

HJR

15

22-LS0568\C
Cook
1/31/02

Adopted

CS FOR HOUSE JOINT RESOLUTION NO. 15(JUD)
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-SECOND LEGISLATURE - SECOND SESSION

BY THE HOUSE JUDICIARY COMMITTEE

Offered:
Referred:

Sponsor(s): HOUSE RULES COMMITTEE BY REQUEST OF THE LEGISLATIVE BUDGET AND AUDIT COMMITTEE

A RESOLUTION

1 Proposing amendments to the Constitution of the State of Alaska requiring income of
2 the permanent fund to be deposited into the permanent fund and limiting
3 appropriations from the permanent fund to six percent of the year-end market values of
4 the fund for the last five fiscal years.

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

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

7 Section 15. Alaska Permanent Fund. (a) At least twenty-five per cent of all
8 mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing
9 payments and bonuses received by the State shall be placed in a permanent fund, the
10 principal of which shall be used only for those income-producing investments
11 specifically designated by law as eligible for permanent fund investments. All income
12 from the permanent fund shall be deposited in the permanent [GENERAL] fund
13 [UNLESS OTHERWISE PROVIDED BY LAW].

14 (b) For any fiscal year, appropriations from the permanent fund shall be
15 limited to six percent of the average of the year-end market values of the

1 permanent fund for the last five fiscal years, including the fiscal year just ended.

2 No other appropriations from the permanent fund may be made.

3 * **Sec. 2.** The amendments proposed by this resolution shall be placed before the voters of
4 the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the
5 State of Alaska, and the election laws of the state.



Alaska Permanent Fund Corporation

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


Telephone (907) 465-2047

Facsimile (907) 586-2057

MEMORANDUM

DATE: February 1, 2002

TO: Representative Norm Rokeberg
Chair, House Judiciary Committee

FROM: Robert D. Storer 
Executive Director

SUBJECT: Presentation on HJR 15 for House Judiciary Committee

What HJR 15 does. HJR 15 is a proposed constitutional amendment to provide the Fund with complete and permanent protection against inflation by limiting the amount of annual appropriations of Fund income to no more than 5% of the total Fund's 5-year average market value. This provides full inflation-proofing because the Fund is expected to earn an approximate 8% long-term annual rate of return, and limiting the payout to 5% allows the Fund to retain the 3% necessary to offset the expected long-term annual rate of inflation.

How it works. The Fund's 5-year average market value equals approximately \$25 billion. Five percent of that is \$1.250 billion. That is how much can be appropriated from a fully inflation-proofed Fund each year on a sustainable basis for all public purposes including dividends. That amount will grow over time at the rate of inflation plus the amount of constitutionally or statutorily dedicated mineral revenues added to principal. If the current dividend formula is maintained, an additional \$175 - \$300 million would be available annually to help fill the fiscal gap.

New money into the economy. That \$175 - \$300 million of Fund income which would be made available annually under the 5% constitutional limit after the payment of dividends per existing statutes would actually represent new money into the economy. Unlike a broad-based tax, or a cut in government spending or a cap on Permanent Fund dividends - all of which would simply switch money from one economic sector to another, Permanent Fund income is new money imported into the state which, when distributed, adds to the overall health of all sectors of the economy.

A paradox: HJR 15 limits spending of the state's largest future revenue source while simultaneously maximizing its long-term production. Over the next 25 years, it is projected that the Fund will produce more than twice as much appropriable income under HJR 15 as will oil, which is projected to total less than \$20 billion over that period according to current forecasts. Paradoxically, by limiting the amount of Fund income which can be appropriated each year to 5% of the Fund's average 5-year market value, Alaskans would be assuring themselves of a sustainable future income stream twice as large as that of the state's second largest income source.

The earnings reserve is an important cushion against investment volatility. Eighteen months ago, on June 30, 2000, the Fund's earnings reserve totaled \$6.5 billion (after the 2000 dividend and inflation-proofing transfers.) As of December 31, 2001, it totaled \$3.7 billion. That \$2.8 billion drop in value reflects three events: payment of the 2001 dividend totaling \$1.1 billion; the transfer of approximately \$700 million to principal for 2001 inflation-proofing; and a \$1.0 billion decline in market value due to the Fund earning a -3.3 percent total return in 2001 and a -.02 percent return in the first six months of fiscal 2002.

It is projected that the earnings reserve will total \$3 billion as of June 30, 2002, after the payment of the 2002 dividends and inflation-proofing - and that assumes that the Fund earns an annualized 8.2% for the next six months. If, on the other hand, the financial markets produce the same kind of returns in the next 18 months as the past 18, the Fund would likely be unable to even pay full dividends and inflation-proofing, much less any money to help fill the fiscal gap.

The fact that the value of the earnings reserve account can shrink by as much as \$3.5 billion in just 24 months demonstrates the wisdom of former lawmakers and Boards of Trustees who created the earnings reserve to serve as a cushion to ensure a relatively smooth annual distribution of Fund income, for whatever public purposes.

Volatility matters. The preceding and following paragraphs make clear why the APFC thinks it is important to take volatility into consideration when analyzing the possible consequences of any proposed change to the Fund's investment or spending policy.

- Time greatly reduces - but does not eliminate - the volatility in annual returns. That is why from an **investment policy** perspective, asset allocation, diversification, disciplined rebalancing and long-term time horizon are all key elements of a successful investment program. In this regard, the important question to ask is, *"Does a particular proposal have a neutral, a positive or an adverse effect on the Board's investment strategy?"* HJR 15 has a positive effect.
- From a **spending policy** perspective, the best way to moderate the impact of volatility is averaging, and averaging market value is superior to averaging income. So, for example, in the case of the Alaska Permanent Fund, which - with its 53 percent target allocation to equities - has a one-in-four chance of a negative total Fund return in any given year, averaging returns over five years reduces the likelihood of a negative return to one-in-twenty. This moderation of the impact of volatility provides a valuable cushion to ensure stability of distributions. In this regard, the important question to ask is, *"Does a particular proposal enhance or diminish the Fund's ability to produce a sustainable and stable income stream (after inflation) to benefit current and future generations?"* HJR 15 represents an enhancement.

Wide public support. The public and many legislators have been receptive to the Board's proposal. To date, the proposal has garnered public support from:

- 1990 Commission on the Future of the Permanent Fund
- 1995 Long-Range Financial Planning Commission
- Governor Hammond
- Governor Knowles
- Commonwealth North
- Fiscal Policy Council
- State Chamber of Commerce
- Zonta Club of Anchorage
- Juneau Empire
- Anchorage Daily News
- Former State Senator Arliss Sturgulewski
- Scott Goldsmith, Director of the Institute for Social and Economic Research (ISER)

An alternative way to deal with emergencies. Some would argue that we should not tie the hands of future legislators by limiting the amount of Fund income which could be accessed in the event of some kind of public emergency. One alternative to compromising the Fund's 5% limit - which, if enacted, would assure protection of both the Fund's long-term purchasing power and a sustained, maximized income stream - would be to dedicate, in the case of an emergency, a portion of the Fund's annual income to the payment of debt service on tax-exempt bonds issued by the state. By taking such an action, if necessary, a future legislature could add significantly to the availability of state funds to deal with an emergency through the prudent use of leverage.

FISCAL NOTE

STATE OF ALASKA
2002 LEGISLATIVE SESSION

Fiscal Note Number: _____
Bill Version: HJR 15
() Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: OOG
Title Constitutional amendment relating BRU Elections
inflation-proofing the permanent fund Component Elections
Sponsor Rules
Requester House Judiciary Component No. 21

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Personal Services						
Travel						
Contractual	1.5					
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	1.5	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
-------------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	1.5					
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	1.5	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2002) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2003 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

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. If this measure requires the printing of an 8-1/2 by 18 inch ballot, the cost will increase by \$22.0.

Prepared by: Gail Fenumiai, Election Administrative Supervisor
Division: Division of Elections
Approved by: Lieutenant Governor Fran Ulmer
Agency: Office of the Lieutenant Governor

Phone 465-3935
Date/Time 1/31/02 3:22 PM
Date 01/31/2002

FISCAL NOTE

STATE OF ALASKA
2002 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HJR 15
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
 Title Constitutional Amendment BRU Permanent Fund Corporation
for the Permanent Fund Component Permanent Fund Corporaiton
 Sponsor House Rules Committee
 Requester House Judiciary Committee Component No. 109

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
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CHANGE IN REVENUES ()	0.0	0.0	0.0	0.0	0.0	0.0
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2002) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2003 budget proposal:

POSITIONS

Full-time	0	0	0	0	0	0
Part-time	0	0	0	0	0	0
Temporary	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

The proposed legislation would not increase the cost of operations for the Alaska Permanent Fund Corporation.

Prepared by: Robert D. Storer, Executive Director
 Division Alaska Permanent Fund Corporation
 Approved by: Larry Persily, Deputy Commissioner
 Agency Department of Revenue

Phone 465-2047
 Date/Time 2/1/02 2:07 PM
 Date 02/01/2002

Bill History/Action Display



BILL: SJR 13

SHORT TITLE: CONST. AM: PERMANENT FUND

BILL VERSION:

SPONSOR(S): RLS BY REQUEST OF LEG BUDGET & AUDIT

CURRENT STATUS: (S) STA

STATUS DATE: 02/14/01

THEN JUD, FIN

TITLE: Proposing amendments to the Constitution of the State of Alaska relating to inflation- proofing the permanent fund.

No Fiscal Notes Available

Jrn-Date	Jrn-Page	Action
02/14/01	0368	(S) READ THE FIRST TIME - REFERRALS
02/14/01	0369	(S) STA, JUD, FIN
02/14/01	0369	(S) REFERRED TO STATE AFFAIRS

Similar Subject Match or Exact Subject MatchCONSTITUTIONAL AMENDMENTSPERMANENT FUNDPUBLIC FINANCEBill Root:

BASIS HAS BEEN RE-PROGRAMMED THIS YEAR

TO REPORT PROBLEMS WITH BASIS INQUIRYLIVE KTOO STREAMS[Return to Basis Main Menu \(22 Legislature\)](#)[Return to Legislature Home Page](#)



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

MEMORANDUM

DATE: October 8, 2001

TO: Representative Norm Rokeberg, Chair
House Judiciary Committee

FROM: Robert D. Storer, *JK fa RDS*
Executive Director

SUBJECT: House Joint Resolution 15 - Permanent Fund
Constitutional Inflation-Proofing Amendment

Thank you for providing a hearing on House Joint Resolution 15, "Proposing amendments to the Constitution of the State of Alaska relating to inflation-proofing the permanent fund."

Please find attached some materials prepared by the Alaska Permanent Fund Corporation (APFC) for you and the Committee members to review in advance of the October 19 meeting.

The Board is unanimous in its support for this proposal. The Trustees believe its benefits are compelling:

1. Provides constitutional protection against inflation for the total Permanent Fund, thereby more effectively safeguarding the Fund and increasing the amount protected.
2. Establishes a limit on annual distributions which helps ensure that the Fund will continue to grow in perpetuity in both nominal and real, inflation-adjusted dollars.

House Joint Resolution 15

October 8, 2001

Page 2

3. Maximizes the total amount of Fund income which can be paid out in the future, at least as compared to higher payout rates, and provides for intergenerational equity by striking a fine balance between short-term and long-term distributions.
4. Beginning in 2003, makes available \$175-\$300 million per year, depending on the Fund's market value, for purposes other than inflation-proofing and dividends. This amount will grow over time as the Fund grows.
5. Lets lawmakers know in advance, within a relatively narrow range, how much Fund income will be available for appropriation each year.

In short, the Trustees believe HJR 15 would be an improvement over existing law in terms of serving the best interests of the Fund and the people of Alaska in the years ahead. I look forward to testifying, along with Trustee Clark Gruening, on October 19.

Attachments

HJR 15 -- Complete and protected inflation-proofing

Alaska Permanent Fund Corporation

Clark S. Gruening, Member, Board of Trustees

Robert D. Storer, Executive Director

House Judiciary Committee

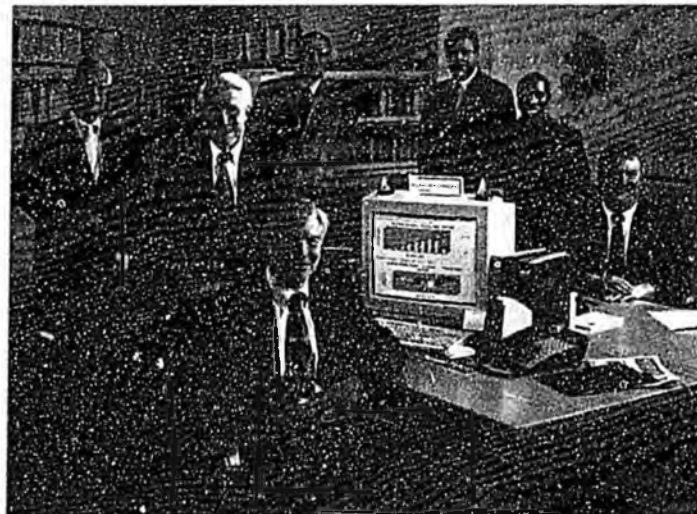
October 19, 2001

www.apfc.org

Alaska Permanent Fund



Board of Trustees unanimously supports HJR 15



**Why is it important and
why should Alaskans support it?**

Alaska Permanent Fund



Reasons to support the Trustees' proposal

(SJR 13/HJR 15)

- 1. Preserves the Fund's purchasing power**
- 2. Limits spending to "real" Fund income**
- 3. Maximizes distributions over the long-term**

Alaska voters get to decide

Alaska Permanent Fund



Past performance is no guarantee of future performance

- The Board's purpose in offering this proposal is to open discussion among all Alaskans that now, for the first time in 25 years, we believe it makes sense to consider a different constitutional approach to managing the Fund.
- The goals are the same: protect the Fund, grow it for the future and maximize income to benefit current and future generations, but...

Alaska Permanent Fund



Past performance is no guarantee of future performance

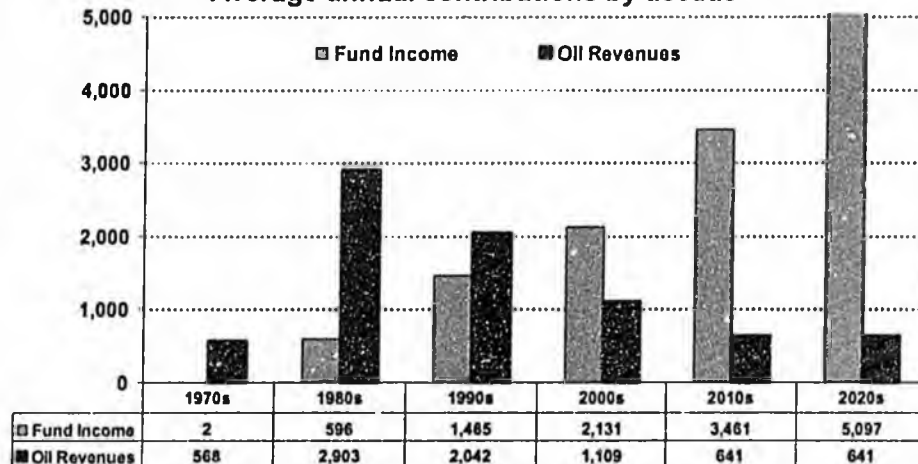
- The past bull market has masked many of the problems inherent in the existing statutes. POMV is a better way. It is how most funds are managed in today's modern world. It is simpler, offers greater inflation protection and enhances the permanence of the Permanent Fund...
- It is also the best way to assure that the Fund will be able to produce the most amount of money in the future for payment of dividends or other public purposes.

Alaska Permanent Fund



A new look at Permanent Fund income vs. state oil revenues

Average annual contributions by decade



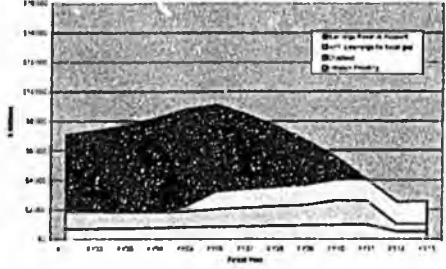
In millions of dollars per year.
on average per decade

Alaska Permanent Fund

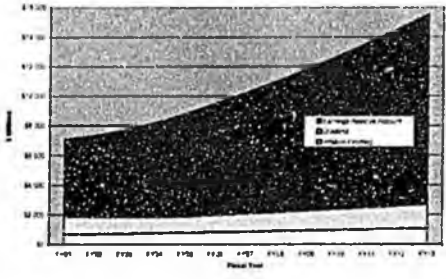


Scenario
planning:
three futures

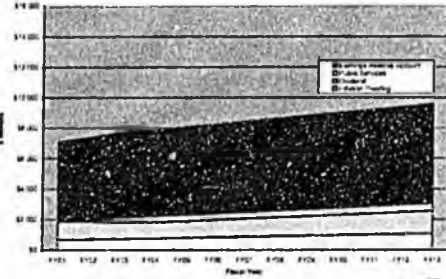
ERA funds fiscal gap



The status quo



HJR 15 - 5% POMV



Alaska Permanent Fund



**Trustees' proposed
constitutional amendment
for the General Election**
November 5, 2002

Section 15. Alaska Permanent Fund. (a) 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 permanent [GENERAL] fund [UNLESS OTHERWISE PROVIDED BY LAW].

(b) For any fiscal year, appropriations from the permanent fund shall be limited to five percent of the average of the year-end market values of the permanent fund for the last five fiscal years, including the fiscal year just ended. No other appropriations from the permanent fund may be made.

Note: new language underlined in blue
language to be removed [CAPS IN BRACKETS.]

Yes [] No []

Alaska Permanent Fund

How does the Trustees' proposal differ from the status quo?

- Inflation-proofing set in Constitution vs. statutes
- Inflation-proofs total Fund, not just the principal
- Constitutional amendment limits withdrawals from the Fund to no more than 5% of the five-year average market value vs.

the entire earnings reserve account being available for appropriation under existing law

Alaska Permanent Fund



Concerns...

Constitutional or statutory?

- Constitutional and statutory both allow legislators to allocate the payout as they deem fit each year
- Statutory less restrictive than constitutional
- Constitutional more permanent than statutory

Alaska Permanent Fund



Concerns...

Why limit payout to 5%?

- 5% real rate of return is at the high end of what is achievable for the Permanent Fund
- 5% is the maximum sustainable payout rate that still maintains the Fund's real value
- 5% allows greater distributions over time than a higher payout
- 5% is what the majority of endowments pay out

Alaska Permanent Fund



Concerns...

Would the 5% POMV work in good markets and bad?

- Since 1926, through the best and worst U.S. markets in history, inflation has averaged 3.3%
- During that same period, a fund invested 60% in stocks and 40% in bonds (like the APF) would have been able to pay out 5% of its average 5-year market value per year and still (barely) maintain its real value
- Result: POMV provides full protection against inflation and highest possible sustainable payouts year in and year out – and works better in bad times than existing statutes

Alaska Permanent Fund



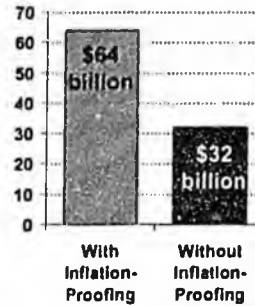
The Trustees' biggest concern is not that the markets won't come back, they will. Our biggest concern is the same it has always been: protecting the Fund against the ravages of inflation.

Inflation will cut the value of the Fund in half within the next twenty years...



2001

2021



Fund in 2021

Alaska Permanent Fund



How inflation-proofing would work in the Trustees' proposal

8.25% Projected average annual return

- 3.25% Projected average annual inflation

5.00% Maximum sustainable payout from *total* Fund



Remains in Fund: **inflation-proofing**

Alaska Permanent Fund

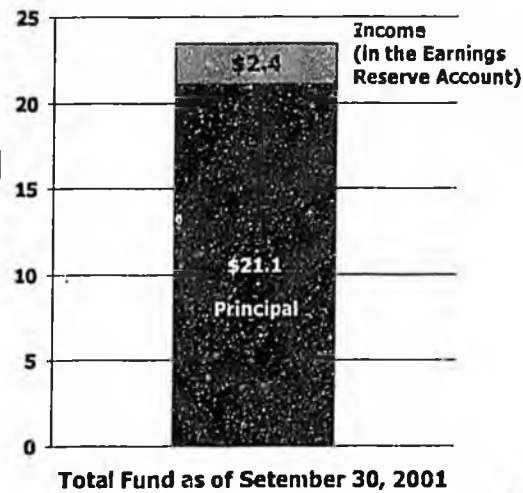


Keeps the whole Fund permanent

"complete and protected inflation-proofing"

The market value of the Permanent Fund is \$23.5 billion

It consists of two parts: principal and income



Total Fund as of September 30, 2001

Alaska Permanent Fund



Trustees' proposal has garnered significant public support

- 1990 Commission on the Future of the Permanent Fund
- 1995 Long-Range Financial Planning Commission
- Governor Jay Hammond
- Commonwealth North
- Fiscal Policy Council
- Juneau Empire editorial
- Anchorage Daily News editorial
- Former State Senator Arliss Sturgulewski



Alaska Permanent Fund



Five myths about how the Permanent Fund works

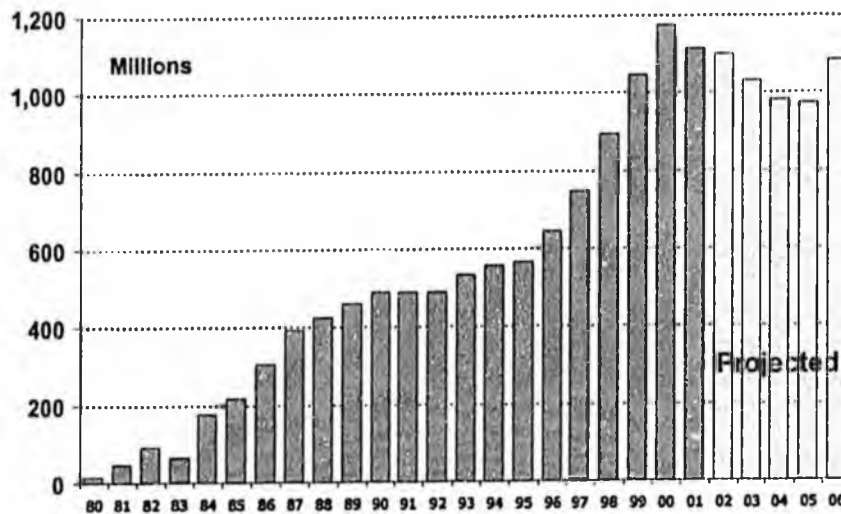
1. It is possible to be precise about how much total investment return the Fund will produce in the future
2. The distribution policy which has worked well for the last 20 years will work well for the next 20 years
3. Any change can be made to the current use of Fund income without affecting the PFD
4. The Permanent Fund is big enough to be all things for all people
5. Permanent Fund dividends always go up

Alaska Permanent Fund



Income paid out for dividends

\$10.9 billion in last 20 years



Alaska Permanent Fund





APFC ANALYSIS OF SJR 13/HJR 15

May 5, 2001

The proposal

The Board of Trustees of the Alaska Permanent Fund Corporation (APFC) unanimously recommends that the legislature approve Senate Joint Resolution 13 or House Joint Resolution 15 which would place before the voters a constitutional amendment to permanently inflation-proof the Fund.

SJR 13/HJR 15 (hereinafter referred to as SJR 13) accomplishes inflation-proofing by limiting the annual payout of Fund income to no more than 5 percent of the Fund's five-year average market value. This methodology protects the purchasing power of the entire Fund and provides the maximum amount of sustainable income to benefit current and future generations.

The benefits

1. Provides constitutional protection against inflation for the total Permanent Fund, thereby more effectively safeguarding the Fund and increasing the amount protected.
2. Maximizes the total amount of Fund income which can be paid out in the future, at least as compared to higher payout rates, and does so in a way that balances the Fund's benefits fairly between the current generation and future generations.
3. Increases the likelihood that both the Fund's principal and its income will continue to grow in perpetuity in both nominal and real, inflation-adjusted dollars.
4. Makes available, beginning in 2003, \$175-\$300 million per year, depending on the Fund's market value, for purposes other than inflation-proofing and dividends. This amount will grow over time as the Fund grows.
5. Uses the percent of market value (POMV) payout methodology which smoothes volatility, treats realized and unrealized income equally as investment return, and is consistent with generally accepted accounting principles and modern endowment practice.



General Election November 5, 2002

Section 15. Alaska Permanent Fund. (a) 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 permanent [GENERAL] fund [UNLESS OTHERWISE PROVIDED BY LAW].

(b) For any fiscal year, appropriations from the permanent fund shall be limited to five percent of the average of the year-end market values of the permanent fund for the last five fiscal years, including the fiscal year just ended. No other appropriations from the permanent fund may be made.

Yes [] No []



6. Lets lawmakers know in advance, within a relatively narrow range, how much Fund income will be available for appropriation each year.

The analysis

Principal and inflation-proofing. Under SJR 13, both the Fund's principal and the earnings reserve account would be inflation-proofed by constitutional mandate. In addition, there would be two constitutional limits on Permanent Fund spending: (1) principal would continue to be unavailable for appropriation; and (2) appropriations from the earnings reserve account in the future would be limited to no more than 5 percent of the Fund's average market value for the past five years. This would provide full inflation-proofing averaged over long periods of time. Accordingly, statutory inflation-proofing transfers to principal would no longer be necessary.

Earnings reserve. All income not appropriated under the 5 percent payout limit would be retained in the earnings reserve account to offset inflation over the long term and to provide a cushion for future payouts in periods of extended down markets. In 2003, the Fund's five-year average market value is projected at \$28 billion, which would limit the maximum payout that year to no more than \$1.4 billion.

5 percent payout. The 5 percent limit is chosen for three reasons: (1) 5 percent is on the high end of sustainable payout rate that still maintains the Fund's real value; (2) 5 percent allows greater distributions over time than a higher payout; and (3) 5 percent is what the majority of endowments pay out; e.g., 85 percent of all public endowment funds pay out 5 percent or less, and the median payout of endowments, according to a 1999 Greenwich Associates study, is 4.9 percent.

Five-year averaging. Under SJR 13, the annual payout may not exceed 5 percent of the Fund's market value averaged over the prior five years, including the fiscal year just ended. This methodology is chosen to dampen volatility and is consistent with the existing statutory five-year averaging provision for computation of the annual dividend.

20-year perspective. Under SJR 13, *if the full 5 percent of the Fund's five-year average market value were paid out*, the Fund would earn \$57 billion of total investment return over the next 20 years, of which \$28 billion would be earmarked for dividends and \$20 billion to inflation-proofing, leaving \$9 billion in residual income available for appropriation. The ending market value of the Fund in 2020 would be \$51 billion.

Dividends. This proposal does not affect the existing dividend program. It should be noted, however, that any future public policy decision to use an additional portion of Fund income for any purpose will affect the dividend, as will market volatility, but under SJR 13, these impacts would either be equal or diminished compared to the status quo.

Residual income available for appropriation. Except in the case of extraordinarily good financial markets, the 5 percent limit set by SJR 13 is above what is required to pay dividends per current law, leaving a residual amount available for appropriation. If the entire 5 percent were paid out, the residual amount is expected to range from \$175-\$300 million per year in a median case, growing over time as the Fund grows. Because of the mechanics of the existing

statutory dividend formula, however, if the dividend in any year is extraordinarily high, the amount of the residual could be reduced to zero.

Why limit the payout to 5%?

- 5% real rate of return is at the high end of what is achievable for the Permanent Fund
- 5% is the maximum sustainable payout rate that still maintains the Fund's real value
- 5% allows greater distributions over time than a higher payout
- 5% is what the majority of endowments pay out



Reasons to support SJR 13

- 1. Preserves** the Fund's purchasing power
- 2. Maximizes** distributions over the long-term
- 3. Minimizes** fluctuations in annual payouts
- 4. Limits** spending to "real" Fund income



**Trustees Request Your Support
for
Constitutional Inflation-Proofing
of the
Alaska Permanent Fund**

**Clark Gruening, Chair, Board of Trustee
Robert D. Storer, Executive Director
Alaska Permanent Fund Corporation**

**Fairbanks Chamber of Commerce
August 21, 2001**

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Alaska Permanent Fund Corporation





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Top stories

July 24, 2001

Trustees support constitutional inflation-proofing

MAY 7 - The Board of Trustees of the Alaska Permanent Fund Corporation (APFC) unanimously recommends that the legislature approve Senate Joint Resolution 13 or House Joint Resolution 15 which would place before the voters a constitutional amendment to permanently inflation-proof the Fund.

[\(Related information\)](#)

Boardroom is named for Hugh Malone

MAY 4 - The Trustees of the Alaska Permanent Fund Corporation have officially named their Goldbelt Place office boardroom the "Hugh Malone Board Room" in honor of Hugh Malone. Malone, who passed away in March, is often called the "father of the Permanent Fund" for the vital role he played in creating the Fund and shepherding it through it's early, formative years. Hugh Malone is on the cover of and featured in the APFC's third quarter report.

Daily unaudited position

as of July 20, 2001

U.S. Fixed Income	38%	\$9,941,700,000
Non-U.S. Fixed Income	2%	\$601,000,000
U.S. Equities	33%	\$8,561,700,000
Non-U.S. Equities	15%	\$3,876,600,000
Real Estate	11%	\$2,749,700,000
Alaska CDs	1%	\$149,100,000
TOTAL	100%	\$25,879,800,000

Quarterly report



With double-digit stock losses offset by positive bond and real estate returns, the Alaska Permanent Fund weathered one of the worst equity quarters in recent years, ending the period down less than 5 percent.

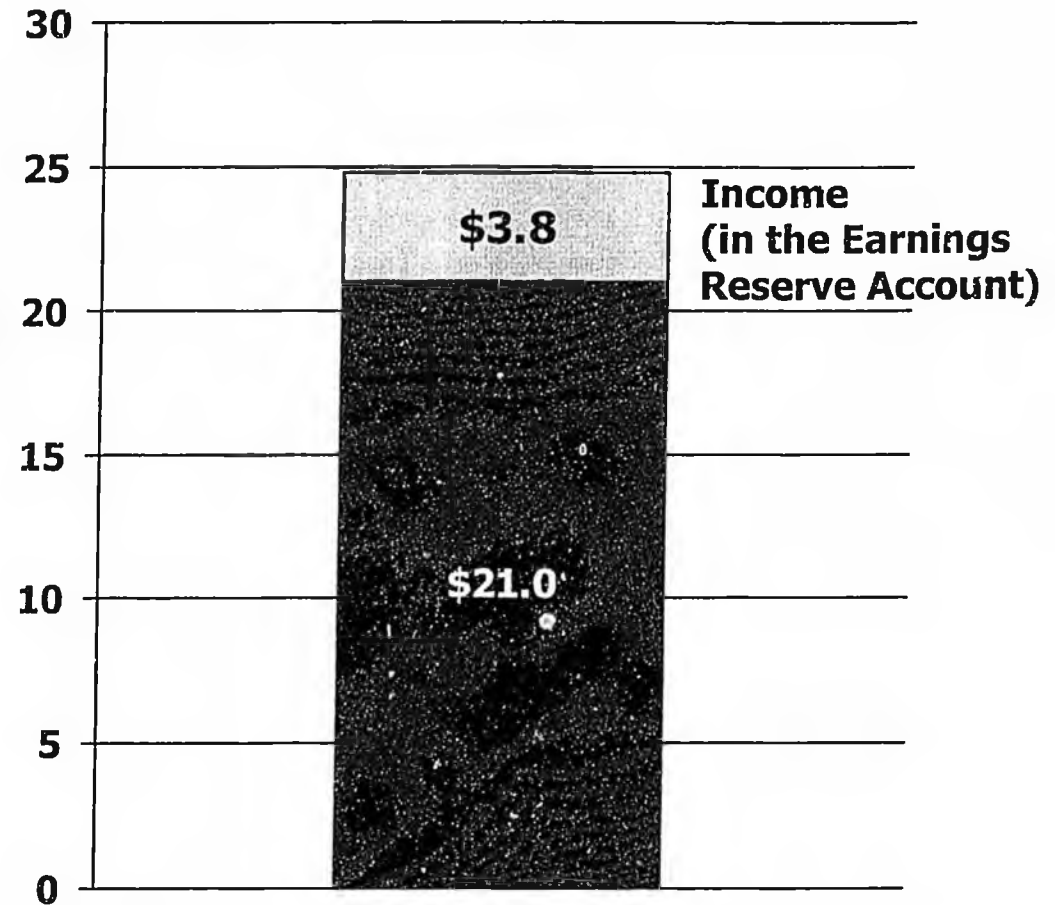
Chart of the day



How is the Fund doing lately?

The market value of the Permanent Fund is \$24.8 billion

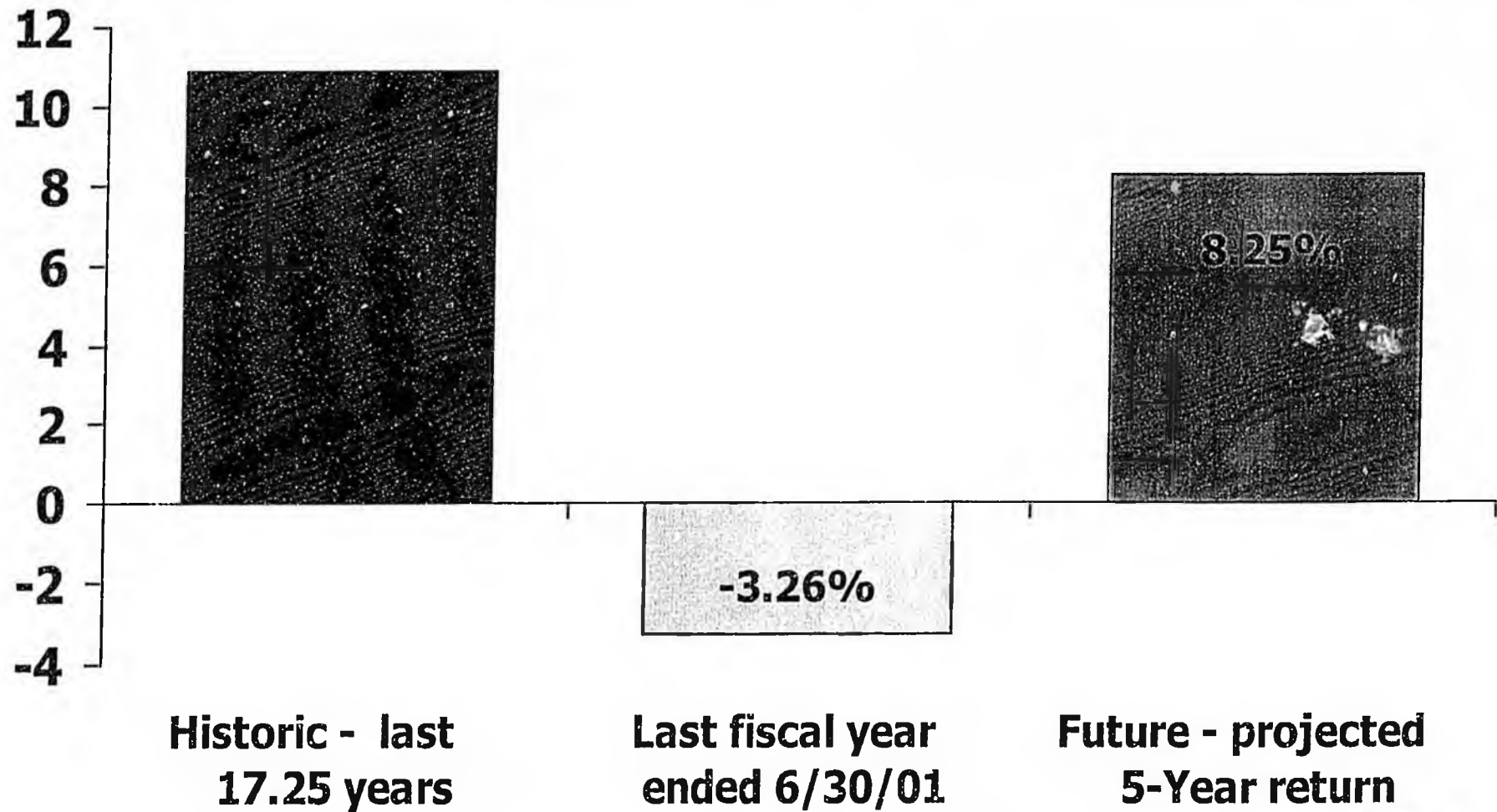
It consists of two parts: principal and income



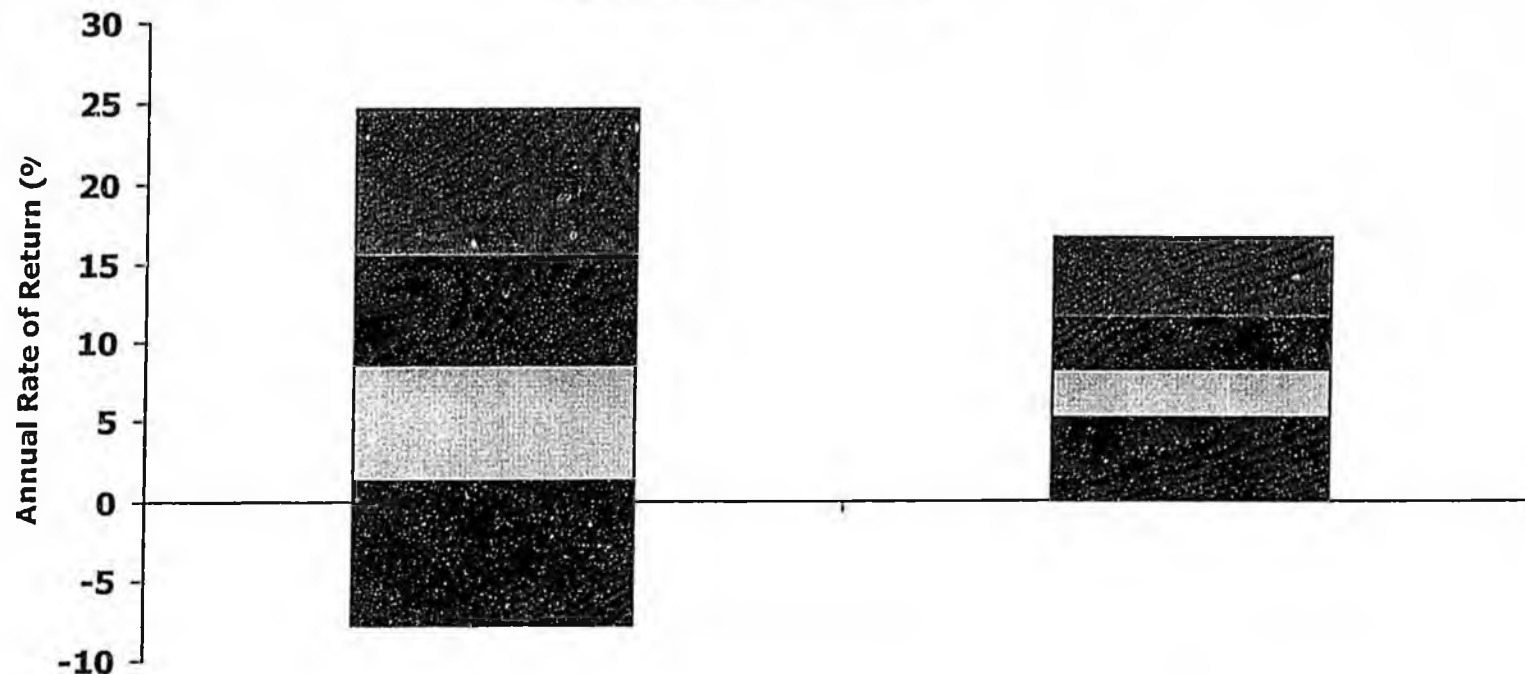
Total Fund as of June 30, 2001



Permanent Fund's total return



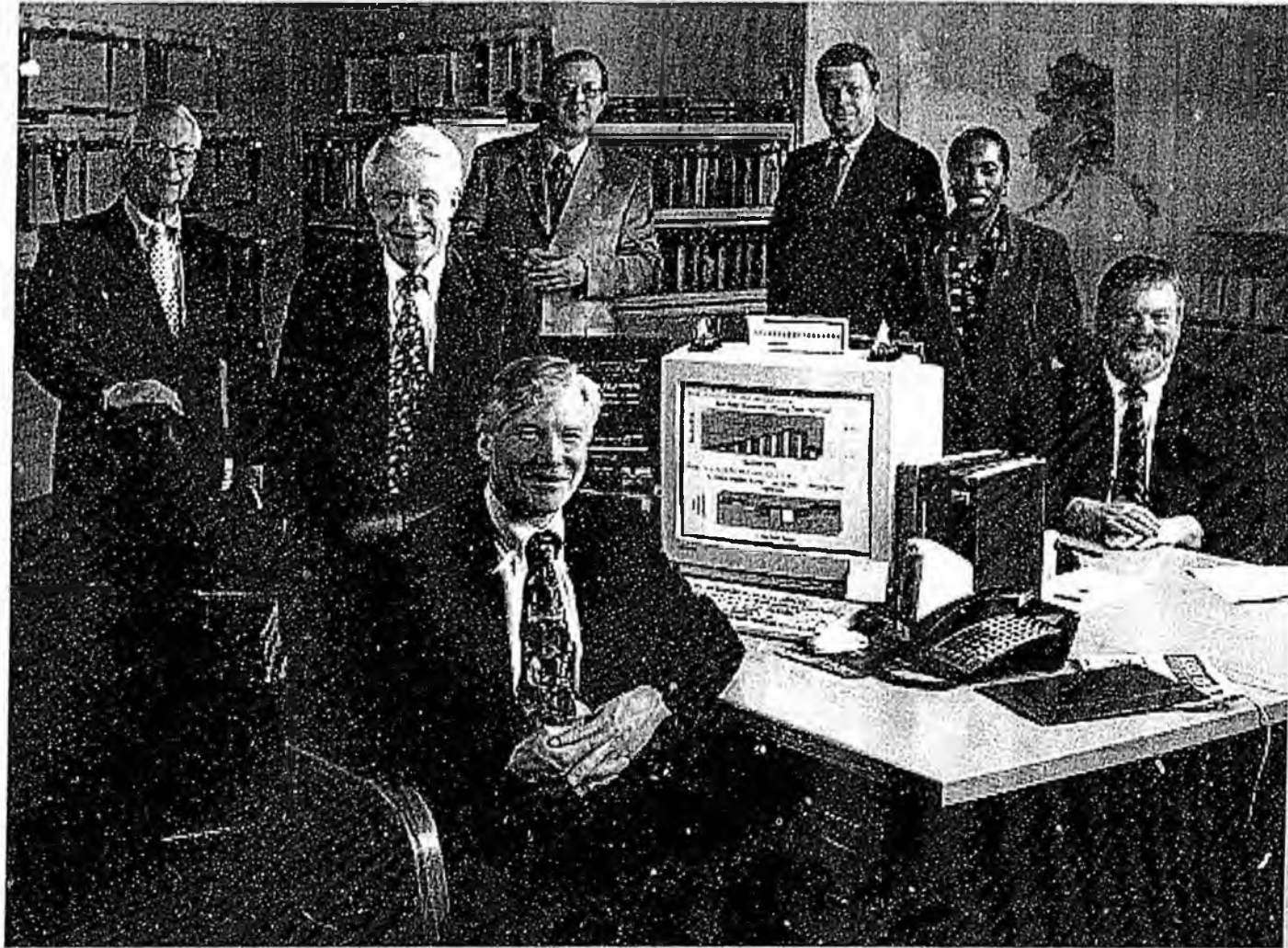
Permanent Fund's projected range of returns



	1-Year Returns	5-Year Returns
5th	27.00	16.2
25th	15.50	11.4
50th	8.25	8.2
75th	1.30	5.1
95th	-7.80	0.7



Permanent Fund Trustees support HJR 15/SJR 13



Why should Alaskans support it?





General Election

November 5, 2002

Section 15. Alaska Permanent Fund. (a) 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 permanent [GENERAL] fund [UNLESS OTHERWISE PROVIDED BY LAW].

(b) For any fiscal year, appropriations from the permanent fund shall be limited to five percent of the average of the year-end market values of the permanent fund for the last five fiscal years, including the fiscal year just ended. No other appropriations from the permanent fund may be made.

*Note: new language underlined in blue,
language to be removed [CAPS IN BRACKETS.]*

Yes [v] No []



"Inflation is like a thief in the night!"



Elmer Rasmuson

First Chair, APFC Board of Trustees



Inflation has eroded the purchasing power of \$1.00 in 1982 to 48 cents in 2001...



1982

2001

How inflation-proofing would work in the Trustees' proposal

8.25% Projected average annual return

- **3.25%** Projected average annual inflation

5.00% Maximum sustainable payout from *total* Fund

Remains in Fund: **inflation-proofing**



Why limit payout to 5%?

- 5% real rate of return is at the **high end** of what is achievable for the Permanent Fund
- 5% is the **maximum sustainable** payout rate that still maintains the Fund's real value
- 5% allows **greater distributions** over time than a higher payout
- 5% is what the **majority** of endowments pay out



How does the Trustees' proposal differ from the status quo?

- Constitution vs. statutes
- Total Fund vs. principal only
- Limits withdrawals from the Fund vs. the entire Earnings Reserve Account being available for appropriation

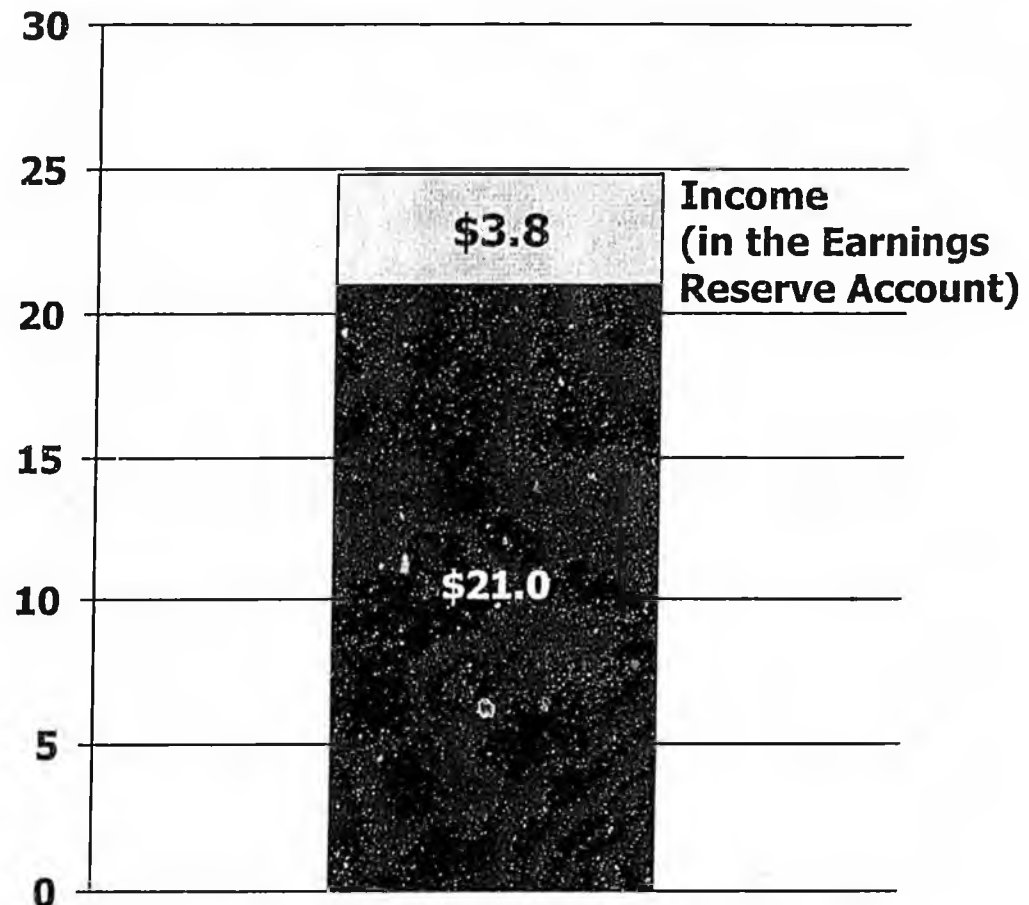


Keeps the whole Fund permanent

"complete and protected inflation-proofing"

The market value of the Permanent Fund is \$24.8 billion

It consists of two parts: principal and income



Total Fund as of June 30, 2001



Reasons to support the Trustees' proposal (SJR 13/HJR 15)

- **Preserves** the Fund's purchasing power
- **Limits** spending to "real" Fund income
- **Maximizes** distributions over the long-term

Alaska voters will decide.



Learn about the constitutional amendment to inflation-proof the Fund

16-Feb-2001

11 QUESTIONS AND ANSWERS ABOUT THE CONSTITUTIONAL AMENDMENT (SJR 13/HJR 15) TO INFLATION-PROOF THE PERMANENT FUND

March 6, 2001

#1. What is the purpose of the proposed constitutional amendment?

The Board is supporting an amendment to the Alaska Constitution to provide constitutional – not just statutory – assurance that a portion of Fund income will always be retained each year to offset the effects of inflation. As Board Chair Clark Gruening points out, this proposal puts emphasis on the word 'permanent.' The amendment would accomplish this by providing that annual payouts from the Fund can be up to but no more than 5 percent of the five-year average market value of the Fund.

#2. How does a payout of no more than 5 percent inflation-proof the Fund?

The Board's best estimate is that, over the long term, the Fund will earn an inflation-adjusted, "real" rate of return of 5 percent. For example, the Board's current 5-year target asset allocation is designed to earn an average, annual rate of return of 8.25 percent with an expected inflation rate of 3.25 percent. This proposal sets the maximum payout at 5 percent – the difference between what the Fund earns and what it loses to inflation – to ensure that the Fund's growth will at least keep up with inflation.

#3. Why is the Board taking this action now?

After four years of study and analysis, the Board is convinced that a constitutional amendment is the best way to protect the Fund against the effects of inflation. By recommending SJR 13 now, almost two years before the 2002 general election, Alaskans will have plenty of time to become familiar (and, hopefully, comfortable) with this major public policy proposal. All Alaskans are encouraged to carefully study SJR 13, debate its merits and express their views. It is also fitting that this debate should take place during the time while Alaskans will be celebrating the 25th anniversary of the Alaska Permanent Fund's creation in 1976.

#4. Does the legislature have to approve this?

Yes. Before any constitutional amendment can be voted on by the people, it first has to win the support of a super majority, that is, two-thirds of the legislature.

#5. Do the people get to vote on this issue?

Yes. Once the legislature gives its two-thirds approval, the proposed constitutional amendment would be placed before the voters at the next general election, November 5, 2002. If a simple majority of the voters approve it, it will go into effect 90 days later.

#6. Why 5 percent?

The Board has been studying percent of market value (POMV) payout limits diligently since 1996 and has found that the majority of large foundations and endowments set payouts of no more than 5 percent of their funds' market value. The Board also reached two important and related conclusions. First, 5 percent is roughly the maximum that a fund can pay out and still maximize its long-term distributions; and second, 5 percent is the maximum sustainable payout rate, beyond which the real value of the Fund would begin to erode.

#7. Why five-year averaging?

Applying the 5 percent payout to the Fund's market value averaged over five years, rather than just the value at the most recent year-end, dampens volatility (that is, the ups and downs) of annual income available for distribution. Five-year averaging also corresponds with the existing statutory formula for dividends which is based on a five-year average of realized earnings.

#8. How does SJR 13 differ from the status quo?

The major difference is that this amendment provides constitutional inflation protection for the entire Fund whereas the status quo provides statutory inflation protection only for the principal. It also limits withdrawals from the Fund by the

legislature – currently all of the earnings reserve is available for appropriation. (Note: as of June 30, 2001, and after the payment of dividends and inflation-proofing, the Fund is projected to total \$25.7 billion – \$20.2 billion in principal and \$5.5 billion in earnings reserve.)

#9. Does SJR 13 change the way principal is treated?

No. Principal cannot be spent under existing constitutional and statutory law. It would continue to be unavailable for appropriation under SJR 13. In addition, a portion of the earnings reserve account would also become unavailable for appropriation: that amount in any given year which is in excess of that required under the 5 percent of average market value limit. So, for example, if the principal in the future were \$22 billion and the earnings reserve were \$10 billion, and the five-year average market value of the Fund were \$30 billion, only \$1.5 billion of the money in the earnings reserve account would be available for appropriation that year (5 percent x \$30 billion = \$1.5 billion.)

#10. How does SJR 13 affect the dividend program?

It doesn't. The Board has modeled this proposal and come to two fundamental conclusions: (1) the constitutional amendment will have no impact on the dividend program vis-à-vis the status quo; and (2) volatility in the financial markets may impact the dividend program, but the impact will be the same under either the status quo or SJR 13.

#11. Is the Board sure that 5 percent is the right number?

The Board's best estimate is that, over the long term, the Fund will earn an inflation-adjusted, "real" rate of return of 5 percent – which can be safely paid out without the Fund losing ground to inflation. There will be short-term periods when earnings are too low and inflation too high and the Fund will not be protected against inflation. However, over the long term, such periods should be offset by periods of strong asset growth.

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ALASKA STATE CHAMBER OF COMMERCE

Priority 2001 - 1

Long Range Fiscal Planning

The Alaska State Chamber of Commerce urges the Administration and Legislature to adopt and bring state spending in line with revenues, encourage and promote economic investment and business development, maintain the state's infrastructure and implement a deferred maintenance plan for all state-owned facilities, and further establish performance measures for state services in concert with results-based government.

The plan should implement a biennial state budget; privatize state services which could be competitively provided by the private sector; promote development of new businesses that could competitively provide goods or services currently provided by the state; and utilize a systematic funding mechanism, such as general obligation bonds, to meet the state's capital needs. The budget shall disclose all revenue and expense items.

ADOPTED

December 1, 2000

BY Pamela La Bolle
Pamela La Bolle
President

BY Rob Shoaf
Rob Shoaf
Chairman

Subject: HJR15

Date: Wed, 10 Oct 2001 15:04:42 -0900

From: Mary Griswold <mgrt@xyz.net>

To: "Rokeberg, Norman" <Representative_Norman_Rokeberg@legis.state.ak.us>

October 10, 2001

I enthusiastically support HJR 15/SJR 13.

The main reason I support this constitutional amendment is that it provides a better money management framework. POMV payout reduces the pressure to manage the permanent fund for return over value. Managing for value is generally considered a better fiscal approach. A 5% payout is generally recognized by large endowments as the highest sustainable payout, beyond which the real value of the fund would diminish over time.

A secondary benefit is that this methodology will provide a reasonable money stream for government if the legislature chooses to use it. Right now the money sitting in the earnings reserve account is available for legislative appropriation for purposes other than dividends, although the legislature has never spent it. There will be more pressure in the future for the legislature to use this money. HJR15 will limit the amount the legislature can use to a predictable and modest amount.

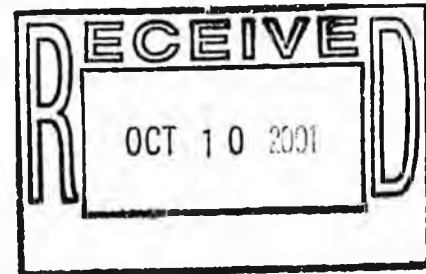
It is important to recognize that our dividends are as much as they are because the legislature made special appropriations from the earnings reserve account to the principal and because it did not spend the earnings available to it. Any use of permanent fund earnings for purposes other than dividends will decrease the value of our checks because whatever is spent will not be available to earn more money. However, our dividends could be cut by much more under the current payout system than under POMV.

5 POMV payout combined with allocating 80% for dividends and 20% for government would preserve the status quo dividend formula with the understanding that the 20% transfer from the fund will reduce the fund's future income producing potential.

I believe it is time to allocate some permanent fund earnings to government and see 5 POMV payout as the best way to do that. But more importantly, I see 5 POMV payout as a better money management tool which will keep the permanent fund permanent for future generations.

Thank you for your consideration.

Mary Griswold P.O. Box 1417 Homer, AK 99603



Subject: RE: Another Permanent Fund story for your newsletter

Date: Wed, 16 May 2001 16:47:26 -0800

From: jkelly@alaskapermfund.com

To: Representative_Norman_Rokeberg@Legis.state.ak.us

CC: Heather_Nobrega@Legis.state.ak.us

Dear Rep. Rokeberg - The e-mail I sent you yesterday was cut off at the end. Here is the full article:

Trustees support Permanent Fund bill

The Permanent Fund Board of Trustees had legislation introduced this session to better protect Fund principal and maximize future Fund income. The legislation, SJR 13/HJR 15, does not change the dividend formula, but does provide constitutional inflation-proofing.

This amendment limits the amount of earnings that can be paid out in any given year to 5 percent of the Fund's market value, averaged over five years. Since the Trustees expect the Fund to earn, on average, approximately 8 percent, the 5 percent payout limit means over the long term, that 3 percent of Fund earnings will be permanently retained in the Fund. The Trustees say that under this proposal, the Fund - and its income -- will double in size over the next 20 years.

This amendment deserves your consideration. It requires legislative-, then voter-approval to take effect. I encourage you to learn more about it at the Fund's web site, www.apfc.org.

> -----Original Message-----

> From: Kelly, Jim

> Sent: Tuesday, May 15, 2001 02:19 PM

> To: 'Representative_Norman_Rokeberg@Legis.state.ak.us'

> Cc: 'Heather_Nobrega@legis.state.ak.us'

> Subject: Another Permanent Fund story for your newsletter

>

> Dear Rep. Rokeberg -

>

> This November, Alaska will celebrate the 25th anniversary of the historic
> vote that created the Alaska Permanent Fund. The constitutional protection
> of principal has served Alaska and the Fund well, but now the Board of
> Trustees, as you know, believes we need to go further and better position
> the Fund for the next 25 years.

>

> We believe SJR 13/HJR 15 does this by modifying the Fund's constitutional
> structure to protect its purchasing power, maximize its sustainable income
> to benefit current and future generations and minimize fluctuations in
> annual payouts.

>

> We have developed a short article on this legislation (150 words -- see
> below), which we hope you will consider including in your end-of-session
> newsletter.

>

> Please let me know if you have any questions or need additional
> information.

> Thank you,

>

> Jim Kelly

> Director of Communications

> Alaska Permanent Fund Corporation

> 801 W. 10th St.

> Suite 302

> Juneau, AK 99801

- > 907-465-2059
- > fax 907-586-2057
- > website: www.apfc.org
- >
- >
- >
- > Trustees support Permanent Fund bill
- >
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- >
- >
- >



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

MEMORANDUM

APR 11 2001

DATE: April 11, 2001

TO: Representative Norm Rokeberg, Chair
House Judiciary Committee

FROM: Robert D. Storer, (RS)
Executive Director

SUBJECT: House Joint Resolution 15 - Permanent Fund
Constitutional Inflation-Proofing Amendment

This is to request a hearing at your earliest convenience on House Joint Resolution 15, "Proposing amendments to the Constitution of the State of Alaska relating to inflation-proofing the permanent fund."

HJR 15 accomplishes inflation-proofing by constitutionally limiting the annual payout of Fund income to no more than 5 percent of the Fund's five-year average market value. This amount comprises all of the Fund's expected "real," i.e., inflation-adjusted, income. For example, the Board's current asset allocation is designed to earn 8.25 percent annually and inflation is expected to average 3.25 percent. By retaining that difference between what is earned and what is paid out, the purchasing power of the Permanent Fund is fully protected against inflation.

The Board is unanimous in its support for this proposal. They believe its benefits are compelling:

1. Provides constitutional protection against inflation for the total Permanent Fund, thereby more effectively safeguarding the Fund and increasing the amount protected.

2. Establishes a limit on annual distributions which helps ensure that the Fund will continue to grow in perpetuity in both nominal and real, inflation-adjusted dollars.
3. Maximizes the total amount of Fund income which can be paid out in the future, at least as compared to higher payout rates, and provides for intergenerational equity by striking a fine balance between short-term and long-term distributions.
4. Beginning in 2003, makes available \$175-\$300 million per year, depending on the Fund's market value, for purposes other than inflation-proofing and dividends. This amount will grow over time as the Fund grows.
5. Uses the percent of market value (POMV) payout methodology which smoothes volatility, treats realized and unrealized income equally as investment return, and is consistent with generally accepted accounting principles and modern endowment practice.
6. Lets lawmakers know in advance, within a relatively narrow range, how much Fund income will be available for appropriation each year.

In short, the Trustees believe HJR 15 serves the best interests of the Fund and the people of Alaska, and we request an opportunity this session to begin discussing with the members of your Committee the very important issues addressed in this resolution.

Thank you for your consideration.



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

RECEIVED
MAY 23 2001

May 10, 2001

Honorable Norman Rokeberg
Chairman, House Judiciary
State Capitol, Room 118
Juneau, Alaska 99801-1182

Re: HJR 15 -- Constitutional amendment for inflation-proofing the Alaska Permanent Fund

Dear Representative Rokeberg:

This is to provide some information and make a request regarding HJR 15, the Board's proposed constitutional amendment for inflation-proofing the Alaska Permanent Fund.

Late in the session, we had a hearing on SJR 13 (the companion bill to HJR 15) in the Senate State Affairs Committee. At that hearing we were presented with a copy of a February 12, 2001 memo prepared by Tamara Cook, the director of Legal Services, raising certain legal issues. Subsequently, we asked Ron Lorensen, outside counsel for the Alaska Permanent Fund Corporation (APFC), to review and comment on Ms. Cook's memo discussing the above-referenced bill. A copy of Ms. Cook's memo and Mr. Lorensen's memo, dated May 9, 2001, are enclosed for your information.

The APFC Board of Trustees held one of its regular meetings here in Juneau on April 30 - May 1. During the Board's work session on May 1, the Board, staff and Mr. Lorensen spent over an hour discussing several of Ms. Cook's comments and concerns. After those discussions, the clear consensus on the Board continues to be strong support for maintaining the existing distinction between principal and income contained in the Constitution and for continuing the Constitution's present protection of principal from appropriation by the Legislature.

In this regard, the Board considered alternative approaches both to the operation of the amendment and to the language of the amendment. At the conclusion of those discussions, the members of the Board reaffirmed their view that the proposed amendment as presently drafted provides the best approach to implementing the Board's policy goals for protecting the Fund for the benefit of both present and future Alaskans.

Honorable Norman Rokeberg
May 10, 2001
Page 2

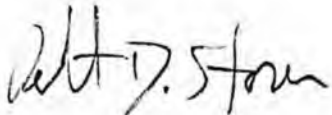
While it is likely that interpretational issues will arise, the Board believes it is important to keep the proposed amendment as short and uncomplicated as possible. The Trustees further believe that they can, in the course of presenting written and oral testimony which helps create the legislative record, make it quite clear that the proposal is definitely intended to continue to keep the principal inviolate.

Now that the first session of this legislature has drawn to a close, the Board asked that I express its hope that your committee and the remaining committees of referral in both houses will continue to move ahead with deliberations on the proposed amendment over the interim and into the second session. In particular, we urge that further hearings on the bills be scheduled so that, if they continue to receive favorable support from the committees, they can be taken up by each house relatively early in that session.

By approving the amendment early next year and avoiding pulling it into the last-minute flurry of negotiations and compromises over funding mechanisms and sources that can arise in the closing days of a legislative session, the Legislature would likely be seen by the public as making a strong statement of its support for providing additional protection to the Fund. Also, the earlier the amendment is passed by the Legislature, the sooner the public discussion and debate over the merits of the proposal can begin in advance of the 2002 general election.

Thank you for your continued interest in the Permanent Fund and attention to this issue.

Sincerely,



Robert D. Storer
Executive Director

Enclosures

c: Board of Trustees

LAW OFFICES OF
SIMPSON, TILLINGHAST, SORENSEN & LONGENBAUGH, P.C.

ONE SEALASKA PLAZA, SUITE 300 • JUNEAU, ALASKA 99801

TELEPHONE: 907-586-1400 • FAX: 907-586-3065

To: Jim Kelly, APFC

From: Ronald W. Lorensen, STS&L

Date: May 9, 2001

Re: SJR 13/HJR 15--Constitutional amendment for inflation-proofing the Alaska
Permanent Fund
Our File No.: 846.14

You have asked for my comments on the February 12, 2001 memo from Tamara Brandt Cook, director of the Legislature's Division of Legal and Research Services, to Senator Gene Therriault discussing the Board of Trustee's proposed constitutional amendment for inflation-proofing the fund. I address her concerns in the order they are discussed in that memo:

1. Title of bill. I think Ms. Cook's observation that the title of the proposed resolution does not reflect its contents is probably the result of an insufficient understanding of the use of percent of market value (POMV) payout rules. On its face, the POMV rule expressed by the resolution appears to be intended simply as a limit on the Legislature's ability to appropriate Fund income (which is not expressed by the title). However, as the Board and those of us who have been studying endowment models and the use of POMV payout rules have come to understand, the real purpose of such a rule is to assure the long-term viability of a fund by allowing, over the long term, only the real portion of the income earned by that fund to be spent. With a POMV spending rule, a fund retains that portion of its income attributable to inflation, with the expectation that the fund will grow (again, over the long term) at the same rate as inflation--thereby "inflation-proofing" the fund.

2. Distinction between principal and income. Ms. Cook does not explain why she believes that retaining the distinction between principal and income of the Fund makes little sense. In any event, it is my understanding that continuing this distinction and assuring that Fund principal remains "inviolable" is an important policy goal for the Board in proposing this constitutional amendment (see my further discussion of this point at Paragraph 3, below). I think Ms. Cook is correct that, by retaining the distinction, the constitution's current requirement that Fund principal be used only for those income-producing investments specifically authorized by law would not apply directly to the Fund's income.

E. BUDD SIMPSON • JON K. TILLINGHAST • STEPHEN F. SORENSEN • LESLIE LONGENBAUGH

L. MERRILL LOWDEN • RONALD W. LORENSEN (OF COUNSEL)

However, the Legislature has already addressed that issue in AS 37.13.145(a) by requiring that money in the earnings reserve account be invested in investments authorized for the investment of Fund principal under AS 37.13.120 ("the legal list").

3. Continued protection of Fund principal. It appears from Ms. Cook's discussion in the third paragraph of her memo that she does not interpret the proposed constitutional amendment to continue to protect Fund principal from appropriation and expenditure by the Legislature (i.e., if the earnings reserve account in a particular year was smaller than the permissible payout for that year, the difference could be satisfied out of principal). As indicated above, that interpretation runs counter to the Board's policy goal of keeping Fund principal "inviolable."

In our (the Board's and staff's) efforts to keep the proposed amendment as short and uncomplicated as possible, we have recognized that this interpretational issue may arise. However, because (i) the amendment retains the distinction between principal and income and (ii) does not in any way alter the existing constitutional language that provides the basis for treating Fund principal as "inviolable",^{1/} I believe that the better interpretation of the amendment is that principal must continue to be inviolable and that the Legislature cannot "dip into" principal in order to make a payout otherwise permitted under new subsection (b). As we have discussed with the Board, one way to strengthen the analytical basis for this latter interpretation is for the Board and staff to create a written and testimonial record that makes it clear that the intended effect and interpretation of the amendment is to continue the special protection that Fund principal currently enjoys. This has, in fact, been done consistently since the Board first formally proposed the amendment at its December, 2000 meeting in Anchorage.

4. Effective date of the amendment. Under Section 1, Article XIII of our constitution, a proposed amendment to the constitution must be presented to the voters at the next general election after it is passed by the Legislature. Under that same provision, if the amendment is approved by the voters, it takes effect 30 days after the election results are certified by the lieutenant governor, unless a different date is provided for in the amendment. The amendment as presently proposed does not specify an effective date. Given the timing of the next general

^{1/} The first sentence of the provision creating the Alaska Permanent Fund (Section 15, Article IX) provides the basis for keeping Fund principal "inviolable." It reads as follows:

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. (emphasis added)

The proposed amendment does not change this language.

election (November 5, 2002)--and assuming there is no unusual, protracted election contest as recently occurred in the 2000 Presidential election in Florida--the amendment, if approved by the voters, would almost certainly take effect before the beginning of the 23rd Alaska Legislature on January 21, 2003 (the third Tuesday in January following a gubernatorial election--AS 24.05.090).

In her memorandum, Ms. Cook suggests that having the amendment take effect in the middle of a fiscal year would be awkward, as it would allow the Legislature to appropriate any amount of the Fund's income in the earnings reserve account during the first part of the 2003 fiscal year, while restricting the amount available to the Legislature during the latter part of that fiscal year, after the amendment takes effect. Why or how this situation might be awkward is not readily apparent to me, however, considering that, unless the 22nd Alaska Legislature convenes itself in special session after its regular adjournment in May, 2002 for the express purpose of appropriating money from the Permanent Fund, its first opportunity in FY 2003 to appropriate funds from the Fund will not arise until after the amendment takes effect.

In any event, the timing of the effective date of the proposed amendment raises a policy question for the Legislature, rather than a legal one. In terms of policy considerations, one could actually argue that providing for a July 1, 2003 effective date as suggested by Ms. Cook could actually undermine the chances for passage of the amendment. This is because the delayed effective date might be seen by those who are exceptionally distrustful of the Legislature and the political process as providing an after-the-fact opportunity for the Legislature to "raid" the Fund before the amendment, although passed by the voters, actually goes into effect.

5. Status of earnings reserve account when amendment takes effect. At the end of her memo, Ms. Cook indicates uncertainty about the status of the earnings reserve account when the amendment takes effect and then states her assumption that the entire balance of that account would be available for appropriation under the constitutional provision as it read before the amendment. I do not believe this assumption is correct--once the amendment takes effect, for any fiscal year, the POMV payout rule expressed in new subsection (b) will operate to limit the Legislature's ability to appropriate from the earnings reserve account to the amount calculated under that rule. Subsection (b) expressly applies to "appropriations from the permanent fund," and, under existing AS 37.13.145(a), the earnings reserve account is already a part of the Fund.^{2/} Unless the Legislature changes current law before the amendment takes effect, that account will continue to be a part of the Fund on the effective date of the amendment and, thus, subject to the limitation of subsection (b) on appropriations from the Fund.

^{2/} AS 37.13.145(a) provides in pertinent part: "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

Jim Kelly, APFC
May 9, 2001
Page 4

If you have any questions about these comments or would like to discuss them further, please do not hesitate to contact me.

cc: Jim Baldwin, Assistant Attorney General, Department of Law

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

JK
State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM

February 12, 2001

SUBJECT: Alaska Permanent Fund (Work Order No. 22-LS0534\C)

TO: Senator Gene Therriault, Chair
Legislative Budget and Audit Committee
Attn: Heather Brakes

FROM: Tamara Brandt Cook
Director *TBC*

You ask for my observations on this draft resolution proposing an amendment to the state constitution dealing with the permanent fund. The title does not reflect the contents of the resolution and, because a joint resolution is supposed to be treated like a bill under the Uniform Rules, normally the title is drafted to reflect the contents. However, because Art. II, sec. 13 only applies to bills, the title defect in this situation is only a procedural and not a constitutional problem. Likewise, a new subsection is normally added as a new bill section and the material is not underlined. The way subsection (b) has been added does not conform to the Legislative Drafting Manual, but will not be fatal to the validity of the resolution if it is adopted by the legislature and approved by the voters.

Substantively, I observe that it makes little sense to retain the distinction between principal and income in subsection (a), since appropriations allowed under subsection (b) are based on averaged market value of the fund and no longer on income generated by the fund. Furthermore, by retaining the distinction between principal and interest, the provision that addresses permanent fund investments applies only to investments of principal. There is no constitutional requirement that interest retained in the fund also "be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments." This seems a bit puzzling, but the legislature can address the investment of interest by law, so the approach probably does not create any great problem.

Subsection (b) is not as clear as might be desirable, but I think it can be applied. However, from my conversation with Mr. Jim Kelly, I gather that it is expected that only income of the fund will be available for appropriation. If this is the intended result, it has not been achieved. That is to say, if fund income is low for a period of years, it will be mathematically possible for an appropriation to be made based on the average of the market values formula that includes some fund principal. Perhaps, this possibility is so remote as not to be a serious problem.

Senator Gene Therriault, Chair

February 12, 2001

Page 2

I think it will be awkward for the constitutional amendment to spring into effect in the middle of a fiscal year and suggest that a July 1, 2003 effective date be added. Otherwise, for part of the year the legislature will be able to appropriate fund income, while at the end of the same year it will have access to an amount based on market value of the fund. Also, I am not sure about the status of the balance in the earnings reserve account on the day the amendment takes effect. I assume the entire balance on that day is available for appropriation under the constitutional language as it read prior to the amendment.

TBC:lmb

01-044.lmb

Investing for Generations



Alaska
Permanent Fund
Corporation

Annual Report 2001

Legacy of the past, hope for the future

The Permanent Fund means different things to each generation of Alaskans.

Children born in this year of the 25th anniversary of Alaska's Permanent Fund do not yet know what an important role the state's savings account will play in their lives. Their parents do, and so do pioneer Alaskans who, over the last quarter century, have watched the Fund grow beyond their most hopeful expectations.

Alaskans who are 25 years old have never known a time when the Permanent Fund was not a part of this state's public policy. They don't remember a fall season since 1982 when they didn't receive their own personal share of Alaska's oil wealth. The Permanent Fund, this great experiment in saving and sharing public wealth, is an integral part of their lives.

It took wisdom and leadership, courage and tenacity 25 years ago to create something of such enduring and abiding value. One of Alaska's past leaders who deserves special thanks is featured

on the cover of this report. Hugh Malone, who passed away this year, made such a lasting contribution that the Trustees this year named the Alaska Permanent Fund Corporation's board room in his honor.

This annual report, which marks the 25th anniversary of the creation of the Permanent Fund, will tell you what happened to the Fund in fiscal 2001. But, it will also highlight the Fund's history and demonstrate why we Alaskans today owe so much to those generations who have come before ... and to those generations of Alaskans still to come. The Permanent Fund belongs to us all.

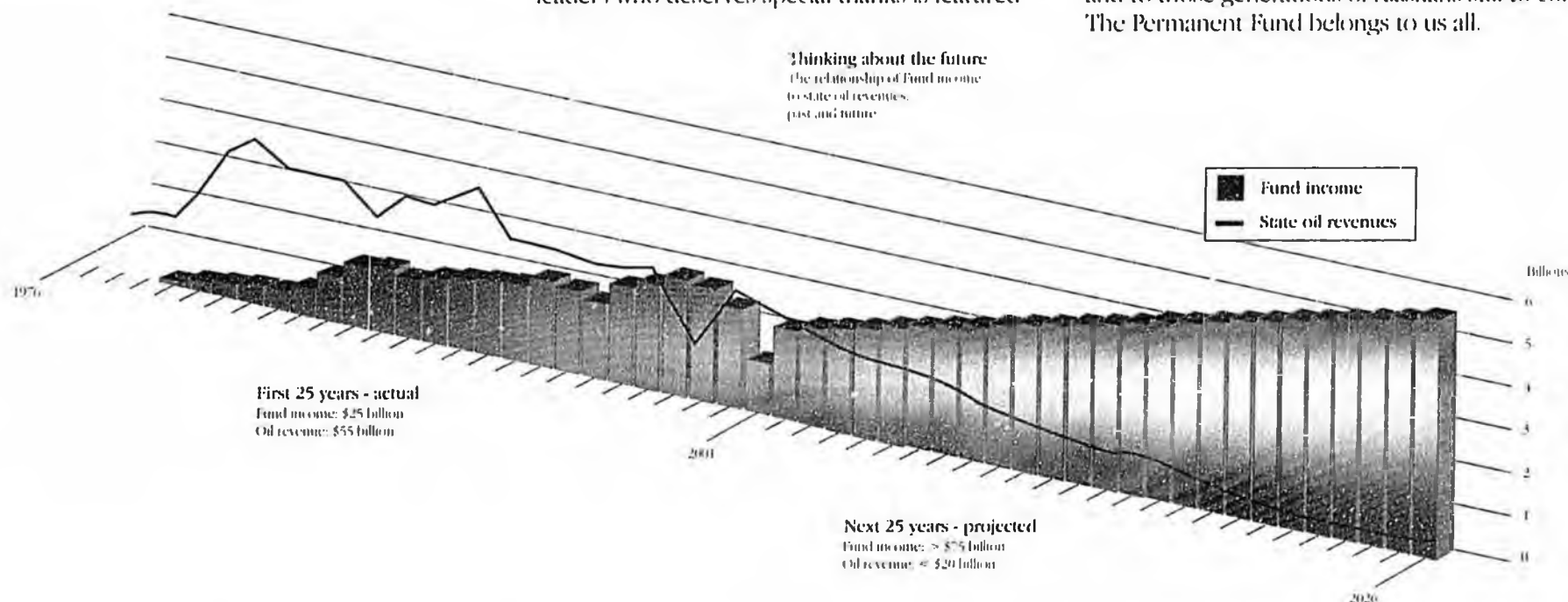
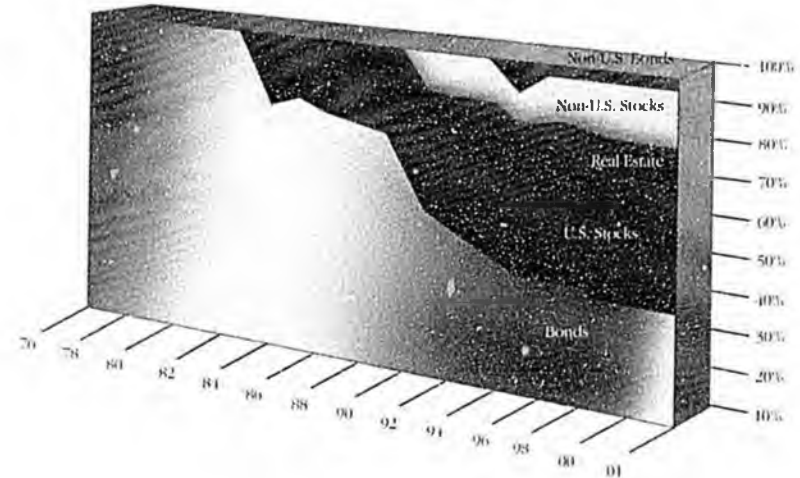


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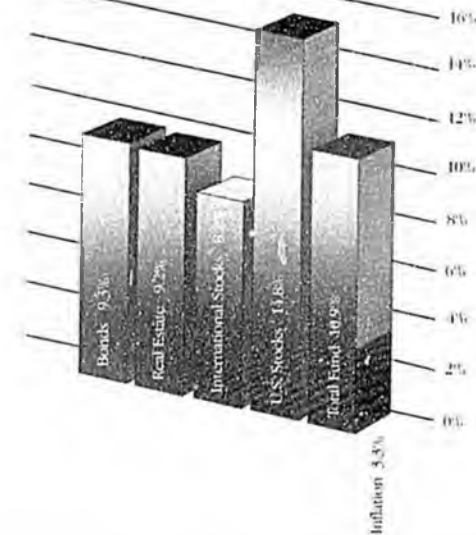
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Managing risk and return by diversifying Fund's asset allocation 1970-2001

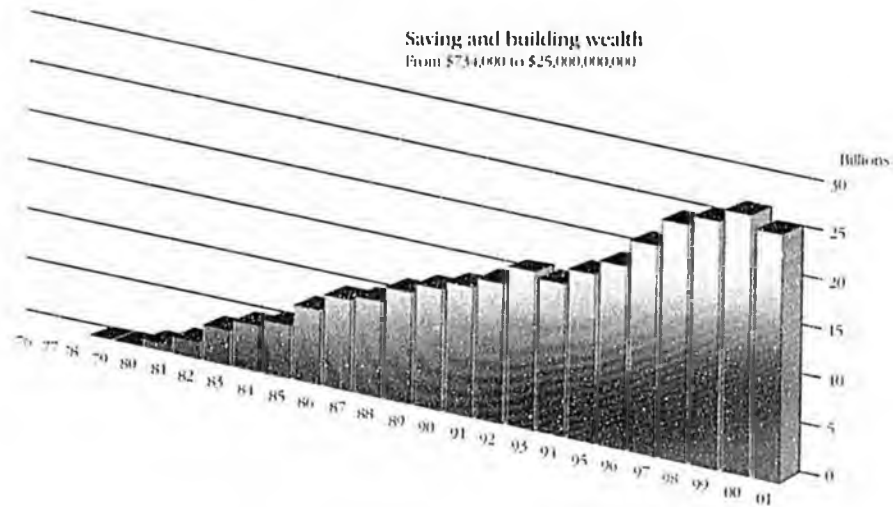


Investing to beat inflation

Long-term returns: 17.5 years ended June 30, 2001
except international stocks is 10 years



Saving and building wealth From \$74,000 to \$25,000,000,000



Letter from the Chair: "Investing for generations"

Dear Alaskan:

In November 1976, voters of Alaska, by a two-to-one margin, approved an amendment to the state's constitution and thereby created the Permanent Fund. This was, arguably, the most significant public policy action in state history. Shortly thereafter, in February 1977, the Fund received its first deposit of dedicated oil revenues: \$734,000. Now, 25 years later, Fund assets exceed \$25 billion.

That remarkable growth is due primarily to two factors: positive financial markets and prudent fiscal management. The chart on the preceding page shows the impact of the positive financial markets. For the prudent fiscal management, we have to thank those who have worked together over many years to maintain and grow the Fund,

diversify it, inflation-proof it for future generations and ensure its safety of principal. Those responsible include 37 distinguished Alaskans who have served as members of the APFC Board of Trustees, and all the Alaska legislatures, governors and APFC employees and investment managers who have worked with the Trustees to enable this unique Fund to invest so successfully.


There have been many significant milestones in the Fund's 25-year history and you can view them in the four-page fold-out timeline that begins on page 19.

Certainly the Fund would not be the magnificent legacy it is today if the residents of Alaska had not voted 25 years ago to save a portion of our one-time oil wealth. Nor would the Fund be as large as it is if the people's elected representatives had not

voted to add approximately \$14 billion of non-constitutionally required money to the Fund's principal by special appropriation and inflation-proofing.

The Fund would not be the empowering source of hope for the future that it is today if not for the Trustees who have consistently argued for, developed and implemented sound investment policies which have proven their value in the crucible of time.

All of the key benchmarks of Alaska's oil-fired public savings account have been achieved by steadfastness, vision, dedication — and a shared common mission — to keep the Permanent Fund permanent.



As one who was privileged to be around when the Fund was being created and now, 25 years later, to have served as the chair of the Board of Trustees, I am humbled by what we have, collectively, been able to accomplish. But, I get truly excited when I think about the future.

The Fund has a proven record of success. That success can and should continue, but we cannot and should not take the future for granted. Just as 25 years ago Alaskans took action to build a bright future by constitutionally creating the Permanent Fund, it is time to take action again, this time to keep the Permanent Fund permanent. That is why the Board of Trustees is urging the legislature and Alaskans to support our proposal to provide complete and protected inflation-proofing.

The proposal calls for constitutionally limiting the annual payout of Fund income to no more than 5 percent of the Fund's five-year average market value. (Note: 5 percent is more than is currently being paid out.) You can read more about it on page 16, but it can only come to pass if it is supported by the legislature and the majority of Alaska's voters, just as the original Permanent Fund constitutional amendment was 25 years ago.

In a world in which the future is uncertain, this proposal represents the Board's best judgment about how best to protect the Fund's purchasing power, ensure that the Fund will continue to grow, and provide the maximum amount of sustainable income to benefit current and future generations.

The proposal has been introduced in the legislature as Senate Joint Resolution 13 and House Joint Resolution 15 and is pending action.

As you reflect on the past 25 years of the Fund's history, I encourage you to try to envision the next 25 years. Think about how you want this unique public trust to move forward. In our view, the future can be quite bright if we Alaskans continue to take a disciplined, long-term, generational approach in both our investment and our public policies.



Clark Gruening
Chair, Board of Trustees

Executive Director's letter: "Focusing on the

Dear Alaskan:

In fiscal 2001, the Alaska Permanent Fund recorded its first-ever fiscal year loss, - 3.3 percent. In a very difficult year for equity markets around the globe, the APFC minimized Fund losses by adhering to a disciplined investment approach which emphasized asset diversification, risk management and "staying the course."

Despite the negative return, it was actually a pretty good year for the Fund:

- Each Permanent Fund portfolio – stocks, bonds and real estate – beat its respective benchmark. For example, the Fund's combined U.S. stocks outperformed the Russell 3000 stock index.
- The Alaska Permanent Fund's performance was better than that of the average public pension fund – largely due to the fact that most other funds had higher allocations to stocks than the Fund.
- Constitutionally protected principal grew by \$1 billion; \$686 million was transferred from the earnings reserve for inflation-proofing and \$339 million was added from new oil and other mineral revenues.
- A total of \$1.13 billion, down \$60 million from last year's all-time record, will be transferred this fall for payment of the 2001 PFDs.
- Long-term asset allocation, designed to balance the risks of negative returns in the short term against the rewards of higher positive returns in the longer term, stayed on course.

Policy actions

One focus of activity during the year was increased internal monitoring. This began with reviewing and rewriting all investment policies to ensure consistency and to emphasize secure internal controls and increased reporting. In the fixed-income area, there was direction provided to increase scenario and compliance analysis. In the area of stocks, more quantitative tools were added to better analyze and monitor the Fund's equity holdings.

The turbulence in the financial markets this year challenged the Board of Trustees to adhere to its disciplined, long-term strategy. At the beginning of the fiscal year, investments in U.S. and non-U.S. stocks totaled 53.5 percent of the Fund, slightly above the asset allocation target of 53 percent. At the end of February 2001, declining markets brought the market value of total stocks below the lower policy boundary of 48 percent. It might have been tempting to allow the Fund's exposure to stocks to continue to decline – but in mid-March the Board instead authorized the purchase of \$750 million of additional stocks to bring the Fund's holdings back within the control bands of the asset allocation policy. This was not an attempt to "time" the market. Rather, it was an affirmation of the belief that a long-term investor will eventually do well by rebalancing; that is, taking profits in the investments that have done well and reinvesting the proceeds in those investments whose prices have fallen below normal levels.

During the year the Board allocated funds to a new Enhanced S&P 500 Index portfolio and selected Deutsche Asset Management to manage it. This portfolio is designed to add incremental return above the index return from security selection, but within much tighter risk constraint and with lower fees than an actively managed portfolio.

The Board of Trustees also made watchful judgments as to the two equity managers who had been placed under heightened scrutiny in the previous year. The Board determined that one of the managers had coped with the changes and uncertainties of new ownership and reorganizations well enough to warrant their retention. The manager went on to post the best

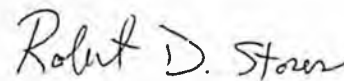
returns for the year of all the active stock managers in both U.S. and international portfolios. The other manager was terminated.

One other challenge facing the Board was how best to use the increased investment flexibility authorized by the 2000 legislature. That flexibility included a 5 percent “basket clause” which allows the Trustees to invest up to 5 percent of the Fund in any investment which meets prudent investor standards. As part of their due diligence looking into alternative investments, the Trustees completed an in-depth study of private equity (i.e., companies which have not yet gone public), and although they decided not to proceed immediately, the issue is certain to come up again in fiscal 2002.

Administrative changes

New directors were hired for two key departments. Joining the APFC this year were Allan Moore who replaced retiring Chief Investment Officer Terry Brown, and Marshal Kendziorek who became the new Director of Information Technology. On the Board, Attorney General Bruce Botelho replaced retiring Trustee John Shively.

The Corporation has been fortunate indeed in the caliber of the professionals who have worked here over the years, and I would like to thank all those who have been with the organization in the past as well as those who continue on with us as we celebrate the Permanent Fund's 25th anniversary.



Robert D. Storer

Robert D. Storer
Executive Director

Fiscal Year 2001 will be remembered as a time when a number of trends ended and reversed. The decade-long economic expansion finally ended, the seemingly inexorable growth in capital expenditures for technology finally abated, and U.S. and international stocks plummeted. Real estate and fixed-income investments produced stronger-than-average returns, but their good performance was insufficient to offset the magnitude of the fall in stocks, and the Alaska Permanent Fund recorded its first-ever fiscal year loss.

More trend reversals are evident by comparing this year's conditions to those reported in last year's 2000 Annual Report. In 2000, the Federal Reserve tried to slow an overheating economy by raising interest rates in steps totaling 1.75 percent; in 2001 the Federal Reserve tried to stimulate a faltering economy by fast steps that lowered rates by 2.75 percent. In 2000, the Fund's international stocks were the best-performing asset class, up 23.3 percent; in 2001 they were the worst-performing asset, down 22.9 percent. In 2000, growth stocks continued several years of superior performance even with a very weak final quarter; in 2001 value stocks bested growth by never-before-seen margins.

Changing benchmarks

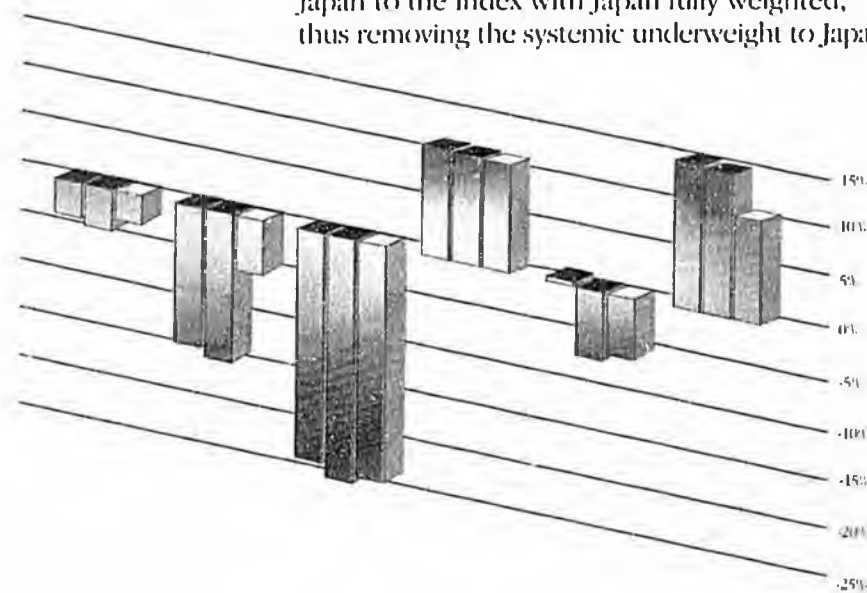
Defining a benchmark for a portfolio is how the Fund establishes objectives and measures results. This year, the Board changed benchmarks for select portfolios investing in both stocks and bonds to better reflect the breadth and depth of the investable markets.

The Board changed the benchmark for the internally managed fixed-income portfolio to the Lehman U. S. Aggregate from the Lehman U.S. Government/Credit index. This "simple" change which adds mortgage-backed securities to the APFC's investment universe, necessitated the turnover of some \$3 billion of fixed-income securities, but it will allow the portfolio to garner equivalent returns with less risk.

The Fund changed the benchmark for two global portfolios, one managed by Brinson Partners and one by Lazard Asset Management. Previously, the benchmark had been a combination of 60 percent S&P 500 — representing U.S. stocks and 40 percent MSCI (Morgan Stanley Capital International) EAFE (Europe, Australia and Far East) index—representing international stocks of developed countries. The new benchmark is the MSCI World Index, which better reflects the Fund's objective to obtain a return like that of all the global developed markets. It also challenges the investment managers to add value by actively managing the ratio of U.S. versus international stocks.

Lastly, the benchmark for the Schrodgers' Pacific Basin portfolio was changed from the Pacific Basin index with a fifty percent weighting for Japan to the index with Japan fully weighted, thus removing the systemic underweight to Japan.

Fund 2001 performance
Permanent Fund compared to benchmarks,
other funds and inflation



Fund 2001 performance

	Total Fund	U.S. Stocks	International Stocks	U.S. Fixed Income	International Fixed Income	Real Estate
Inflation	3.4%					
APFC	-3.3%	-13.1%	-22.9%	11.4%	0.8%	14.8%
Benchmarks	-1.5%	-14.5%	-24.8%	11.2%	-7.4%	14.1%
Median fund	-3.6%	-5.3%	-23.4%	11.0%	-6.5%	10.2%

Alaska Permanent Fund Asset Allocation

Dollars in millions, as of June 30, 2001 (including cash held by managers)

	Market Value	% of Total Fund		Market Value	% of Total Fund
Actively Managed Stocks			Fixed Income		
U.S. Managers			APFC - Internal Fixed Income		
Alliance Capital Management	151	0.58%	Alaska Permanent Capital Management	238	0.91%
Brinson Partners	550	2.11%	Alliance Bernstein	342	1.31%
Dresdner RCM - Large Cap	1,225	4.70%	Brinson Partners	300	1.15%
Invesco Capital Management	503	1.93%	Julius Baer	271	1.04%
Lazard Freres	521	2.00%	Rogge Global Partners	325	1.25%
McKinley Capital Management	174	0.67%	Alaska CD Program	149	0.57%
Putnam Investments	601	2.31%			
Capital Guardian - Small Cap	693	2.66%	Total - all fixed-income managers	10,554	40.48%
Dresdner RCM - Small Cap	355	1.36%			
Total - U.S. managers	4,773	18.31%	Real Estate		
International Managers			Direct Investments		
Capital Guardian	501	1.92%	AEW Capital Management	188	0.72%
Clay Finlay - Europe	606	2.33%	CB Richard Ellis	368	1.41%
Schroders Pacific Rim	194	0.74%	Heitman Property	46	0.18%
Brinson Partners	590	2.26%	Henderson Investors	74	0.28%
Lazard Freres	532	2.04%	Kennedy Property	225	0.86%
Dresdner RCM	157	0.60%	L&B Property	340	1.30%
Schroders Capital Mgmt. - Emerging Markets	193	0.74%	LaSalle Property	307	1.18%
Capital Guardian - Emerging Markets	263	1.01%	Sentinel I & II	193	0.74%
Total - international managers	3,037	11.65%	Total real estate - direct	1,742	6.68%
Total active equity	7,810	29.95%	Other		
Passively Managed Stocks			Commingled Funds	9	0.03%
Deutsche Asset Mgmt. - S&P 500	2,591	9.94%	REITs (Real estate investment trusts)	679	2.60%
Deutsche Asset Mgmt. - S&P 500 Enhanced	830	3.18%	Mortgages / CMBS	306	1.17%
Deutsche Asset Mgmt. - S&P 1000	546	2.09%	Total real estate - other	994	3.81%
Deutsche Asset Mgmt. - EAFE	1,006	3.86%	Total - all real estate managers	2,736	10.49%
Total passive equity	4,974	19.08%			
Total - all equities managers	12,784	49.03%			

Market events over the past twelve months reminded investors that patience, humility and moderation are virtues, that beauty is subjective, and that financial markets can be very fickle indeed. Above all, the past year underscored the importance of diversification, both within and between asset classes.

The Fund's equity performance for the past year has been consistent with market trends. Overall, the U.S. stock portfolio returned -13.1 percent. Style and size were the major determinants of performance, as value and small-cap stocks returned to favor. Brinson Partners led all Fund

U.S. equity managers with an 11.7 percent return, and outperformed its benchmark, the Russell 1000, by 26.7 percent.

The Fund's passive S&P 1000 portfolio (consisting of the S&P MidCap 400 Index and the S&P SmallCap 600 Index) returned 9.8 percent, reflecting benchmark returns for smaller-cap equities. However, the remainder of the Fund's domestic equity portfolios posted negative returns for the fiscal year, ranging from -0.5 percent for Lazard Asset Management's portfolio to -29.3 percent for Dresdner RCM Global Investors' small-cap growth product.

The Board concluded its search for an enhanced S&P 500 index product in September by hiring Deutsche Asset Management. Deutsche also manages the Fund's other passive equity portfolios. In December, the Board terminated a large-cap value manager, due to poor long-term performance. To avoid a potential style imbalance in comparison to the broad market (i.e., growth stocks versus value stocks, large capitalization versus small capitalization), in April the Board of Trustees subsequently authorized searches for two value style managers, one large-cap and one small-cap.



"Indeed the strength and impact of the Alaska Permanent Fund is felt in ways we cannot measure or quantify."

Byron I. Mallott,
former trustee and executive director

U.S. equities managers' performance

FOR PERIODS ENDED JUNE 30, 2001

U.S. EQUITY LARGE CAP	1-Year Return	3-Year Returns	5-Year Returns	10-Year Returns	17 1/2-Year Returns
Passive Managers					
Deutsche Asset Mgmt. - S&P 500	-14.7%	-4.0%	14.5%	15.1%	15.3%
Deutsche Asset Mgmt. - S&P 500 Enhanced	-	-	-	-	-
<i>S&P 500 Index</i>	-14.8%	-3.9%	14.5%	15.1%	15.3%
Large-Cap Value Managers					
Brinson Partners	11.7%	2.6%	10.6%	-	-
Invesco Capital Management	-1.2%	0.3%	9.7%	13.0%	-
Lazard Freres	-0.5%	2.4%	11.0%	-	-
<i>Russell 1000 Index</i>	-15.0%	4.3%	14.3%	15.2%	15.1%
<i>Russell 1000 Value</i>	10.3%	5.4%	15.0%	15.8%	15.3%
Large-Cap Growth Managers					
Alliance Capital Management	-28.2%	-	-	-	-
Dresdner RCM	-18.2%	16.2%	22.2%	18.6%	18.1%
McKinley Capital Management	-26.3%	-	-	-	-
Putnam Investments	-27.8%	0.8%	-	-	-
<i>Russell 1000 Index</i>	-15.0%	4.3%	14.3%	15.2%	15.1%
<i>Russell 1000 Growth</i>	-36.2%	0.7%	12.0%	13.8%	14.2%
U.S. EQUITY SMALL CAP					
Passive Managers					
Deutsche Asset Mgmt. - S&P 1000	9.8%	12.8%	-	-	-
<i>S&P 1000 Index</i>	9.5%	12.5%	-	-	-
Small-Cap Value Managers					
Capital Guardian	-22.4%	-	-	-	-
<i>Russell 2000 Index</i>	0.6%	5.3%	9.6%	13.5%	11.0%
<i>Russell 2000 Value Index</i>	30.8%	6.9%	13.4%	16.0%	13.2%
Small-Cap Growth Managers					
Dresdner RCM	-29.3%	-	-	-	-
<i>Russell 2000 Index</i>	0.6%	5.3%	9.6%	13.5%	11.0%
<i>Russell 2000 Growth Index</i>	-23.3%	2.2%	4.8%	10.2%	8.4%
Combined Fund U.S. equities return					
<i>Russell 3000 Index</i>	-13.1%	4.1%	13.0%	14.5%	14.8%
	-13.9%	4.2%	13.8%	15.0%	14.7%

Permanent Fund's target asset allocation

U.S. Equities	37%	+/-7%
International Equities	16%	+/-5%
Total Equities	53%	+/-5%
U.S. Bonds	35%	+/-7%
Non-Dollar Bonds	2%	+/-2%
Total Bonds	37%	+/-5%
Total Real Estate	10%	+/-2%

Increasing correlations between the world's equity markets and the growing interdependence of global economies contributed to poor returns for the Fund's international stock portfolios.

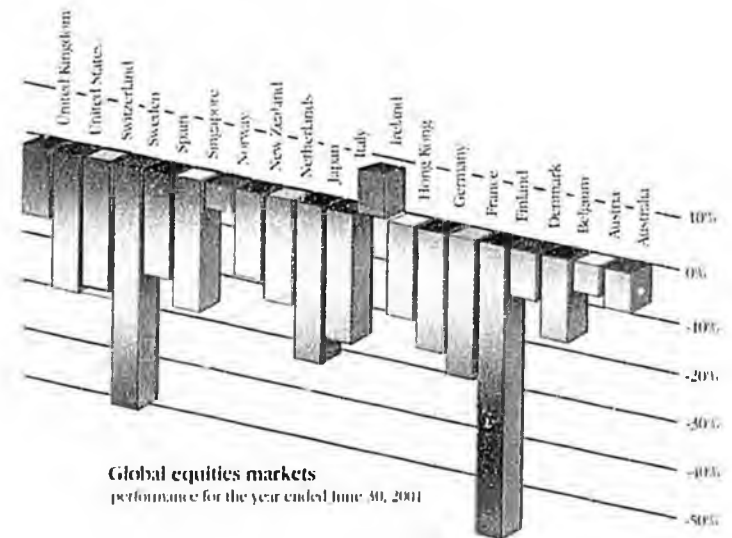
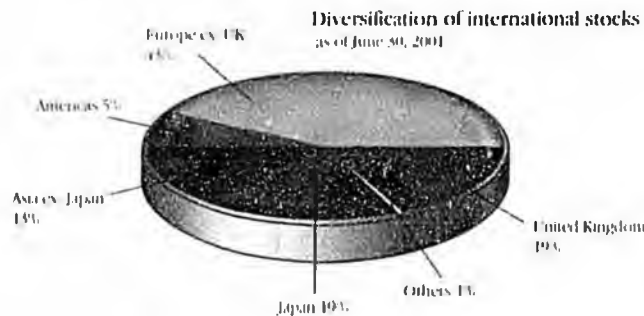
Developed and emerging markets both suffered as growth in U.S. GDP slowed, particularly in capital goods spending.

"I was proud growing up in Alaska to be taught about the Fund and how our leaders took the initiative to establish something that can live on for many generations."

Aдриanna Coonrod, 25-year-old Alaskan.

The best absolute and relative performing non-U.S. Fund manager was Brinson Partners. Although Brinson's MSCI EAFE (Morgan Stanley Capital International Europe, Australia and Far East stock index) portfolio lost 12.8 percent during the fiscal year, the firm outperformed its benchmark by 11.0 percent. Dresdner RCM Global Investors, because of its strong growth-style orientation, went from being one of last year's top performing non-U.S. EAFE managers to the APFC's worst this fiscal year, down 30.0 percent. The passively managed EAFE index portfolio returned -23.3 percent.

In the emerging markets, increasing investors' risk aversion contributed significantly to a 25.9 percent decline in the MSCI Emerging Markets Free Index. The Fund's emerging markets managers Schroder Investment Management and Capital Guardian Trust, who are benchmarked against the MSCI Emerging Markets Free Index, returned a disappointing -31.2 percent and -31.8 percent, respectively for the fiscal year, lagging the benchmark return of -25.9 percent.



International equities managers' performance

FOR PERIODS ENDED JUNE 30, 2001

	1-Year Return	3-Year Returns	5-Year Returns	10-Year Returns
EAFE Passive Manager				
Deutsche Asset Mgmt. - EAFE	-23.3%	-1.0%	4.0%	-
Morgan Stanley Capital International (MSCI) EAFE	-23.8%	-1.3%	2.8%	6.4%
EAFE Active Managers				
Brinson Partners	-12.8%	2.3%	6.7%	-
Lazard Freres	-19.0%	-0.7%	7.0%	-
Dresdner RCM	-30.0%	-	-	-
Capital Guardian	-27.4%	7.6%	11.5%	13.4%
MSCI EAFE (Europe, Australia and Far East)	-23.8%	-1.3%	2.8%	6.4%
Europe Manager				
Clay Finlay	-18.8%	1.5%	13.8%	14.6%
MSCI Europe Index	-22.1%	-3.8%	9.6%	11.6%
Pacific Manager				
Schroders Capital Management - Pacific Rim	-17.8%	15.3%	-4.8%	5.5%
Custom Pacific Basin target	-21.6%	12.7%	-7.7%	3.6%
Emerging Markets Managers				
Capital Guardian	-31.8%	-	-	-
MSCI Emerging Markets Free Index	-25.9%	-	-	-
Schroders Capital Management	-31.2%	-	-	-
MSCI Emerging Markets Free Custom Index	-26.3%	-	-	-
Combined Fund international equities return	-22.9%	1.3%	6.0%	8.2%



As real estate in general experienced stronger-than-average returns in fiscal 2001, the Fund's real estate portfolio posted an overall return of 14.3 percent net of fees, compared to its blended benchmark of 14.1 percent.

It was the Fund's best performing asset class for the year and for the trailing three years.

These positive results in real estate reflect the value of asset diversification in a year marked by a significant downturn in the stock market. The portfolio was fully invested at 10.5 percent at fiscal year-end, marking the first time it has ever been above its asset allocation target of 10 percent of the total Fund.

Approximately two-thirds of the real estate portfolio consists of direct holdings of individual properties. The Fund's direct investments returned 11.4 percent net of fees, just short of the NCREIF Classic Index of 11.5 percent gross of fees.

"This accomplishment is something all Alaskans can take great pride in. It is also exciting to think about how large the Fund can grow in the future if we continue the prudent policies of the past."

Oral Freeman, former trustee.

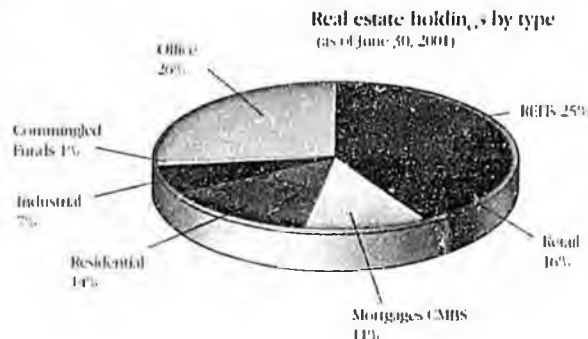
Another 25 percent of the Fund's real estate portfolio was invested in Real Estate Investment Trusts (REITs). The APFC's two REIT portfolios managed by AEW Capital Management continued to post above-average returns, with 23.8 and 24.2 percent. The returns from the equity securities component of the portfolio exceeded

the benchmark Morgan Stanley REIT Index return of 23.5 percent.

The remaining 11 percent of the Fund's real estate portfolio was invested in mortgages. Managed by Lend Lease, this is a fully invested, diversified portfolio of investment-grade commercial mortgage-backed securities (CMBS) and whole loans. Lend Lease returned 13.3 percent for the year compared to the Lehman Brothers Corporate Series A Index of 12.5 percent.

During the year, two direct investments – 919 North Michigan and Arboretum Lakes – and three commingled funds were sold, there were no new acquisitions, and partner's interests were purchased in two apartment properties, making those properties, the Island Club located on Brickell Key in downtown Miami and Treetops located in suburban Philadelphia, 100 percent wholly owned by the Alaska Permanent Fund.

The total portfolio closed the year with a market value of \$2.8 billion which included \$293 million in unrealized gains



Real estate managers' performance

PERIODS ENDED JUNE 30, 2001

	1-Year Return	3-Year Return	5-Year Return	8 1/2-Year Return
Direct Investments	11.4%	11.7%	12.1%	9.5%
AEW Capital Mgmt	10.6%	15.8%	20.9%	-
CB Richard Ellis	9.7%	9.3%	11.7%	-
Heitman Property Agg	33.0%	19.5%	16.8%	9.5%
Henderson Investors	12.2%	12.4%	12.5%	-
Kennedy Property Agg	8.7%	9.8%	10.1%	8.8%
L&B Property Agg	8.3%	9.8%	9.3%	6.9%
LaSalle Property Agg	17.3%	14.2%	11.7%	10.0%
Sentinel I & III*	8.5%	10.6%	11.0%	11.7%
REITs	23.8%	11.9%	10.0%	7.6%
AEW Capital - Focus	23.8%	-	-	-
AEW Capital	24.2%	10.6%	-	-
Simon Property Group	21.7%	12.0%	10.4%	7.9%
Real Estate Mortgages	13.3%	-	-	-
Lend Lease	13.3%	-	-	-
Commingled	4.8%	7.6%	10.2%	8.7%

Combined Fund Real Estate

Net of Fee	14.3%	11.6%	11.9%	9.3%
Gross of Fee	14.8%	12.1%	12.4%	9.9%

Benchmarks

NCREIF Classic Index	11.5%	12.6%	13.5%	10.4%
Morgan Stanley REIT	23.5%	5.4%	11.0%	-
LB Credit A	12.5%	5.6%	7.3%	7.3%
APFC Target	14.1%	10.4%	11.6%	9.3%



Fixed-income performance was quite good last year. The Fund's total domestic fixed income returned 11.4 percent versus 11.2 percent for its benchmark. That small increment of added value may seem modest, but on a base of \$10 billion in assets it's \$20 million of profit. Likewise, the Fund's international non-dollar assets return of 0.8 exceeded the benchmark's return of 0.4 percent.

Among the domestic bond managers, the portfolio managed by APFC staff provided the best returns, while Julius Baer topped the non-dollar manager rankings. Please refer to the accompanying table showing performance data for more details.

Diversification makes sense

The difference in performance between bonds and stocks was so large last year that the Trustees were forced to rebalance in late March in order to stay within the Fund's asset allocation control bands. So, the Fund sold \$750 million of bonds, on which the Fund had earned a large profit, to buy stocks, which had fallen in price. If one never buys stocks when they are down in price, one never owns cheap stocks. And if one never sells bonds when prices are high, one always owns expensive bonds.

Benchmark and procedural changes

There were a number of procedural changes made during the last year to better assure that the APFC staff is taking all reasonable steps to invest and monitor the Fund's investments in fixed income. The Board changed the benchmark for the internal domestic portfolio to the Lehman U.S. Aggregate from the Lehman U. S. Government/Credit index. This change adds mortgage-backed securities issued by major government-sponsored agencies such as Federal National Mortgage Association to our investment universe. Mortgage-

"The most important thing for my future is that the Fund is protected so it can continue to grow."

Scott Bell, 15-year-old Alaskan.

backed securities are a high quality bond sector, and so this change reduces some of the credit risk inherent in the previous benchmark.

The Board's guidelines for fixed-income investing were rewritten to reflect the new benchmark. At the same time, the Board decided to apply the same guidelines to our external domestic managers that we apply to the internally managed portfolio, to consolidate all fixed-income

resolutions into one simpler document. All of the changes were designed to expand and streamline oversight of internal and external managers.

How the economy affected bonds

Last year was truly a tale of two economies. The first half of the fiscal year saw real economic growth in excess of a 4 percent annual rate, with growing capacity constraints, particularly in skilled labor.

As the year began, the Federal Reserve had just finished raising its target for the federal funds rate for the sixth time. They raised the rate a total of 1.75 percent in six steps beginning in mid-1999 to reach 6.50 percent. By the end of the fiscal year, it was the complete opposite. The Federal Reserve had just finished its sixth reduction in rates, having dropped them a full 2.50 percent in six steps beginning at the end of December.

By fiscal year-end, the economy had slowed dramatically, capital investment had dropped precipitously and profits were collapsing. All of these things were supportive of lower interest rates and higher bond prices, but also indicated a deterioration in credit quality of corporate bonds.

Market highlights

There were several noteworthy bond market developments last year. The first is that virtually the entire decline in interest rates occurred in the bonds with shortest maturities. Thirty-year interest rates fell only one-eighth of one percent while one-year rates for treasury notes fell over two percentage points.

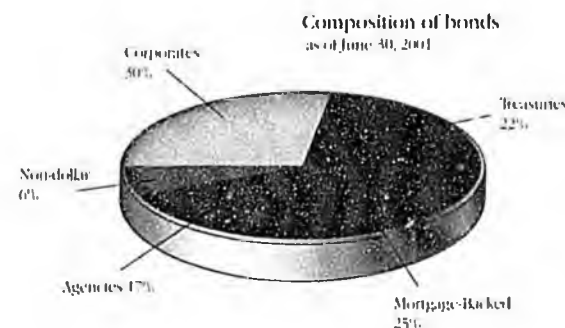
The second is that during the year 2000 and the first half of 2001, the publicly traded securities portion of the U. S. treasury market shrank in size. This helped treasuries to post excellent results during the period. Normally, this less-risky asset also provides a less robust return. The rapidly disappearing federal budget surplus may cause a reversal of this trend soon.

The third event of note concerns the significant transformation of the corporate bond sector. On the one hand, there has been remarkably strong foreign investor demand for U. S. corporate bonds. This has raised prices in the corporate bond market so far this calendar year. On the other hand, the sharp decline in profits and a reduced appetite for risk have reduced the prices for any corporate bonds perceived as likely to be down-graded by a major rating agency. The market prices of such bonds can decline precipitously. The only antidotes are strong research and widespread diversification of holdings.

Fixed-income managers' performance

FOR PERIODS ENDED JUNE 30, 2001

U.S. FIXED INCOME	1-Year Return	3-Year Returns	5-Year Returns	10-Year Returns	17 1/2-Year Returns
APFC in-house	11.5%	5.5%	7.1%	7.7%	9.3%
Alaska Permanent Capital Mgmt.	9.3%	5.4%	-	-	-
Brinson Partners	10.5%	5.9%	-	-	-
Alliance Bernstein	10.9%	6.5%	-	-	-
APFC in-house target	11.2%	6.0%	7.4%	7.9%	9.5%
Lehman Aggregate Index	11.2%	6.3%	7.5%	7.9%	9.6%
Combined Fund U.S. fixed-income return	11.4%	5.5%	7.1%	7.7%	9.3%
NON-U.S. FIXED INCOME	1-Year Return	3-Year Returns			
Julius Baer	1.7%	2.6%			
Rogge Global Partners	0.0%	2.4%			
Salomon Non-US World Gov Bond Index (50% Hedged)	0.4%	3.1%			
Combined Fund non-U.S. fixed-income return	0.8%	2.5%			



"I'm sure that it's obvious to everyone who is sitting ... around this table that one of the big problems with the Permanent Fund is that there's no protection against inflation ..."

— Trustee Tom Williams, Minutes of the Board of Trustees' first meeting, September 12, 1980

The Board of Trustees this year put forth a proposal to solve that problem once and for all. The proposal, introduced in the legislature as Senate Joint Resolution 13 and House Joint Resolution 15, calls for constitutionally limiting the annual payout of Fund income to no more than 5 percent of the Fund's five-year average market value.

The proposed constitutional amendment is designed to

- preserve the Fund's purchasing power;
- maximize distributions of Fund income over the long-term; and
- limit spending to "real," i.e., after inflation-proofing, Fund income.

"Trustees should always have a due regard for the contract with the public and the foundation of trust upon which this institution is built."

The late Hugh Malone, former trustee.

The proposal would add a new constitutional limit on Permanent Fund spending. Principal would continue to be off-limits for spending, and appropriations from the earnings reserve would be limited to no more than 5 percent of the Fund's average market value for the past five years.

Why limit the payout to 5 percent?

- 5 percent real rate of return is at the high end of what is actually achievable for the Permanent Fund;
- 5 percent is the maximum sustainable payout rate that still maintains the Fund's real value;
- 5 percent allows greater distributions over time than a higher payout; and
- 5 percent is what the majority of endowments pay out.

The proposal does not impact the existing dividend program because the 5 percent limit is set higher than what is needed to accommodate the annual distribution which, under current law, pays out the equivalent of approximately 4 percent of the Fund's average market value. All income not used in excess of the 5 percent payout limit would be retained in the Fund to offset inflation.

In the words of Board Chair Clark Gruening, "It's been 25 years since we've asked the people of Alaska to make a constitutional change to the Fund, and it may be another 25 years or longer before another change is recommended. This proposal is of the utmost importance as we look at the long-term. It will keep Alaska's Permanent Fund permanent."

How SJR 13/HJR 15 works

8.25%	Fund's projected average annual return
<u>-5.00%</u>	Maximum sustainable payout from Fund
3.25%	Equals projected average annual inflation/ remains in the Fund as inflation-proofing

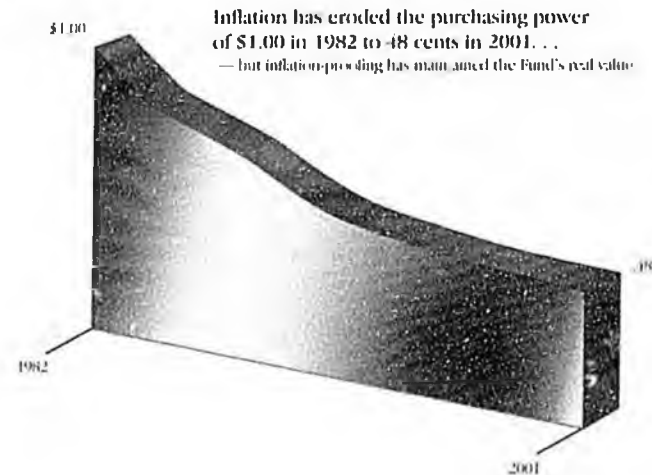
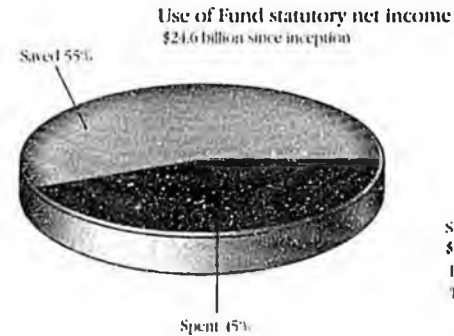
Trustees' proposed constitutional amendment for complete and protected inflation-proofing

Section 15. Alaska Permanent Fund. (a) At least twenty-five percent 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 permanent (GENERAL) fund [UNLESS OTHERWISE PROHIBITED BY LAW].

(b) For any fiscal year, appropriations from the permanent fund shall be limited to five percent of the average of the year-end market values of the permanent fund for the last five fiscal years, including the fiscal year just ended. No other appropriations from the permanent may be made.

NOTE: New language to be added is underlined; language removed is [CAPS IN BRACKETS].

Saved for future generations	
\$14.4 billion (55%)	
Added to principal by inflation-proofing:	\$ 0
Added to principal by special appropriations:	\$ 1
Retained in Fund as undistributed income:	\$ 2.4

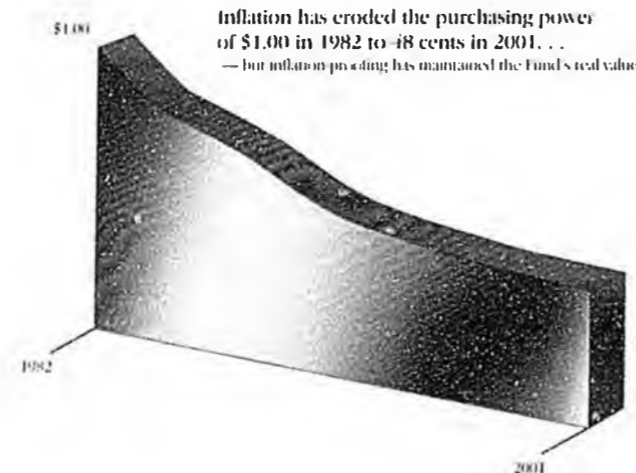
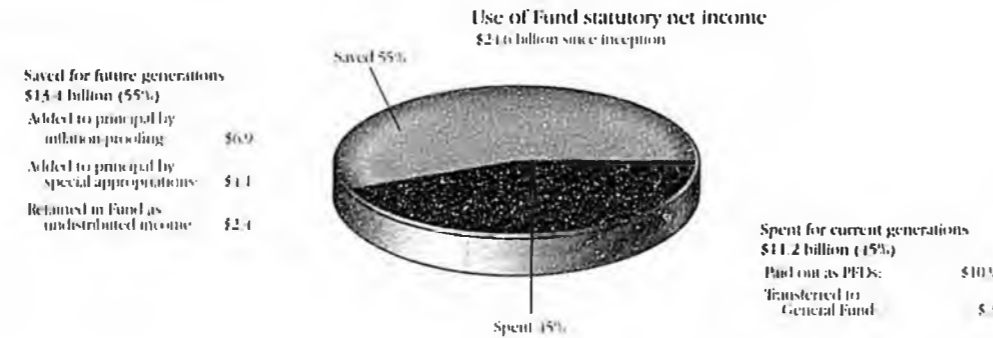


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Since the APFC was established by statute in 1980, 37 Alaskans have been members of the Board of Trustees. The Board is comprised of six members, of whom four are public members appointed by the governor, and two, including the Commissioner of Revenue, are Cabinet members. The board members serve staggered four-year terms.

"My wish for the Permanent Fund on its 25th birthday is that it will grow even larger and stronger by its 50th birthday."

Austin Sture, 9-year-old Alaskan.

This year, the 25th anniversary of the Fund, the Board consists of Chair Clark Gruening, who was a key participant in legislation establishing the Fund, Vice Chair Melphine Evans, Trustee Wilson Condon, who served on the original 1980 Board, and Trustees Jim Sampson, Bruce Botelho and Eric Wohlforth.

The APFC Board of Trustees sets policy for the Corporation and establishes the Fund's asset allocation.

The APFC staff is led by Executive Director Robert D. Storer, who oversees the management and daily operations of the Fund. Allan Moore assumed the position of Chief Investment Officer in November, 2001. He is responsible for all investment functions and a staff of ten. Bob

Bartholomew is the Fund's Chief Operating Officer. He is responsible for the APFC's annual management plan and directs the activities of all support departments (Administration, Finance, Information Technology and Communications).

The APFC's Finance Director is Chris Phillips, who oversees the financial reporting, accounting and supervision of the Finance Department. Marshal Kendziorek is Director of Information Technology, having joined the organization in March, 2001. Communications Director Jim Kelly leads the public information program, overseeing communication with the public, media and legislature, as well as all external print and electronic publications.



From left to right: Chair Clark S. Gruening, Vice Chair Melphine Evans, Trustee Wilson L. Condon, Trustee Jim Sampson, Trustee Eric E. Wohlforth, Trustee Bruce M. Botelho and Executive Director Robert D. Storer.



1976

In the General Election on November 2, Alaska voters approve a constitutional amendment establishing the Permanent Fund by a margin of 75,588 to 38,518.

1977

On February 28, the Permanent Fund receives its first deposit of dedicated oil revenues totaling \$734,000.

1978-79

Continuing debate concerning whether the Permanent Fund should be invested and managed as a public trust or as an economic development bank.

1980

The Alaska Legislature creates the Alaska Permanent Fund Corporation, adds \$900 million in surplus oil revenues to the Permanent Fund by special appropriation, and approves the first Permanent Fund Dividend program, which later was ruled unconstitutional by the Supreme Court.

1981

The Alaska Legislature approves a second special appropriation of surplus oil revenues to the Permanent Fund for \$1.8 billion.

1982

The Alaska Legislature, at the request of the Board of Trustees, enacts inflation-proofing to protect the Fund's purchasing power. The first Permanent Fund dividend check of \$1,000 is distributed. (Note: The legislature paid this first dividend, not with Permanent Fund income, but with surplus oil revenues.)

1983

The Permanent Fund makes its first investment in the stock market, and later that year, in equity real estate.

1984

Permanent Fund assets reach \$5 billion.

1985

The Permanent Fund initiates the "Learning is Permanent" education program.

1986

The Alaska Legislature approves the Fund's third special appropriation. This \$1.26 billion addition to Fund principal is transferred from undistributed Fund income.

1987

In its first decade, the Alaska Permanent Fund has grown larger than any endowment or private Foundation in the U.S.

1988

The Permanent Fund, with an above-national-average allocation to bonds, ranks in the top 9 percent of all public funds in the United States as the stock market crashes in the preceding October.



1989

Permanent Fund assets reach \$10 billion.

1990

The Permanent Fund begins to invest in stock and bond markets outside the United States.

1991

The Permanent Fund's dedicated share of state oil revenues reaches \$435 million, the largest single-year amount in its history.

1992

The Permanent Fund dividend distributed to Alaskans totals \$488 million, or \$915.84 per person.

1993

Permanent Fund assets reach \$15 billion.

1994

Dedicated oil revenues received by the Fund since inception reach \$5 billion.

1995

The Permanent Fund's investments in stocks reach \$7 billion.

1996

Fund assets reach \$24 billion.

1997

The Fund combined all its custody and safekeeping services under one global contractor, Bank of New York, the nation's oldest bank.

1998

For the first time, Fund earnings exceed state oil revenues as the Fund earns a record \$2.6 billion and reaches \$25 billion in assets.

1999

The Alaska Legislature grants increased investment flexibility to the Board of Trustees, including, for the first time, authorization to invest up to 5 percent of the Fund in accordance solely with the Prudent Investor Rule rather than the statutory list of investments.

2000

With markets returning to higher, more traditional levels of volatility, Trustees further diversify the Fund's investment portfolio and increase the equity allocation to 53 percent.

2001

At the request of the Board of Trustees, the Alaska Legislature introduces House Joint Resolution 15 and Senate Joint Resolution 13, which would place before Alaska voters a constitutional amendment to provide complete and permanently protected inflation-proofing to the Fund.

The Alaska Permanent Fund owes much of its success to the efforts of many dedicated Alaskans. This group includes all the Trustees, past and present who have worked diligently as fiduciaries in maintaining the safety of principal and maximizing income within prudent risk parameters. To those who have committed their time, expertise and energy to this challenge, we pay tribute.

"The Permanent Fund is not a private business. It is not a pension fund. There is no other fund like it on the face of the earth ... Public confidence is the very backbone and lifeblood of the Permanent Fund Corporation."

March, 1991, Trustee Oral Freeman.

"Twenty-five percent of the mineral bounty has been, in one form or another, parked in the Permanent Fund. That's a huge commitment by the people of Alaska to the future."

August, 1990, Trustee Hugh Malone.

On the 25th anniversary of the Fund, we'd like to provide a special acknowledgement of those Trustees who served the Fund and have passed away. These include Hugh Malone, a former legislator and House Speaker from the Kenai Peninsula, who, more than anyone, can properly be called the father of the Permanent Fund. Also included are long-time Alaska bankers Elmer Rasmuson and Arnold Espe, former Commissioner of Transportation and Public Facilities Robert Ward, Anchorage CPA and business leader Clyde Sherwood and former Fairbanks lawmaker Charlie Parr.

These Trustees are each in their own way responsible for part of the foundation upon which the Fund was firmly constructed. Their hard work and dedication, their foresight and commitment will not be forgotten.

"I think we might well preserve the essential objective, which is safety ... and offset the ravages of inflation, which I just think is prudent for anybody managing money to consider."

January, 1981, Trustee Elmer Rasmuson.



From left to right: Arnold Espe, Hugh Malone, Charlie Parr, Elmer Rasmuson, Clyde Sherwood and Robert Ward

Providing benefits to the people of Alaska has always been a critical part of the APFC's mission. Maintaining safety of principal and producing a competitive rate of return are the primary ways the mission is accomplished, but there are other means as well. One is the APFC's Alaska college student internship program.

The intern program, which began in 1988 as a way for the Fund to help young Alaskans gain entry into the field of finance and investing, is a cooperative effort between the APFC and its various investment managers. Students are accepted to intern either directly with the APFC or with one of the managers. In fiscal 2001, there were 18 participating firms and 14 Alaska students were hired.

Designed to serve as a career springboard for Alaska college students, the program has a high success rate of permanent placement. One of the APFC's managers, Kennedy Associates of Seattle, has permanently hired a total of seven Permanent Fund interns.

In addition to investing in our young Alaskans, the APFC provides opportunities for established Alaska money managers. There are currently two such Alaska businesses serving as Permanent Fund investment managers.

Another means by which the Fund contributes to the Alaska economy is the Alaska brokerage program, through which nine Alaska businesses are able to share in the commissions that result from the Fund's stock trades.

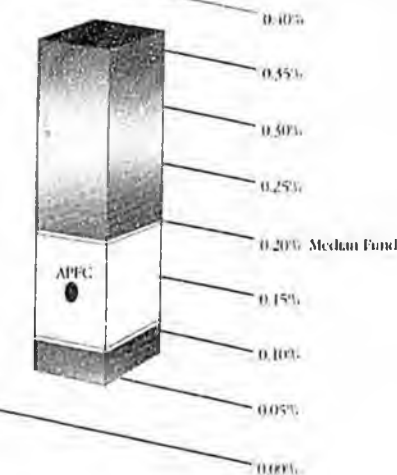
Lastly, the APFC manages three other funds besides the Permanent Fund. See the financial statements footnote 17 for details.

APFC FY01 total operating expenses were \$39.5 million, or .15% of the Fund's average market value. That equates to 15 cents for every \$100 of Fund value — compared to 20 cents for the median large (10 billion plus) institutional fund. Source: APFC and Cullin Associates, Inc.

Management costs for each APFC portfolio are well below median

	U.S. Stocks	Non-U.S. Stocks	U.S. Bonds	Non-U.S. Bonds
APFC	.19%	.27%	.03%	.22%

APFC operating expenses
Compare favorably to other large institutional funds



Olivia Mendoza of UAS, an intern this summer with Kennedy Associates in Seattle.

The Board of Trustees
Alaska Permanent Fund Corporation
(A Component Unit of the State of Alaska):

We have audited the accompanying statements of assets, liabilities, principal and earnings reserve of the Alaska Permanent Fund as of June 30, 2001 and 2000, and the related statements of revenues and expenses, changes in principal and earnings reserve, and cash flows for the years then ended. These financial statements are the responsibility of the Alaska Permanent Fund Corporation's (a Component Unit of the State of Alaska) management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Alaska Permanent Fund as of June 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

Anchorage, Alaska
August 10, 2001

Statements of assets, liabilities, principal and earnings reserve

June 30,	<u>2001</u>	<u>2000</u>
Assets		
Cash and temporary investments	\$ 544,014,000	747,739,000
Receivables, prepaid expenses and other assets	365,158,000	496,173,000
Investments		
Marketable debt securities	10,005,722,000	9,723,751,000
Preferred and common stock	12,617,711,000	14,663,750,000
Real estate	2,504,466,000	2,326,403,000
Alaska certificates of deposit	147,423,000	152,318,000
Total investments	<u>25,275,322,000</u>	<u>26,866,248,000</u>
Total assets	<u>\$ 26,184,494,000</u>	<u>28,110,160,000</u>
Liabilities		
Accounts payable	\$ 253,160,000	419,018,000
Income distributable to the State of Alaska	1,116,444,000	1,175,231,000
Total liabilities	<u>1,369,604,000</u>	<u>1,594,249,000</u>
Principal and earnings reserve		
Principal	21,047,579,000	20,014,648,000
Earnings reserve		
Unrealized earnings reserve	1,383,576,000	3,528,801,000
Remaining earnings reserve	2,383,735,000	2,972,459,000
Total earnings reserve	<u>3,767,311,000</u>	<u>6,501,263,000</u>
Total principal and earnings reserve	<u>24,814,890,000</u>	<u>26,515,911,000</u>
Total liabilities, principal and earnings reserve	<u>\$ 26,184,494,000</u>	<u>28,110,160,000</u>

Years ended June 30,

2001

2000

Revenues

Investment income —

Interest	\$ 710,312,000	687,158,000
Dividends	155,551,000	166,816,000
Real estate and other income	225,215,000	195,570,000
Total investment income	<u>1,091,078,000</u>	<u>1,049,544,000</u>

Net increase (decrease) in the fair value of investments —

Marketable debt securities	359,608,000	(334,289,000)
Preferred and common stock	(2,486,857,000)	1,547,321,000
Real estate	119,877,000	29,186,000
Foreign exchange contracts	37,172,000	2,296,000
Currency	(5,280,000)	(3,825,000)
Total gains (losses)	<u>(1,975,480,000)</u>	<u>1,240,689,000</u>
Total revenues	(884,402,000)	2,290,233,000

Expenses

Operating expenses	<u>(39,490,000)</u>	<u>(41,457,000)</u>
Net income (loss)	\$ <u>(923,892,000)</u>	<u>2,248,776,000</u>

Adjustments to bring net income (loss) to statutory net income — settlement earnings and unrealized (gains) losses

	<u>2,122,997,000</u>	<u>(26,613,000)</u>
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Statutory net income	\$ <u>1,199,105,000</u>	<u>2,222,163,000</u>
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Statements of changes in principal and earnings reserve

Years ended June 30,

2001

2000

Principal

Balance, beginning of year	\$ 20,014,648,000	19,000,909,000
Dedicated state revenues	339,315,000	310,488,000
State transfer from earnings reserve	—	250,000,000
Inflation-proofing	685,929,000	422,920,000
Settlement earnings	7,687,000	30,331,000
Balance, end of year	\$ 21,047,579,000	20,014,648,000

Earnings reserve

Balance, beginning of year	\$ 6,501,263,000	6,131,203,000
Appropriation to other state agencies	(3,843,000)	(3,014,000)
State transfer from earnings reserve	—	(250,000,000)
Inflation-proofing	(685,929,000)	(422,920,000)
Settlement earnings	(7,687,000)	(30,331,000)
Dividends	(1,112,601,000)	(1,172,451,000)
Net income (loss)	(923,892,000)	2,248,776,000
Balance, end of year	\$ 3,767,311,000	6,501,263,000

Total

Balance, beginning of year	\$ 26,515,911,000	25,132,112,000
Dedicated state revenues	339,315,000	310,488,000
Appropriation to other state agencies	(3,843,000)	(3,014,000)
Dividends	(1,112,601,000)	(1,172,451,000)
Net income (loss)	(923,892,000)	2,248,776,000
Balance, end of year	\$ 24,814,890,000	26,515,911,000

Earnings reserve components

Unrealized earnings reserve	\$ 1,383,576,000	3,528,804,000
Remaining earnings reserve	2,383,735,000	2,972,459,000
Total earnings reserve	\$ 3,767,311,000	6,501,263,000

Years ended June 30,

2001

2000

Cash flows from investments

Net (purchases), sales and maturities of investments —		
Marketable debt securities	\$ 23,805,000	675,380,000
Preferred and common stock	(506,180,000)	(1,505,015,000)
Real estate	(54,310,000)	(283,401,000)
Alaska certificates of deposit	4,896,000	(9,903,000)
Net change in unsettled trades	(53,186,000)	38,051,000
Total net (purchases), sales and maturities	(584,975,000)	(1,084,888,000)
Investment income received	1,288,180,000	2,302,054,000
Undistributed real estate income	(34,697,000)	(25,679,000)
Net cash provided by investments	668,508,000	1,191,487,000

Cash flows from non-capital financing

Contributions from the state	345,382,000	282,385,000
Income distributions	(1,175,231,000)	(1,048,225,000)
Net cash used by non-capital financing	(829,849,000)	(765,840,000)

Cash flows from operations

Net increase (decrease) in cash and temporary investments	(42,384,000)	(39,089,000)
Cash and temporary investments at beginning of year	(203,725,000)	386,558,000
Cash and temporary investments at end of year	747,739,000	361,181,000
	\$ 544,014,000	747,739,000

Reconciliation of net income to net cash used by operations

Net income (loss)	\$ (923,892,000)	2,248,776,000
Adjustments to reconcile net income (loss) to net cash used by operations —		
Investment (earnings) loss	884,402,000	(2,290,233,000)
Net change in prepaid expenses and accrued liabilities	(2,894,000)	2,368,000
Net cash used by operations	\$ (42,384,000)	(39,089,000)

June 30, 2001 and 2000

1. Entity

The Constitution of the State of Alaska (the "State") was amended by public referendum in 1976 to dedicate a portion of certain natural resource revenues to the Alaska Permanent Fund (the "Fund"). The principal of the Fund is to be invested in perpetuity. The Alaska State Legislature (the "Legislature") created the Alaska Permanent Fund Corporation (the "Corporation"), a component unit of the State that is administered by a board of trustees (the "Trustees"), to manage the investments of the Fund. By statute, (i) a portion of annual earnings is transferred to the State's dividend fund, and (ii) a portion of the earnings reserve account sufficient to offset the impact of inflation is transferred to the principal of the Fund. The balance of the Fund's earnings is held in the earnings reserve account and is subject to appropriation by the Legislature.

The accounting and reporting policies of the Fund conform to generally accepted accounting principles. The Fund follows the accrual method of accounting. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the balance sheet and revenue and expenses for the period. Actual results could differ from those estimates. The more significant accounting and reporting policies applied in the preparation of the accompanying financial statements are discussed in note 2.

2. Significant Accounting Policies

As allowed by the Governmental Accounting Standards Board Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Corporation has elected not to apply Statements and Interpretations issued by the Financial Accounting Standards Board after November 30, 1989.

Contributions

Contributions from dedicated State revenues are recorded when certain revenues defined by statute are received or reported by the Alaska Department of Natural Resources. Contributions from appropriations and other sources are recorded when received.

Dividend Appropriations

Current statutes require that one-half of twenty-one percent of the Fund's net income for the last five fiscal years, excluding earnings from contributions made in the North Slope royalty case (*State v. Amerada Hess, et al.*) settlements and unrealized gains and losses, be made available for the payment of dividends and other appropriations each year.

Forward Exchange Contracts

The Fund is party to a variety of forward contracts in its trading activities and in the management of its foreign exchange rate exposure. These contracts are speculative in nature and the contract amounts do not appear on the balance sheet. Realized and unrealized gains and losses are currently included in net income, and are determined on the maturity date of the contracts. Unrealized gains and losses are calculated using foreign currency forward rates at the balance sheet date.

Inflation Impact

The impact of inflation is measured by the change in the prior calendar year average of the United States consumer price index for all urban consumers, applied against the balance of contributed equity at the end of the fiscal year. The inflation rates were 3.37% and 2.19% and applied to the years ended June 30, 2001 and 2000, respectively.

Interest Income

Interest income is accrued monthly as earned.

Income Taxes

As integral parts of the State, the Fund and the Corporation are not subject to Federal or State income taxes. In addition, the Internal Revenue Code provides that gross income for tax purposes does not include income accruing to a state or any subdivision thereof, which is derived from the exercise of any essential governmental function. The Fund and the Corporation perform an essential governmental function and are therefore exempt from Federal income taxes under that provision, as well.

Investments

The Fund's marketable securities, excluding direct real estate investments, are reported at fair value in the financial statements. Unrealized gains and losses are reported as components of net income. Fair values are obtained from independent sources for marketable debt and equity securities and real estate investment trusts.

Real estate commingled funds, direct real estate investments and direct commercial mortgages are carried at historical cost plus the Fund's share of undistributed earnings. If, in the opinion of management, a permanent impairment of value has occurred, the investment is written down to fair market value by a charge to operations.

Securities Transactions

Securities transactions are recorded on the trade date that securities are purchased or sold.

Statement of Cash Flows

The Fund considers all highly liquid short-term investments purchased with an original maturity of one year or less to be cash equivalents for purposes of the statement of cash flows.

3. Cash and Temporary Investments

All cash and temporary investments bear interest at competitive rates, and are summarized as follows at June 30:

	2001	2000
Cash ^(a)	\$ 111,649,000	99,981,000
U.S. agencies ^(b)	60,839,000	212,719,000
Commercial paper ^(c)	271,526,000	435,039,000
Total Cash and Temporary Investments	\$ 544,014,000	747,739,000

a) Share ownership in a money market fund, payable on demand.

Collateralized by underlying securities held by the fund in the name of the custodian.

b) Debt obligation guaranteed by the U.S. government.

c) Commercial paper rated investment grade.

4. Receivables, Prepaid Expenses and Other Assets

Receivables, prepaid expenses and other assets at June 30 are as follows:

	2001	2000
Interest receivable	\$ 144,902,000	173,928,000
Dividends receivable	13,973,000	13,761,000
Sales receivable	154,712,000	255,660,000
Foreign exchange contracts	8,152,000	3,337,000
Contributions receivable	43,419,000	49,487,000
Total Receivables, Prepaid Expenses and Other Assets	\$ 365,158,000	496,173,000

5. Marketable Debt Securities

The Corporation is authorized by statute to invest Fund assets in (i) corporate bonds rated investment grade; (ii) obligations of the United States Treasury, its agencies and instrumentalities; and (iii) foreign obligations of comparable quality. All marketable debt securities are held by custodian banks in the name of the Corporation on behalf of the Fund.

Marketable debt securities at June 30 are summarized as follows:

	Cost	Market	Unrealized Gains/(Losses)
2001			
Treasury notes/bonds	\$ 2,266,045,000	2,214,159,000	(51,886,000)
Mortgage-backed securities	2,516,102,000	2,521,856,000	5,754,000
Other federal agencies	1,657,298,000	1,708,042,000	50,744,000
Corporate bonds	2,954,476,000	3,005,088,000	50,612,000
Non-domestic bonds	587,719,000	556,577,000	(31,142,000)
Total Marketable Debt Securities	\$ 9,981,640,000	10,005,722,000	24,082,000
2000			
Treasury notes/bonds	\$ 3,234,534,000	3,191,033,000	(43,501,000)
Mortgage-backed securities	811,435,000	786,199,000	(25,236,000)
Other federal agencies	1,675,307,000	1,650,972,000	(24,335,000)
Corporate bonds	3,751,391,000	3,587,763,000	(163,628,000)
Non-domestic bonds	532,778,000	507,784,000	(24,994,000)
Total Marketable Debt Securities	\$ 10,005,445,000	9,723,751,000	(281,694,000)

6. Preferred and Common Stock

The Corporation is authorized by statute to invest Fund assets in the preferred and common stock of United States and non-domestic corporations. All preferred and common stock investments are held by custodian banks in the name of the Corporation on behalf of the Fund.

The Corporation may invest Fund assets in (i) equity securities up to 55% of total Fund investments, and (ii) other investments, which meet the test of prudence, including those currently authorized by law, up to 5% of total Fund investments.

Preferred and common stocks at June 30 are summarized as follows:

	Cost	Market	Unrealized Gains/(Losses)
2001			
Domestic	\$ 7,608,189,000	8,924,945,000	1,316,756,000
Non-domestic	3,752,908,000	3,692,766,000	(60,142,000)
Total Preferred and Common Stock	\$ 11,361,097,000	12,617,711,000	1,256,614,000
2000			
Domestic	\$ 7,469,847,000	10,297,594,000	2,827,747,000
Non-domestic	3,385,069,000	4,366,182,000	981,113,000
Total Preferred and Common Stock	\$ 10,854,916,000	14,663,776,000	3,808,860,000

7. Real Estate

The Corporation is authorized by statute to invest Fund assets in real estate improved by substantially rented buildings located in the United States. Real estate investments may take the form of direct equity interests, real estate title-holding entities, real estate investment trusts, real estate operating companies or other entities whose assets consist primarily of real property, debt obligations secured by real property or similar entities. All real estate investments are held by the Corporation in its own name on behalf of the Fund, and are managed by professional real estate management firms. Real estate investment trusts and commercial mortgage backed securities are held by custodian banks in the name of the Corporation on behalf of the Fund.

The carrying value of real estate at June 30 was \$2,504,466,000 in 2001 and \$2,326,403,000 in 2000. Carrying value consists of the equity value of direct real estate investments, commingled funds and commercial mortgages and the market value of real estate investment trusts and commercial mortgage backed securities.

In the ordinary course of business, the Corporation has made commitments related to real estate investments. In the opinion of management, meeting these commitments will not have a material adverse effect on the Corporation's financial position, results of operation or liquidity.

Real estate investments at June 30 are summarized as follows:

	Book Value	Market	Unrealized Gains/(Losses)
2001			
Commingled funds	\$ 4,783,000	8,984,000	4,201,000
Real estate investment trusts	559,071,000	651,590,000	92,519,000
Commerical mortgage backed securities	221,026,000	223,773,000	2,747,000
Commercial mortgages	72,035,000	72,035,000	—
Alaska residential mortgages	117,000	117,000	—
Direct investments -			
Retail	398,817,000	430,200,000	31,383,000
Office	625,644,000	725,416,000	99,772,000
Industrial	184,223,000	197,485,000	13,262,000
Residential	343,484,000	388,148,000	44,664,000
Total Real Estate	\$2,409,200,000	2,697,748,000	288,548,000
2000			
Commingled funds	\$ 12,338,000	18,236,000	5,898,000
Real estate investment trusts	510,621,000	520,799,000	10,178,000
Commerical mortgage backed securities	225,937,000	221,971,000	(3,966,000)
Commerical mortgages	65,644,000	64,278,000	(1,366,000)
Alaska residential mortgages	198,000	198,000	—
Direct investments -			
Retail	385,377,000	385,166,000	(211,000)
Office	636,194,000	753,364,000	117,170,000
Industrial	172,459,000	177,166,000	4,707,000
Residential	311,423,000	329,820,000	18,397,000
Total Real Estate	\$ 2,320,191,000	2,470,993,000	150,807,000

8. Alaska Certificates of Deposit

The Corporation is authorized by statute to invest Fund assets in certificates of deposit or the equivalent instruments of banks, savings and loan associations, mutual savings banks, and credit unions doing business in Alaska. Letters of credit from the Federal Home Loan Bank secure these investments. The market value of these certificates approximates cost.

9. Accounts Payable

Accounts payable at June 30 are summarized as follows:

	<u>2001</u>	<u>2000</u>
Accrued liabilities	\$ 9,505,000	12,398,000
Service fees payable	1,754,000	3,275,000
Foreign exchange contracts	740,000	8,051,000
Securities purchased	241,161,000	395,294,000
Total Accounts Payable	\$ <u>253,160,000</u>	<u>419,018,000</u>

10. Income Distributable to The State of Alaska

The Legislature appropriated a portion of the Fund's statutory net income for various purposes, including the payment of dividends to qualified residents of the State of Alaska. In addition, the Legislature appropriated a portion of the Fund's earnings reserves to fund various other agency activities. Income distributable to the State at June 30 is summarized as follows:

	<u>2001</u>	<u>2000</u>
Dividends	\$ 1,082,300,000	1,142,148,000
Appropriation to the Departments of -		
Corrections	3,615,000	2,929,000
Health and Social Services	16,147,000	17,518,000
Revenue	5,099,000	4,985,000
Public Safety	5,376,000	4,871,000
Legislature	64,000	—
Total to Dividend Fund	<u>1,112,601,000</u>	<u>1,172,451,000</u>
Other agencies	<u>3,843,000</u>	<u>2,780,000</u>
Total Income Distributable	<u>\$ 1,116,444,000</u>	<u>1,175,231,000</u>

11. Principal

The principal balance of the Fund at June 30 is shown as follows:

	<u>2001</u>	<u>2000</u>
Dedicated State revenues	\$ 7,070,741,000	6,731,426,000
Appropriations from the State	6,885,906,000	6,885,906,000
Inflation-proofing	6,929,350,000	6,243,421,000
Settlement earnings	<u>161,582,000</u>	<u>153,895,000</u>
Total Principal	<u>\$ 21,047,579,000</u>	<u>20,014,648,000</u>

On June 30, 2000, a \$250,000,000 transfer was made from earnings reserve to the principal of the Fund. The transfer was authorized by the Legislature through House Bill 18, "An Act making a special appropriation in an amount not to exceed \$250,000,000 from the earnings reserve account to the principal of the permanent fund; and providing for an effective date."

The Fund received dedicated State revenues from North Slope royalty case (*State v. Amerada Hess, et al.*) settlements. By statute, realized earnings from these settlements are to be treated in the same manner as other Fund income, except that these earnings on settlements are excluded from the dividend calculation. Total realized earnings on settlement principal were \$22,230,000 in 2001 and \$38,638,000 in 2000. Of these amounts, \$14,543,000 and \$8,307,000 during 2001 and 2000 respectively, were added to inflation-proofing. The remaining earnings of \$7,687,000 and \$30,331,000 during 2001 and 2000 respectively, have been added to Fund principal in accordance with law. Accumulated settlement related activity, which is included in the principal balance of the Fund at June 30, is shown as follows:

	2001	2000
Settlement -		
Principal	\$ 229,242,000	215,655,000
Earnings	161,582,000	153,895,000
Inflation-proofing	62,948,000	48,405,000
Total Settlement Principal	\$ 453,772,000	417,955,000

12. Investment Income by Source

Investment income during the years ended June 30 is summarized as follows:

	<u>2001</u>	<u>2000</u>
Interest		
Marketable debt securities	\$ 656,442,000	672,348,000
Alaska certificates of deposit	7,633,000	8,189,000
Cash and other interest	46,237,000	6,621,000
Total Interest	\$710,312,000	687,158,000
Dividends		
Domestic preferred and common stock	\$ 89,212,000	100,122,000
Non-domestic preferred and common stock	66,339,000	66,694,000
Total Dividends	\$155,551,000	166,816,000
Real Estate and Other Income		
Real estate interest	\$ 22,297,000	21,568,000
Real estate dividends	39,130,000	34,086,000
Other real estate income	150,226,000	129,963,000
Loaned security and other income	13,562,000	9,953,000
Total Real Estate and Other Income	\$225,215,000	195,570,000

Under Statute 37.13.120(f), the Corporation is authorized to enter into securities lending transactions. The Corporation, through an agreement with the Bank of New York (the "Bank"), lends marketable debt and equity securities. These loans are fully collateralized at not less than one hundred two percent (102%) of the market value of the loaned securities for U.S. securities and one hundred five percent (105%) of market value for non-U.S. securities. The Corporation is fully indemnified by the Bank against any loss resulting from a default on a loaned security. The Corporation is able to sell any securities out on loan. The Bank may sell collateral upon borrower default. The Bank receives a fee based on earnings from securities lending. At June 30, 2001, there was \$3,670,925,000 in loaned securities outstanding. During the years ended June 30, 2001 and 2000, there were no losses incurred as a result of securities lending transactions.

13. Net Realized Losses On Currency

Net realized losses on foreign currency inventory were \$5,280,000 and \$3,825,000 for the years ended June 30, 2001 and 2000, respectively. Currency gains and losses resulting from the purchase and sale of securities are included as part of the net increase or decrease in the fair value of the traded securities.

14. Foreign Exchange Contracts and Off-Balance Sheet Risk

The Corporation entered into foreign currency forward exchange contracts to buy and sell specified amounts of foreign currencies at specified rates on specified future dates for the purpose of hedging existing cash positions in these currencies. The maturity periods for these contracts ranged from one to five months. At June 30, 2001, the Corporation had net unrealized gains with respect to such contracts.

The counterparties to the foreign currency forward contracts consisted of a diversified group of financial institutions. The Corporation is exposed to credit risk to the extent of non-performance by these counterparties; however, the Corporation considers the risk of default to be remote. The Corporation's market risk is limited to the difference between contractual rates and forward rates at the end of the fiscal year.

The Corporation had net sale contracts outstanding totaling \$8,053,000 and \$263,447,000 for the years ended June 30, 2001 and 2000, respectively. The market value of these contracts, using the forward rate at June 30, 2001 and 2000, was \$506,000 and \$268,228,000, respectively. This resulted in net unrealized gains of \$12,328,000 for the year ended June 30, 2001 and net unrealized losses of \$11,690,000 for the year ended June 30, 2000, including prior year reversals in each year. The Fund had realized gains amounting to \$24,844,000 and \$13,986,000 for the years ended June 30, 2001 and 2000, respectively.

15. Operating Expenses

Operating expenses of the Corporation for the years ended June 30 are summarized as follows:

	<u>2001</u>	<u>2000</u>
Salaries and benefits	\$ 2,687,000	2,810,000
Travel	235,000	245,000
Communications	978,000	864,000
Custody and safekeeping fees	1,701,000	2,047,000
Consulting fees	369,000	595,000
Investment management fees	32,135,000	32,784,000
Legal and audit fees	278,000	433,000
Public information and subscriptions	245,000	231,000
Rent	154,000	308,000
Property and equipment	203,000	340,000
Other expenses	505,000	800,000
Total Operating Expenses	<u>\$ 39,490,000</u>	<u>41,457,000</u>

16. Pension Plan

All full-time employees of the Corporation participate in the State of Alaska Public Employees Retirement System (PERS), a multiple employer public employee retirement system. Total salaries and benefits for employees covered by PERS for the years ended June 30, 2001 and 2000 amounted to \$2,687,000 and \$2,810,000, respectively.

Corporation employees are required to contribute 6.13% of their annual salaries to PERS. The Corporation contributes the remaining amounts necessary to pay benefits when due. These contributions represented 8.09% and 8.13% of covered salary expenses in the years ended June 30, 2001 and 2000, respectively.

17. Investments Managed on Behalf of Other Entities

By statute, the Alaska Science and Technology Endowment Fund, the Alaska Mental Health Trust Fund and the International Trade and Business Endowment Fund (other funds) are invested by the Corporation under the same investment authority as the Fund is managed. The assets of the other funds are commingled with the assets of the Fund for investment purposes. Earnings are separately allocated to the other funds on the basis of unit and fractional unit shares, which have undivided beneficial interests in the commingled assets equal to the proportion that such shares bear to the total units outstanding. Unit shares are credited to the other funds on the basis of amounts contributed to the investment pool. The following represents the other funds' shares of the commingled net assets, which are not reflected in the accompanying financial statements:

	<u>2001</u>	<u>2000</u>
Alaska Science and Technology Endowment Fund	\$ 106,680,000	117,715,000
Alaska Mental Health Trust Fund	306,406,000	327,301,000
International Trade and Business Endowment Fund	<u>5,647,000</u>	<u>5,917,000</u>
Total Other Funds	<u>\$ 418,733,000</u>	<u>450,933,000</u>



***Executive Director
& Corporate Secretary/Treasurer***

ROBERT D. STORER

Sandra Firestack, Executive Assistant

Investments

ALLAN MOORE, CHIEF INVESTMENT OFFICER

Joyce Andrews, Executive Secretary

Rosemarie Santana, Investment Associate

Fixed Income

Richard Shafer, Manager of Fixed Income Investments

Jim Parise, Senior Investment Officer/Fixed Income

Steven Eason, Investment Officer/Fixed Income

Equities

Michael Bell, Manager of Equities Investments

Christy Leer, Investment Associate

Real Estate

Peter Naoroz, Manager of Real Estate Investments

Andrew Donovan, Investment Officer/Real Estate

Christi Grussendorf, Investment Officer/Real Estate

Chief Operating Officer

ROBERT N. BARTHOLOMEW

Administration

Shawn Lew, Executive Secretary

Freda Westman, Administrative Officer

Kathy Thatcher, Administrative Specialist

Ted Fosket, Procurement Specialist

Lisa Flores, Receptionist/Secretary

Finance

CHRIS PHILLIPS, DIRECTOR OF FINANCE

Dawn Vetter, Executive Secretary

Valerie Mertz, Controller

Tobie Putman, Portfolio Accountant

Ruth Danner, Portfolio Accountant

Karen Emberton, Accountant

Jeffrey Holzinger, Accounting Technician

Information Technology

MARSHAL KENDZIOREK,

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Rob McKnight, Senior Information Technology Specialist

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