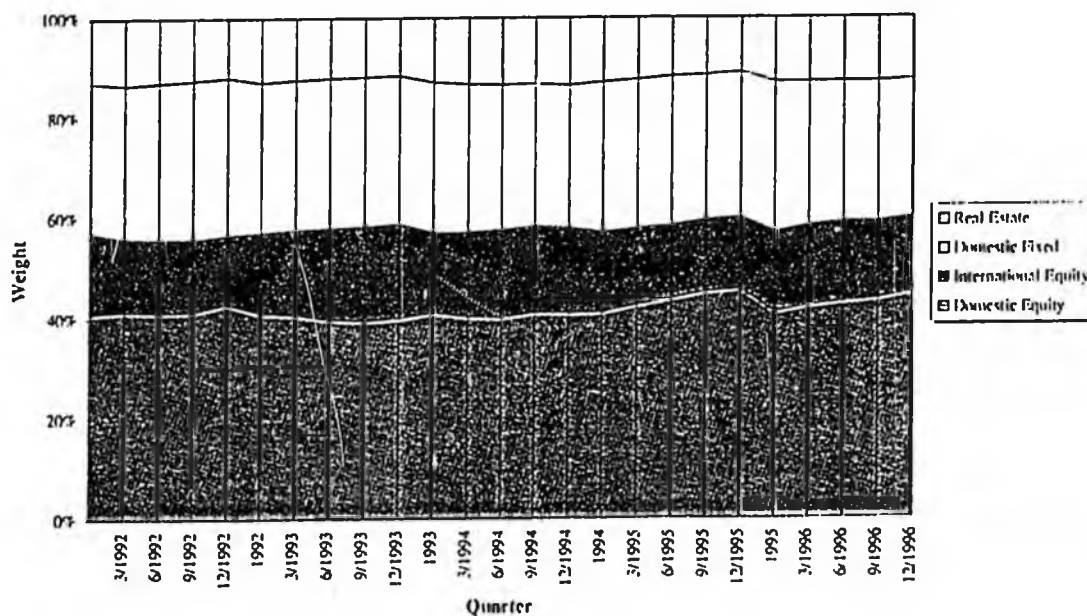
**GRAPH 10**  
*Asset Class Weights - Current Mix*  
 (1992 - 1996)



GRAPH 11  
*Asset Class Weights - Mix A*  
 (1992 - 1996)



GRAPH 12  
*Asset Class Weights - Mix B*  
 (1992 - 1996)

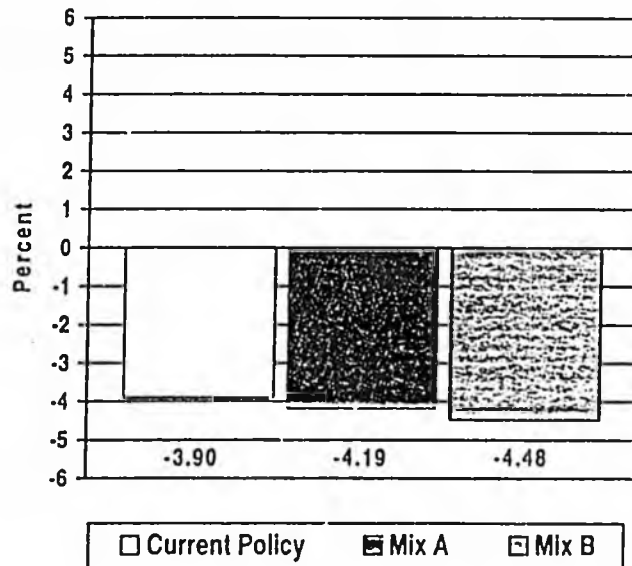


## Summary

The stress test helps illustrate the worst reasonable case that one might expect for each of the three policies. One might think that the differences are comparatively small. They are. However, the range of policies was narrow. The most aggressive policy only had 9% more in total equity than the most conservative (57% versus 48%). Nonetheless, during a weak market environment, the differences in return were meaningful. It also is important to recognize that despite the fact that a positive total return was achieved in the 1973-1977 period, the real return was negative. This is depicted in Graph 13.

GRAPH 13

### *1973 - 1977 Real Return Comparison*



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Callan Associates Inc.  
March 13, 1997

## Total Return (1973 - 1977)

Date	Domestic Fixed				
	Domestic Equity	International Equity	Income	Real Estate	Inflation
3/1973	-4.86%	10.63%	-0.44%	-0.36%	1.96%
6/1973	-5.79	-1.16	0.30	1.21	2.00
9/1973	4.78	-7.03	2.50	2.74	2.34
12/1973	-9.25	-16.32	-0.05	-1.01	2.21
1973	-14.77	-14.93	2.30	2.56	8.78
3/1974	-2.81	1.13	-1.79	1.61	3.32
6/1974	-7.54	-6.03	-3.47	-2.12	2.71
9/1974	-25.05	-21.24	0.06	-1.03	3.25
12/1974	9.41	2.62	5.60	0.95	2.55
1974	-26.31	-23.19	0.17	-0.63	12.36
3/1975	22.90	31.67	3.71	3.62	1.53
6/1975	15.31	-0.37	2.83	1.47	1.70
9/1975	-10.92	-8.89	-1.08	-0.17	1.86
12/1975	8.64	13.37	6.44	2.61	1.64
1975	37.15	35.50	12.29	7.70	6.90
3/1976	14.96	2.39	3.90	2.33	0.72
6/1976	2.46	-1.77	1.12	1.20	1.60
9/1976	1.89	-3.09	4.33	2.57	1.40
12/1976	3.18	5.20	5.45	3.77	1.04
1976	23.83	2.54	15.59	10.22	4.84
3/1977	-7.44	1.62	-0.80	1.33	2.22
6/1977	3.28	4.51	3.02	2.61	2.01
9/1977	-2.80	5.65	0.82	2.27	1.31
12/1977	-0.13	5.16	-0.04	4.19	1.13
1977	-7.20	17.99	2.99	10.79	6.83
Cumulative Annualized Return	-0.20	1.38	6.50	6.03	7.92

## *Income Return (1973 - 1977)*

Date	Domestic Equity	International Equity	Domestic Fixed Income	Real Estate	Inflation
3/1973	0.67%	0.56%	1.64%	1.65%	1.96%
6/1973	0.77	0.49	1.67	1.58	2.00
9/1973	0.78	0.57	1.71	1.70	2.34
12/1973	0.90	0.52	1.72	1.78	2.21
1973	3.16	2.16	6.91	6.88	8.78
3/1974	0.86	0.71	1.76	1.64	3.32
6/1974	0.99	0.66	1.83	1.52	2.71
9/1974	1.17	0.70	1.97	1.61	3.25
12/1974	1.35	0.90	2.04	1.49	2.55
1974	4.44	3.00	7.82	6.41	12.36
3/1975	1.19	1.13	1.98	1.52	1.53
6/1975	1.07	0.78	1.96	1.63	1.70
9/1975	1.03	0.70	1.95	1.33	1.86
12/1975	1.05	0.90	2.03	1.38	1.64
1975	4.41	3.56	8.16	5.98	6.90
3/1976	0.91	0.64	1.94	1.52	0.72
6/1976	1.00	0.69	1.92	1.60	1.60
9/1976	0.98	0.69	1.93	1.24	1.40
12/1976	1.00	0.87	1.89	1.09	1.04
1976	3.95	2.91	7.90	5.57	4.84
3/1977	1.03	0.70	1.80	1.44	2.22
6/1977	1.19	0.75	1.86	1.42	2.01
9/1977	1.14	0.78	1.83	1.64	1.31
12/1977	1.39	0.78	1.85	1.98	1.13
1977	4.84	3.05	7.54	6.64	6.83
Cumulative Annualized Return	4.16	2.94	7.67	6.30	7.92

## Current Mix - Returns, Weights & Dates of Rebalancing (73-77)

Date	Portfolio Total Return (%)	Portfolio Income Return (%)	Asset Class Weights at End of Each Period				Total Equity Allocation	
			Domestic Equity	International Equity	Domestic Fixed Income	International Fixed Income		
			36.0%	12.0%	42.0%	0.0%	10.0%	48.0%
3/1973	-0.69	1.16	34.5%	13.4%	42.1%	0.0%	10.0%	47.9%
6/1973	-1.90	1.19	33.1%	13.5%	43.1%	0.0%	10.4%	46.6%
9/1973	2.00	1.25	34.0%	12.3%	43.3%	0.0%	10.4%	46.3%
12/1973	-5.28	1.30	36.0%	12.0%	42.0%	0.0%	10.0%	48.0%
1973	-5.89	4.99	36.0%	12.0%	42.0%	0.0%	10.0%	
3/1974	-1.47	1.30	35.5%	12.3%	41.9%	0.0%	10.3%	47.8%
6/1974	-5.09	1.36	34.6%	12.2%	42.6%	0.0%	10.6%	46.8%
9/1974	-11.34	1.50	36.0%	12.0%	42.0%	0.0%	10.0%	48.0%
12/1974	6.15	1.60	37.1%	11.6%	41.8%	0.0%	9.5%	48.7%
1974	-11.99	5.88	36.0%	12.0%	42.0%	0.0%	10.0%	
3/1975	13.96	1.55	36.0%	12.0%	42.0%	0.0%	10.0%	48.0%
6/1975	6.80	1.46	36.0%	12.0%	42.0%	0.0%	10.0%	48.0%
9/1975	-5.47	1.41	36.0%	12.0%	42.0%	0.0%	10.0%	48.0%
12/1975	7.68	1.48	36.3%	12.6%	41.5%	0.0%	9.5%	49.0%
1975	23.90	6.03	36.0%	12.0%	42.0%	0.0%	10.0%	
3/1976	7.54	1.37	38.5%	11.4%	40.6%	0.0%	9.5%	49.9%
6/1976	1.31	1.39	38.9%	11.1%	40.5%	0.0%	9.5%	50.0%
9/1976	2.39	1.36	38.7%	10.5%	41.3%	0.0%	9.5%	49.2%
12/1976	4.38	1.36	38.3%	10.6%	41.7%	0.0%	9.5%	48.8%
1976	16.45	5.60	36.0%	12.0%	42.0%	0.0%	10.0%	
3/1977	-2.69	1.36	34.2%	12.5%	42.8%	0.0%	10.4%	46.8%
6/1977	3.25	1.45	34.3%	12.7%	42.7%	0.0%	10.3%	46.9%
9/1977	0.34	1.44	33.2%	13.4%	42.9%	0.0%	10.5%	46.5%
12/1977	1.07	1.57	32.8%	13.9%	42.4%	0.0%	10.9%	46.7%
1977	1.90	5.94						
	4.02	5.69	Cumulative Annualized Return					

Portfolio automatically rebalanced if total equity exceeds 50%. The portfolio is rebalanced annually regardless of total equity. Annual returns are shown in the rows labeled with just the years.

## *Current Mix - Dollar Returns, Capital Gains/Losses (73-77)*

Date	Market Value	Total Change in Market Value	Change Due to Income	Change Due to Capital Gain/Loss	Total Return (%)	Income Return (%)	Capital Gain/Loss (%)
12/1972	1,000.00						
3/1973	993.05	(6.95)	11.61	(18.56)	(0.69)	1.16	(1.86)
6/1973	974.14	(18.91)	11.86	(30.77)	(1.90)	1.19	(3.10)
9/1973	993.59	19.45	12.15	7.30	2.00	1.25	0.75
12/1973	941.14	(52.44)	12.91	(65.35)	(5.28)	1.30	(6.58)
1973		(58.86)	46.99	(105.85)	(5.89)	4.99	(10.49)
3/1974	927.34	(13.80)	12.22	(26.03)	(1.47)	1.30	(2.77)
6/1974	880.13	(47.21)	12.57	(59.78)	(5.09)	1.36	(6.45)
9/1974	780.32	(99.80)	13.19	(113.00)	(11.34)	1.50	(12.84)
12/1974	828.30	47.98	12.50	35.48	6.15	1.60	4.55
1974		(112.84)	48.70	(161.54)	(11.99)	5.88	(17.11)
3/1975	943.97	115.67	12.81	102.86	13.96	1.55	12.42
6/1975	1,008.19	64.22	13.82	50.39	6.80	1.46	5.34
9/1975	953.06	(55.13)	14.18	(69.32)	(5.47)	1.41	(6.88)
12/1975	1,026.26	73.20	14.08	59.12	7.68	1.48	6.20
1975		197.95	61.85	136.10	23.90	6.03	17.12
3/1976	1,103.67	77.41	14.09	63.33	7.54	1.37	6.17
6/1976	1,118.16	14.49	15.39	(0.90)	1.31	1.39	(0.08)
9/1976	1,144.90	26.74	15.17	11.56	2.39	1.36	1.03
12/1976	1,195.10	50.20	15.61	34.60	4.38	1.36	3.02
1976		168.84	66.94	101.91	16.45	5.60	10.42
3/1977	1,162.99	(32.11)	16.20	(48.31)	(2.69)	1.36	(4.04)
6/1977	1,200.82	37.83	16.82	21.01	3.25	1.45	1.81
9/1977	1,204.94	4.12	17.32	(13.20)	0.34	1.44	(1.10)
12/1977	1,217.84	12.90	18.90	(6.00)	1.07	1.57	(0.50)
1977		22.74	72.34	(49.60)	1.90	5.94	(3.86)

## Mix A - Returns, Weights & Dates of Rebalancing (73-77)

Date	Portfolio Total Return (%)	Portfolio Income Return (%)	Asset Class Weights at End of Each Period				Real Estate	Total Equity Allocation
			Domestic Equity	International Equity	Domestic Fixed Income	International Fixed Income		
			38.0%	14.0%	37.0%	0.0%	11.0%	52.0%
3/1973	-0.56	1.12	36.4%	15.6%	37.0%	0.0%	11.0%	51.9%
6/1973	-2.04	1.15	35.0%	15.7%	37.9%	0.0%	11.4%	50.7%
9/1973	1.83	1.20	36.0%	14.3%	38.2%	0.0%	11.5%	50.3%
12/1973	-5.80	1.26	38.0%	14.0%	37.0%	0.0%	11.0%	52.0%
1973	-6.57	4.82	38.0%	14.0%	37.0%	0.0%	11.0%	
3/1974	-1.39	1.26	37.5%	14.4%	36.9%	0.0%	11.3%	51.8%
6/1974	-5.21	1.31	36.5%	14.2%	37.5%	0.0%	11.7%	50.8%
9/1974	-12.27	1.45	38.0%	14.0%	37.0%	0.0%	11.0%	52.0%
12/1974	6.12	1.56	39.2%	13.5%	36.8%	0.0%	10.5%	52.7%
1974	-12.99	5.70	38.0%	14.0%	37.0%	0.0%	11.0%	
3/1975	14.91	1.51	38.0%	14.0%	37.0%	0.0%	11.0%	52.0%
6/1975	6.97	1.42	41.0%	13.0%	35.6%	0.0%	10.4%	54.0%
9/1975	-6.03	1.35	38.8%	12.6%	37.4%	0.0%	11.1%	51.5%
12/1975	7.75	1.44	39.2%	13.3%	37.0%	0.0%	10.6%	52.5%
1975	24.45	5.83	38.0%	14.0%	37.0%	0.0%	11.0%	
3/1976	7.72	1.32	40.6%	12.3%	35.7%	0.0%	10.4%	53.9%
6/1976	1.29	1.35	41.6%	12.7%	35.6%	0.0%	10.4%	53.9%
9/1976	2.19	1.31	40.9%	12.7%	36.4%	0.0%	10.5%	53.1%
12/1976	4.31	1.32	40.5%	12.3%	36.8%	0.0%	10.4%	52.8%
1976	16.30	5.40	38.0%	14.0%	37.0%	0.0%	11.0%	
3/1977	-2.75	1.31	36.2%	14.6%	37.7%	0.0%	11.5%	50.8%
6/1977	3.29	1.41	36.2%	14.8%	37.6%	0.0%	11.4%	51.0%
9/1977	0.39	1.40	35.0%	15.6%	37.8%	0.0%	11.6%	50.6%
12/1977	1.23	1.54	34.5%	16.2%	37.3%	0.0%	11.9%	50.7%
1977	2.08	5.78						
	3.73	5.51	Cumulative Annualized Returns					

Portfolio automatically rebalanced if total equity exceeds 55%. The portfolio is rebalanced annually regardless of total equity. Annual returns are shown in the rows labeled with just the years.

## *Mix A - Dollar Returns, Capital Gains/Losses (73-77)*

Date	Market Value	Total Change In Market Value	Change Due to Income	Change Due to Capital Gain/Loss	Total Return (%)	Income Return (%)	Capital Gain/Loss (%)
12/1972	1,000.00						
3/1973	994.39	(5.61)	11.20	(16.81)	(0.56)	1.12	(1.68)
6/1973	974.09	(20.30)	11.45	(31.74)	(2.04)	1.15	(3.19)
9/1973	991.89	17.80	11.73	6.06	1.83	1.20	0.62
12/1973	934.31	(57.58)	12.49	(70.07)	(5.80)	1.26	(7.06)
1973		(65.69)	45.03	(110.72)	(6.57)	4.82	(10.99)
3/1974	921.28	(13.03)	11.76	(24.79)	(1.39)	1.26	(2.65)
6/1974	873.29	(47.99)	12.09	(60.07)	(5.21)	1.31	(6.52)
9/1974	766.11	(107.18)	12.69	(119.87)	(12.27)	1.45	(13.73)
12/1974	812.99	46.88	11.95	34.93	6.12	1.56	4.56
1974		(121.32)	46.35	(167.67)	(12.99)	5.70	(17.91)
3/1975	934.18	121.19	12.27	108.92	14.91	1.51	13.40
6/1975	999.33	65.16	13.26	51.90	6.97	1.42	5.56
9/1975	939.04	(60.30)	13.45	(73.75)	(6.03)	1.35	(7.38)
12/1975	1,011.77	72.74	13.48	59.26	7.75	1.44	6.31
1975		198.78	59.02	139.76	24.45	5.83	17.86
3/1976	1,089.87	78.10	13.38	64.72	7.72	1.32	6.40
6/1976	1,103.90	14.03	14.70	(0.67)	1.29	1.35	(0.06)
9/1976	1,128.05	24.15	14.44	9.71	2.19	1.31	0.88
12/1976	1,176.72	48.67	14.87	33.80	4.31	1.32	3.00
1976		164.95	63.58	101.37	16.30	5.40	10.48
3/1977	1,144.36	(32.36)	15.46	(47.83)	(2.75)	1.31	(4.06)
6/1977	1,181.95	37.59	16.09	21.51	3.29	1.41	1.88
9/1977	1,186.57	4.62	16.61	(11.99)	0.39	1.40	(1.01)
12/1977	1,201.16	14.59	18.24	(3.66)	1.23	1.54	(0.31)
1977		24.44	69.47	(45.03)	2.08	5.78	(3.55)

## Mix B - Returns, Weights & Dates of Rebalancing (73-77)

Date	Portfolio Total Return (%)	Portfolio Income Return (%)	Asset Class Weights at End of Each Period					Total Equity Allocation
			Domestic Equity	International Equity	Domestic Fixed Income	International Fixed Income	Real Estate	
			41.0%	16.0%	30.0%	0.0%	13.0%	57.0%
3/1973	-0.47	1.07	39.2%	17.8%	30.0%	0.0%	13.0%	57.0%
6/1973	-2.23	1.10	37.8%	18.0%	30.8%	0.0%	13.5%	55.7%
9/1973	1.68	1.15	38.9%	16.4%	31.0%	0.0%	13.6%	55.4%
12/1973	-6.44	1.21	41.0%	16.0%	30.0%	0.0%	13.0%	57.0%
1973	-7.42	4.61	41.0%	16.0%	30.0%	0.0%	13.0%	
3/1974	-1.30	1.21	40.4%	16.4%	29.9%	0.0%	13.4%	56.8%
6/1974	-5.35	1.26	39.4%	16.3%	30.4%	0.0%	13.8%	55.7%
9/1974	-13.46	1.40	41.0%	16.0%	30.0%	0.0%	13.0%	57.0%
12/1974	6.08	1.51	42.3%	15.5%	29.9%	0.0%	12.4%	57.8%
1974	-14.24	5.48	41.0%	16.0%	30.0%	0.0%	13.0%	
3/1975	16.04	1.46	41.0%	16.0%	30.0%	0.0%	13.0%	57.0%
6/1975	7.26	1.36	44.1%	14.9%	28.8%	0.0%	12.3%	58.9%
9/1975	-6.47	1.28	42.0%	14.5%	30.4%	0.0%	13.1%	56.5%
12/1975	7.86	1.37	42.3%	15.2%	30.0%	0.0%	12.5%	57.5%
1975	25.57	5.59	41.0%	16.0%	30.0%	0.0%	13.0%	
3/1976	7.99	1.26	43.6%	15.2%	28.9%	0.0%	12.3%	58.8%
6/1976	1.28	1.29	44.2%	14.7%	28.8%	0.0%	12.3%	58.9%
9/1976	1.94	1.24	44.1%	14.0%	29.5%	0.0%	12.4%	58.1%
12/1976	4.21	1.26	43.7%	14.1%	29.8%	0.0%	12.3%	57.8%
1976	16.18	5.14	41.0%	16.0%	30.0%	0.0%	13.0%	
3/1977	-2.86	1.26	39.1%	16.7%	30.6%	0.0%	13.6%	55.8%
6/1977	3.32	1.35	39.1%	16.9%	30.5%	0.0%	13.5%	56.0%
9/1977	0.42	1.36	37.8%	17.8%	30.7%	0.0%	13.7%	55.6%
12/1977	1.43	1.50	37.2%	18.5%	30.2%	0.0%	14.1%	55.7%
1977	2.23	5.59						
	3.44	5.28	Cumulative Annualized Return					

Portfolio automatically rebalanced if total equity exceeds 60%. The portfolio is rebalanced annually regardless of total equity. Annual returns are shown in the rows labeled with just the years.

## *Mix B - Dollar Returns, Capital Gains/Losses (73-77)*

Date	Market Value	Total Change In Market Value	Change Due to Income	Change Due to Capital Gain/Loss	Total Return (%)	Income Return (%)	Capital Gain/Loss (%)
12/1972	1,000.00						
3/1973	995.29	(4.71)	10.70	(15.40)	(0.47)	1.07	(1.54)
6/1973	973.12	(22.18)	10.93	(33.10)	(2.23)	1.10	(3.33)
9/1973	989.47	16.35	11.22	5.13	1.68	1.15	0.53
12/1973	925.79	(63.68)	11.98	(75.66)	(6.44)	1.21	(7.65)
1973		(74.21)	42.67	(116.88)	(7.42)	4.61	(11.63)
3/1974	913.76	(12.03)	11.18	(23.21)	(1.30)	1.21	(2.51)
6/1974	864.86	(48.91)	11.49	(60.39)	(5.35)	1.26	(6.61)
9/1974	748.44	(116.42)	12.08	(128.50)	(13.46)	1.40	(14.86)
12/1974	793.95	45.51	11.27	34.24	6.08	1.51	4.58
1974		(131.84)	43.48	(175.31)	(14.24)	5.48	(18.93)
3/1975	921.30	127.35	11.59	115.76	16.04	1.46	14.58
6/1975	988.17	66.87	12.55	54.31	7.26	1.36	5.90
9/1975	924.27	(63.90)	12.67	(76.57)	(6.47)	1.28	(7.75)
12/1975	996.96	72.69	12.67	60.02	7.86	1.37	6.49
1975		203.01	55.71	147.29	25.57	5.59	19.20
3/1976	1,076.60	79.65	12.53	67.12	7.99	1.26	6.73
6/1976	1,090.34	13.74	13.91	(0.17)	1.28	1.29	(0.02)
9/1976	1,111.54	21.20	13.55	7.65	1.94	1.24	0.70
12/1976	1,158.28	46.74	13.96	32.78	4.21	1.26	2.95
1976		161.33	59.58	101.75	16.18	5.14	10.63
3/1977	1,125.18	(33.11)	14.62	(47.72)	(2.86)	1.26	(4.12)
6/1977	1,162.48	37.30	15.23	22.07	3.32	1.35	1.96
9/1977	1,167.35	4.87	15.80	(10.92)	0.42	1.36	(0.94)
12/1977	1,184.08	16.72	17.55	(0.83)	1.43	1.50	(0.07)
1977		25.79	66.21	(40.41)	2.23	5.59	(3.23)

## *Total Return (1992 - 1996)*

Date	Domestic Equity	International Equity	Domestic Fixed Income	Real Estate	Inflation
3/1992	-2.56%	-11.87%	-1.50%	0.26%	0.81%
6/1992	1.98	2.12	4.05	-0.84	0.80
9/1992	3.11	1.50	4.89	-1.03	0.72
12/1992	5.10	-3.86	0.08	-3.13	0.50
1992	7.69	-12.18	7.59	-4.69	2.86
3/1993	4.26	11.99	4.65	1.00	0.93
6/1993	0.53	10.06	3.00	0.62	0.64
9/1993	2.57	6.63	3.31	0.37	0.42
12/1993	2.24	0.87	-0.29	-0.27	0.49
1993	9.91	32.57	11.03	1.73	2.50
3/1994	-3.84	3.49	-3.13	1.19	0.77
6/1994	0.40	5.11	-1.24	1.29	0.69
9/1994	4.91	0.10	0.49	1.46	1.03
12/1994	-0.01	-1.02	0.37	2.31	0.20
1994	1.27	7.78	-3.51	6.39	2.72
3/1995	9.73	1.86	4.98	1.72	1.02
6/1995	9.53	0.73	6.49	1.58	0.81
9/1995	7.99	4.17	1.91	1.29	0.47
12/1995	5.95	4.05	4.66	1.05	0.20
1995	37.51	11.21	19.24	5.76	2.52
3/1996	5.47	2.89	-2.34	2.24	1.33
6/1996	4.53	1.58	0.47	1.85	0.78
9/1996	3.09	-0.12	1.76	2.31	0.65
12/1996	8.35	1.59	3.06	2.46	0.52
1996	23.14	6.05	2.90	9.16	3.32
Cumulative Annualized Return	15.21	8.16	7.18	3.56	2.78

## *Income Return (1992 - 1996)*

Date	Domestic Equity	International Equity	Domestic Fixed Income	Real Estate	Inflation
3/1992	0.68%	0.41%	1.90%	1.44%	0.81%
6/1992	0.85	0.51	1.95	1.42	0.80
9/1992	0.71	0.52	1.89	1.55	0.72
12/1992	0.79	0.46	1.81	1.48	0.50
1992	3.07	1.92	7.77	6.92	2.86
3/1993	0.61	0.50	1.80	1.69	0.93
6/1993	0.78	0.44	1.73	1.69	0.64
9/1993	0.69	0.39	1.69	1.48	0.42
12/1993	0.66	0.37	1.64	1.92	0.49
1993	2.77	1.71	7.04	6.96	2.50
3/1994	0.63	0.35	1.64	1.71	0.77
6/1994	0.75	0.37	1.72	1.75	0.69
9/1994	0.75	0.36	1.78	1.75	1.03
12/1994	0.71	0.37	1.81	1.89	0.20
1994	2.88	1.47	7.13	7.28	2.72
3/1995	0.67	0.41	1.84	1.77	1.02
6/1995	0.66	0.42	1.80	1.82	0.81
9/1995	0.64	0.42	1.72	1.88	0.47
12/1995	0.55	0.42	1.71	1.91	0.20
1995	2.54	1.68	7.26	7.59	2.52
3/1996	0.61	0.40	1.64	1.92	1.33
6/1996	0.61	0.38	1.69	2.08	0.78
9/1996	0.57	0.41	1.72	2.09	0.65
12/1996	0.57	0.40	1.72	1.89	0.52
1996	2.38	1.60	6.94	8.23	3.32
Cumulative Annualized Return	2.73	1.67	7.23	7.21	2.78

## Current Mix - Returns, Weights & Dates of Rebalancing (92-96)

Date	Portfolio Total Return (%)	Portfolio Income Return (%)	Asset Class Weights at End of Each Period				Real Estate	Total Equity Allocation
			Domestic Equity	International Equity	Domestic Fixed Income	International Fixed Income		
			36.0%	12.0%	42.0%	0.0%	10.0%	48.0%
3/1992	-2.95	1.23	36.1%	10.9%	42.6%	0.0%	10.3%	47.0%
6/1992	2.59	1.34	35.9%	10.8%	43.2%	0.0%	10.0%	46.8%
9/1992	3.29	1.28	35.9%	10.7%	43.9%	0.0%	9.6%	46.5%
12/1992	1.15	1.27	37.3%	10.1%	43.4%	0.0%	9.2%	47.4%
1992	4.02	5.23	36.0%	12.0%	42.0%	0.0%	10.0%	
3/1993	5.03	1.20	35.7%	12.8%	41.8%	0.0%	9.6%	48.5%
6/1993	2.79	1.22	35.0%	13.7%	41.9%	0.0%	9.4%	48.7%
9/1993	3.23	1.14	34.7%	14.2%	42.0%	0.0%	9.2%	48.9%
12/1993	0.75	1.15	35.2%	14.2%	41.5%	0.0%	9.1%	49.4%
1993	12.28	4.80	36.0%	12.0%	42.0%	0.0%	10.0%	
3/1994	-2.16	1.13	35.4%	12.7%	41.6%	0.0%	10.3%	48.1%
6/1994	0.41	1.21	35.4%	13.3%	40.9%	0.0%	10.4%	48.7%
9/1994	2.10	1.23	36.4%	13.0%	40.3%	0.0%	10.4%	49.4%
12/1994	0.25	1.23	36.3%	12.9%	40.3%	0.0%	10.6%	49.1%
1994	0.56	4.88	36.0%	12.0%	42.0%	0.0%	10.0%	
3/1995	5.99	1.24	37.3%	11.5%	41.6%	0.0%	9.6%	48.8%
6/1995	6.49	1.22	38.3%	10.9%	41.6%	0.0%	9.2%	49.2%
9/1995	4.43	1.18	36.0%	12.0%	42.0%	0.0%	10.0%	48.0%
12/1995	4.69	1.16	36.4%	11.9%	42.0%	0.0%	9.7%	48.4%
1995	23.39	4.88	36.0%	12.0%	42.0%	0.0%	10.0%	
3/1996	1.56	1.15	37.4%	12.2%	40.4%	0.0%	10.1%	49.5%
6/1996	2.26	1.17	36.0%	12.0%	42.0%	0.0%	10.0%	48.0%
9/1996	2.07	1.18	36.4%	11.7%	41.9%	0.0%	10.0%	48.1%
12/1996	4.75	1.16	37.6%	11.4%	41.2%	0.0%	9.8%	49.0%
1996	11.04	4.75						
	9.98	4.91	Cumulative Annualized Return					

Portfolio automatically rebalanced if total equity exceeds 50%. The portfolio is rebalanced annually regardless of total equity. Annual returns are shown in the rows labeled with just the years.

## *Current Mix - Dollar Returns, Capital Gains/Losses (92-96)*

Date	Market Value	Total Change In Market Value	Change Due to Income	Change Due to Capital Gain/Loss	Total Return (%)	Income Return (%)	Capital Gain/Loss (%)
12/1991	1,000.00						
3/1992	970.50	(29.50)	12.34	(41.84)	(2.95)	1.23	(4.18)
6/1992	995.60	25.10	13.01	12.09	2.59	1.34	1.25
9/1992	1,028.37	32.77	12.79	19.98	3.29	1.28	2.01
12/1992	1,040.23	11.86	13.07	(1.21)	1.15	1.27	(0.12)
1992		40.23	54.41	(14.17)	4.02	5.23	(1.16)
3/1993	1,092.51	52.28	12.53	39.75	5.03	1.20	3.82
6/1993	1,123.01	30.50	13.32	17.18	2.79	1.22	1.57
9/1993	1,159.28	36.27	12.82	23.45	3.23	1.14	2.09
12/1993	1,168.02	8.75	13.31	(4.56)	0.75	1.15	(0.39)
1993		127.79	56.03	71.76	12.28	4.80	7.23
3/1994	1,142.80	(25.22)	13.18	(38.40)	(2.16)	1.13	(3.29)
6/1994	1,147.47	4.66	13.81	(9.15)	0.41	1.21	(0.80)
9/1994	1,171.60	24.13	14.06	10.07	2.10	1.23	0.88
12/1994	1,174.55	2.95	14.44	(11.49)	0.25	1.23	(0.98)
1994		6.53	57.34	(50.81)	0.56	4.88	(4.17)
3/1995	1,244.90	70.35	14.58	55.77	5.99	1.24	4.75
6/1995	1,325.66	80.76	15.14	65.62	6.49	1.22	5.27
9/1995	1,384.40	58.74	15.61	43.13	4.43	1.18	3.25
12/1995	1,449.33	64.93	16.03	48.91	4.69	1.16	3.53
1995		274.78	70.72	204.06	23.39	4.88	17.88
3/1996	1,471.90	22.57	16.66	5.91	1.56	1.15	0.41
6/1996	1,505.19	33.29	17.16	16.13	2.26	1.17	1.10
9/1996	1,536.32	31.13	17.83	13.30	2.07	1.18	0.88
12/1996	1,609.31	72.99	17.89	55.09	4.75	1.16	3.59
1996		159.97	76.39	83.58	11.04	4.75	6.08

## Mix A - Returns, Weights & Dates of Rebalancing (92-96)

Date	Portfolio Total Return (%)	Portfolio Income Return (%)	Asset Class Weights at End of Each Period					Total Equity Allocation
			Domestic Equity	International Equity	Domestic Fixed Income	International Fixed Income	Real Estate	
			38.0%	14.0%	37.0%	0.0%	11.0%	52.0%
3/1992	-3.16	1.18	38.2%	12.7%	37.6%	0.0%	11.4%	51.0%
6/1992	2.46	1.29	38.1%	12.7%	38.2%	0.0%	11.0%	50.8%
9/1992	3.13	1.23	38.1%	12.5%	38.9%	0.0%	10.6%	50.5%
12/1992	1.16	1.22	39.5%	11.9%	38.5%	0.0%	10.1%	51.4%
1992	3.51	5.00	38.0%	14.0%	37.0%	0.0%	11.0%	
3/1993	5.13	1.15	37.7%	14.9%	36.8%	0.0%	10.6%	52.6%
6/1993	2.87	1.17	36.8%	16.0%	36.9%	0.0%	10.3%	52.8%
9/1993	3.26	1.09	36.6%	16.5%	36.9%	0.0%	10.9%	53.1%
12/1993	0.83	1.10	37.1%	16.5%	36.5%	0.0%	9.9%	53.6%
1993	12.60	4.60	38.0%	14.0%	37.0%	0.0%	11.0%	
3/1994	-2.00	1.08	37.3%	14.8%	36.6%	0.0%	11.4%	52.1%
6/1994	0.60	1.16	37.2%	15.4%	35.9%	0.0%	11.4%	52.7%
9/1994	2.19	1.18	38.2%	15.1%	35.3%	0.0%	11.4%	53.3%
12/1994	0.23	1.18	38.1%	14.9%	35.4%	0.0%	11.6%	53.1%
1994	0.98	4.68	38.0%	14.0%	37.0%	0.0%	11.0%	
3/1995	5.99	1.19	39.3%	13.5%	36.6%	0.0%	10.6%	52.8%
6/1995	6.39	1.17	40.5%	12.7%	36.7%	0.0%	10.1%	53.2%
9/1995	4.60	1.13	41.8%	12.7%	35.7%	0.0%	9.8%	54.5%
12/1995	4.77	1.08	42.3%	12.6%	35.7%	0.0%	9.4%	54.9%
1995	23.58	4.65	38.0%	14.0%	37.0%	0.0%	11.0%	
3/1996	1.86	1.11	39.3%	14.1%	35.5%	0.0%	11.0%	53.5%
6/1996	2.38	1.12	40.2%	14.0%	34.8%	0.0%	11.0%	54.2%
9/1996	2.09	1.11	40.6%	13.7%	34.7%	0.0%	11.0%	54.3%
12/1996	4.94	1.09	38.0%	14.0%	37.0%	0.0%	11.0%	52.0%
1996	11.72	4.51						
	10.20	4.69	Cumulative Annualized Return					

Portfolio automatically rebalanced if total equity exceeds 55%. The portfolio is rebalanced annually regardless of total equity. Annual returns are shown in the rows labeled with just the years.

## *Mix A - Dollar Returns, Capital Gains/Losses (92-96)*

Date	Mrkrt Value	Total Change in Market Value	Change Due to Income	Change Due to Capital Gain/Loss	Total Return (%)	Income Return (%)	Capital Gain/Loss (%)
12/1991	1,000.00						
3/1992	968.39	(31.61)	11.76	(43.37)	(3.15)	1.18	(4.34)
6/1992	992.17	23.78	12.44	11.34	2.46	1.29	1.17
9/1992	1,023.22	31.05	12.21	18.84	3.13	1.23	1.90
12/1992	1,035.07	11.85	12.49	(0.64)	1.16	1.22	(0.06)
1992		35.07	51.79	(16.72)	3.51	5.00	(1.44)
3/1993	1,088.15	53.08	11.94	41.14	5.13	1.15	3.97
6/1993	1,119.39	31.24	12.77	18.47	2.87	1.17	1.70
9/1993	1,155.91	36.53	12.22	24.31	3.26	1.09	2.17
12/1993	1,165.49	9.58	12.75	(3.17)	0.83	1.10	(0.27)
1993		130.42	53.59	76.83	12.60	4.60	7.74
3/1994	1,142.21	(23.28)	12.63	(35.91)	(2.00)	1.08	(3.08)
6/1994	1,149.03	6.83	13.27	(6.44)	0.60	1.16	(0.56)
9/1994	1,174.15	25.11	13.51	11.60	2.19	1.18	1.01
12/1994	1,176.90	2.76	13.89	(11.13)	0.23	1.18	(0.95)
1994		11.41	55.12	(43.71)	0.98	4.68	(3.58)
3/1995	1,247.39	76.49	14.00	56.50	5.99	1.19	4.80
6/1995	1,327.14	79.74	14.55	65.20	6.39	1.17	5.23
9/1995	1,388.16	61.02	15.02	46.01	4.60	1.13	3.47
12/1995	1,454.37	66.21	15.01	51.21	4.77	1.08	3.69
1995		277.47	67.58	209.89	23.58	4.65	18.31
3/1996	1,481.48	27.10	16.10	11.01	1.86	1.11	0.76
6/1996	1,516.69	35.21	16.63	18.58	2.38	1.12	1.25
9/1996	1,548.40	31.71	16.89	14.82	2.09	1.11	0.98
12/1996	1,624.86	76.46	16.91	59.56	4.94	1.09	3.85
1996		170.49	73.27	97.22	11.72	4.51	6.98

## Mix B - Returns, Weights & Dates of Rebalancing (92-96)

Date	Portfolio Total Return (%)	Portfolio Income Return (%)	Asset Class weights at end of each period					Real Estate	Total Equity Allocation
			Domestic Equity	International Equity	Domestic Fixed Income	International Fixed Income			
			41.0%	16.0%	30.0%	0.0%	13.0%	57.0%	
3/1992	-3.37	1.10	41.3%	14.6%	30.6%	0.0%	13.5%	55.9%	
6/1992	2.25	1.21	41.2%	14.6%	31.1%	0.0%	13.1%	55.8%	
9/1992	2.89	1.16	41.3%	14.4%	31.7%	0.0%	12.6%	55.7%	
12/1992	1.18	1.16	42.9%	13.7%	31.4%	0.0%	12.0%	56.6%	
1992	2.87	4.71	41.0%	16.0%	30.0%	0.0%	13.0%		
3/1993	5.19	1.09	40.6%	17.0%	29.8%	0.0%	12.5%	57.7%	
6/1993	2.90	1.12	39.7%	18.2%	29.9%	0.0%	12.2%	57.9%	
9/1993	3.26	1.03	39.4%	18.8%	29.9%	0.0%	11.9%	58.2%	
12/1993	0.93	1.05	39.9%	18.8%	29.5%	0.0%	11.7%	58.7%	
1993	12.81	4.36	41.0%	16.0%	30.0%	0.0%	13.0%		
3/1994	-1.80	1.03	40.1%	16.9%	29.6%	0.0%	13.4%	57.0%	
6/1994	0.83	1.11	40.0%	17.6%	29.0%	0.0%	13.5%	57.6%	
9/1994	2.32	1.12	41.0%	17.2%	28.5%	0.0%	13.3%	58.2%	
12/1994	0.23	1.12	40.9%	17.0%	28.5%	0.0%	13.6%	57.9%	
1994	1.55	4.45	41.0%	16.0%	30.0%	0.0%	13.0%		
3/1995	6.00	1.12	42.4%	15.4%	29.7%	0.0%	12.5%	57.8%	
6/1995	6.28	1.10	43.7%	14.6%	29.8%	0.0%	11.9%	58.3%	
9/1995	4.82	1.08	45.1%	14.5%	28.9%	0.0%	11.5%	59.5%	
12/1995	4.74	1.02	45.6%	14.4%	28.9%	0.0%	11.1%	60.0%	
1995	23.69	4.40	41.0%	16.0%	30.0%	0.0%	13.0%		
3/1996	2.29	1.06	42.3%	16.1%	28.6%	0.0%	13.0%	58.4%	
6/1996	2.54	1.07	43.1%	15.9%	28.1%	0.0%	12.9%	59.0%	
9/1996	2.10	1.06	43.5%	15.6%	28.0%	0.0%	12.9%	59.1%	
12/1996	5.05	1.04	44.9%	15.1%	27.4%	0.0%	12.6%	60.0%	
1996	12.52	4.30							
	10.40	4.44	Cumulative Annualized Return						

Portfolio automatically rebalanced if total equity exceeds 60%. The portfolio is rebalanced annually regardless of total equity. Annual returns are shown in the rows labeled with just the years.

## *Mix B - Dollar Returns, Capital Gains/Losses (92-96)*

Date	Market Value	Total Change in Market Value	Change Due to Income	Change Due to Capital Gain/Loss	Total Return (%)	Income Return (%)	Capital Gain/Loss (%)
12/1991	1,000.00						
3/1992	966.35	(33.65)	11.00	(44.65)	(3.37)	1.10	(4.46)
6/1992	988.12	21.77	11.72	10.05	2.25	1.21	1.04
9/1992	1,016.66	28.53	11.7	17.06	2.89	1.16	1.73
12/1992	1,028.69	12.04	11.75	0.29	1.18	1.16	0.03
1992		28.69	48.46	(19.76)	2.87	4.71	(1.78)
3/1993	1,082.08	53.39	11.21	42.18	5.19	1.09	4.10
6/1993	1,113.48	31.40	12.09	19.31	2.90	1.12	1.78
9/1993	1,149.81	36.32	11.46	24.87	3.26	1.03	2.23
12/1993	1,160.48	10.67	12.08	(1.41)	0.93	1.05	(0.12)
1993		131.79	50.55	81.24	12.81	4.36	8.19
3/1994	1,139.59	(20.89)	11.94	(32.83)	(1.80)	1.03	(2.83)
6/1994	1,149.03	9.44	12.61	(3.17)	0.83	1.11	(0.28)
9/1994	1,175.67	26.65	12.83	13.81	2.32	1.12	1.20
12/1994	1,178.42	2.75	13.21	(10.46)	0.23	1.12	(0.89)
1994		17.94	52.42	(34.47)	1.55	4.45	(2.81)
3/1995	1,249.18	70.76	13.25	57.51	6.00	1.12	4.88
6/1995	1,327.66	78.48	13.80	64.68	6.28	1.10	5.18
9/1995	1,391.72	64.06	14.28	49.78	4.82	1.08	3.75
12/1995	1,457.64	65.93	14.25	51.68	4.74	1.02	3.71
1995		279.22	64.12	215.10	23.69	4.40	18.70
3/1996	1,491.09	33.44	15.41	18.03	2.29	1.06	1.24
6/1996	1,529.02	37.93	16.00	21.94	2.54	1.07	1.47
9/1996	1,561.20	32.18	16.24	15.94	2.10	1.06	1.04
12/1996	1,640.11	78.91	16.18	62.73	5.05	1.04	4.02
1996		182.47	70.46	112.00	12.52	4.30	7.97



**REPRESENTATIVE ALAN AUSTERMAN** Alaska State Legislature

P.O. Box 2368, Kodiak, Alaska 99615 (907) 486-5930 • Session: State Capitol, Juneau, Alaska 99801 465-2487

April 22, 1997

9

Representative Joe Green  
Chairman, Judiciary Committee

Reference: HJR25 – Changes to Permanent Fund

Chairman Green,

You had asked a question at the committee hearing yesterday on HJR25 if the 25% of all royalties that is addressed in Section 2 of this resolution would have any effect on the 50% royalty that is covered in AS 37.13.010.

As I tried to explain to the committee, under Section 15 of the Alaska Constitution, the language is quite clear, “*At least* twenty-five per cent of all mineral lease....” The “At least” language gives the legislature the authority to put a larger amount into the Permanent Fund. The legislature, under AS37.13.010, have increased the amount to 50% after certain dates. HJR 25 does not address AS 37.13.010, so has no effect upon the percentage of royalty.

The language in HJR25 dealing with percentages of royalties is what is currently in the Alaska Constitution and we are not trying to change the percentage language.

I spoke to Tam Cook this morning and she agrees with my above statements. If there are still questions in your mind about this, please let me know and I will get a written opinion from Tam Cook.

Alan Austerman

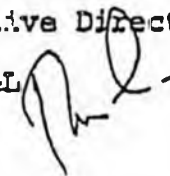
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DANIEL H. INOUE  
KATHRYN L. KURTZ  
L. MERRILL LOWDEN

MEMORANDUM

To: Byron I. Mallott, Executive Director, APFC  
From: Ronald W. Lorensen, STS&L   
Date: March 10, 1997  
Re: HJR 25 & SJR 18, Proposing amendments to the Alaska  
constitution relating to the permanent fund  
Our File No.: 846.1

---

The purpose of this memo is to express a cautionary note regarding possible issues relating to the tax status of the permanent fund that may arise if the amendments to Article IX, sec. 15 of the Alaska Constitution proposed by HJR 25 and SJR 18 are ultimately adopted. Based on the analysis set out in certain studies with which I am familiar, it appears that adoption of the proposed amendments might weaken the State's long-standing position that the income of the fund is not subject to federal taxation. Unfortunately, because of the sensitive nature of the fund's tax status, I am not able to address specific concerns in a public record such as this memorandum. However, with the permission of the APFC, I could provide information about those studies on a confidential basis to appropriate legislative committees or staff.

HJR 25  
Page 2 of 4

# CALLAN ASSOCIATES.

March 10, 1997

MICHAEL J. O'LEARY, JR., CFA  
EXECUTIVE VICE PRESIDENT



SAN FRANCISCO

NEW YORK

CHICAGO

ATLANTA

DENVER

Mr. Jim Kelly  
Alaska Permanent Fund Corporation  
801 W. 10th Street, Suite 302  
P.O. Box 25500  
Juneau, AK 99802-5500

**RE: Proposed Constitutional Amendment**

Dear Jim:

As requested, I want to share several initial thoughts regarding the proposed constitutional amendment that you forwarded to me (Senate Joint Resolution 18). Obviously, the intent of the proposal is to limit distributions from the Permanent Fund to dividends (a percent of average realized income) unless the electorate specifically approved other distributions. Naturally, any decision regarding the use of Permanent Fund earnings is entirely a decision for the people of Alaska and their representatives.

Current statute and the proposed amendment both have significant investment related implications that may influence policy makers in their deliberations. I have attempted to succinctly outline several significant issues that warrant careful consideration as the legislature proceeds with its analysis.

1. Stocks will make the earnings stream both higher and more volatile. Investing a meaningful proportion of the Fund's assets in stocks is critical for attainment of its long-term goals. However, the pattern of stock returns is much more volatile than the pattern of bond returns. The current statutory language and the proposed constitutional amendment, combined with the growing proportion of equities in the APFC, result in greater volatility of earnings (and hence, dividends) than may have been originally perceived.
2. APFC has not yet experienced the downside of equity investment. Fortunately, the Fund has experienced "good" volatility, not both "good" and "bad" volatility. However, there inevitably will be meaningful periods of "bad" (i.e., poor markets) volatility. For example, in 265 rolling five year periods from 1926 to 1996, a 50/50 stock/bond combination had zero or negative real returns 21% of the time (55 periods of 0% or negative real returns).

Mr. Jim Kelly  
Page Two  
March 10, 1997

3. Other "endowments" have moved away from distribution policies tied to earnings. The majority of endowments and foundations link distributions to a percent of market value, not to a proportion of earnings. They do this to ensure a more consistent and reliable distribution pattern.
4. New Mexico moves from income to market value approach. The citizens of New Mexico passed a constitutional amendment that changed the distribution pattern for that State's Permanent and Tax Severance funds to a percent of market value approach. In part, the rationale for the change was a recognition that tying distributions to "realized" earnings resulted in sub-optimal investment policy. In effect, a dollar of income return was more valuable than a dollar of unrealized return. This tended to push policy toward higher current income at the expense of future growth.
5. At AFPC's direction, Callan is "stress" testing APFC's current and alternative asset allocation policies to help the Board and staff understand how earnings may be affected by a poor market environment. In this analysis, we will examine the 1973-1977 market environment and illustrate how APFC's current asset allocation policy would have performed. By looking at this poor market period, policy makers may better understand the implications of the current statutory and proposed constitutional amendments implications for dividend payments and inflation proofing.

I hope that this letter helps you address the questions confronting you.

Sincerely,



Michael J. O'Leary, Jr., CFA  
Executive Vice President

MJO:dsb

HJR 25  
page 4 of 4

\*\*\* TOTAL PAGE. 23 \*\*\*

Article 1. Alaska Permanent Fund.

Section

- 10. Alaska permanent fund
- 20. Findings
- 30. Purpose
- 40. Alaska Permanent Fund Corporation
- 50. Composition and qualifications of board of trustees
- 60. Term of office
- 70. Removal and vacancies
- 80. Quorum and voting
- 90. Compensation of board members
- 100. Corporation staff

Section

- 110. Conflicts of interest
- 120. Investment responsibilities of the board
- 140. Income
- 145. Disposition of income
- 150. Corporation budget
- 160. Audits
- 170. Reports and publications
- 180. Tax exemption
- 190. Political activities
- 200. Public access to information
- 205. Regulations

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

(1) 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, net profit shares under AS 38.05.180(f) and (g), and federal mineral revenue sharing payments received by the state from mineral leases issued on or before December 1, 1979, and 25 percent of all bonuses received by the state from mineral leases issued on or before February 15, 1980;

(2) 50 percent of all mineral lease rentals, royalties, royalty sale proceeds, net profit shares under AS 38.05.180(f) and (g), and federal mineral revenue sharing payments received by the state from mineral leases issued after December 1, 1979, and 50 percent of all bonuses received by the state from mineral leases issued after February 15, 1980;

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

(b) Payments due the Alaska permanent fund under (a) of this section shall be made to the fund within three banking days after the day the amount due to the fund reaches at least \$3,000,000 and at least once each month.

(c) The Alaska permanent fund shall be managed by the Alaska Permanent Fund Corporation established in this chapter. (§ 5 ch 18 SLA 1980; am § 2 ch 134 SLA 1992)

Effect of amendments. — The 1992 amendment, effective July 1, 1992, inserted "within three banking days after the day the amount due to the fund reaches at least \$3,000,000 and at least" in subsection (b).

Legislative history reports. — For the Free Conference Committee Report on ch. 18, SLA 1980 (FCCSSB 161), see 1980 House Journal, Joint Supplement No. 7, April 2, 1980.

NOTES TO DECISIONS

Stated in State, Dept of Revenue v. Cosio, 858 P.2d 621 (Alaska 1993).

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

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

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

(3) the fund should be used as a savings device managed to allow the maximum use of disposable income from the fund for purposes designated by law. (§ 5 ch 18 SLA 1980; am § 3 ch 134 SLA 1992)

The transfer shall be

fund" or "unreserved, restricted by law to a accepted principles of g system established

the State of Alaska, of each house of the n affirmative vote of ch 5 SLA 1994)

of the unconstitutionally tion sources identified in elf relies primarily on the graph (a)(1); it cannot be ephs and therefore is also Cowper, 374 P.2d 922

is to consider all amounts appropriation' within the f the state constitution in payment obligation, it is Cowper, 374 P.2d 922

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Funds.

oration.

Corporation.

investments to the extent  
prudent investment opportu-

of this section.  
that are not of a quality that  
fair value must be secured

(4), or (8) — (10) of this

that are rated at least "A"  
secondary market;  
administration loans;  
issued by the federal Depart-

commercial or residential real  
financial institution retains at

(m) of this section must  
deposit being secured. The  
the continued satisfaction of

means a Standard & Poor's  
Agency, Inc., rating of Baa or  
other variations that occur  
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AS 2; am § 1 ch 33 SLA 1986;  
am § 1 ch 56 SLA 1994; am

inserted "the total value held by  
an investment does not exceed  
of the total value held by the fund  
exceeds \$150,000,000," and made  
change in the introductory lan-  
"33 percent" for "50 percent" in  
and (B), and substituted "57 per-  
cent" in item (F) (i).  
amendment, effective June 26, 1996,  
"investment grade" for "A or better" in  
and (g)(19), rewrote paragraph  
paragraph (i)(5), and added subsection

tory reports. — For Senate letter  
to the 1989 amendments to this  
SLA 1989 (CSHB 69(SA)), see 1989  
1.

SLA 1982.)

des income of the earnings  
come of the fund shall be  
in accordance with generally  
gains or losses. Income avail-  
ne fund for the last five fiscal  
ed net income of the fund for  
reserve account described in

AS 37.13.145. (§ 5 ch 18 SLA 1980; am § 3 ch 31 SLA 1982; am § 1 ch 28 SLA 1986; am  
§ 18 ch 134 SLA 1992)

Effect of amendments. — The 1992 amendment, effective July 1, 1992, inserted near the beginning "fund includes income of the earnings reserve account" and substituted "fund" for "corporation" in three places.

Sec. 37.13.145. Disposition of income. (a) The earnings reserve account is estab-  
lished as a separate account in the fund. Income from the fund shall be deposited by the  
corporation into the account as soon as it is received. Money in the account shall be  
invested in investments authorized under AS 37.13.120.

(b) At the end of each fiscal year, the corporation shall transfer from the earnings  
reserve account to the dividend fund established under AS 43.23.045, 50 percent of the  
income available for distribution under AS 37.13.140.

(c) After the transfer under (b) of this section, the corporation shall transfer from the  
earnings reserve account to the principal of the fund an amount sufficient to offset the  
effect of inflation on principal of the fund during that fiscal year. The corporation shall  
calculate the amount to transfer to the principal under this subsection by

- (1) computing the average of the monthly United States Consumer Price Index for all  
urban consumers for each of the two previous calendar years;
- (2) computing the percentage change between the first and second calendar year  
average; and
- (3) applying that rate to the value of the principal of the fund on the last day of the  
fiscal year just ended.

(d) Notwithstanding (b) of this section, income earned on money awarded in or  
received as a result of State v. Amerada Hess, et al., 1JU-77-847 Civ. (Superior Court,  
First Judicial District), including settlement, summary judgment, or adjustment to a  
royalty-in-kind contract that is tied to the outcome of this case, or interest earned on the  
money, or on the earnings of the money shall be treated in the same manner as other  
income of the Alaska permanent fund, except that it is not available for distribution to the  
dividend fund, and shall be annually deposited into the principal of the Alaska  
permanent fund. (§ 9 ch 31 SLA 1982; am § 2 ch 28 SLA 1986; am § 19 ch 134 SLA 1992)

Conditional repeal of subsection (d). — Under § 28, ch. 134, SLA 1992, subsection (d) "is repealed on the day that the revisor of statutes certifies to the legislature that the Alaska Supreme Court has made a final determination that, in the absence of AS 43.23.045(e), repealed by sec. 29 of this Act, or AS 37.13.145(d), added by sec. 19 of this Act, no judge or juror is disqualified from serving as a judge or juror solely because the judge or juror may qualify to receive a permanent fund dividend."  
Cross references. — For transfer of certain income earned by the Alaska permanent fund prior to July 1, 1982, to the undistributed income account, see § 15, ch. 31, SLA 1982.  
Effect of amendments. — The 1992 amendment, effective July 1, 1992, rewrote this section.

NOTES TO DECISIONS

Stated in State, Dep't of Revenue v. Cosio, 858 P.2d 621 (Alaska 1993); Exxon Corp. v. Heinze, Nos. 92-35266, 92-35323, 32 F.3d 1399 (9th Cir. 1994).

Sec. 37.13.150. Corporation budget. The revenue generated by the fund's invest-  
ments must be identified as the source of the operating budget of the corporation in the  
state's operating budget under AS 37.07 (Executive Budget Act). The unexpended balance  
of the corporation's annual operating budget does not lapse at the end of the fiscal year  
but shall be treated as income under AS 37.13.140. (§ 5 ch 18 SLA 1980; am § 10 ch 31  
SLA 1982; am § 20 ch 134 SLA 1992)

Effect of amendments. — The 1992 amendment, effective July 1, 1992, substituted "fund's invest-  
ments" for "corporation's investments."

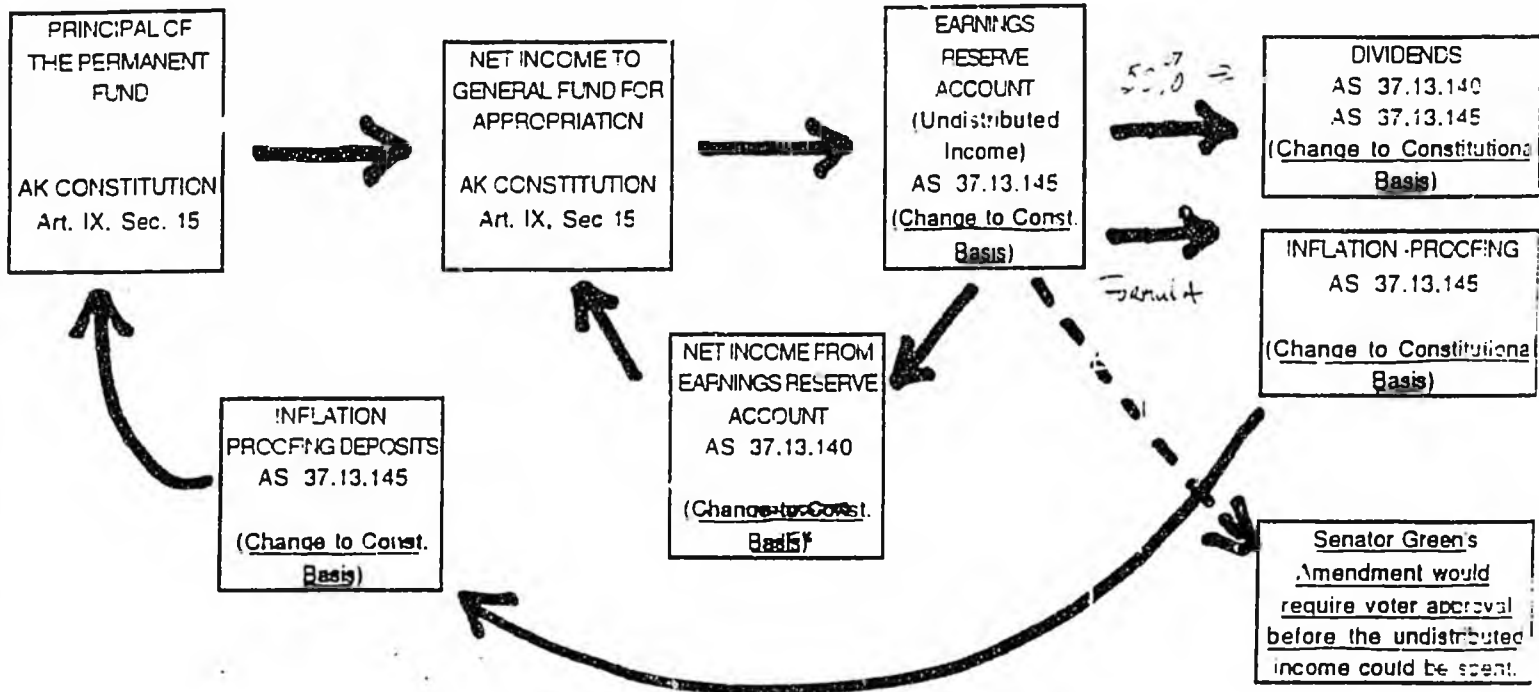
## Deposits Into the Permanent Fund by the Alaska Legislature

Oil Royalties 1978 - 1996	\$5.711 Billion
Inflation Proofing 1983 - 1996	\$4.624 Billion
<b>Additional <u>Legislative Appropriations</u>:</b>	
1981	\$900 Million
1982	\$800 Million
1983	\$400 Million
1984	\$300 Million
1985	\$300 Million
1987	\$1.264 Billion
1995/6	\$1.842 Billion
<b>Additional <u>Legislative Appropriations Total</u></b>	<b><u>\$5.807 Billion</u></b>
<b>Total Deposits 1978 - 1996</b>	<b>\$16.142 Billion*</b>

\* Does not represent the total amount in the Fund at this time; does not include some earnings.

Source: Jim Kelly, Alaska Permanent Fund Corporation

MM/pckp



# WHAT HAPPENS TO PERMANENT FUND INCOME?

## Present Use of Fund Income

Income earned during the fiscal year is credited during the year to the earnings reserve account in the Permanent Fund. On June 30 of each year, appropriations are made from that account first for dividends, then for inflation-proofing.

the earnings reserve account to the Dividend Fund in the General Fund by legislative appropriation.

The amount transferred for inflation-proofing is calculated by multiplying the percentage change in the prior calendar year average of the U.S. consumer price index for all urban

If any income remains after the transfers, it remains in the earnings reserve account as undistributed income. In future years, if there is insufficient net income to fully pay dividends or inflation-proofing, the trustees would request that any previously-accumulated undistributed income in the earnings reserve account be drawn down for those purposes. This happened in fiscal 1990 and 1991. The legislature may appropriate funds from the earnings reserve account at any time for any lawful purpose.

*On June 30 of each year, appropriations are made from the earnings reserve account first for dividends, then for inflation-proofing... if there is insufficient net income to fully pay dividends or inflation-proofing, any previously-accumulated undistributed income in the earnings reserve account would be drawn down for those purposes.*

The dividend formula is calculated to produce a stable flow of dividends over time: (1) add together the Fund's net income for the last five years; (2) multiply that number by 21%; and (3) divide that number in half. That amount is transferred from

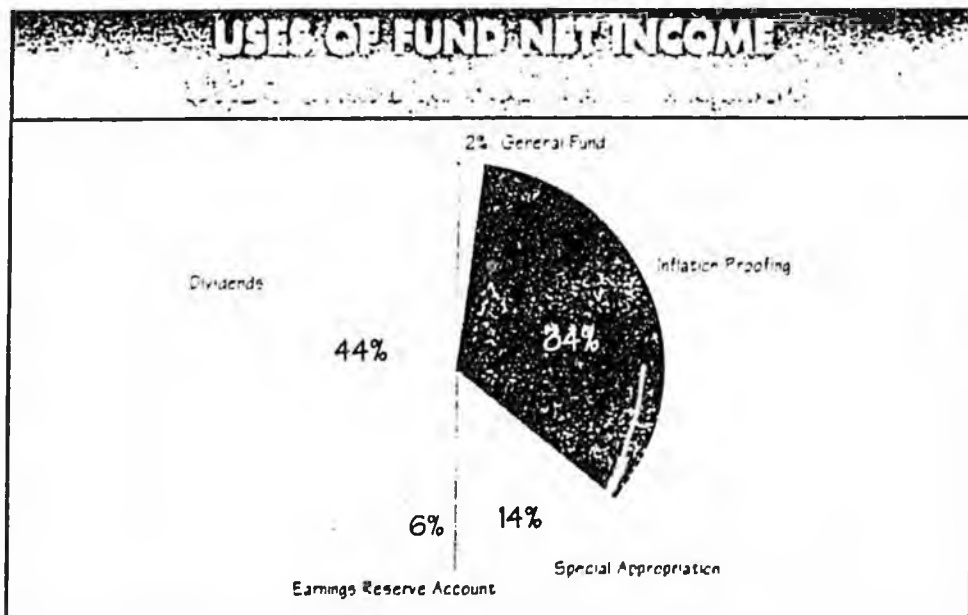
consumers by the Fund's principal balance at the end of the fiscal year. That amount is automatically transferred from the earnings reserve account to the Permanent Fund's principal on June 30 of each year by legislative appropriation.

## The Dividend Program

The dividend program is a finely-crafted piece of public policy which was specifically intended to create a broad and powerful constituency to protect the Fund, encourage its growth, and distribute a significant portion of Fund income for the benefit of the current generation of Alaskans. And it has worked.

Since every man, woman and child who is an Alaska resident is entitled to a portion of each year's earnings, there is strong interest in the Fund's operating and investment activities. Further, earnings of the Fund undergo special public scrutiny since any expenditure of such earnings must be subject to the legislative appropriation process.

No other state in the U.S. has anything like Alaska's dividend program. Each Alaska resident who makes application and qualifies, no matter how young or old, rich or poor, gets a personal share of the



## 1995 DIVIDEND CALCULATION

Distributable Fund net income  
for the last five fiscal years:

1991	\$1,030,478,283.10
1992	1,045,812,513.59
1993	1,205,021,811.67
1994	1,094,284,277.87
1995	1,007,804,493.80

21% of total per AS 37.13.140

X .21  
-----  
213,634,943.75

1,130,514,289.81

One-half transferred to the  
dividend fund per AS 37.13.145

X .50  
-----  
565,257,144.90

Less net prior-year obligations

- 1,994,226.82

Less hold-harmless costs

- 21,887,100.00

Less Dividend Division costs

- 4,418,100.00

Net available in the dividend fund

\$537,007,718.03

Estimated eligible applicants

= 542,269

Per capita dividend checks

\$990.30

revenue the State earns from the production of State-owned oil. And each Alaskan can decide for himself or herself whether to spend it or save it.

In its first 13 years of operation, the dividend program has paid out nearly \$5 billion to all the citizens of the State through the annual distribution of per capita dividend checks. It is interesting to note that there are now

The dividend program is a finely-crafted piece of public policy which was specifically intended to create a broad and powerful constituency to protect the Fund, encourage its growth, and distribute a significant portion of Fund income for the benefit of the current generation of Alaskans.

nearly five times as many Alaskans receiving dividends as there were who originally voted for the Permanent Fund in 1976.

Dollar for dollar, the dividend program has been shown to produce a more positive *macroeconomic* impact than any other type of government expenditure. Dividends help create thousands of in-state jobs each year with great efficiency and unparalleled equal treatment for all Alaska residents, and dividends add significantly to the annual disposable incomes of Alaska's families.

The dividend program is administered by the Dividend Division of the Department of Revenue. The Alaska Permanent Fund earns the money to be used in the dividend program, and the money is then appropriated annually to the Department of Revenue. Alaskans

must submit an application to the Department of Revenue each year in order to get a dividend, and the checks are distributed by the State government. In 1993, a direct deposit option was initiated.

## Investing Your Permanent Fund Dividends for the Future

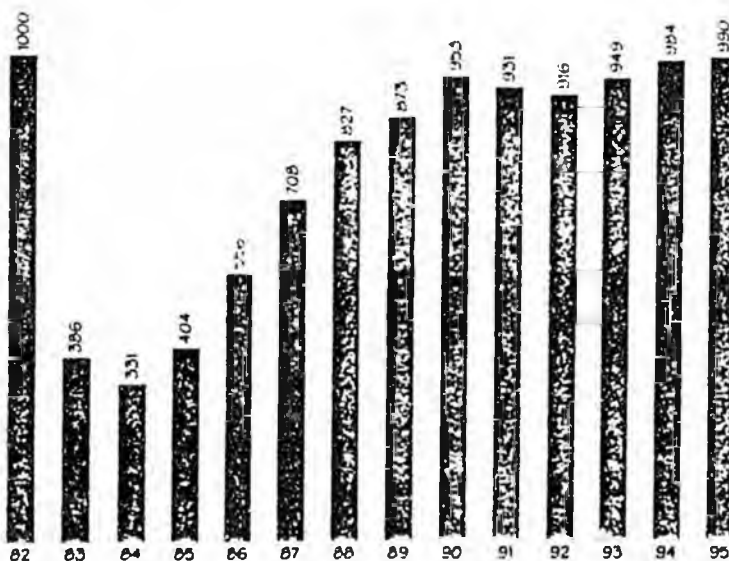
A child born in 1982 would have been eligible to receive the first Permanent Fund dividend. Imagine if that child's parents had decided then to start a college savings account. If that dividend, and all the dividends paid since then, had been saved and invested, it would now amount to quite a bit of money. In fact, assuming a 7% compounded annual rate of return, that child's savings account would now total more than \$15,000.

Now imagine if that child's parents

continue to reinvest all income earned. By the year 2000, when the child born in 1982 is ready to enter college, his or her personal Permanent Fund dividend account will amount to approximately \$11,150. Assuming a 3.7% rate of inflation, that will still be worth about \$26,000 in 1995 dollars - enough for a health down payment on a good college education!

Note: The University of Alaska offers an individual investment program for Alaskans interested in using their Permanent Fund dividends to buy college tuition credits at today's cost for use in the future. For more information about this Advance College Tuition Program, call 800-478-0003.

## PER CAPITA DIVIDENDS



# Inflation-Proofing: An Important Use of Fund Income

Inflation protection for the Permanent Fund is provided by Alaska Statute 37.13.145. Popularly known as inflation-proofing, this provision of law was first passed by

Fund during that year. The amount may come from current year earnings or, if earnings are insufficient, from the earnings reserve account.

Depending on the inflation rate and the earnings rate of the Fund during any given year, the percentage of income required for inflation-

## Past Use of Fund Income

According to the instructions from the 1976 constitutional amendment, all Fund income was to be deposited in the General Fund until such time as the legislature authorized another use for it.

*Depending on the inflation rate and the earnings rate of the Fund during any given year, the percentage of income required for inflation-proofing could be relatively high or low.*

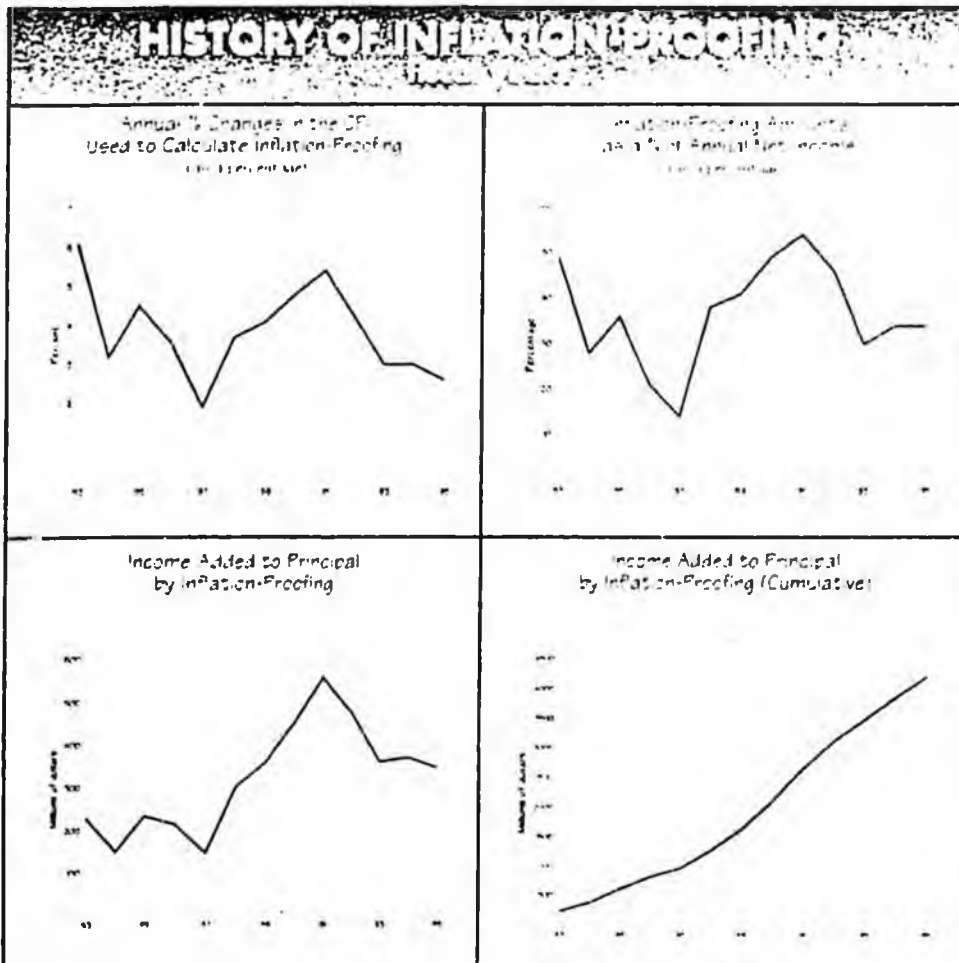
the legislature in 1982 to assist the trustees in their efforts to maintain the real value of the Fund over the long term.

Inflation-proofing protects the Fund by requiring the automatic reinvestment of income each year in an amount sufficient to offset the effect of inflation on the principal of the

proofing could be relatively high or low. For example, in fiscal 1987, 14% of net income was required to inflation-proof the principal; in fiscal 1991, 54% of income was required. In fiscal 1995, inflation-proofing took 34% of net income. Cumulatively, inflation-proofing has added \$4.2 billion to Fund principal.


<b>CALCULATION FOR 1995 INFLATION-PROOFING</b>	
1994 Calendar Year Average CPI-U	444.0
1993 Calendar Year Average CPI-U	432.7
Annual Change in the CPI-U	11.3
$11.3 \div 432.7 = 2.61\%$ Annual Rate of Inflation	
Fiscal Year-End Principal	\$13.3 Billion
x Rate of Inflation	x 2.61%
<b>Fiscal 1995 Inflation-Proofing</b>	<b>= \$348 Million</b>

For the first four years, the legislature did not authorize any other use, and the income went directly and solely to the General Fund. To date, a total of \$266 million of Fund income has been transferred to the General Fund. This represents 2% of the \$12.3 billion of net income the Fund has produced since inception.



### INFLATION-PROOFING EFFECTS

**The Fund In 2010**

	<p><u>Without Inflation-Proofing</u></p> <p>Assets \$17 Billion</p> <p>Annual Income \$1.4 Billion</p> <p>Dividends \$700 Million</p>
	<p><u>With Inflation-Proofing</u></p> <p>Assets \$34 Billion</p> <p>Annual Income \$3.1 Billion</p> <p>Dividends \$1.4 Billion</p>

In 1980, lawmakers authorized the first new use of Fund income: the payment of Permanent Fund dividends. However, because this first version of the dividend program tied the amount of the dividend to the length of residency, it was ruled unconstitutional by the U.S. Supreme Court and was never implemented. Nonetheless, since that year, one-half of Fund income available for distribution has been set aside for payment as dividends.

In 1982, the legislature enacted a plan for the use of all Fund income which, with minor changes, is still in place today.

First, a new version of the dividend program was passed and initiated

with a special \$1000 per capita payment. Second, inflation-proofing was adopted so that a portion of Fund income would be added automatically to principal at the end of each fiscal year in "an amount sufficient to offset the effect of inflation."

Lastly, the 1982 legislature directed that any income remaining after the payment of dividends and inflation-proofing be transferred to an undistributed income account in the Permanent Fund. The trustees subsequently designated this account a reserve for future inflation impact and dividend payments.

This undistributed income account grew during each of the next four

years as the Fund experienced a sustained period of relatively high earnings with relatively low inflation. By the end of fiscal 1986, this account amounted to \$1.264 billion.

In a showing of fiscal *prudence*, rather than use this money to try to sustain an unrealistic level of spending, the 1986 legislature appropriated the entire balance of the undistributed income account to the principal of the Fund, effective July 1, 1986. They also renamed this account the earnings reserve account.

As of June 30, 1995, undistributed income in the earnings reserve account totaled \$1.203 billion.

## On Inflation-Proofing

The following comments are excerpts from the special Permanent Fund Tenth Anniversary meeting held in Juneau on February 9-10, 1987 and attended by both past and present members of the Board of Trustees.

First chairman of the Board of Trustees Elmer Rasmuson: *"Inflation is like a thief in the night. It steals from you silently and nobody knows what is being done. We were urged by everyone we contacted to be sure that we put back enough money for inflation-proofing.... As a result of that, the first board took a strong position on inflation-proofing."*

Former chairman of the Board of Trustees Byron I. Mallott: *"The case has been strongly made for inflation-proofing as a significant policy, and in that regard, I have not seen any wavering on the part of the trustees.... There's a strong consensus among the trustees that it (inflation-proofing) is a key to meeting the board's fiduciary and investment responsibilities."*

Former trustee Tom Williams: *"One of the things that may be overlooked a little bit in terms of inflation-proofing is its relationship with the Fund's long-term goal of a 3% real rate of return. All the different assumptions one might make about inflation will not hide the fact that if the Fund's long-term goal is achieved, the Fund will be producing a 3% real income that will be available for distribution.... You must also realize, despite the \$1.26 billion special legislative appropriation made in 1986 - if inflation were to go to 10% and we didn't inflation-proof, with a Permanent Fund of over \$8 billion, most of that deposit would evaporate. It doesn't show up on any ledgers or anything like that, but it's gone just as surely as if it had been spent."*

## Glossary

*Consumer Price Index.* The period: tabulation of selected consumer goods and services indicating price trends and the rate of inflation.

*Fiduciary.* One who holds something or acts in trust for another.

*Macroeconomic.* A broad view of the economy. Concerned with general behavior and the economy as a whole, in contrast to "micro-economic" which is concerned with details and the economic behavior of individuals and small groups of individuals.

*Prudent.* Wise, exercising good judgment with common sense, careful.



# FISCAL NOTES

A BUDGET UPDATE FROM THE ALASKA STATE CHAMBER • VOL. 3 ISSUE #4 • WEEK OF MARCH 3, 1997

## Permanent Fund celebrates 20 years of vision and success

February 28, 1997 marked the 20th anniversary of the first deposit—\$734,000—in the Permanent Fund. Today the fund's value is over \$20 billion.

The Fund was created when voters amended Alaska's Constitution in 1976 to save some of Alaska's oil profits. While many Alaskans think the Fund and the dividend program are synonymous, the dividend program wasn't created for another four years.

### PF First Proposed in 1970

The idea to save some of Alaska's revenues was first proposed in 1970 when the state got \$900 million from the Prudhoe Bay lease sale. Governor Keith Miller introduced a bill to establish the "Alaska Resources Permanent Fund" and proposed to deposit \$500 million. The bill, however, did not pass—the House Special Monetary Committee decided the full \$900 million was needed to meet more immediate needs.

Pipeline construction brought another boom in the mid-1970s.

State leaders wanted to find a way to make the State's wealth more "permanent." The 1976 constitutional amendment was a way to do that. Advocates said:

- The Fund would create an investment base from which to generate future income. When oil revenues declined, it would be a way to pay for state services;
- Deposit of 2.5% of all oil royalties would prevent the Legislature from spending it; and
- The Fund was a way to transform some non-renewable resource revenues into a renewable source of wealth for future generations.

The amendment was approved by a 32% margin—75,588 to 38,518.

### Fund's Management

From 1976 to 1980 Alaskans debated how the Fund should be managed. In 1980 the Alaska Legislature decided it should be managed as a public trust with the primary purpose of protecting its principal. This meant it would follow the "Prudent Investor Rule" by which investments would be of trust-grade quality and made at market rates.

The legislation also made the

Fund's earnings available to be spent by the Legislature. The Legislature then made an extra deposit of \$900 million into the Permanent Fund.

### Dividend Program

In 1980 the dividend program was created but later ruled unconstitutional because it used residency to determine each dividend amount. In 1982 a legally-acceptable dividend program was finally created. A mechanism to "inflation-proof" the Fund by re-depositing extra interest earnings back into it was also established.

### Earnings Exceed Oil Revenues

In FY 1996 the Permanent Fund earned a record \$1.8 billion, exceeding oil revenues to the state's treasury. Of this amount:

- \$613 million went for dividends
- \$33 million was spent on state programs
- \$406 million for inflation-proofing
- \$765 million was "leftover."

These "leftover" earnings accumulate in an Earnings Reserve Account. The Legislature has appropriated these extra earnings—a total of \$5.8 billion—back into the Fund.

*Fiscal Notes' goal is to educate Alaska businesses about the state's budget process—not only by monitoring its budget-related actions, but more importantly, reporting what they mean. This understanding will enable Chamber members to more effectively help the state achieve the Chamber's desired balance between a responsible level of state spending and appropriate level of state services.*

## Looking forward: a role for the Fund in closing the fiscal gap?

While many think President Bush lost re-election because of the "t" word (hint: "taxes"), the Alaskan political equivalent is "PF." Talk about using Permanent Fund (PF) earnings for anything other than dividends is close to political suicide.

### "Vote of the people"

The Long Range Financial Planning Commission's recommendation that the Fund's earnings be used to replace declining oil dollars sparked a round of calls from politicians that they won't support any change in the PF without "a vote of the people." The fact is no one can touch the Fund's \$20 billion principal without voter approval. Some now want to extend this slogan to its earnings which the Legislature now spends by a majority vote. This is how dividends are paid and the fund inflation-protected. This is also how another \$33 million in earnings is spent for "PF" connected programs.

There are now calls to put dividends and the Fund's inflation protection into the Constitution. Two such proposals also go one step further—voters would have to approve spending the earnings on anything else.

### Lack of self-restraint

While such efforts sound good, they blur responsibility for the state's long term fiscal security. It appears some legislators don't think they or their colleagues can continue the same self-restraint in how earnings are spent. They also don't believe legislators can continue to be trusted to make the best decisions on if and when Fund earnings should be used for other purposes in the future. Instead, such decisions should be bumped to the voters.

In evaluating such proposals, it is important to not only look at how it works but also at what it means in the context of the state's long-term fiscal security. While "protecting the PF" is a popular political cry, what it

means is a dramatic limit on the choices legislatures will have as they try to balance future budgets.

### Makes income tax more likely

Even if this Legislature's Majority succeeds in cutting state spending by \$250 million over five years, the state will still have a fiscal gap, and other revenues will be needed to fill it. Two major sources for other revenues are a personal income tax and/or PF earnings. In the absence of a crisis, it is a pretty safe guess voters will reject the use of PF earnings to pay for "government." *(For some proponents, "let the people vote" is more about setting the stage for further cuts in government because they don't think future legislators will pass an income tax. If they take PF earnings off the table, it makes increases in current taxes or further cuts more likely. In fact, should Alaska get that close to an income tax, no doubt there will be another call to "let the people decide")*

The proving ground will be if the Legislature succeeds in cutting the budget as they have proposed. While their first year target to cut \$70 million was hit, decisions to cut another \$180 million are going to be more difficult and politically-unpopular *(perhaps this may be another opportunity to play political "dodge ball"—"let the people vote" on budget cuts)*

### First secure Alaska's fiscal future

In politics there are few rewards for being concerned about what today's decisions will mean in 20 years. Instead, the preoccupation is with what they will mean come the next re-election. Before the Legislature and Governor limit what fiscal tools are available to close the gap, it is important Alaska first has a long range strategy securely in place that not only closes the state's fiscal gap but also results in the kind of Alaska we want to leave future generations.

### Asset allocation: key to Fund's long-term earning potential

While Alaskans can be proud the Fund has grown to \$20 billion, according to the PF Corporation, its historic performance is just average or slightly below-average.

A reason is limits on its asset allocation. How to achieve a larger, consistent, long-term revenue stream by changing the allocation is being discussed. Currently no

more than 50% can be invested in stocks. This has meant that as the stock market has sky rocketed, the Fund has had to sell stocks because their high earnings bumped the portfolio against the 50% ceiling. While changing the limit could increase flexibility, it also carries increased risk and management cost.

*"Fiscal Notes" is a project of the Alaska State Chamber of Commerce. Information is compiled and written by Cheryl Frasca. It is distributed to organizations who fax it to members. If you get more than one copy or no longer want to receive "Fiscal Notes," contact organizations of which you are a member. For other comments or suggestions, contact the Chamber's Anchorage office at 278-2722; fax 278-6643. Please copy and distribute "Fiscal Notes" to others interested.*

# Legislative Research Agency

Alaska State Legislature



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FUND CORPORATION

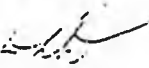
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Phone: (907) 465-3990  
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May 3, 1994

## MEMORANDUM

TO: Representative Bill Hudson

FROM: Deb Davidson   
Legislative Analyst

RE: Appropriations of Permanent Fund Income  
Research Request 94.192

You asked us to identify and group all Permanent Fund income appropriations since 1977 into the following categories: Permanent Fund Corporation operating budget, inflation-proofing, Permanent Fund Dividend payments, Permanent Fund Dividend Division administrative costs, payments to the departments of Corrections, Health and Social Services, Law, and Public Safety, and any other appropriations of Permanent Fund income. You also asked us to identify the program, amount and purpose of the appropriations to the individual departments.

Below is brief explanation of the ways the Permanent Fund income has been allocated since the fund's creation and the various programs which receive partial or full funding by Permanent Fund income. Attached to this memorandum is a table showing, by fiscal year, the allocation of the fund's income. This information was obtained from the annual reports of the Permanent Fund Corporation and from discussions with corporation staff.

When the Permanent Fund was created in FY 77, all income from the fund was to be deposited into the general fund "unless otherwise provided by law." This is what occurred until FY 81, when the Permanent Fund Corporation was established and took over the administration of the fund from the Alaska Department of Revenue, and the Dividend Fund was created within the general fund to receive a portion of the income from the Permanent Fund in accordance with legislative appropriations. Money was initially deposited into this fund for payment of the Permanent Fund Dividends, the first of which were distributed in 1982.

Two changes were made in FY 83 which affected the way the administrative costs of the Permanent Fund were paid for and how the income from the fund would be used. Operating costs for the Permanent Fund Corporation would henceforth be taken from the income of the

Representative Hudson  
May 3, 1994  
Page 2

Permanent Fund (they are not, however, deducted from the 'net income'). Prior to FY 83, these costs had been paid out of the general fund. Secondly, the statutory provisions requiring the "inflation-proofing" of the principal of the Permanent Fund from the net income of the fund went into effect.

In FY 84, the Permanent Fund Dividend Division was created within the Department of Revenue to administer the Permanent Fund Dividend Program. The costs of this division are paid for by the net income of the Permanent Fund which is deposited into the Dividend Fund.

The "hold harmless" provisions enacted effective in FY 83 insure that individuals denied federal benefits as a result of receiving Permanent Fund Dividends receive the same level of assistance that would have been received had they maintained their eligibility for federal benefits. These costs were paid for out of the general fund from FY 83 through FY 85. Beginning in FY 86, the costs of these "hold harmless" provisions were paid for out of the net income deposited into the Dividend Fund.

Statutes that went into effect in FY 89 required that the amount of dividend funds that would have gone to individuals convicted of a felony or incarcerated during a part of a fiscal year would be appropriated to the Violent Crimes Compensation Board within the Department of Public Safety rather than being distributed to the individuals. The Governor's Office of Management and Budget and the Department of Corrections determined that the Violent Crimes Compensation Board would not need all the funds withheld for this purpose and recommended that the balance be used to fund two programs within the Department of Corrections.

As a result of ending the payment of dividends to incarcerated felons, the courts ruled that funding must be provided to the Department of Corrections for "gate money" (money paid to prisoners at the time they are released to help with their transition back into society). These funds were provided through a portion of the above balance. The rest was used to fund the Sex Offender Treatment Program.

In addition to appropriations made from the Dividend Fund for the foregoing programs, since FY 89 the legislature has appropriated funds from Permanent Fund income to the general fund for use by the Department of Law to cover the costs of certain oil and gas litigation.

We hope this information is useful. If you have any questions or would like additional information, please call.

Attachments

**DISTRIBUTION OF PERMANENT FUND NET INCOME**  
**FY 77 - FY 93 (in thousands of dollars)**  
 (See accompanying memorandum 91-192 for explanation of the table)

Fiscal Year	Permanent Fund Net Income	Permanent Fund Corporation Operating Expenses	Inflation-Proofing (see note a)	General Fund	To Dividend Fund within General Fund						Department of Law	Other	Notes to Other	Earnings Reserve Account		
					Dividends	Corrections	Health & Social Services	Public Safety	Revenue	Total to Dividend Fund				Undist. Income Deposited (Withdrawn)	Cumulative Balance (b)	
FY 77	36															
FY 78	1,791			1,298												
FY 79	7,967			6,547												
FY 80	32,427		266	11,838	11,838											
FY 81	149,867	Gen'l Fund	219	27,466	27,466											
FY 82	368,426	Gen'l Fund		71,145	71,145											
FY 83	471,125	1,139	231,192	109,515	107,875		Gen'l Fund									
FY 84	529,157	2,695	150,935		171,471		Gen'l Fund		3,513	171,985						
FY 85	657,761	3,979	234,570		214,571		Gen'l Fund		2,701	217,274						
FY 86	1,020,922	5,318	216,476		297,351			3,525	2,547	303,425						
FY 87	1,066,512	4,925	148,112		379,525			8,581	2,877	390,983					529,417	529,417
FY 88	789,152	5,110	302,861		411,268			9,850	1,258	424,376					61,915	591,332
FY 89	863,493	5,688	360,212		413,174	761	11,764	737	3,537	439,915	3,501	689 to Permanent Fund Excess		41,087	635,419	
FY 90	915,859	6,977	451,999		469,951	761	12,217	737	3,816	457,451	3,500	100 Commission on the Future of the Permanent Fund (to dividend fund) 1,505 to Permanent Fund Excess		(10,729)	601,690	
FY 91	1,030,177	9,581	558,811		469,162	761	11,705	746	4,114	489,439	3,750	1,615 to Permanent Fund Excess		(21,221)	581,469	
FY 92	1,015,959	11,122	476,893		463,714	758	18,511	801	4,288	488,210	5,250	137 to Dividend Fund to implement ch 4 SFA 92 1,616 to Permanent Fund Excess		61,728	645,197	
FY 93	1,226,036	14,915	462,150		506,023	803	19,252	1,508	4,304	531,890	4,950	6,511 \$4,611 to principal, \$1,840 to Excess		120,231	965,131	
<b>Total</b>	<b>\$10,174,297</b>	<b>571,751</b> not from net income	<b>\$3,196,989</b>	<b>\$227,929</b>	<b>\$4,014,538</b>	<b>\$1,350</b>	<b>\$98,415</b>	<b>\$4,531</b>	<b>\$14,951</b>	<b>\$4,186,445</b>	<b>\$20,950</b>					

NOTE: Minor discrepancies may exist between the data presented in this table and that contained in the Permanent Fund Corporation annual reports. This is most likely due to rounding and to changes over the years in the way the data were presented.

(a) The FY 80 and FY 81 appropriations for inflation were transfers from capital gains to the principal of the Permanent Fund in accordance with the 1960 Law.

(b) In 1986, the Legislature appropriated all undistributed income accepted since the fund's inception (\$1,264,385,000) to the principal of the fund and renamed the undistributed income fund to the Earnings Reserve Account.

Source: Alaska Permanent Fund Corporation, personal communication and annual reports.

Prepared by the Legislative Research Agency, May 1991 (91-192)

subject of a lease-purchase agreement between the Department of Natural Resources and Alaska Court System did not constitute unrestricted "program receipts" for deposit in the state treasury and did not violate this provision. *Carr-Gottstein Properties v. State*, 899 P.2d 136 (Alaska 1995).

*Quoted in Zerbetz v. Alaska Energy Ctr.*, 708 P.2d 1270 (Alaska 1985).

**Section 14. Legislative Post-Audit.** The legislature shall appoint an auditor to serve at its pleasure. He shall be a certified public accountant. The auditor shall conduct post-audits as prescribed by law and shall report to the legislature and to the governor.

**Section 15. Alaska Permanent Fund.** At least 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. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.

**Cross references.** — For provisions governing the management of the Alaska permanent fund, see AS 37.13; for provisions concerning permanent fund dividends, see AS 43.23.

**Effective dates.** — This section took effect February 21, 1977 (9th Legislature's SCS CSSHJR 39 (Res) am S (1976)).

**Legislative history reports.** — For report on House Joint Resolution No. 39 (CS SSHJR 39, SSHJR 39), see 1976 House Journal, p. 683.

**Opinions of attorney general.** — Since this section specifically authorizes dedications to the Permanent Fund of "at least" 25 percent of certain revenues, any additional dedication to the fund by statute or by appropriation is also permissible. November 30, 1982 Op. Att'y Gen.

If the legislature enacts any other distribution program which is consistent with the intent of the

*Cited in Ault v. Alaska State Mtg. Ass'n*, 387 P.2d 698 (Alaska 1963); *Vest v. Schafer*, 757 P.2d 586 (Alaska 1988); *Public Employees' Local 71 v. State*, 775 P.2d 1062 (Alaska 1989); *Hickel v. Cowper*, 874 P.2d 922 (Alaska 1994).

permanent fund dividend law (AS 43.23), any appropriation to implement that program will be exempt from the appropriation limit of § 16, art. IX, of the state constitution. 1983 Op. Att'y Gen. No. 01.

The appropriation limit of section 16 of this article must be interpreted consistently with the permanent fund amendment contained in this section. Each legislature may reexamine existing law and enact different laws providing for the use of income earned by the Alaska permanent fund. If section 16 were interpreted so that the exception for permanent fund dividends applied only to appropriations to finance cash dividends under AS 43.23, the legislature would essentially be denied the flexibility to adjust to changing philosophies concerning the propriety of making cash payments directly to residents, which this section expressly reserves to it. 1983 Op. Att'y Gen. No. 01.

#### NOTES TO DECISIONS

**Expectancy is not a financial interest.** — An Alaska federal district judge's receipt of a permanent fund dividend does not give rise to a cause for recusal because it is only a possible future receipt of Alaska Permanent Fund dividends; where the judge's order denying recusal neither disclosed nor betrayed even the slightest hint of personal bias or prejudice and where the plaintiffs' arguments substantially oversimplified the extremely complex matter of how the profits of the Alaska Permanent Fund, out of which dividends derive, are generated, recusal was not required. *Exxon Corp. v. Heinze*, 792 F. Supp. 77 (D. Alaska 1992).

In a suit in federal court seeking injunctive relief barring state trial judges and jurors from deciding a dispute over royalties allegedly due from a plaintiff corporation to the state for oil drilled on state land, where the plaintiff contended that its counterclaims

in the royalty litigation might conceivably affect the quantity of money in Alaska's Permanent Fund, and where the United States District Court Judges for this District of Alaska received dividends, as do all resident Alaska judges, recusal of the judge was not warranted because the expectancy a citizen has in receiving Permanent Fund dividends is not a financial interest but is subject to legislative whim. *Exxon Corp. v. Heinze*, 792 F. Supp. 72 (D. Alaska 1992).

*Quoted in Williams v. Zobel*, 619 P.2d 422 (Alaska 1980); *Alaska Oil Co. v. Alaska*, 45 Bankr. 356 (D. Alaska 1985); *State v. Anthony*, 810 P.2d 155 (Alaska 1991); *State, Dept of Revenue v. Cosio*, 858 P.2d 621 (Alaska 1993).

*Stated in Zobel v. Williams*, 457 U.S. 55, 102 S. Ct. 2309, 72 L. Ed. 2d 672 (1982).

*Cited in United States v. Pleier*, 849 F. Supp. 1321 (D. Alaska 1994).

**Section 16. Appropriation Limit.** Except for appropriations for Alaska permanent fund dividends, appropriations of revenue bond proceeds, appropriations required to pay the principal and interest on general obligation bonds, and appropriations of money received from a non-State source in trust for a specific purpose, including revenues of a public enterprise or public corporation of the State that issues revenue bonds, appropri-

ations from the treasury than the cumulative change in population and inflation. Money reserved for capital projects shall not be included in the limit in bills for appropriations for capital projects by the governor, or passed by the legislature over a veto, or approved by the voters. Capital projects in excess of the limit shall, as provided by law, be for the maintenance of the capital stock of the State. The governor shall cause any project to be sold in a competitive market.

**Effective dates.** — This section took effect November 24, 1982 (12th Legislature's SCS CSSHJR 39 (1981)).

**Opinions of attorney general.** — This section imposes an appropriation limit on the legislature. The legislature may not appropriate money which exceeds available revenues. Money which exceeds available revenues may not be paid under those appropriations. 1983 Op. Att'y Gen. No. 01.

There is history which supports the interpretation of the term "capital projects" in section 16. 1983 Op. Att'y Gen. No. 01.

If the legislature enacts a program which is consistent with the permanent fund dividend law, the legislature may appropriate to implement that program. 1983 Op. Att'y Gen. No. 01.

If the legislature provides for a program which may not be expended until

**Section 17. Budget.** The State treasury shall be maintained in the permanent fund under the provisions of this section. On July 1, 1990, as a result of administrative proceedings, lease bonuses, rentals, payments or bonuses, property, shall be deposited in the permanent fund. The amount shall be invested so as to produce the maximum return. The amount shall be retained in the permanent fund under this section. The amount shall be authorized under (b) or (c).

(b) If the amount appropriated for the permanent fund reserve fund. However, the amount may not exceed the amount appropriated in the previous year.

(c) An appropriation of money upon affirmative vote



Alaska Permanent Fund Corporation  
P.O. Box 25500 Juneau, Alaska 99802-5500  
(907) 465-2047

## MEMORANDUM

DATE: January 22, 1996

TO: Byron I. Mallott  
Executive Director

FROM: Peter A. Bushre *PAB*  
Chief Financial Officer  
and  
Jim Kelly *JK*  
Director of Communications

SUBJECT: Accounting Treatment of  
Permanent Fund Income

### STEP 1

Sec. 37.13.145. Disposition of income. (a) The earnings reserve account is established as a separate account in the fund. Income from the fund shall be deposited by the corporation into the account as soon as it is received. Money in the account shall be invested in investments authorized under AS 37.13.120.

### STEP 2

Sec. 37.13.140. Income. Net income of the fund includes income of the earnings reserve account established under AS 37.13.145. Net income of the fund shall 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.

### **STEP 3**

**Sec. 37.13.145. Disposition of income. ... (continued)...**

(d) Notwithstanding (b) of this section, income earned on money awarded in or received as a result of *State v. Amerada Hess, et al.*, 1JU-77-847 Civ. (Superior Court, First Judicial District), including settlement, summary judgment, or adjustment to a royalty-in-kind contract that is tied to the outcome of this case, or interest earned on the money, or on the earnings of the money shall be treated in the same manner as other income of the Alaska permanent fund, except that it is not available for distribution to the dividend fund, and shall be annually deposited into the principal of the Alaska permanent fund.

### **STEP 4**

**Sec. 37.13.140. Income. ... (continued)...** Income available for distribution equals 21 percent of the net income of the fund for the last five fiscal years, including the fiscal year just ended, but may not exceed net income of the fund for the fiscal year just ended plus the balance in the earnings reserve account described in AS 37.13.145.

### **STEP 5**

**Sec. 37.13.145. Disposition of income. ... (continued)...**

(b) At the end of each fiscal year, the corporation shall transfer to the dividend fund established under AS 43.23.045 50 percent of the income available for distribution under AS 37.13.140.

### **STEP 6**

**Sec. 37.13.145. Disposition of income. ... (continued)...**

(c) After the transfer under (b) of this section, the corporation shall transfer from the earnings reserve account to the principal of the fund an amount sufficient to offset the effect of inflation on principal of the fund during that fiscal

year. The corporation shall calculate the amount to transfer to the principal under this subsection by

(1) computing the average of the monthly United States Consumer Price Index for all urban consumers for each of the two previous calendar years;

(2) computing the percentage change between the first and second calendar year average; and

(3) applying that rate to the value of the principal of the fund on the last day of the fiscal year just ended.

In 1980, lawmakers authorized the first new use of Fund income: the payment of Permanent Fund dividends. However, because this first version of the dividend program tied the amount of the dividend to the length of residency, it was ruled unconstitutional by the U.S.

Supreme Court and was never implemented. Nonetheless, since that year, one-half of Fund income available for distribution has been set aside for payment as dividends.

In 1982, the legislature enacted a plan for the use of all Fund income which, with minor changes, is still in place today.

First, a new version of the dividend program was passed and initiated

with a special \$1000 per capita payment. Second, inflation-proofing was adopted so that a portion of Fund income would be added automatically to principal at the end of each fiscal year in "an amount sufficient to offset the effect of inflation."

Lastly, the 1982 legislature directed that any income remaining after the payment of dividends and inflation-proofing be transferred to an undistributed income account in the Permanent Fund. The trustees subsequently designated this account a reserve for future inflation impact and dividend payments.

This undistributed income account grew during each of the next four

years as the Fund experienced a sustained period of relatively high earnings with relatively low inflation. By the end of fiscal 1986, this account amounted to \$1.264 billion.

In a showing of fiscal *prudence*, rather than use this money to try to sustain an unrealistic level of spending, the 1986 legislature appropriated the entire balance of the undistributed income account to the principal of the Fund, effective July 1, 1986. They also renamed this account the earnings reserve account.

As of June 30, 1995, undistributed income in the earnings reserve account totaled \$1.203 billion.

## On Inflation-Proofing

The following comments are excerpts from the special Permanent Fund Tenth Anniversary meeting held in Juneau on February 9-10, 1987 and attended by both past and present members of the Board of Trustees.

First chairman of the Board of Trustees Elmer Rasmussen: *"Inflation is like a thief in the night. It steals from you silently and nobody knows what is being done. We were urged by everyone we contacted to be sure that we put back enough money for inflation-proofing.... As a result of that, the first board took a strong position on inflation-proofing."*

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Former trustee Tom Williams: *"One of the things that may be overlooked a little bit in terms of inflation-proofing is its relationship with the Fund's long-term goal of a 3% real rate of return. All the different assumptions one might make about inflation will not hide the fact that if the Fund's long-term goal is achieved, the Fund will be producing a 3% real income that will be available for distribution.... You must also realize, despite the \$1.26 billion special legislative appropriation made in 1986 - if inflation were to go to 10% and we didn't inflation-proof, with a Permanent Fund of over \$8 billion, most of that deposit would evaporate. It doesn't show up on any ledgers or anything like that, but it's gone just as surely as if it had been spent."*

## Glossary

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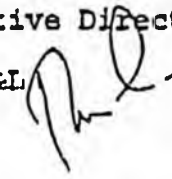
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L. MERRILL LOWDEN

MEMORANDUM

To: Byron I. Mallott, Executive Director, APFC  
From: Ronald W. Lorensen, STS&L   
Date: March 10, 1997  
Re: HJR 25 & SJR 18, Proposing amendments to the Alaska  
constitution relating to the permanent fund  
Our File No.: 846.1

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The purpose of this memo is to express a cautionary note regarding possible issues relating to the tax status of the permanent fund that may arise if the amendments to Article IX, sec. 15 of the Alaska Constitution proposed by HJR 25 and SJR 18 are ultimately adopted. Based on the analysis set out in certain studies with which I am familiar, it appears that adoption of the proposed amendments might weaken the State's long-standing position that the income of the fund is not subject to federal taxation. Unfortunately, because of the sensitive nature of the fund's tax status, I am not able to address specific concerns in a public record such as this memorandum. However, with the permission of the APFC, I could provide information about those studies on a confidential basis to appropriate legislative committees or staff.

HJR 25  
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# CALLAN ASSOCIATES<sub>INC.</sub>

March 10, 1997

MICHAEL J. O'LEARY, JR., CFA  
EXECUTIVE VICE PRESIDENT



SAN FRANCISCO

NEW YORK

CHICAGO

ATLANTA

DENVER

Mr. Jim Kelly  
Alaska Permanent Fund Corporation  
801 W. 10th Street, Suite 302  
P.O. Box 25500  
Juneau, AK 99802-5500

**RE: Proposed Constitutional Amendment**

Dear Jim:

As requested, I want to share several initial thoughts regarding the proposed constitutional amendment that you forwarded to me (Senate Joint Resolution 18). Obviously, the intent of the proposal is to limit distributions from the Permanent Fund to dividends (a percent of average realized income) unless the electorate specifically approved other distributions. Naturally, any decision regarding the use of Permanent Fund earnings is entirely a decision for the people of Alaska and their representatives.

Current statute and the proposed amendment both have significant investment related implications that may influence policy makers in their deliberations. I have attempted to succinctly outline several significant issues that warrant careful consideration as the legislature proceeds with its analysis.

1. Stocks will make the earnings stream both higher and more volatile. Investing a meaningful proportion of the Fund's assets in stocks is critical for attainment of its long-term goals. However, the pattern of stock returns is much more volatile than the pattern of bond returns. The current statutory language and the proposed constitutional amendment, combined with the growing proportion of equities in the APFC, result in greater volatility of earnings (and hence, dividends) than may have been originally perceived.
2. APFC has not yet experienced the downside of equity investment. Fortunately, the Fund has experienced "good" volatility, not both "good" and "bad" volatility. However, there inevitably will be meaningful periods of "bad" (i.e., poor markets) volatility. For example, in 265 rolling five year periods from 1926 to 1996, a 50/50 stock/bond combination had zero or negative real returns 21% of the time (55 periods of 0% or negative real returns).

Mr. Jim Kelly  
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3. Other "endowments" have moved away from distribution policies tied to earnings. The majority of endowments and foundations link distributions to a percent of market value, not to a proportion of earnings. They do this to ensure a more consistent and reliable distribution pattern.
4. New Mexico moves from income to market value approach. The citizens of New Mexico passed a constitutional amendment that changed the distribution pattern for that State's Permanent and Tax Severance funds to a percent of market value approach. In part, the rationale for the change was a recognition that tying distributions to "realized" earnings resulted in sub-optimal investment policy. In effect, a dollar of income return was more valuable than a dollar of unrealized return. This tended to push policy toward higher current income at the expense of future growth.
5. At AFPC's direction, Callan is "stress" testing APFC's current and alternative asset allocation policies to help the Board and staff understand how earnings may be affected by a poor market environment. In this analysis, we will examine the 1973-1977 market environment and illustrate how APFC's current asset allocation policy would have performed. By looking at this poor market period, policy makers may better understand the implications of the current statutory and proposed constitutional amendments implications for dividend payments and inflation proofing.

I hope that this letter helps you address the questions confronting you.

Sincerely,



Michael J. O'Leary, Jr., CFA  
Executive Vice President

MJO:dsb

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\*\* TOTAL PAGE.03 \*\*

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Sincerely,



Michael J. O'Leary, Jr., CFA  
Executive Vice President

MJO:dsb

HJR 25  
page 4 of 4

Revision Date: \_\_\_\_\_ Dept. Affected: Revenue  
 Title: HJR 25. Proposing amendments to the Constitution to BRU: Alaska Permanent Fund Corporation  
guarantee permanent fund dividends, etc. Component: Alaska Permanent Fund Corporation  
 Sponsor: Rep. Austerman  
 Requestor: House State Affairs Committee COMPONENT SERIAL NO. 113

Expenditures/Revenues: (Thousands of Dollars)

OPERATING EXPENDITURES	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	0.0	0.0	0.0	0.0	0.0	0.0
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY97) cost \$ 0.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

As noted above, this fiscal note indicates zero fiscal impact. However, please see the two attachments which raise issues which could potentially lead to significant fiscal impact on the Permanent Fund and the State of Alaska. As noted in the letter from the Fund's investment consultant, Michael O'Leary of Callan Associates, "current statute and the proposed amendment both have significant investment-related implications that may influence policy makers in their deliberations." The APFC would request the opportunity to conduct the analysis described in the Callan letter and would be pleased to present the analysis to the legislature at the appropriate time.

Prepared by: Byron J. Mallott, Executive Director  
 Division: Alaska Permanent Fund Corporation  
 Approved by Commissioner: Wilson L. Condon  
 Agency: Revenue

Phone: 465-2059  
 Date: March 10, 1997  
 Date: March 10, 1997

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## **REPRESENTATIVE ALAN AUSTERMAN** Alaska State Legislature

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### **SPONSOR STATEMENT - CS HJR 25**

Within the Constitution of the State of Alaska (Article IX, Section 15), all income from the Alaska Permanent Fund is deposited into the general fund and available for appropriation. The Legislature by statute, has created an earnings reserve account (AS 37.13.145), from which dividends and inflation-proofing are paid. Funds then remaining in the earnings reserve account are called undistributed income or (left-over earnings).

Historically, this undistributed income has been deposited back into the principal of the Permanent Fund by the Legislature. Last year the Legislature deposited \$1.8 billion of undistributed interest earnings back into the corpus of the Permanent Fund, leaving a balance of about \$100 million in the earnings reserve account.

Under current law, the permanent fund dividend and inflation-proofing could be eliminated by a simple majority vote of the Legislature and subsequent approval by the Governor.

A constitutional amendment is the only way to guarantee the permanent fund dividend program continues and provide for inflation-proofing of the Alaska Permanent Fund itself.

With both the permanent fund dividend and inflation-proofing permanently protected by the constitution, Alaskans might feel more comfortable about the Legislature considering other uses for undistributed income in the earnings reserve account.

[HJR 25]

Cliff Stone from Austerman's

☐ Jim Kelly PFD - 2059  
Next week exec. session  
will bring counsel

Byron Malloy, Director

↳ let him know re exec session

To Joe/Lisa  
 Date 4/25 Time 1:50  
**While You Were Out**  
 M Janet  
 of Rep. Rokeberg  
 Phone \_\_\_\_\_  
 AREA CODE NUMBER EXTENSION

TELEPHONED		PLEASE CALL	
WAS IN TO SEE YOU		WILL CALL AGAIN	
WANTS TO SEE YOU		URGENT	
RETURNED YOUR CALL			

Message He will be late to Monday a.m. Mtg., he has a bill up in another committee  
(Yeah right - he's not an early bird.)  
 Operator

Jim Kelly  
Tam Cook  
Byron Malloy  
Lorenson?

Roke

Taxation Issue

Ron Woreason

— Joe Green

Fax 586 3065

— 463 3044 msg.

Tom Cook

Exec Session

Unit Rule (22(b)(1)) adversely affect joint



- HJR 25

- Tax issues

- announce holding