

HJR

14

ALASKA STATE HOUSE OF REPRESENTATIVES

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Room 102

REPRESENTATIVE JOHN COGHILL

Memorandum

Date: April 11, 2002
To: Tam Cook, Legal Counsel
From: Rynnieva Moss, Legislative Aide
Re: LS0526\O.1 Amendment

I need a final Committee Substitute on SSHJR 14, Version O, with the attached amendment that you drafted.

Thanks for your help.

A M E N D M E N T

OFFERED IN THE HOUSE

BY REPRESENTATIVE CROFT

TO: SSHJR 14

1 Page 2, lines 5 - 8

2 Delete all material and insert:

3 "Section 30. Suspension and Repeal of Subsection. (a) Notwithstanding
4 Section 1 of Article XIII, Section 15(c) of Article IX is suspended on the date of an
5 initial determination by the Internal Revenue Service that all or a portion of the
6 permanent fund is subject to federal taxation. The suspension is terminated on the
7 date Section 15(c) of Article IX is repealed under (b) of this section or 180 days after
8 the date of a final, nonappealable judgment or order by a federal court deciding that no
9 portion of the permanent fund would be subject to federal taxation as a result of the
10 application of Section 15(c) of Article IX.

11 (b) Notwithstanding Section 1 of Article XIII, Section 15(c) of Article IX is
12 repealed 180 days after the date of a final, nonappealable judgment or order by a
13 federal court deciding that all or a portion of the permanent fund is subject to federal
14 taxation.

15 (c) In this section, "final, nonappealable judgment or"



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

March 29, 2002

The Honorable President of the Senate Rick Halford
The Honorable Speaker of the House Brian Porter
Alaska State Legislature, The Capitol
Juneau, Alaska 99811

Dear President Halford and Speaker Porter:

The Board of Trustees of the Alaska Permanent Fund Corporation (APFC) just completed a two-day Board meeting at which, among other things, we discussed legislation pending in both bodies which relates to the Permanent Fund. This letter is to express to you the Board's position on two items.

First, the Board continues to feel strongly that the best way to ensure complete and protected inflation-proofing is for the Legislature to enact either SJR 13 or HJR 15 in their original form. Based on our meetings with the public over the past couple of years, we are convinced that this measure would be approved by a large majority of Alaska voters in the 2002 General Election.

We understand that the House State Affairs Committee will be holding a hearing next week on SS HJR 14, which includes the Board's proposal, but adds language which would put Permanent Fund dividend payments in the Alaska State Constitution. We also understand that the Senate State Affairs Committee is considering a similar proposal as a committee substitute to SJR 13. We respectfully ask you to consider our long-standing advice on this issue which is excerpted here from a legal opinion written for the APFC in April of 1998:

"To the extent that the Fund, or some portion of it, becomes irreversibly dedicated to the benefit of private beneficiaries, or to the extent that the dividend program becomes an entitlement that is beyond the reach of government, then it is more like the prepaid tuition programs and is subject to potential challenge by the IRS as a private, rather than a public, investment activity."

Senate President Halford and House Speaker Porter

March 29, 2002

Page 2

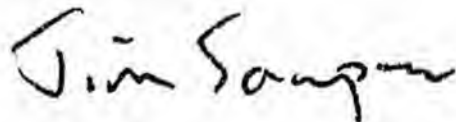
In simple words, the Board is concerned that putting the dividend program into the constitution would put the Fund at risk by jeopardizing its current tax-exempt status. We understand that some legislative members may believe it is possible to draft constitutional language which would mitigate the risk. In our view, the risk/reward benefits are not there.

On a different issue, HB 304 which passed recently from House Finance, the Board has mixed feelings. Clearly, the Board thinks that limiting annual payouts of Fund income to no more than 5 percent of the Fund's five-year average market value is a more desirable approach than the status quo. On the issue of how that payout should be divided up between government and dividends, the Board, of course, has no position; that is completely your prerogative. In recognition of that fact, you will note that the Board's proposed constitutional amendment does not affect the dividend.

However, the Board is concerned about the repeal of statutory inflation-proofing as part of this statutory implementation of the Board's proposal. Although the Legislature has an excellent record in support of inflation-proofing up to this date, as the state enters a period of much tighter revenue constraints, there is no certainty that future Legislatures will stay on the same disciplined path. A constitutional POMV provides a much greater assurance that the Fund will be inflation-proofed for all generations than does a statutory scheme which could be changed by any future Legislature.

Consequently, the Board asks that the Legislature not repeal statutory inflation-proofing, at least not until the constitutional change requested by the Board which would provide complete and protected inflation-proofing is approved by the Legislature and the voters. We commend you for your courageous efforts to construct a viable long-range financial plan for the state, and we thank you for your consideration of our views.

Yours truly,



Jim Sampson
Chair, Board of Trustees

c: All members, 22nd Alaska State Legislature
All members, APFC Board of Trustees
Governor's Chief of Staff and Legislative Liaison

Alaska State Legislature
House of Representatives

Alaska State Capitol
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Representative Harry Crawford
District 22

**REPRESENTATIVE HARRY CRAWFORD
SPONSOR STATEMENT FOR HJR 14**

The State of Alaska has a fiscal crisis looming, although there is a great deal of talk about creating a long range fiscal plan, there has been little substantive action in that direction. HJR 14 Proposes to amend the Alaska State Constitution and convert the Constitutional Budget Reserve into the Alaska Heritage Fund. The Alaska Heritage Fund would convert the balance of the ailing CBRF into a permanent endowment. The principal advantage of this approach would be to create a renewable and sustainable fund which will grow at a rate greater than inflation, and provide a steady source of revenue long after the Prudoe Bay fields have run dry.

LEGAL SERVICES

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

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Mail Stop 3101

State Capitol
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Deliveries to: 129 6th St., Rm. 329

MEMORANDUM

February 21, 2001

SUBJECT: Alaska Heritage Fund (HJR 14)

TO: Representative Harry Crawford
Attn: David D'Amato

FROM: Tamara Brandt Cook
Director *TBC*

Here is the sectional summary you requested.

Sec. 1. Amends the state constitution to change the budget reserve fund to the Alaska heritage fund. Money in the fund is to be used for income-producing investments designated by law.

Sec. 2. Appropriations from the Alaska heritage fund for a fiscal year may not exceed five percent of the average of the year-end market values of the fund for the preceding five fiscal years.

Sec. 3. Permits appropriations to the Alaska heritage fund at any time.

Sec. 4. Requires the prudent investor rule to be applied in the management of the Alaska heritage fund.

Sec. 5. Provides an effective date for these constitutional amendments of July 1, 2003. The balance in the budget reserve fund shall be transferred to the Alaska heritage fund.

Sec. 6. The proposed amendments are submitted to the voters at the 2002 general election.

TBC:glc
01-184.glc

Alaska State Legislature
House of Representatives

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Representative Harry Crawford
District 22

Memorandum

To: Representative John Coghill, Chairman House Committee on State Affairs

From: Representative Harry Crawford

RE: HJR14: Proposing amendments to the Constitution of the State of Alaska relating to the budget reserve fund and to the Alaska heritage fund; and providing for an effective date for the amendments.

I respectfully request that this bill be scheduled for a hearing in your committee. Attached are all the pertinent background materials.

Alaska Heritage Fund

Earnings Rate	Inflation Rate
8.5%	3.25%

	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Beginning Balance				\$ 2,282.2	\$ 2,407.4	\$ 2,540.4	\$ 2,681.9	\$ 2,832.3	\$ 2,992.5
Earnings				\$ 199.3	\$ 210.3	\$ 221.9	\$ 234.4	\$ 247.6	\$ 261.5
Oil & Gas Tax Dispute Resolutions				\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0
* Withdrawals @ 5%				\$ (114.1)	\$ (117.2)	\$ (120.5)	\$ (123.9)	\$ (127.4)	\$ (134.5)
Ending Balance	<u>\$ 3,112.8</u>	<u>\$ 2,810.0</u>	<u>\$ 2,282.2</u>	<u>\$ 2,407.4</u>	<u>\$ 2,540.4</u>	<u>\$ 2,681.9</u>	<u>\$ 2,832.3</u>	<u>\$ 2,992.5</u>	<u>\$ 3,159.4</u>
Oil Price **	\$30.17	\$24.20	\$22.06	\$21.06	\$20.38	\$17.25	\$17.25	\$17.25	\$17.25
	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Beginning Balance	\$ 3,159.4	\$ 3,333.2	\$ 3,514.3	\$ 3,702.7	\$ 3,898.7	\$ 4,102.7	\$ 4,314.9	\$ 4,535.7	\$ 4,765.5
Earnings	\$ 275.9	\$ 291.0	\$ 306.7	\$ 323.1	\$ 340.1	\$ 357.7	\$ 376.2	\$ 395.3	\$ 415.2
Oil & Gas Tax Dispute Resolutions	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0
* Withdrawals @ 5%	\$ (142.1)	\$ (150.0)	\$ (158.3)	\$ (167.0)	\$ (176.1)	\$ (185.5)	\$ (195.3)	\$ (205.5)	\$ (216.2)
Ending Balance	<u>\$ 3,333.2</u>	<u>\$ 3,514.3</u>	<u>\$ 3,702.7</u>	<u>\$ 3,898.7</u>	<u>\$ 4,102.7</u>	<u>\$ 4,314.9</u>	<u>\$ 4,535.7</u>	<u>\$ 4,765.5</u>	<u>\$ 5,004.5</u>

* Withdrawals are computed in FY04 by the previous fiscal years' ending balance multiplied by 5%. In FY05, withdrawals are computed by average ending balance of the two previous fiscal years multiplied by 5%, etc.

** Official DOR Fall Forecast

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Permanent Fund Basics: Income, Distributions and Percent of Market Value (POMV)

Robert D. Storer, Executive Director
Jim Kelly, Director of Communications
Alaska Permanent Fund Corporation

Fiscal Policy Caucus
April 6, 2001

www.apfc.org

Alaska Permanent Fund Corporation



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Alaska Permanent Fund
professionalism • performance • permanence

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Top stories
April 05, 2001

- Mayors learn more about Fund**
MAY 29 - A group of Alaska mayors attending the Alaska Municipal League meeting in Juneau today learned what might be ahead for Alaska's future if inflation-proofing is enacted constitutionally to prevent erosion of the Fund's purchasing power. [EXERCISE](#)
- Board to hold videoconference work session**
MAY 29 - Legislation pertaining to the Permanent Fund will be the topic of discussion for a Board of Trustees work session to be held via videoconference on Thursday, April 5 from 9:00 a.m. to 1:00 p.m. The public is invited to attend. Teleconference access information and a full agenda follow. [EXERCISE](#)
- Intern opportunities continue**
MAY 28 - Alaska students

Daily unaudited position
As of April 04, 2001

U.S. Government	35%	\$2,679,000,000
Top 25 U.S. Stocks	2%	\$602,200,000
U.S. Bonds	31%	\$7,509,000,000
Foreign Bonds	16%	\$2,965,400,000
Real Estate	11%	\$2,640,000,000
Residuals	1%	\$142,700,000
TOTAL	100%	\$14,538,300,000

Quarterly report
The Alaska Permanent Fund's loss for the quarter of 3.4 percent illustrates the benefit of diversification.

Chart of the day

Alaska Permanent Fund Corporation



Permanent Fund Basics:

A primer on income and distributions

www.apfc.org

Alaska Permanent Fund Corporation

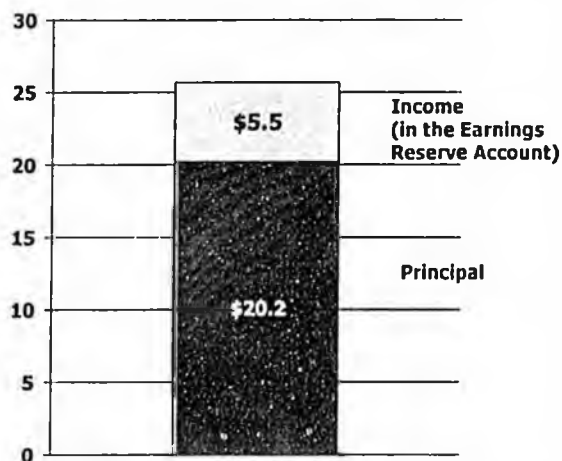


How the Fund works

Permanent Fund market value

The market value of the Permanent Fund is currently \$25.7 billion

It consists of two parts: principal and income



Total Fund as of 2/28/01

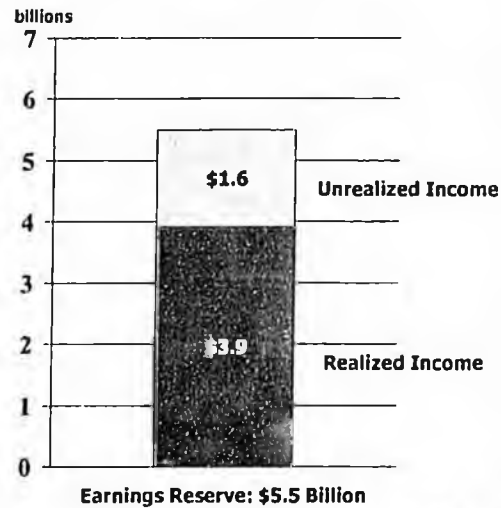
Alaska Permanent Fund Corporation



How the Fund works

Permanent Fund income

- As provided by law, all income from the Permanent Fund's investments is deposited into the Earnings Reserve Account in the Permanent Fund
- It is retained there until appropriated by the legislature



Earnings Reserve: \$5.5 Billion

Alaska Permanent Fund Corporation



How the Fund works

Statutory use of Fund income

- Alaska Statutes (AS 37.13.140 and 145) provide the following priority for the payment of dividends and inflation-proofing:
- First, dividends are calculated and paid; then
- Second, an amount of income sufficient to offset the effect of inflation is transferred to principal.

Alaska Permanent Fund Corporation

How the Fund works

2000 PFD calculation: \$1.172 billion

Statutory net income -- excludes unrealized gains (in millions)

FY96	\$1,769		
FY97	\$2,036		
FY98	\$2,595		
FY99	\$2,544		
FY00	<u>\$2,220</u>		
	\$11,164		
x 0.21	=	<u>\$2,344</u>	= Income available for distribution ...unless it is less than the balance in the earnings reserve account

**1/2 of the lesser amount is transferred to the dividend fund,
and paid out to qualified applicants.**

**Since the beginning of the dividend program,
the amount transferred has always been the lesser amount.**

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How the Fund works

2000 inflation-proofing calculation

- 2.19% = change from average CPI for calendar 1998 to average CPI for calendar 1999;
- Principal on June 30, 2000 was \$19.597 billion;
- Fund principal \$19.597 billion x .0219 CPI = \$423 million

**CPI inflation rate for 2001 will be 3.37%
x estimated principal balance of \$20.373 billion
= estimated 2001 inflation-proofing of \$687 million**

Alaska Permanent Fund Corporation



Basic principles of the Trustees' investment policy

- Diversify to protect the Fund
- Do the utmost due diligence, apply best judgment and accept the consequences
- Invest for the long-term, be disciplined and be prepared for extended periods of short-term volatility
- Balance the income benefits between current and future generations

Alaska Permanent Fund Corporation



APFC'S 2000-2003 ASSET ALLOCATION

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

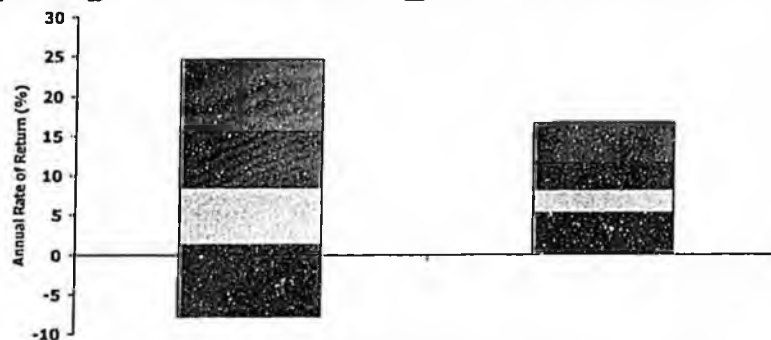
*Includes an allocation of 3% of the total Fund to Emerging Markets.

**Includes an allocation of \$300,000,000 for Alaska Financial Institutions' Certificates of Deposit.

Alaska Permanent Fund Corporation



Permanent Fund's projected range of returns



	1-year Returns	5-Year Returns
5th	27.00	16.20
25 th	15.50	11.40
50th	8.25	8.25
75th	1.30	5.10
95th	-7.80	0.70

Alaska Permanent Fund Corporation



Permanent Fund Basics:

A primer on POMV

www.apfc.org

Alaska Permanent Fund Corporation



What is POMV?

Percent Of Market Value = Payout of Fund income

5% x \$28 billion = \$1.4 billion

PF Total return – Payout = Inflation-Proofing

8.25% – 5% = 3.25%

Alaska Permanent Fund Corporation



Benefits of POMV

1. Preserves the Fund's purchasing power
2. Maximizes distributions over the long-term
3. Minimizes fluctuations in annual payouts

Alaska Permanent Fund Corporation



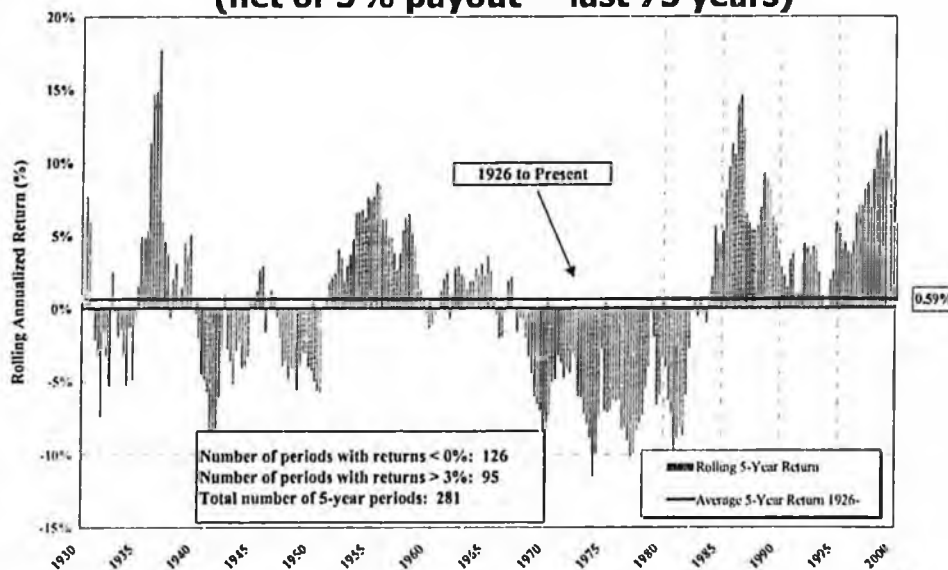
Why limit the payout to 5%?

- 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 payout

Alaska Permanent Fund Corporation



Rolling 5-year real return for 60% stock/40% bond mix (net of 5% payout -- last 75 years)



SOURCE: Callan Associates, Inc.

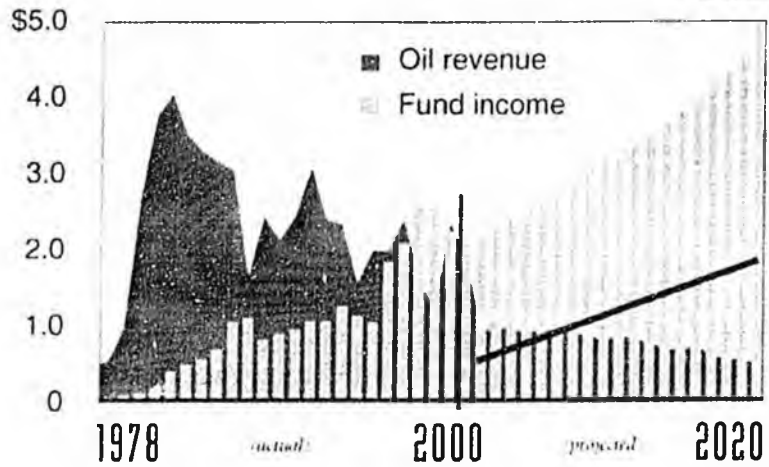
Alaska Permanent Fund Corporation



Fund statutory net income vs. state oil revenue

(Dollars in billions)

5% POMV



\$57 billion total investment return

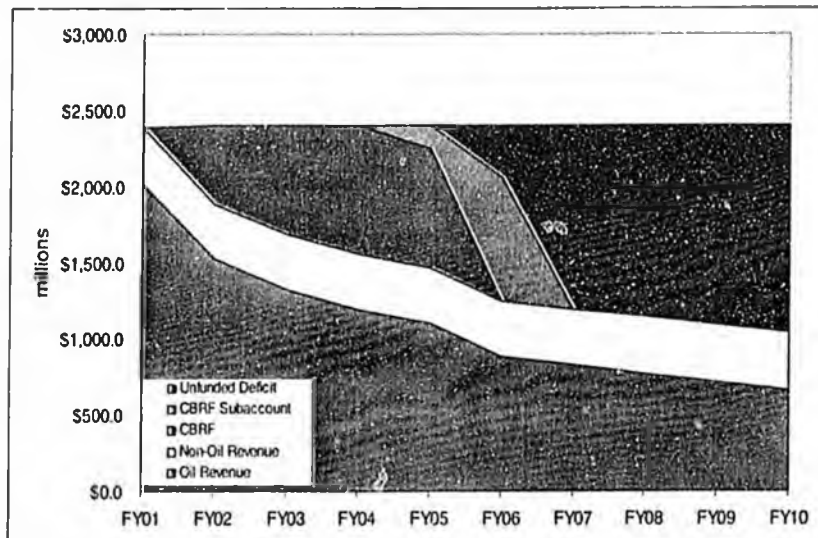
\$37 billion available

\$20 billion inflation-proofing

Alaska Permanent Fund Corporation

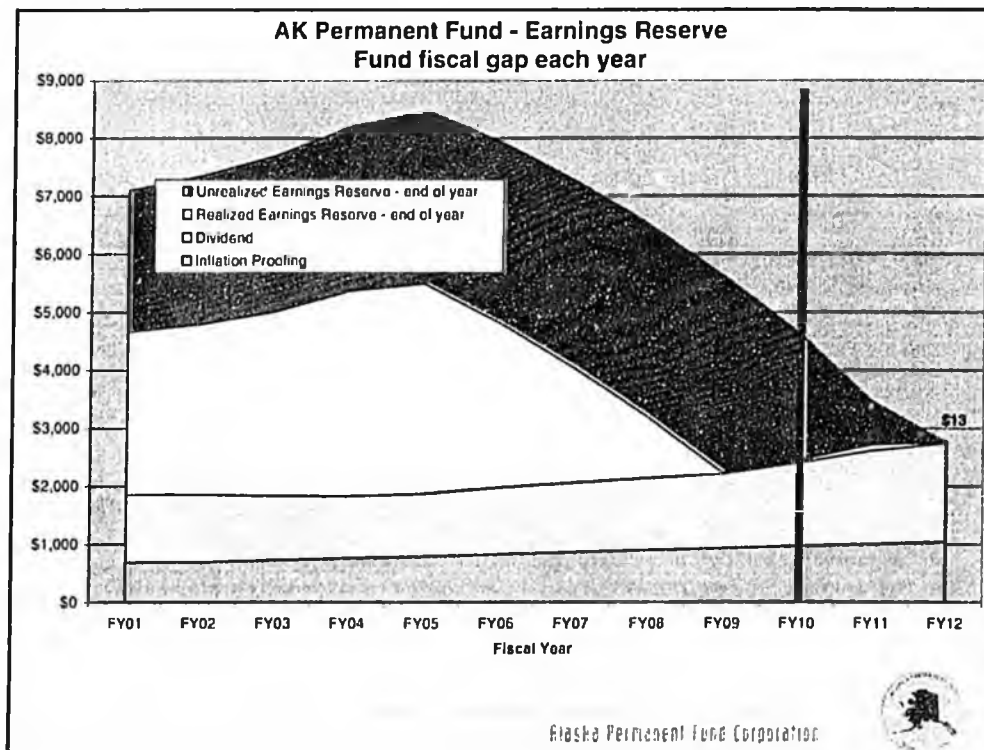
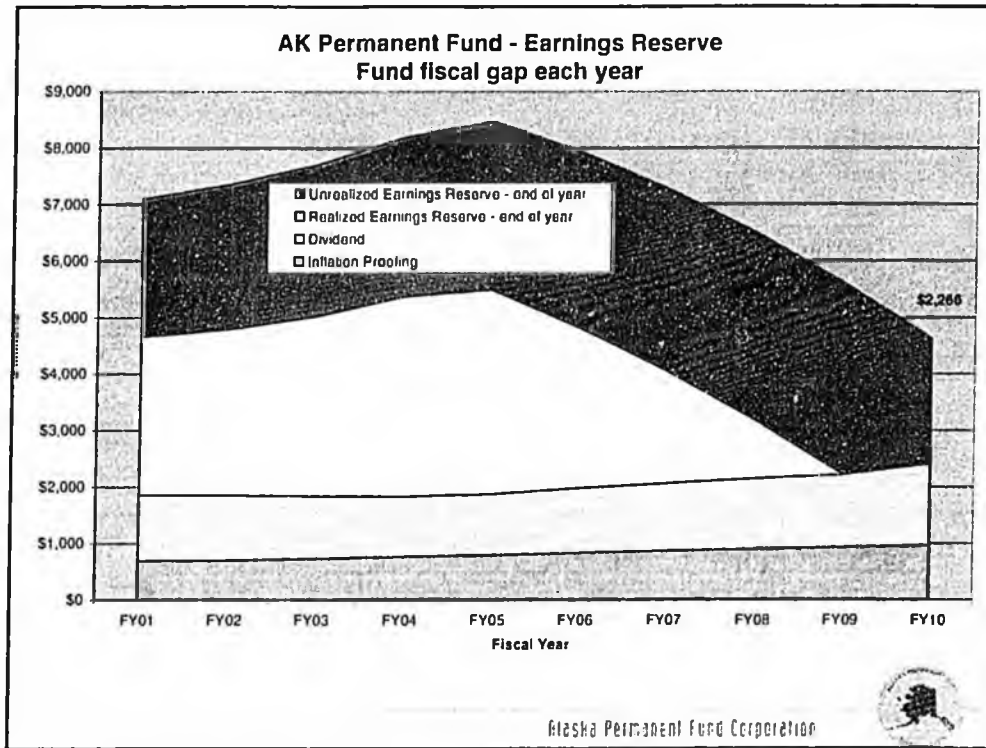


State of Alaska Revenue Sources

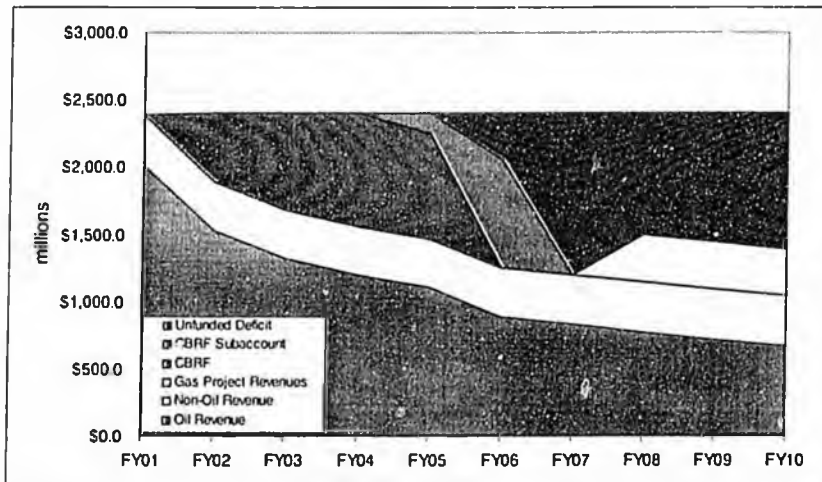


Alaska Permanent Fund Corporation





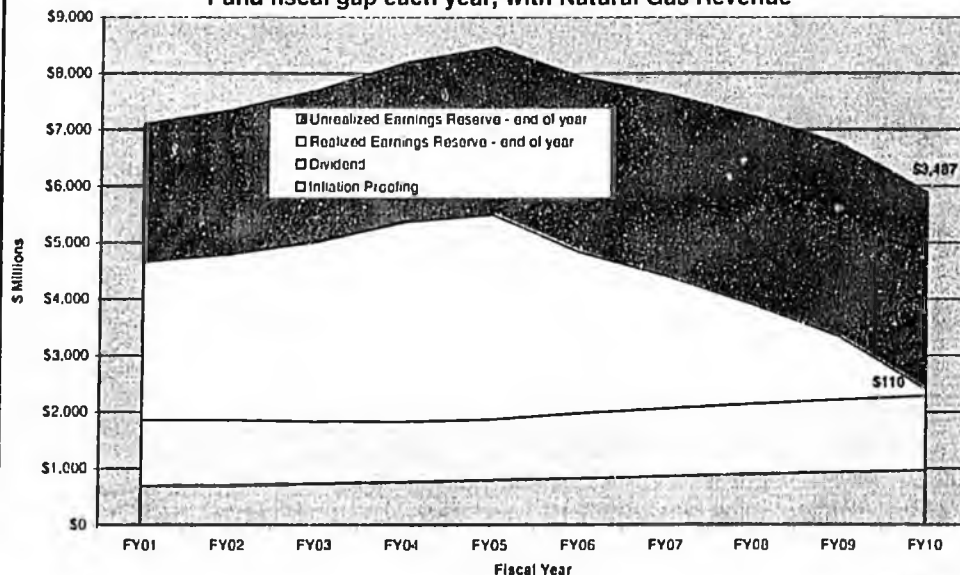
State of Alaska Revenue Sources with \$350 Million Revenue from North Slope Natural Gas Project Starting in FY 2008



Alaska Permanent Fund Corporation



AK Permanent Fund - Earnings Reserve Fund fiscal gap each year, with Natural Gas Revenue



Alaska Permanent Fund Corporation



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 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 Corporation



Post-It® Fax Note	7671	Date	1/29/01	# of pages	12
To	Dave D'Amato		From	T. Navegant	
Dept	Rep. Crawford		Co.	Treasury	
Phone #	0		Phone #	465-3751	
Fax #	465-4565		Fax #		

Constitutional Budget Reserve Fund - Investment Policy Statement

1. Overview

The state must deposit in a Constitutional Budget Reserve Fund (CBRF) all money received by the state after July 1, 1990 as a consequence of the resolution of disputes about the amount of mineral lease bonuses, royalties or taxes.

The Legislature may appropriate funds from the CBRF to fund the operations of state government only under certain conditions. If, at any time, the amount of funds from other sources available to the Alaska Legislature for appropriation is less than the amount appropriated to fund state government for the previous fiscal year, then the Legislature may appropriate from the CBRF on a simple majority vote. When the amount of funds from other sources exceeds the amount appropriated for the previous fiscal year, the Legislature may appropriate from the Fund for any public purpose with a three-fourths vote of the members of each house.

The Alaska state constitutional provision governing the operation of the CBRF requires the state's general fund to repay the money that has been appropriated from the CBRF if and when there is a surplus in the general fund at the end of any fiscal year. The general fund does not pay interest on the money it has "borrowed" from the CBRF.

Treasury's investment policies for the CBRF have changed over the years as balance and the expected uses of the CBRF have changed. A significant change occurred this year when the 21st Legislature created a special subaccount in the CBRF in order to "yield higher returns than might be feasible to obtain with other money in the budget reserve fund." The legislature directed that "In establishing or modifying the investment policy for the subaccount in the constitutional budget reserve fund, the commissioner of revenue shall assume that those funds will not be needed for at least five years. Income earned on money in the subaccount shall be retained in the subaccount by the department." AS 37.10.430(c).

Treasury, according to the constitution, credits to the CBRF the amount earned by the investment of the money in the CBRF. That is, the main account of the CBRF retains its investment earnings and the subaccount of the CBRF retains its investment earnings.

Appendix V contains the constitutional and statutory provisions applicable to the CBRF.

2. History

- November 1990. Voters of Alaska adopt an amendment to the Alaska State Constitution creating the CBRF. Article IX, 17 - See Appendix V.
- 1992-1994. Litigation over meaning of key terms in the constitutional provision.
- 1994. Legislature attempts to define "administrative proceedings involving taxes" and "money available for appropriation." 1 Ch. 5 SLA 1994. AS 37.10.410-420.
- April 1994. Alaska Supreme Court decision in *Hickel v. Halford* 872 P.2d 171 defining scope of "dispute" and "administrative proceedings."
- May 1994. Alaska Supreme Court decision in *Hickel v. Cowper* 874 P.2d 922 defining meaning of "amount available for appropriation."
- 1996. Legislature modifies definition of "administrative proceedings involving taxes." 5 Ch. 108 SLA 1996. See Appendix V.
- 1996. Legislature grants commissioner discretion to transfer management of all or a portion of CBRF to Alaska Permanent Fund Corporation. 1 Ch. 41 SLA 1996. AS 37.10.430. See Appendix V.
- 1997. Commissioner of Revenue decides to manage and invest all of CBRF through the Treasury Division, and Commissioner adopts Reserves Policy for the state.
- 1997. Commissioner adopts investment policy for CBRF based on three separate purposes of CBRF:
 - Fund to implement the state's Reserves Policy to cover anticipated and unanticipated shortfalls in the next two fiscal years' budgets;
 - Fund to provide a transition to a long-term fiscal plan; and
 - Fund to act as long-term reserve account to cover unanticipated budget shortfalls well into the future.
- June 1997. Legislature appropriates money from the CBRF for the first time from the CBRF to pay for CBRF equity investment management fees.
- July 1998. Because of anticipated heavy use of CBRF in short to medium term to balance state budgets, Commissioner modifies investment policy and eliminates consideration of using a portion of the CBRF to act as long-term reserve account.
- December 1998. Treasury reviews the Department of Revenue's Fall oil revenue forecast and the Office of Management and Budget's updated expenditure forecast. Treasury determines that the CBRF will be exhausted within five years to meet revenue shortfalls. Commissioner modifies investment policies and eliminates all equity investments.
- July 1999-September 1999. Treasury recommends and Commissioner accepts an investment policy recognizing a two-year investment horizon for the entire balance of the CBRF. Very large draws on CBRF to balance FY 98 and FY 99 budgets, together with a projected \$600 million to \$1.0 billion draw to balance FY 00 budget, reduces the anticipated time horizon for the balance of fund.

Commissioner concludes this change is appropriate no matter how the public votes in the September 14, 1999 special election relating to the state's long-range finances. Similarly, the Commissioner concludes that the higher oil prices experienced in the late spring and summer of 1999 should not alter this proposed policy.

- April 2000. Treasury recommends and Commissioner accepts an investment policy that recognizes a balance in the CBRF in excess of the state's two year reserve requirement and the state's cash flow needs. Higher than anticipated oil prices and a significant settlement increased the balance of the CBRF enough to cause the change in the investment policy
- July 2000. A significant change in the legislation relating to the fund caused Treasury to recommend significant changes to the investment policy of the fund. Treasury recommended and the commissioner accepted an investment policy that recognized a distinction for the newly created subaccount of the fund, the likely life of the fund, and the role of the balance of the fund in filling the reserve requirements of the State. (Related decision document in Appendix Y.) (Earlier versions of these decision documents are maintained in permanent files in Treasury's Asset Accounting Section. Revised documents relating to those policy decisions may be found in Appendices W and X.)

3. Facts and Figures

Fund Cash Flow History by Fiscal Year

Alaska's Public Finances Constitutional Budget Reserve Fund, Main Account (\$millions)

	Settlement Contributions ^(a)	Investment Income ^(b)	Net Loans to General Fund	Balance Available to Loan GF at Year End ^(c)
FY 91	291	6	-	297
FY 92	247	19	-	563
FY 93	914	57	(849)	685
FY 94 ^(d)	437	61	(569)	614
FY 95	1,543	122	(285)	1,994
FY 96	586	111	(173)	2,518
FY 97	570	167	(83)	3,172
FY 98	343	369	(325)	3,559
FY 99	56	114	(1,101)	2,628
FY 00	448	115	^(c) (357)	^(f) 2,734
FY 01 (Proj.)	100	128	117	^(e) 2,679
FY 02 (Proj.)	45	133	(515)	2,342
FY 03 (Proj.)	45	107	(717)	1,777
Total	5,625	1509	(\$4,857)	

Data sources:

- (a) Department of Revenue, Income and Excise Audit Division, Mineral Payments Report (ties in total through FY99).
- (b) Derived (by formula).
- (c) State of Alaska Comprehensive Annual Financial Report (ending balance less the outstanding receivable from the state's general fund).
- (d) Although the table above is based on cash flows, it does not reflect the timing of the \$1,006,038,474 legislative appropriation (Ch 14, SLA 1994) resulting from an Alaska Supreme Court order to restore the CBRF for certain settlement payments deposited to the state's general fund from FY 1990-1994.
- (e) FY00 includes draw to finalize FY99 budget (42mm).
- (f) Reflects \$100 million transfer to Power Cost Equalization Endowment Fund.
- (g) Reflects \$400 million transfer to CBRF subaccount on July 1, 2000.

Alaska's Public Finances
Constitutional Budget Reserve Fund, Subaccount
(\$millions)

	Settlement Contributions ^(a)	Investment Income ^(b)	Net Loans to General Fund	Balance Available to Loan GF at Year End ^(c)
FY 00	0	0	0	0
FY 01 (Proj.)	400	34	0	434
FY 02 (Proj.)	0	37	0	471
FY 03 (Proj.)	0	40	0	511
Total	400	111	0	

4. Investment Policy

For the main account of the CBRF (excluding the subaccount that has a five-year time horizon), Treasury recognizes the State's current two-year reserve requirement, General Fund cash flow borrowing needs, money in excess of that which might be needed within two years and the Investment policy of the GcFONSI. At this time, the current high oil prices and the balance in the CBRF support a somewhat more aggressive policy for the money in the main account of the CBRF than had been the case in recent years.

Treasury would invest the main account of the CBRF with the following in mind:

Risk Tolerance	Moderately high. Fund should not be needed for several years.
Investment Objectives	Moderately high exposure of principal to loss in return for higher expected longer-term returns. Limited current income requirement. Moderate inflation protection needed. Moderate liquidity requirement.
Time Horizon	Intermediate.

Effective July 1, 2000, Treasury's investment policy for the main account of the CBRF would be:

- 25% Board Market Fixed Income Investment Pool
- 65% Intermediate-term Fixed Income Investment Pool
- 10% Short-term Fixed Income Investment Pool

Treasury's performance benchmark for the main account of the CBRF is:

- 25% Lehman Brothers Aggregate Bond Index
- 65% Merrill Lynch 1-5 year Government Index
- 10% Three-month U.S. Treasury Bill

Treasury would invest the subaccount of the CBRF with the following in mind:

- Risk Tolerance** High. The legislature has expressly provided guidance by instructing the Commissioner to use at least a five year time horizon in establishing an investment policy for the subaccount.
- Investment Objectives** High exposure of principal to loss in return for higher expected longer-term returns.
Limited current income requirement.
Inflation protection needed.
Moderate liquidity requirement.
- Time Horizon** Long.

Effective July 1, 2000, Treasury's investment policy for the subaccount of the CBRF would be:

- 42% Board Market Fixed Income Investment Pool
- 41% Domestic Equity Investment Pool
- 17% International Equity Investment Pool

Treasury's performance benchmark for the main account of the CBRF is:

- 42% Lehman Brothers Aggregate Bond Index
- 41% Russell 3000 Stock Index
- 17% Morgan Stanley Capital International Europe, Australia, and Far East Stock Index

5. Control and Reporting Requirements

On or before March 15 each year, AS 37.10.430 requires Treasury to prepare a report to the Legislature comparing beginning and ending balances in the CBRF for the immediately preceding calendar year together with comparative nominal, real and realized returns for the CBRF, the Permanent Fund and the

general fund. The State Comptroller in the Treasury Division is responsible for compiling this information and preparing and distributing the required report.

The Alaska Legislature made AS 37.10.071 directly applicable to the CBRF. Accordingly, the Commissioner, through the State Comptroller, maintains accounting records for the Fund in accordance with generally accepted accounting principles (as would be required by AS 37.10.071(a)(8)) and engages an independent certified public accountant to perform an annual audit of the financial condition of the Fund and the pertinent investment transactions (as would be required by AS 37.10.071(a)(9)).

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
8/19/99	9/1/99	CBRF - elimination of Transition Fund and Long-term Reserve Fund, modification to investment policy of Two-year Shortfall Fund including asset allocation.	1.2
3/7/00	4/1/00	Treasury updates 2000 capital market assumptions and changes asset allocation policy accordingly. Target policy was 15% Short-term Fixed Income Investment Pool, 85% Intermediate-term Fixed Income Investment Pool.	1.3
4/7/00	4/10/00	Treasury revises asset allocation after receiving a \$416.3 million settlement from an oil tax dispute in early April 2000. Asset allocation was 25% Short-term Investment Pool, 75% Intermediate-term Investment Pool.	1.4
1/29/01	7/1/00	Treasury revises asset allocation when the 21st Legislature creates a special \$400 million "subaccount" in the CBRF effective July 1, 2000 and establishes a new \$100 million Power Cost Equalization Endowment Fund.	1.7

FISCAL NOTE

STATE OF ALASKA
2002 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: SSHJR 14
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: OOG
 Title Constitutional amendment relating BRU Elections
the Alaska permanent fund Component Elections
 Sponsor Representative Crawford
 Requester House State Affairs 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 Phone 465-3935
 Division Division of Elections Date/Time 3/27/02 10:07 AM
 Approved by: Lieutenant Governor Fran Ulmer Date 03/27/2002
 Agency Office of the Lieutenant Governor

Alaska State Legislature
House of Representatives

Alaska State Capitol
Juneau, Alaska 99801-1182
1-907-465-3438 (phone)
1-888-478-3438 (toll free)
1-907-465-4565 (fax)



Interim Address
716 West Fourth Avenue
Anchorage, Alaska 99501-2133
(phone) 1-907-269-0100
(fax) 1-907-269-0105

Representative Harry Crawford
District 22

**REPRESENTATIVE HARRY CRAWFORD
SPONSOR STATEMENT FOR HJR 14**

The State of Alaska has a fiscal crisis looming, although there is a great deal of talk about creating a long range fiscal plan, there has been little substantive action in that direction. HJR 14 Proposes to amend the Alaska State Constitution and convert the Constitutional Budget Reserve into the Alaska Heritage Fund. The Alaska Heritage Fund would convert the balance of the ailing CBRF into a permanent endowment. The principal advantage of this approach would be to create a renewable and sustainable fund which will grow at a rate greater than inflation, and provide a steady source of revenue long after the Prudoe Bay fields have run dry.

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

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

MEMORANDUM

February 21, 2001

SUBJECT: Alaska Heritage Fund (HJR 14)

TO: Representative Harry Crawford
Attn: David D'Amato

FROM: Tamara Brandt Cook
Director *TBC*

Here is the sectional summary you requested.

Sec. 1. Amends the state constitution to change the budget reserve fund to the Alaska heritage fund. Money in the fund is to be used for income-producing investments designated by law.

Sec. 2. Appropriations from the Alaska heritage fund for a fiscal year may not exceed five percent of the average of the year-end market values of the fund for the preceding five fiscal years.

Sec. 3. Permits appropriations to the Alaska heritage fund at any time.

Sec. 4. Requires the prudent investor rule to be applied in the management of the Alaska heritage fund.

Sec. 5. Provides an effective date for these constitutional amendments of July 1, 2003. The balance in the budget reserve fund shall be transferred to the Alaska heritage fund.

Sec. 6. The proposed amendments are submitted to the voters at the 2002 general election.

TBC:glc
01-184.glc

Alaska State Legislature
House of Representatives

Alaska State Capitol
Juneau, Alaska 99801-1182
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Representative Harry Crawford
District 22

Memorandum

To: Representative John Coghill, Chairman House Committee on State Affairs

From: Representative Harry Crawford

RE: HJR14: Proposing amendments to the Constitution of the State of Alaska relating to the budget reserve fund and to the Alaska heritage fund; and providing for an effective date for the amendments.

I respectfully request that this bill be scheduled for a hearing in your committee. Attached are all the pertinent background materials.

Alaska Heritage Fund

Earnings Rate	Inflation Rate
8.5%	3.25%

	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Beginning Balance				\$ 2,282.2	\$ 2,407.4	\$ 2,540.4	\$ 2,681.9	\$ 2,832.3	\$ 2,992.5
Earnings				\$ 199.3	\$ 210.3	\$ 221.9	\$ 234.4	\$ 247.6	\$ 261.5
Oil & Gas Tax Dispute Resolutions				\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0
* Withdrawals @ 5%				\$ (114.1)	\$ (117.2)	\$ (120.5)	\$ (123.9)	\$ (127.4)	\$ (134.5)
Ending Balance	<u>\$ 3,112.8</u>	<u>\$ 2,810.0</u>	<u>\$ 2,282.2</u>	<u>\$ 2,407.4</u>	<u>\$ 2,540.4</u>	<u>\$ 2,681.9</u>	<u>\$ 2,832.3</u>	<u>\$ 2,992.5</u>	<u>\$ 3,159.4</u>
Oil Price **	\$30.17	\$24.28	\$22.06	\$21.06	\$20.38	\$17.25	\$17.25	\$17.25	\$17.25
	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Beginning Balance	\$ 3,159.4	\$ 3,333.2	\$ 3,514.3	\$ 3,702.7	\$ 3,898.7	\$ 4,102.7	\$ 4,314.9	\$ 4,535.7	\$ 4,765.5
Earnings	\$ 275.9	\$ 291.0	\$ 306.7	\$ 323.1	\$ 340.1	\$ 357.7	\$ 376.2	\$ 395.3	\$ 415.2
Oil & Gas Tax Dispute Resolutions	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0
* Withdrawals @ 5%	\$ (142.1)	\$ (150.0)	\$ (158.3)	\$ (167.0)	\$ (176.1)	\$ (185.5)	\$ (195.3)	\$ (205.5)	\$ (216.2)
Ending Balance	<u>\$ 3,333.2</u>	<u>\$ 3,514.3</u>	<u>\$ 3,702.7</u>	<u>\$ 3,898.7</u>	<u>\$ 4,102.7</u>	<u>\$ 4,314.9</u>	<u>\$ 4,535.7</u>	<u>\$ 4,765.5</u>	<u>\$ 5,004.5</u>

* Withdrawals are computed in FY04 by the previous fiscal years' ending balance multiplied by 5%. In FY05, withdrawals are computed by average ending balance of the two previous fiscal years multiplied by 5%, etc.

** Official DOR Fall Forecast

Permanent Fund Basics: Income, Distributions and Percent of Market Value (POMV)

Robert D. Storer, Executive Director
Jim Kelly, Director of Communications
Alaska Permanent Fund Corporation

Fiscal Policy Caucus
April 6, 2001

www.apfc.org

Alaska Permanent Fund Corporation



www.apfc.org

Alaska Permanent Fund
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Top stories
April 05, 2001

- **Mayors learn more about Fund**
MAYOR 23 - A group of Alaska mayors attending the Alaska Municipal League meeting in Juneau today, is armed with thought to ahead for Alaska's future - and understanding is another contribution to the present structure of the Fund's purchasing power.
- **Board to hold videoconference worksession**
MAYOR 23 - Legislation pertaining to the Permanent Fund will be the topic of a discussion by a Board of Trustees with reason to be held via videoconference on Monday, April 9 from 9:00 a.m. to 3:00 p.m. The public's interest in the videoconference will be high and a full agenda follows.
- **Intern opportunities continue**
MAYOR 23 - Alaska students

Daily unaudited position
as of April 05, 2001

Net Assets	37%	\$1,653,000,000
Net Distributions	2%	\$677,200,000
Net Assets	7%	\$7,589,600,000
Net Distributions	16%	\$3,266,400,000
Net Assets	11%	\$2,846,600,000
Net Distributions	1%	\$142,700,000
TOTAL	100%	\$26,714,800,000

Quarterly report
The Alaska Permanent Fund's loss for the quarter of 3.8 percent illustrates the benefit of diversification.

Chart of the day

Alaska Permanent Fund Corporation



Permanent Fund Basics:

A primer on income and distributions

www.apfc.org

Alaska Permanent Fund Corporation

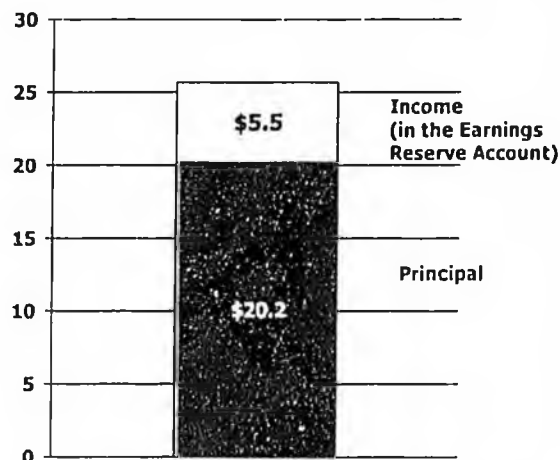


How the Fund works

Permanent Fund market value

The market value of the Permanent Fund is currently \$25.7 billion

It consists of two parts: principal and income



Total Fund as of 2/28/01

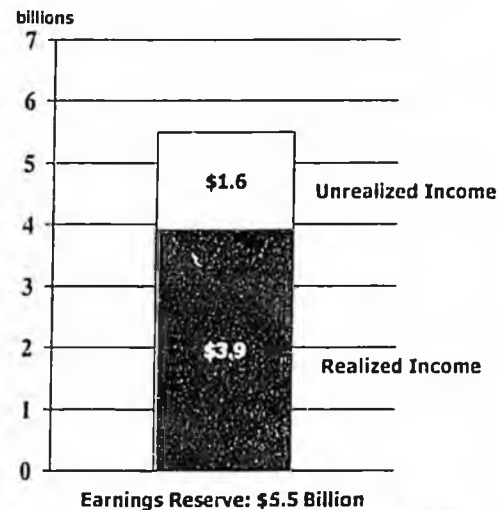
Alaska Permanent Fund Corporation



How the Fund works

Permanent Fund income

- As provided by law, all income from the Permanent Fund's investments is deposited into the Earnings Reserve Account in the Permanent Fund
- It is retained there until appropriated by the legislature



Alaska Permanent Fund Corporation



How the Fund works

Statutory use of Fund income

- Alaska Statutes (AS 37.13.140 and 145) provide the following priority for the payment of dividends and inflation-proofing:
- First, dividends are calculated and paid; then
- Second, an amount of income sufficient to offset the effect of inflation is transferred to principal.

Alaska Permanent Fund Corporation

How the Fund works

2000 PFD calculation: \$1.172 billion

Statutory net income -- excludes unrealized gains (in millions)

FY96	\$1,769		
FY97	\$2,036		
FY98	\$2,595		
FY99	\$2,544		
FY00	<u>\$2,220</u>		
	\$11,164		
x 0.21	=	<u>\$2,344</u>	= Income available for distribution ...unless it is less than the balance in the earnings reserve account

**1/2 of the lesser amount is transferred to the dividend fund,
and paid out to qualified applicants.**

**Since the beginning of the dividend program,
the amount transferred has always been the lesser amount.**

Alaska Permanent Fund Corporation



How the Fund works

2000 inflation-proofing calculation

- 2.19% = change from average CPI for calendar 1998 to average CPI for calendar 1999;
- Principal on June 30, 2000 was \$19.597 billion;
- Fund principal \$19.597 billion x .0219 CPI = \$423 million

**CPI inflation rate for 2001 will be 3.37%
x estimated principal balance of \$20.373 billion
= estimated 2001 inflation-proofing of \$687 million**

Alaska Permanent Fund Corporation



Basic principles of the Trustees' investment policy

- Diversify to protect the Fund
- Do the utmost due diligence, apply best judgment and accept the consequences
- Invest for the long-term. be disciplined and be prepared for extended periods of short-term volatility
- Balance the income benefits between current and future generations

Alaska Permanent Fund Corporation



APFC'S 2000-2003 ASSET ALLOCATION

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

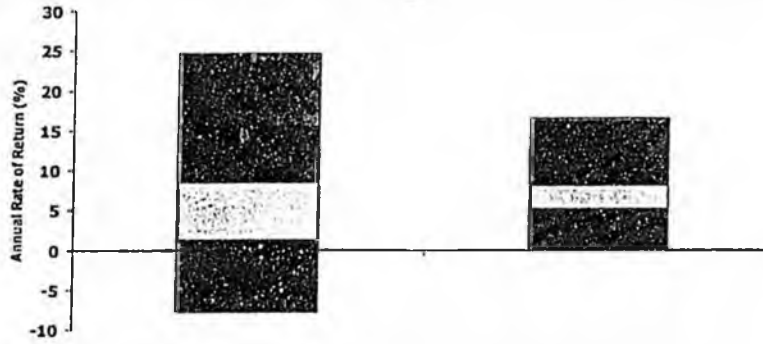
*Includes an allocation of 3% of the total Fund to Emerging Markets.

**Includes an allocation of \$300,000,000 for Alaska Financial Institutions' Certificates of Deposit.

Alaska Permanent Fund Corporation



Permanent Fund's projected range of returns



	1-Year Returns	5-Year Returns
5th	27.00	16.20
25th	15.50	11.40
50th	8.25	8.25
75th	1.30	5.10
95th	-7.80	0.70

Alaska Permanent Fund Corporation



Permanent Fund Basics:

A primer on POMV

www.apfc.org

Alaska Permanent Fund Corporation



What is POMV?

Percent Of Market Value = Payout of Fund income

5% x \$28 billion = \$1.4 billion

PF Total return – Payout = Inflation-Proofing

8.25% – 5% = 3.25%

Alaska Permanent Fund Corporation



Benefits of POMV

1. Preserves the Fund's purchasing power
2. Maximizes distributions over the long-term
3. Minimizes fluctuations in annual payouts

Alaska Permanent Fund Corporation



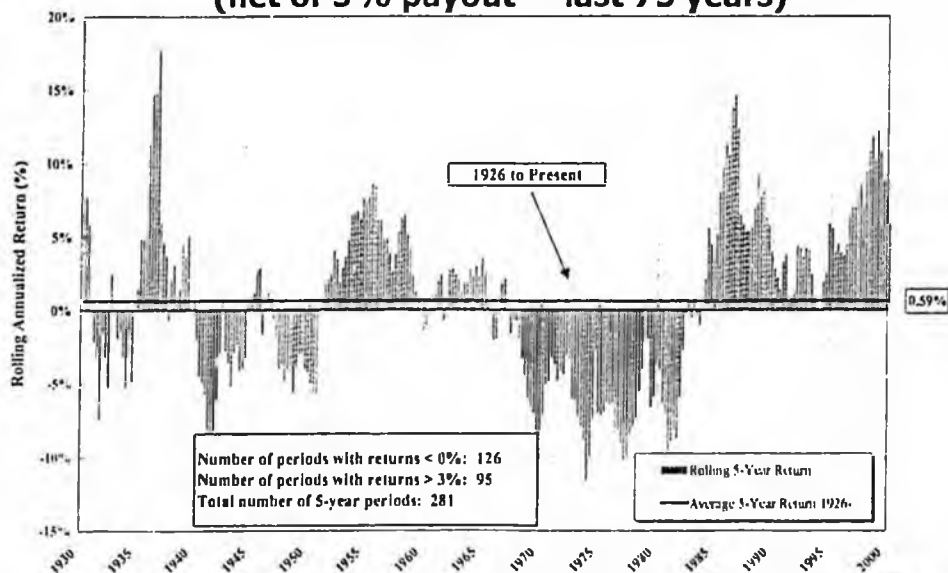
Why limit the payout to 5%?

- 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 payout

Alaska Permanent Fund Corporation



Rolling 5-year real return for 60% stock/40% bond mix (net of 5% payout -- last 75 years)



SOURCE: Callan Associates, Inc.

CPI 1926-2000: 3.3%

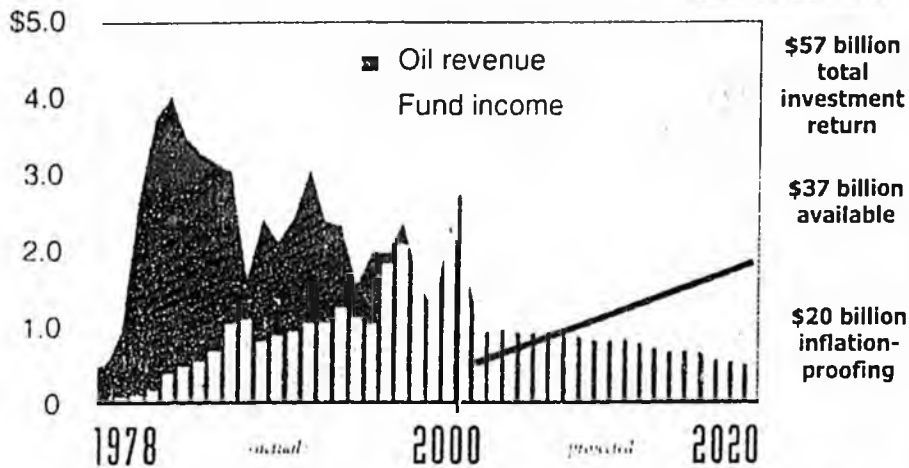
Alaska Permanent Fund Corporation



Fund statutory net income vs. state oil revenue

(Dollars in billions)

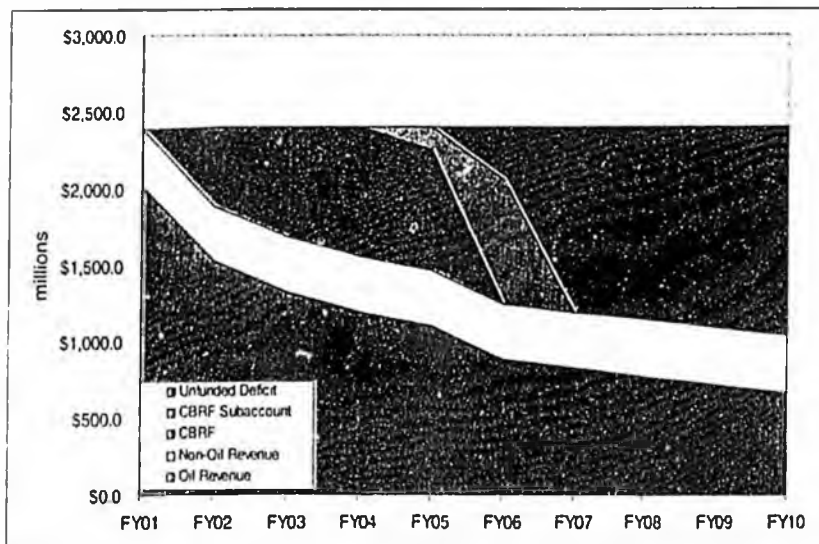
5% POMV



Alaska Permanent Fund Corporation

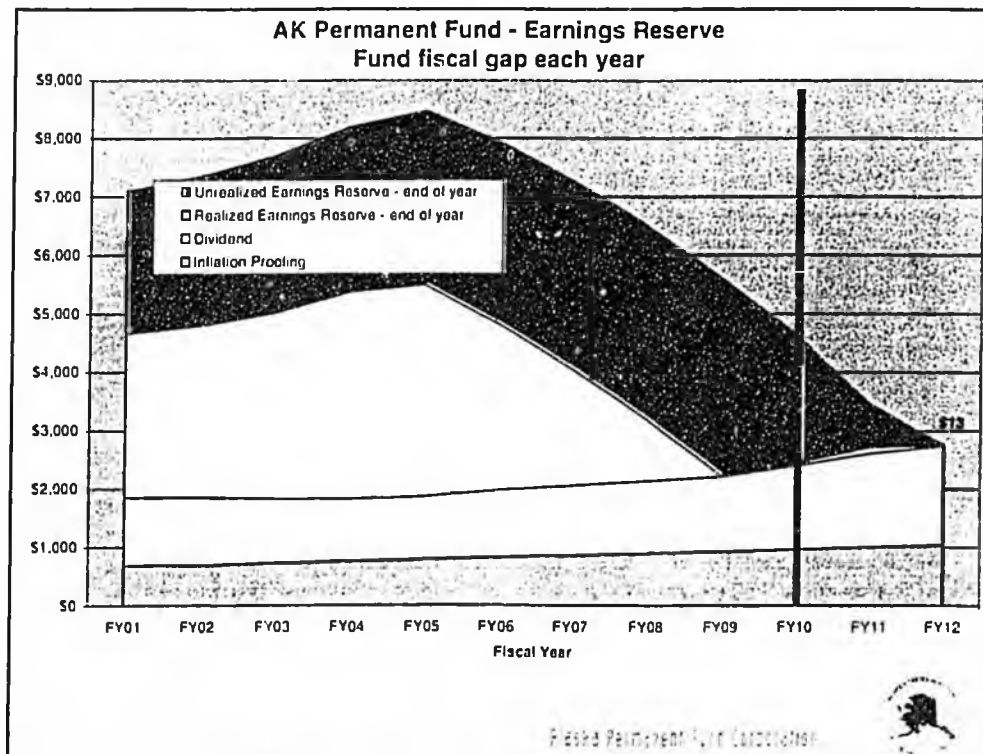
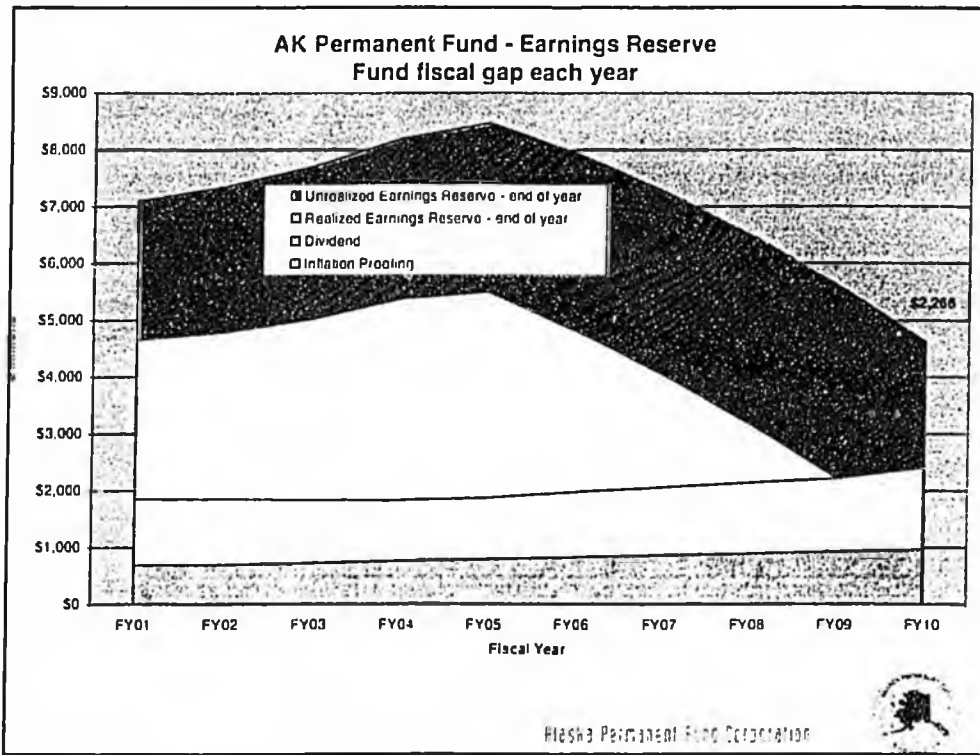


State of Alaska Revenue Sources

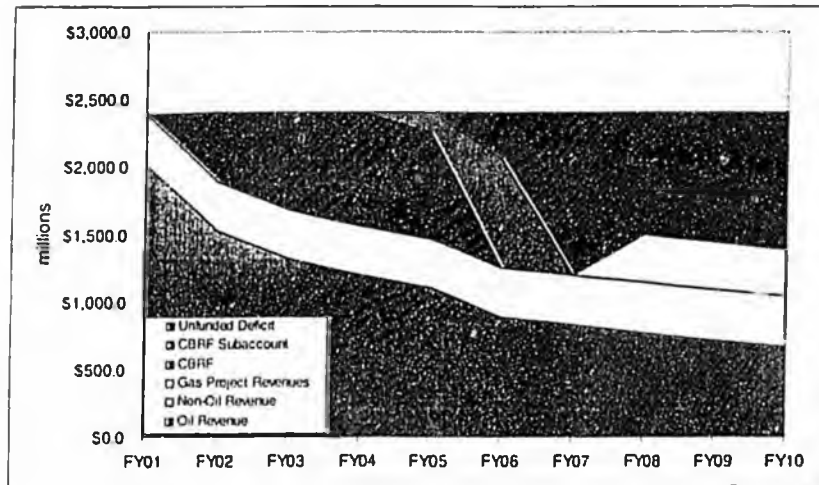


Alaska Permanent Fund Corporation





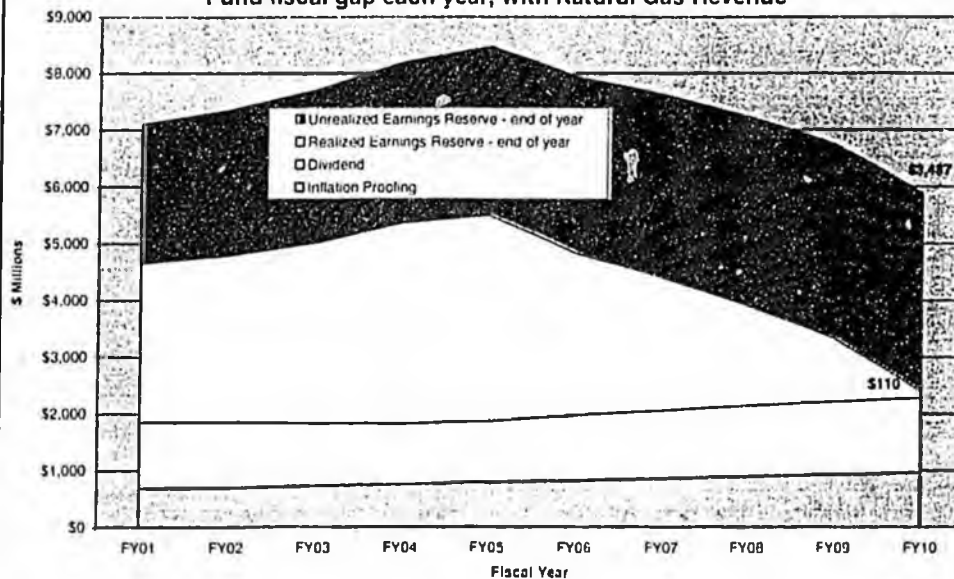
State of Alaska Revenue Sources with \$350 Million Revenue from North Slope Natural Gas Project Starting in FY 2008



Alaska Permanent Fund Corporation



AK Permanent Fund - Earnings Reserve Fund fiscal gap each year, with Natural Gas Revenue



Alaska Permanent Fund Corporation



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 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 Corporation



Post-It* Fax Note 7671		Date: 1/29/01	# of pages 12
To: Dave D'Amato	From: T. Davenport		
Dept: Rep. Crawford	Co: Treasury		
Phone #	Phone # 465-3751		
Fax # 465-4565	Fax #		

Constitutional Budget Reserve Fund - Investment Policy Statement

1. Overview

The state must deposit in a Constitutional Budget Reserve Fund (CBRF) all money received by the state after July 1, 1990 as a consequence of the resolution of disputes about the amount of mineral lease bonuses, royalties or taxes.

The Legislature may appropriate funds from the CBRF to fund the operations of state government only under certain conditions. If, at any time, the amount of funds from other sources available to the Alaska Legislature for appropriation is less than the amount appropriated to fund state government for the previous fiscal year, then the Legislature may appropriate from the CBRF on a simple majority vote. When the amount of funds from other sources exceeds the amount appropriated for the previous fiscal year, the Legislature may appropriate from the Fund for any public purpose with a three-fourths vote of the members of each house.

The Alaska state constitutional provision governing the operation of the CBRF requires the state's general fund to repay the money that has been appropriated from the CBRF if and when there is a surplus in the general fund at the end of any fiscal year. The general fund does not pay interest on the money it has "borrowed" from the CBRF.

Treasury's investment policies for the CBRF have changed over the years as balance and the expected uses of the CBRF have changed. A significant change occurred this year when the 21st Legislature created a special subaccount in the CBRF in order to "yield higher returns than might be feasible to obtain with other money in the budget reserve fund." The legislature directed that "In establishing or modifying the investment policy for the subaccount in the constitutional budget reserve fund, the commissioner of revenue shall assume that those funds will not be needed for at least five years. Income earned on money in the subaccount shall be retained in the subaccount by the department." AS 37.10.430(c).

Treasury, according to the constitution, credits to the CBRF the amount earned by the investment of the money in the CBRF. That is, the main account of the CBRF retains its investment earnings and the subaccount of the CBRF retains its investment earnings.

Appendix V contains the constitutional and statutory provisions applicable to the CBRF.

Commissioner concludes this change is appropriate no matter how the public votes in the September 14, 1999 special election relating to the state's long-range finances. Similarly, the Commissioner concludes that the higher oil prices experienced in the late spring and summer of 1999 should not alter this proposed policy.

- April 2000. Treasury recommends and Commissioner accepts an investment policy that recognizes a balance in the CBRF in excess of the state's two year reserve requirement and the state's cash flow needs. Higher than anticipated oil prices and a significant settlement increased the balance of the CBRF enough to cause the change in the investment policy
- July 2000. A significant change in the legislation relating to the fund caused Treasury to recommend significant changes to the investment policy of the fund. Treasury recommended and the commissioner accepted an investment policy that recognized a distinction for the newly created subaccount of the fund, the likely life of the fund, and the role of the balance of the fund in filling the reserve requirements of the State. (Related decision document in Appendix Y.) (Earlier versions of these decision documents are maintained in permanent files in Treasury's Asset Accounting Section. Revised documents relating to those policy decisions may be found in Appendices W and X.)

3. Facts and Figures

Fund Cash Flow History by Fiscal Year

Alaska's Public Finances Constitutional Budget Reserve Fund, Main Account (\$millions)

	Settlement Contributions ^(a)	Investment Income ^(b)	Net Loans to General Fund	Balance Available to Loan GF at Year End ^(c)
FY 91	291	6	-	297
FY 92	247	19	-	563
FY 93	914	57	(849)	685
FY 94 ^(d)	437	61	(569)	614
FY 95	1,543	122	(285)	1,994
FY 96	586	111	(173)	2,518
FY 97	570	167	(83)	3,172
FY 98	343	369	(325)	3,559
FY 99	56	114	(1,101)	2,628
FY 00	448	115	^(c) (357)	^(f) 2,734
FY 01 (Proj.)	100	128	117	^(e) 2,679
FY 02 (Proj.)	45	133	(515)	2,342
FY 03 (Proj.)	45	107	(717)	1,777
Total	5,625	1509	(\$4,857)	

Data sources:

- (n) Department of Revenue, Income and Excise Audit Division, Mineral Payments Report (ties in total through FY99).
- (b) Derived (by formula).
- (c) State of Alaska Comprehensive Annual Financial Report (ending balance less the outstanding receivable from the state's general fund).
- (d) Although the table above is based on cash flows, it does not reflect the timing of the \$1,006,038,474 legislative appropriation (Ch 14, SLA 1994) resulting from an Alaska Supreme Court order to restore the CBRF for certain settlement payments deposited to the state's general fund from FY 1990-1994.
- (e) FY00 includes draw to finalize FY99 budget (42mun).
- (f) Reflects \$100 million transfer to Power Cost Equalization Endowment Fund.
- (g) Reflects \$400 million transfer to CBRF subaccount on July 1, 2000.

Alaska's Public Finances
Constitutional Budget Reserve Fund, Subaccount
(\$millions)

	Settlement Contributions ^(a)	Investment Income ^(b)	Net Loans to General Fund	Balance Available to Loan GF at Year End ^(c)
FY 00	0	0	0	0
FY 01 (Proj.)	400	34	0	434
FY 02 (Proj.)	0	37	0	471
FY 03 (Proj.)	0	40	0	511
Total	400	111	0	

4. Investment Policy

For the main account of the CBRF (excluding the subaccount that has a five-year time horizon), Treasury recognizes the State's current two-year reserve requirement, General Fund cash flow borrowing needs, money in excess of that which might be needed within two years and the Investment policy of the GeFONSI. At this time, the current high oil prices and the balance in the CBRF support a somewhat more aggressive policy for the money in the main account of the CBRF than had been the case in recent years.

Treasury would invest the main account of the CBRF with the following in mind:

Risk Tolerance	Moderately high. Fund should not be needed for several years.
Investment Objectives	Moderately high exposure of principal to loss in return for higher expected longer-term returns. Limited current income requirement. Moderate inflation protection needed. Moderate liquidity requirement.
Time Horizon	Intermediate.

Effective July 1, 2000, Treasury's investment policy for the main account of the CBRF would be:

- 25% Board Market Fixed Income Investment Pool
- 65% Intermediate-term Fixed Income Investment Pool
- 10% Short-term Fixed Income Investment Pool

Treasury's performance benchmark for the main account of the CBRF is:

- 25% Lehman Brothers Aggregate Bond Index
- 65% Merrill Lynch 1-5 year Government Index
- 10% Three-month U.S. Treasury Bill

Treasury would invest the subaccount of the CBRF with the following in mind:

- Risk Tolerance** High. The legislature has expressly provided guidance by instructing the Commissioner to use at least a five year time horizon in establishing an investment policy for the subaccount.
- Investment Objectives** High exposure of principal to loss in return for higher expected longer-term returns.
Limited current income requirement.
Inflation protection needed.
Moderate liquidity requirement.
- Time Horizon** Long.

Effective July 1, 2000, Treasury's investment policy for the subaccount of the CBRF would be:

- 42% Board Market Fixed Income Investment Pool
- 41% Domestic Equity Investment Pool
- 17% International Equity Investment Pool

Treasury's performance benchmark for the main account of the CBRF is:

- 42% Lehman Brothers Aggregate Bond Index
- 41% Russell 3000 Stock Index
- 17% Morgan Stanley Capital International Europe, Australia, and Far East Stock Index

5. Control and Reporting Requirements

On or before March 15 each year, AS 37.10.430 requires Treasury to prepare a report to the Legislature comparing beginning and ending balances in the CBRF for the immediately preceding calendar year together with comparative nominal, real and realized returns for the CBRF, the Permanent Fund and the

general fund. The State Comptroller in the Treasury Division is responsible for compiling this information and preparing and distributing the required report.

The Alaska Legislature made AS 37.10.071 directly applicable to the CBRF. Accordingly, the Commissioner, through the State Comptroller, maintains accounting records for the Fund in accordance with generally accepted accounting principles (as would be required by AS 37.10.071(a)(8)) and engages an independent certified public accountant to perform an annual audit of the financial condition of the Fund and the pertinent investment transactions (as would be required by AS 37.10.071(a)(9)).

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
8/19/99	9/1/99	CBRF - elimination of Transition Fund and Long-term Reserve Fund, modification to investment policy of Two-year Shortfall Fund including asset allocation.	1.2
3/7/00	4/1/00	Treasury updates 2000 capital market assumptions and changes asset allocation policy accordingly. Target policy was 15% Short-term Fixed Income Investment Pool, 85% Intermediate-term Fixed Income Investment Pool.	1.3
4/7/00	4/10/00	Treasury revises asset allocation after receiving a \$416.3 million settlement from an oil tax dispute in early April 2000. Asset allocation was 25% Short-term Investment Pool, 75% Intermediate-term Investment Pool.	1.4
1/29/01	7/1/00	Treasury revises asset allocation when the 21st Legislature creates a special \$400 million "subaccount" in the CBRF effective July 1, 2000 and establishes a new \$100 million Power Cost Equalization Endowment Fund.	1.7

BALLOT MEASURE NO. 1

Budget Reserve Constitutional Amendment [HCS CSSSSJR 5 (Fin) am H]

BALLOT LANGUAGE

This proposal would create the "Budget Reserve Fund" in the state treasury. Money the state receives from mineral revenue lawsuits or administrative actions would be deposited in the Fund, and invested at competitive rates. The Fund could be used when money available for appropriation in the year is less than the year before, but only to make up the shortfall. The legislature could only appropriate from the Fund for other purposes with a 3/4 vote. At the end of each year, the Fund would have to be paid back from money left in the treasury's general fund.

Should this constitutional amendment be adopted?

Yes No

VOTES CAST BY MEMBERS OF THE 16TH ALASKA LEGISLATURE ON FINAL PASSAGE

House: Yeas 38 Nays 2 Senate: Yeas 15 Nays 5

LEGISLATIVE AFFAIRS AGENCY SUMMARY

This measure will amend the state constitution by creating the budget reserve fund. Money from certain mineral revenue sources received by the state from an administrative proceeding or litigation is placed in the fund. Income of the fund is kept in the fund.

Appropriations may be made from the fund if money available for a fiscal year is less than the amount appropriated for the prior year. When this occurs the amount that may be taken from the fund is limited. Only the money needed to make up the difference may be appropriated.

Money may also be appropriated from the reserve fund by special vote of the legislature. Three-fourths of the members of each house must approve. The amount that may be taken is unlimited when this vote is obtained.

Money that is appropriated from the reserve fund must be repaid. Surplus general fund money must be deposited in the reserve fund at the end of each year until the reserve fund is repaid.

FULL TEXT OF PROPOSED LAW

*Section 1. Article IX, Constitution of the State of Alaska, is amended by adding a new section to read:

SECTION 17: BUDGET RESERVE FUND. (a) There is

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

(b) If the amount available for appropriation for a fiscal year is less than the amount appropriated for the previous fiscal year, an appropriation may be made from the budget reserve fund. However, the amount appropriated from the fund under this subsection may not exceed the amount necessary, when added to other funds available for appropriation, to provide for total appropriations equal to the amount of appropriations made in the previous calendar year for the previous fiscal year.

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

(d) If an appropriation is made from the budget reserve fund, until the amount appropriated is repaid, the amount of money in the general fund available for appropriation at the end of each succeeding fiscal year shall be deposited in the budget reserve fund. The legislature shall implement this subsection by law.

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

STATEMENT IN SUPPORT

- Cut the budget.
- Reduce state spending.
- Get state spending under control.

Each year these battle cries are raised by Alaskans. While elected officials say they listen and promise to do all they can, the simple fact is the Legislature's record shows it consistently spends most or all of the money available in the treasury. Alaska is confronted with an impending fiscal crisis of staggering proportions as a result of an inevitable "gap" between general fund revenues and current state spending levels. Present levels

BALLOT MEASURE NO. 1

of state general fund expenditure simply cannot be sustained over the long term.

Ballot Measure Number 1 is the first step Alaskans can take to *effectively* control state spending.

The measure creates the Budget Reserve Fund in the Constitution. Revenues from mineral or oil and gas legal settlements and administrative proceedings will be deposited into the Budget Reserve. The Legislature will be able to spend money from the Budget Reserve only if:

- revenues are less than the amount appropriated the previous year, in which case money could be appropriated from the Budget Reserve in an amount not to exceed the shortfall; or
- three-fourths of the members of both the House and Senate vote to spend money from the Budget Reserve for a public purpose, such as a disaster.

The Legislature will be required to repay any money it appropriates from the Budget Reserve. If the next year revenues are insufficient the Legislature cannot afford to replenish the Budget Reserve, the "debt" will carry forward until it is repaid.

Legal settlements involving mineral or oil and gas revenues received after July 1, 1990, will be deposited into the Budget Reserve. As an example, if voters approve this ballot measure, \$216 million of the amount the state received in September from ARCO's settlement of royalty litigation will be deposited into this Budget Reserve.

Should voters not approve this measure, these funds will be available to the legislature to spend next year. Approval of Ballot Measure Number 1 is the first step toward a long-term spending plan. With Alaska's revenues subject to the whims of the world oil market, trying to take steps which will provide some stability in Alaska's spending is especially difficult. If approved, the Budget Reserve Fund will help hold down spending by removing from the table the oil and gas revenue "windfalls" that result from pending litigation and tax disputes. At the very least, this ballot measure will establish a savings account that can help minimize the effects of a "boom" one year, and a "bust" the next.

While other major budget decisions will be necessary to close the future's fiscal gap, this Ballot Measure is a major step toward a long-term spending plan for the state. It is a step we urge Alaskans to support.

If approved by the voters, the Budget Reserve Fund will be a significant help in managing the transition to sustainable spending.

Senator Jan. Faiks
Representative Kay Brown
Representative Randy Phillips

STATEMENT IN OPPOSITION

In sharp contrast to what its proponents have been telling us, the proposed budget reserve fund

- will *not* save any windfalls,
- does *not* require a $\frac{3}{4}$ vote to gain access to it,

- *endorses* the legislature's bloated \$3 billion budget
- will result in *slower growth* of the Permanent Fund, and
- will *reduce the amount* of future PFD checks.

Your vote *against* Ballot Measure #1 will send a signal to the legislature that you do not approve of their excessive spending, and that you want the windfalls deposited into the Permanent Fund.

The most significant danger of this proposal is that it will establish a budget floor at \$3 billion, and allow it to increase every year. Under paragraph (b) of the proposed constitutional change, a simple majority in the legislature could "borrow" funds from the reserve, to make up any shortfall in revenues, *up to the amount appropriated in the previous year*. This year the legislature spent more than \$3 billion. Some of that was vetoed by the governor, but it is expected the legislature will restore the funding and add supplemental appropriations in January. In other words, *the total amount appropriated for FY 91 has not yet been determined*. A "yes" vote on this ballot measure amounts to rubber-stamping a blank check of at least \$3 billion!

How would the budget continue to increase? Legislative leaders can easily get a $\frac{3}{4}$ vote out of their members by dangling capital project plums in front of them.

The appeal of this ballot measure is to save the "windfalls" of oil tax settlements, variously estimated at between \$2 billion and \$5 billion. This can easily be spent in three years.

Constitutionally, 25% of our oil income is dedicated to the Permanent Fund. And under state law, an additional 25% of income from certain leases is put into the Permanent Fund. In other words, as much as 50% of the windfalls should be deposited in the Permanent Fund, by law. The language in this constitutional amendment is unclear regarding the second 25%, and could be interpreted by big-spending legislators to rationalize putting only the constitutionally-dedicated 25% into the Permanent Fund, and leaving 75% for them to spend.

It would be better to save all of these anticipated windfalls, by putting 100% into the Permanent Fund. There, these funds will help the Permanent Fund produce greater annual income, for use as Permanent Fund Dividends to all Alaskans, or to fund necessary functions of state government. In the Permanent Fund, the windfalls would definitely be saved, and would not be accessible by big spenders in the legislature.

If you are one of the 65% of Alaskans who in opinion polls consistently ask the legislature to cut the budget, or if you believe the windfalls should *truly* be saved, you owe it to yourself not to be taken in by the proponents of Ballot Measure #1. Vote NO on the budget reserve amendment.

Representative Terry Martin

NOTES TO THE FINANCIAL STATEMENTS

Note 1

The composition of the amount owed to the CBRF is as follows:

Long-term Portion	
Chapter 14, SLA 1994, section 7	\$ 1,006,038,474
Chapter 14, SLA 1994, section 8	49,608,135
Chapter 14, SLA 1994, section 9	368,581,990
Chapter 3, FSSLA 1994, section 39(c)	22,417,886
Chapter 3, FSSLA 1994, section 40	68,738,958
Chapter 3, FSSLA 1994, section 22(a)	11,250,000
Chapter 6, FSSLA 1994, section 1	130,300,000
Article IX, section 17(d) Alaska Constitution (FY 95)	(95,506,853)
Chapter 94, SLA 1995, section 43(a)	95,506,853
Chapter 94, SLA 1995, miscellaneous operating appropriations	16,672,928
Chapter 94, SLA 1995, section 43(b)	284,873,567
Article IX, section 17(d) Alaska Constitution (FY 96)	(74,352,026)
Chapter 5, FSSLA 1996, section 1 (a)	74,352,026
Article IX, section 17(d) Alaska Constitution (FY 97)	(166,019,445)
Chapter 98, SLA 1997, section 35(a)	166,019,445
Chapter 98, SLA 1997, page 47, line 3	529,258
Chapter 98, SLA 1997, section 35(b)	423,319,190
Article IX, section 17(d) Alaska Constitution (FY 98)	(89,264,067)
Chapter 139, SLA 1998, section 42(a)	89,264,067
Chapter 2, SLA 1999, section 16(c)	460,000
Chapter 27, SLA 1999, Y2K appropriations	7,930,475
Chapter 2, FSSLA 1999, section 21(a)	1,042,014,840
Article IX, section 17(d) Alaska Constitution (FY 99)	(94,632,453)
Chapter 84, SLA 1999, section 35(a)	94,632,453
Chapter 2, FSSLA 1999, section 21(b)	295,898,497
Chapter 8, SLA 2000, section 8(a)	3,227,666
Chapter 75 SLA 2000, section 1(b)	100,000,000
Article IX, section 17(d) Alaska Constitution (FY 00)	(111,438,806)
Total Long-term Portion	<u>3,720,423,158</u>
Short-term portion	
Article IX, section 17(d) Alaska Constitution (FY 00)	111,438,806
Excess drawn, chapter 2, FSSLA 1999, section 21(b)	4,101,503
Total Due to the CBRF	<u>\$ 3,835,963,467</u>

The amounts appropriated in chapter 14, SLA 1994, sections 7 and 8 are equal to the amounts appropriated from the general fund to the CBRF to comply with court orders. In FY 91 through FY 94, the State deposited revenue into the general fund that several parties contended should have been deposited into the CBRF. The Alaska Superior Court and Supreme Court agreed that these moneys should have been deposited in the CBRF and the State was ordered to restore the CBRF, including interest earnings, retroactive to July 1, 1990. Chapter 14, SLA 1994, was enacted into law to comply with the courts' orders and sections 2, 3, and 4 of the law appropriated \$1,006,038,474, plus \$49,608,135 in interest which would have been earned on the money after June 30, 1990, from the general fund to the CBRF effective April 15, 1994.

Chapter 14, SLA 1994, section 9, chapter 3, FSSLA 1994, section 39(c), chapter 94, SLA 1995, section 43(b), chapter 98, SLA 1997, section 36(b), and chapter 2, FSSLA 1999, section 21(a) and (b) appropriated additional amounts from the CBRF to the general fund to fund any shortfalls between State revenue and general fund appropriations for fiscal years 1994, 1995, 1996, 1998, 1999, and 2000 respectively.

Chapter 3, FSSLA 1994, section 40, appropriated an amount to cover the share of the State's actual expenditures for oil and gas litigation from July 1, 1990, through February 15, 1994, that is attributable to the CBRF. The appropriation in section 22(a) of chapter 3 was to cover costs related to legal proceedings and audit activity involving oil and gas revenue due or paid to the State or State title to oil and gas land, for the fiscal year ending June 30, 1995.

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II. ALASKA'S FISCAL OPTIONS

Sources of Government Revenue and the Alaska Economy

The Constitutional Budget Reserve Fund — like the Permanent Fund dividend program — has become a major component of the state's economy. The budget reserve fund contributed almost \$4 billion to Alaska's economic base during the 1990s, and was especially important during the low oil prices of FY 1999 when it added more to the state's total personal income than even the dividend program.

And just as you would weaken the economy if you removed or reduced the annual dividend program, you will cause the same problems if no suitable replacement is found before the CBRF runs out of money.

Alaska's economic base depends on "new" money circulating throughout the economy — money from outside that comes in, increases purchasing power, and moves around. New money that comes into the state generates additional income when it is spent, either by businesses or by workers. It can start out as wages or it can begin as payments for goods that then works its way into personal income as it's paid out as wages.

The important thing about the economic base is that the money comes from outside the state, brought into Alaska to pay for goods and services. It could be money from oil, tourism, seafood or timber sales; military or federal civilian payroll; or oil taxes and royalties paid to the state. A dollar paid to the state in oil taxes or a dollar earned by the state from oil royalties could move around the same as a dollar paid in wages by an oil company. The state treasury is simply a stopover before the tax dollar goes out as public employee wages, as a construction contract, an office supply order or other purchase.

Eventually, most every dollar brought into Alaska will find its way back out of state to purchase goods, raw materials or services. The number of times the money circulates through the state's economy before it leaves is called the multiplier effect.

Presenting the problem is easy. Finding the solution is the hard part.

Assuming Alaska wants to maintain — if not grow — its economic base, it has to find at least some new money to fill the gap the CBRF eventually will leave behind. The options of taxes, cutting the budget or using some of the Permanent Fund dividend cash would not bring any new money into the economic base, although any of the three certainly would be the fastest to implement and easiest to control.

In looking around for sources of new money, there are some options — although they are harder to quantify and not necessarily within Alaska's control.

We could bring new money into the state through new oil discoveries and higher recovery rates at existing oil wells; development of a natural gas project; building a stronger market for seafood sales; attracting more visitors to spend more money in Alaska — anything to bring a dollar from outside into the hands of a business or worker inside Alaska.

Another option is to increase the multiplier effect for the money already here. The more that dollar bounces around the state, the more it benefits Alaskans. It's sort of like a pinball game. The more cushions and bumpers the ball touches, the higher the score. But once that ball falls through the flippers and down the chute, it's gone forever.

The more goods and services that are available in Alaska, the better our medical services, the more competitive our businesses become, the longer a dollar will stay in our economy before slipping through to an out-of-state provider.

In looking at the state's economic base and the new money that builds that base, we see that here, too, the CBRF is similar to the Permanent Fund dividend program. The dividend program is new money because the cash for the annual checks comes mostly from earnings on investments outside Alaska. It's not simply recirculating money already here. The same is true for the CBRF.

The money in that account came from taxes and royalties paid by oil companies — new money to Alaska, not money already in the pockets of Alaskans or the cash registers of local businesses. As the state uses the CBRF to pay for wages, goods and services, the money is added to Alaska's personal income total.

The point is that when oil prices were at their lowest in Fiscal 1999, the CBRF supplied about one-eighth of the state's total economic base. The \$1.1 billion drawn out of the CBRF that year went to wages, goods and services purchased in Alaska. That money then moved through the economy, measured by the multiplier effect. Based on 1995 research by the University of Alaska's Institute for Social and Economic Research, the multiplier effect magnified the CBRF's Fiscal 1999 contribution to Alaska's economic base to \$2 billion — about 12 percent of the state's overall personal income that year.

Although oil prices have recovered, the outlook is for the heavy drain on the CBRF to resume in another year. This report forecasts that the CBRF payment to support the activities of state government — and to help fund Alaska's economic base — will average more than \$910 million a year from FY 2003-2006. That figure represents the CBRF's contribution before the multiplier effect.

The need for the money will not end in Fiscal 2006, but the money will. Even assuming oil prices remain above historic levels for several more years, the Department of Revenue forecasts the CBRF will hit empty in December 2005. The loss of the budget reserve fund will mean a major reduction in the cash flowing through Alaska's economy, which means the economic base, and the economy itself, will shrink.

If Alaska wants to protect its economic base it will need to find another source or sources of new money. That will not be easy. The three options most often mentioned all have the same drawback: They would simply alter the flow of money already in Alaska, doing nothing to fill the hole.

Broad-based taxes, such as a sales tax or a personal income tax, would mostly take money already moving through the economy and redirect it toward government services. Yes, we could add a little new money to Alaska's economic base by collecting sales taxes from visitors or income taxes from out-of-state workers, but both taxes from outside sources combined would likely fall short of even 10 percent of the \$910 million a year average draw from the CBRF.

Reducing the Permanent Fund dividend presents the same problem. Much of that money already is being added to Alaska's economic base. Shifting it from the dividend program to the state treasury to pay for teachers wages or road maintenance contracts or child care assistance would not add to the economic base and would not replace the gaping hole left by the empty CBRF.

It's the same problem with cutting the budget. If you reduce government support for public services to make up for the loss of \$910 million a year in CBRF money, the lower spending on goods and services would weaken the state's economic base.

None of these proposals would replace the contribution of the CBRF to Alaska's economic base. Selecting among these proposals — or a combination — would only determine which Alaskans bear the major burden of the economic retrenchment.

One less-painful option for bringing new money into Alaska's economic base is the annual earnings reserve of the Permanent Fund. That's the money left over from each year's investment earnings after dividends are paid and after money is added back to the fund to protect it from inflation. That amount is likely to average around \$250 million a year and could be directed toward filling part of the gap left behind by the CBRF. Because that money is not currently part of the state's economic base — it isn't being used for goods or services — it would be new money to Alaska.

Another hope is that a North Slope natural gas project could get under way in the next couple of years, generating public revenue of \$200 million to \$400 million a year or more in new money for the economic base by 2007. A gas project also would bring additional new money into the state to pay for wages, goods and services in the gas fields and transportation system. New oil discoveries also could produce additional pockets of new money to help cushion the loss of the CBRF.

One more option for bringing new money into the state is to increase taxes on the oil and gas industry. But that carries the risk of driving new investment to other areas worldwide if the industry believes Alaska is extracting too high a price. To fill the entire budget gap of \$910 million a year from increased oil and gas taxes alone would require almost tripling the state's three primary oil and gas taxes.

There just isn't any easy or painless answer to replacing the CBRF. Still, we need to talk about an eventual answer. And while we look at the options, Alaskans need to think of the budget reserve fund not just as a funding source for government but as a key part of the state's economic base. We need to think about how to replace that source of money without just moving funds between Alaska's limited pockets. If that's all we're thinking about, the economic reality that hits us when the CBRF is gone will be painful.

For more information on Alaska's economic base and the multiplier effect:

"What Makes the Alaska Economy Tick," by the Institute of Social and Economic Research at the University of Alaska, Anchorage; December 1991.

"Structural Analysis of the Alaska Economy," by the Institute of Social and Economic Research at the University of Alaska, Anchorage; January 1994.

"Structural Analysis of the Alaska Economy: A Perspective from 1997," by the Institute of Social and Economic Research at the University of Alaska, Anchorage; August 1997.

"A Long-Term Economic Development Strategy for Alaska," by the Alaska Science & Technology Foundation; April 2000.

Ex 5
Alaska Heritage Fund

Earnings Rate 8.5%	Inflation Rate 3.25%
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	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Beginning Balance				\$ 2,282.2	\$ 2,407.4	\$ 2,540.4	\$ 2,681.9	\$ 2,832.3	\$ 2,992.5
Earnings				\$ 199.3	\$ 210.3	\$ 221.9	\$ 234.4	\$ 247.6	\$ 261.5
Oil & Gas Tax Dispute Resolutions				\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0
* Withdrawals @ 5%				\$ (114.1)	\$ (117.2)	\$ (120.5)	\$ (123.9)	\$ (127.4)	\$ (134.5)
Ending Balance	<u>\$ 3,112.8</u>	<u>\$ 2,810.0</u>	<u>\$ 2,282.2</u>	<u>\$ 2,407.4</u>	<u>\$ 2,540.4</u>	<u>\$ 2,681.9</u>	<u>\$ 2,832.3</u>	<u>\$ 2,992.5</u>	<u>\$ 3,159.4</u>

Oil Price **	\$30.17	\$24.28	\$22.06	\$21.06	\$20.38	\$17.25	\$17.25	\$17.25	\$17.25
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	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Beginning Balance	\$ 3,159.4	\$ 3,333.2	\$ 3,514.3	\$ 3,702.7	\$ 3,898.7	\$ 4,102.7	\$ 4,314.9	\$ 4,535.7	\$ 4,765.5
Earnings	\$ 275.9	\$ 291.0	\$ 306.7	\$ 323.1	\$ 340.1	\$ 357.7	\$ 376.2	\$ 395.3	\$ 415.2
Oil & Gas Tax Dispute Resolutions	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0	\$ 40.0
* Withdrawals @ 5%	\$ (142.1)	\$ (150.0)	\$ (158.3)	\$ (167.0)	\$ (176.1)	\$ (185.5)	\$ (195.3)	\$ (205.5)	\$ (216.2)
Ending Balance	<u>\$ 3,333.2</u>	<u>\$ 3,514.3</u>	<u>\$ 3,702.7</u>	<u>\$ 3,898.7</u>	<u>\$ 4,102.7</u>	<u>\$ 4,314.9</u>	<u>\$ 4,535.7</u>	<u>\$ 4,765.5</u>	<u>\$ 5,004.5</u>

* Withdrawals are computed in FY04 by the previous fiscal years' ending balance multiplied by 5%. In FY05, withdrawals are computed by average ending balance of the two previous fiscal years multiplied by 5%, etc.

** Official DOR Fall Forecast

What is POMV?

Percent Of Market Value = Payout of Fund Income

5% x \$2.2 Billion = \$114 Million (2004)

5% x \$2.9 Billion = \$134 Million (2009)

5% x \$3.8 Billion = \$176 Million (2014)

AKHF Total return – Payout = Inflation proofing

8.25% - 5% = 3.25%

Benefits of POMV

1. Preserves the funds purchasing power
2. Maximizes distributions over the long term
3. Minimizes fluctuations in annual payments

Ex 7

POLICIES AND PROCEDURES APPLICABLE
TO THE TREASURY DIVISION,
DEPARTMENT OF REVENUE,
STATE OF ALASKA
.....

APPENDIX Y

MEMORANDUM**STATE OF ALASKA
Department of Revenue****To:** File**Date:** December 29, 2000**Telephone:** 465-2301**From:** Wilson L. Condon
Commissioner**Subject:** Decision and Justification for Asset
Allocation for the Constitutional
Budget Reserve Fund

The Constitutional Budget Reserve Fund (CBRF or Fund) is a very important financial asset of the state. By adopting a constitutional amendment (Article IX, Section 17 of the Alaska State Constitution) the voters of Alaska established the Fund in 1990. The state must deposit all money received as a result of administrative proceedings or litigation on (1) mineral lease payments or (2) taxes on mineral income into the Fund. The legislature can appropriate money from the Fund with a three-quarters vote of both houses or, under some restricted circumstances, with a simple majority.

This memorandum records two changes in investment policy. The first is a result of a legislative directive to invest some of the CBRF money more aggressively, in the hope of reaping some higher return from the riskier capital markets. The second is a change resulting from a modification in internal investment methodology in an attempt to dampen some of the volatility caused by the ever-changing nature of the CBRF.

A significant change that affects the CBRF investment policy occurred in 2000 when the 21st Legislature created a special "subaccount" in the CBRF in order to "yield higher returns than might be feasible to obtain with other money in the budget reserve fund." The legislature directed that "In establishing or modifying the investment policy for the subaccount in the constitutional budget reserve fund, the commissioner of revenue shall assume that those funds will not be needed for at least five years." The legislature funded this subaccount with \$400 million. Creation of this subaccount required creation of a new investment policy for the \$400 million.

**POLICIES AND PROCEDURES APPLICABLE
TO THE TREASURY DIVISION,
DEPARTMENT OF REVENUE,
STATE OF ALASKA**
.....

At the same time, the Department will effect a subtle change in its investment policy for the main account. In the ten years that the Fund has been in existence, the Department has not been able to maintain a consistent investment policy in part because the balance, purpose, and intended use of the fund, and consequent investment time frame, have changed over time. In the recent past, the Department would consider the asset allocation of that portion of the CBRF needed to fill the State reserve policy separately from the remainder, if any. The Department would develop two separate investment policies, which it would then blend to create one policy for the Fund. This process lead to frequent changes in the CBRF investment policy based on changes in assumptions or circumstances that had a material effect on the amounts of the CBRF not needed to meet the State's reserve policy. As explained below, although the Department will still calculate the amount needed for the two-year reserve, it will no longer develop, and then blend, a separate investment policy for the reserve and the remainder. This should allow for a more consistent match of investment objectives.

This is the fifth major change in the investment policy for the CBRF over the past 24 months. The Department expects that as a result of the change it is making in how the policy is derived, changes in the future will be more evolutionary in nature and more likely than not caused by changes in the capital markets assumption the Department receives each year. The table below shows the investment policies that have been in place for the entire CBRF over the past several years.

Table 1

	7/97 - 7/98	Change No. 1 7/98 - 12/98	Change No. 2 12/98 - 8/99	Change No. 3 8/99	Change No. 4 4/00
Equity Pool	19%	9%	0%	0%	0%
Broad Market Fixed Income Investment Pool	49%	33%	44%	0%	10%
Intermediate-term Fixed Income Investment Pool	31%	47%	30%	85%	75%
Short-term Fixed Income Investment Pool	1%	11%	26%	15%	15%

POLICIES AND PROCEDURES APPLICABLE
TO THE TREASURY DIVISION,
DEPARTMENT OF REVENUE,
STATE OF ALASKA

Many of these changes were caused by the unexpected decline in oil prices from late 1997 through early 1999. This price decline and the consequent revenue shortfall required substantially larger than expected draws from the CBRF. This in turn reduced the CBRF balance substantially and shortened the CBRF's average investment time horizon from almost five years to less than two years. The average time horizon of the fund increased slightly in the spring of 2000.

Three developments gave rise to the need to change investment policy for the CBRF on July 1, 2000. First was the creation of the "subaccount" by the Legislature. Second was a decision by the Department to create only one investment policy for the main account of the CBRF rather than continue with its past practice of developing several individual policies for various segments of the CBRF and the combining them. Finally, continued high oil prices extended the expected life of the fund. Based on these developments the Department created the following separate investment policies for the main account and the subaccount of the CBRF.

Main Account of the CBRF

Updated through late November Treasury estimates that the balance of the main account of the CBRF balance will be \$2,678,000,000 on June 30, 2001. The same account balance was \$2,334,200,000 on July 1, 2000.

For the main account of the CBRF, Treasury considers the State's current two-year reserve requirement, General Fund cash flow borrowing needs, money in excess of that which might be needed within two years and the investment policy of the GeFONSI. At this time, although it appears the state will need most of the money from the CBRF to implement its Reserves Policy (Appendix X)¹ and to meet its cash flow needs, the current high oil prices and the balance in the CBRF support a somewhat more aggressive policy for the money in the main account of the CBRF than has been the case in recent years.

¹ This memorandum is the latest in a series of similar memoranda dated September 26, 1997, July 15, 1998, December 28, 1998 and August 10, 1999.

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Based on current spending and revenue projections, Treasury estimates that \$2,100,000,000 in the CBRF should be allocated to the reserve to cover the next two years' anticipated and unanticipated budget shortfalls, and that \$300,000,000 should be allocated to meet cash flow needs. As explained in Appendix X, to calculate the amount of reserve necessary, Treasury used an average estimated or implied standard deviation of oil prices, \$3.83/barrel, over the relevant period to estimate the amount of money needed to cover a 90th percentile oil price decline. This results in a reserve large enough to meet anticipated expenditures even if oil prices fell, except for a 10% probability that the reserve would not be sufficient. Treasury's estimate of money required for reserve reflects both the state's current fiscal position and the possibility of a material decline in oil prices estimated using market measures of price volatility for oil. The estimated CBRF balance on June 30, 2001 exceeded the state's short-term reserve needs and cash flow requirements by \$278 million.

The investment policy for the main account, however, remains conservative. Treasury has a moderate to moderately high risk tolerance. Treasury has a limited liquidity requirement for the Fund. The primary factor limiting the risk tolerance for the main account of the CBRF is the relatively short time horizon. The state may need a significant amount of this money within one year. The Department of Revenue estimates that the balance of the main account of the Fund will be exhausted by July of 2005. Treasury has concluded that the best way to meet the objectives for the main account of the CBRF while maximizing returns is to invest 10% in the Short-term Fixed Income Investment Pool, 65% in the Intermediate-term Fixed Income Investment Pool and 25% in the Broad-Market Fixed Income Investment Pool.

The recommended policy has the following characteristics:

Expected Return	5.82%
Risk	3.95%
Probability of Negative Return	7.05%

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The Subaccount of the CBRF

The subaccount of the CBRF was created by the legislature with the express intent of investing the subaccount more aggressively in an attempt to "yield higher returns than might be feasible to obtain with other money in the budget reserve fund " AS37.10.430(c). In giving this instruction the legislature provide statutory authority for the commissioner to have a clearly different risk tolerance when investing this money. Specifically the legislature provided that "In establishing or modifying the investment policy for the subaccount in the constitutional budget reserve fund, the commissioner of revenue shall assume that those funds will not be needed for at least five years." AS 37.10.430(c). The Department has publicly maintained and believes that time horizon is a major determinant of risk tolerance. In developing the investment policy for the CBRF over the years the possibility that the State could exhaust the Fund in just a few years has led to a more conservative investment policy than would otherwise have been the case. The legislature explicitly removed this constraint from the Commissioner when developing investment policy for the subaccount.

The legislature did not establish how much higher the expected rate of return might be or exactly how much risk could or should be accepted in the investment policy for the subaccount. The Department was left to consider these questions in light of how it and other fiduciaries would address the questions for a long-term endowment like fund. The most common approach to development of investment policies for endowments and other long-term funds is to look at historically achievable real or inflation adjusted returns for various asset classes and overall portfolios. Using this information, adjusted for current conditions and future expectation, fiduciaries can judge the likelihood of achieving various levels of returns and what the risk of the investment policies might be.

Most fiduciaries are comfortable with investment policies that target 5 percent real returns over time. As an example the State Retirement Systems have a current target of 5.15 percent. The Permanent fund has traditionally targeted something close to 5 percent. Both of these funds are clearly long-term funds. The majority of endowment or other long-term investment funds have

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investment policies that are likely to produce real or inflation-adjusted returns in the 4 to 6 percent range.

In evaluating the investment policy for the subaccount, the critical question becomes, is the fund significantly different from a typical endowment? Based on the legislative instruction the Department has concluded that it is not at this time different enough in any relevant way from a typical fund to justify either a more aggressive or more conservative investment policy than a typical fund. Treasury has concluded and I concur that a 5 percent real expected rate of return should be the target of the investment policy of the subaccount. Treasury has further concluded that the best way to meet the objectives for the subaccount of the CBRF while controlling risk is to invest 41% in the Domestic Equity Investment Pool, 17% in the International Equity Investment Pool and 42% in the Broad-Market Fixed Income Investment Pool.

The recommended policy has the following characteristics:

Expected Return	8.25%
Risk	10.56%
Probability of Negative Return	21.74%
Real rate of Return	5.00%

Ex 8

Post-it* Fax Note	7671	Date	1/29/01	# of pages	12
To	Dave D'Amato		From	T. Davenport	
Dept	Rep. Crawford		Co.	Treasury	
Phone #	0		Phone #	465-3751	
Fax #	465-4565		Fax #		

Constitutional Budget Reserve Fund - Investment Policy Statement

1. Overview

The state must deposit in a Constitutional Budget Reserve Fund (CBRF) all money received by the state after July 1, 1990 as a consequence of the resolution of disputes about the amount of mineral lease bonuses, royalties or taxes.

The Legislature may appropriate funds from the CBRF to fund the operations of state government only under certain conditions. If, at any time, the amount of funds from other sources available to the Alaska Legislature for appropriation is less than the amount appropriated to fund state government for the previous fiscal year, then the Legislature may appropriate from the CBRF on a simple majority vote. When the amount of funds from other sources exceeds the amount appropriated for the previous fiscal year, the Legislature may appropriate from the Fund for any public purpose with a three-fourths vote of the members of each house.

The Alaska state constitutional provision governing the operation of the CBRF requires the state's general fund to repay the money that has been appropriated from the CBRF if and when there is a surplus in the general fund at the end of any fiscal year. The general fund does not pay interest on the money it has "borrowed" from the CBRF.

Treasury's investment policies for the CBRF have changed over the years as balance and the expected uses of the CBRF have changed. A significant change occurred this year when the 21st Legislature created a special subaccount in the CBRF in order to "yield higher returns than might be feasible to obtain with other money in the budget reserve fund." The legislature directed that "In establishing or modifying the investment policy for the subaccount in the constitutional budget reserve fund, the commissioner of revenue shall assume that those funds will not be needed for at least five years. Income earned on money in the subaccount shall be retained in the subaccount by the department." AS 37.10.430(c).

Treasury, according to the constitution, credits to the CBRF the amount earned by the investment of the money in the CBRF. That is, the main account of the CBRF retains its investment earnings and the subaccount of the CBRF retains its investment earnings.

Appendix V contains the constitutional and statutory provisions applicable to the CBRF.

2. History

- November 1990. Voters of Alaska adopt an amendment to the Alaska State Constitution creating the CBRF. Article IX, 17 - See Appendix V.
- 1992-1994. Litigation over meaning of key terms in the constitutional provision.
- 1994. Legislature attempts to define "administrative proceedings involving taxes" and "money available for appropriation." 1 Ch. 5 SLA 1994. AS 37.10.410-420.
- April 1994. Alaska Supreme Court decision in *Hickel v. Halford* 872 P.2d 171 defining scope of "dispute" and "administrative proceedings."
- May 1994. Alaska Supreme Court decision in *Hickel v. Cowper* 874 P.2d 922 defining meaning of "amount available for appropriation."
- 1996. Legislature modifies definition of "administrative proceedings involving taxes." 5 Ch. 108 SLA 1996. See Appendix V.
- 1996. Legislature grants commissioner discretion to transfer management of all or a portion of CBRF to Alaska Permanent Fund Corporation. 1 Ch. 41 SLA 1996. AS 57.10.430. See Appendix V.
- 1997. Commissioner of Revenue decides to manage and invest all of CBRF through the Treasury Division, and Commissioner adopts Reserves Policy for the state.
- 1997. Commissioner adopts investment policy for CBRF based on three separate purposes of CBRF:
 - Fund to implement the state's Reserves Policy to cover anticipated and unanticipated shortfalls in the next two fiscal years' budgets;
 - Fund to provide a transition to a long-term fiscal plan; and
 - Fund to act as long-term reserve account to cover unanticipated budget shortfalls well into the future.
- June 1997. Legislature appropriates money from the CBRF for the first time from the CBRF to pay for CBRF equity investment management fees.
- July 1998. Because of anticipated heavy use of CBRF in short to medium term to balance state budgets, Commissioner modifies investment policy and eliminates consideration of using a portion of the CBRF to act as long-term reserve account.
- December 1998. Treasury reviews the Department of Revenue's Fall oil revenue forecast and the Office of Management and Budget's updated expenditure forecast. Treasury determines that the CBRF will be exhausted within five years to meet revenue shortfalls. Commissioner modifies investment policies and eliminates all equity investments.
- July 1999-September 1999. Treasury recommends and Commissioner accepts an investment policy recognizing a two-year investment horizon for the entire balance of the CBRF. Very large draws on CBRF to balance FY 98 and FY 99 budgets, together with a projected \$600 million to \$1.0 billion draw to balance FY 00 budget, reduces the anticipated time horizon for the balance of fund.

Commissioner concludes this change is appropriate no matter how the public votes in the September 14, 1999 special election relating to the state's long-range finances. Similarly, the Commissioner concludes that the higher oil prices experienced in the late spring and summer of 1999 should not alter this proposed policy.

- April 2000. Treasury recommends and Commissioner accepts an investment policy that recognizes a balance in the CBRF in excess of the state's two year reserve requirement and the state's cash flow needs. Higher than anticipated oil prices and a significant settlement increased the balance of the CBRF enough to cause the change in the investment policy
- July 2000. A significant change in the legislation relating to the fund caused Treasury to recommend significant changes to the investment policy of the fund. Treasury recommended and the commissioner accepted an investment policy that recognized a distinction for the newly created subaccount of the fund, the likely life of the fund, and the role of the balance of the fund in filling the reserve requirements of the State. (Related decision document in Appendix Y.) (Earlier versions of these decision documents are maintained in permanent files in Treasury's Asset Accounting Section. Revised documents relating to those policy decisions may be found in Appendices W and X.)

3. Facts and Figures

Fund Cash Flow History by Fiscal Year

Alaska's Public Finances
Constitutional Budget Reserve Fund, Main Account
 (\$millions)

	Settlement Contributions ^(a)	Investment Income ^(b)	Net Loans to General Fund	Balance Available to Loan GF at Year End ^(c)
FY 91	291	6	-	297
FY 92	247	19	-	563
FY 93	914	57	(849)	685
FY 94 ^(d)	437	61	(569)	614
FY 95	1,543	122	(285)	1,994
FY 96	586	111	(173)	2,518
FY 97	570	167	(83)	3,172
FY 98	343	369	(325)	3,559
FY 99	56	114	(1,101)	2,628
FY 00	448	115	^(c) (357)	^(b) 2,734
FY 01 (Proj.)	100	128	117	^(b) 2,679
FY 02 (Proj.)	45	133	(515)	2,342
FY 03 (Proj.)	45	107	(717)	1,777
Total	5,625	1509	(\$4,857)	

Data sources:

- (a) Department of Revenue, Income and Excise Audit Division, Mineral Payments Report (ties in total through FY99).
- (b) Derived (by formula).
- (c) State of Alaska Comprehensive Annual Financial Report (ending balance less the outstanding receivable from the state's general fund).
- (d) Although the table above is based on cash flows, it does not reflect the timing of the \$1,006,038,474 legislative appropriation (Ch 14, SLA 1994) resulting from an Alaska Supreme Court order to restore the CBRF for certain settlement payments deposited to the state's general fund from FY 1990-1994.
- (e) FY00 includes draw to finalize FY99 budget (42num).
- (f) Reflects \$100 million transfer to Power Cost Equalization Endowment Fund.
- (g) Reflects \$400 million transfer to CBRF subaccount on July 1, 2000.

Alaska's Public Finances
Constitutional Budget Reserve Fund, Subaccount
(\$millions)

	Settlement Contributions ^(a)	Investment Income ^(b)	Net Loans to General Fund	Balance Available to Loan GF at Year End ^(c)
FY 00	0	0	0	0
FY 01 (Proj.)	400	34	0	434
FY 02 (Proj.)	0	37	0	471
FY 03 (Proj.)	0	40	0	511
Total	400	111	0	

4. Investment Policy

For the main account of the CBRF (excluding the subaccount that has a five-year time horizon), Treasury recognizes the State's current two-year reserve requirement, General Fund cash flow borrowing needs, money in excess of that which might be needed within two years and the Investment policy of the GcFONSI. At this time, the current high oil prices and the balance in the CBRF support a somewhat more aggressive policy for the money in the main account of the CBRF than had been the case in recent years.

Treasury would invest the main account of the CBRF with the following in mind:

Risk Tolerance	Moderately high. Fund should not be needed for several years.
Investment Objectives	Moderately high exposure of principal to loss in return for higher expected longer-term returns. Limited current income requirement. Moderate inflation protection needed. Moderate liquidity requirement.
Time Horizon	Intermediate.

Effective July 1, 2000, Treasury's investment policy for the main account of the CBRF would be:

25%	Board Market Fixed Income Investment Pool
65%	Intermediate-term Fixed Income Investment Pool
10%	Short-term Fixed Income Investment Pool

Treasury's performance benchmark for the main account of the CBRF is:

25%	Lehman Brothers Aggregate Bond Index
65%	Merrill Lynch 1-5 year Government Index
10%	Three-month U.S. Treasury Bill

Treasury would invest the subaccount of the CBRF with the following in mind:

Risk Tolerance	High. The legislature has expressly provided guidance by instructing the Commissioner to use at least a five year time horizon in establishing an investment policy for the subaccount.
Investment Objectives	High exposure of principal to loss in return for higher expected longer-term returns. Limited current income requirement. Inflation protection needed. Moderate liquidity requirement.
Time Horizon	Long.

Effective July 1, 2000, Treasury's investment policy for the subaccount of the CBRF would be:

42%	Board Market Fixed Income Investment Pool
41%	Domestic Equity Investment Pool
17%	International Equity Investment Pool

Treasury's performance benchmark for the main account of the CBRF is:

42%	Lehman Brothers Aggregate Bond Index
41%	Russell 3000 Stock Index
17%	Morgan Stanley Capital International Europe, Australia, and Far East Stock Index

5. Control and Reporting Requirements

On or before March 15 each year, AS 37.10.430 requires Treasury to prepare a report to the Legislature comparing beginning and ending balances in the CBRF for the immediately preceding calendar year together with comparative nominal, real and realized returns for the CBRF, the Permanent Fund and the

general fund. The State Comptroller in the Treasury Division is responsible for compiling this information and preparing and distributing the required report.

The Alaska Legislature made AS 37.10.071 directly applicable to the CBRF. Accordingly, the Commissioner, through the State Comptroller, maintains accounting records for the Fund in accordance with generally accepted accounting principles (as would be required by AS 37.10.071(a)(8)) and engages an independent certified public accountant to perform an annual audit of the financial condition of the Fund and the pertinent investment transactions (as would be required by AS 37.10.071(a)(9)).

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
8/19/99	9/1/99	CBRF - elimination of Transition Fund and Long-term Reserve Fund, modification to investment policy of Two-year Shortfall Fund including asset allocation.	1.2
3/7/00	4/1/00	Treasury updates 2000 capital market assumptions and changes asset allocation policy accordingly. Target policy was 15% Short-term Fixed Income Investment Pool, 85% Intermediate-term Fixed Income Investment Pool.	1.3
4/7/00	4/10/00	Treasury revises asset allocation after receiving a \$416.3 million settlement from an oil tax dispute in early April 2000. Asset allocation was 25% Short-term Investment Pool, 75% Intermediate-term Investment Pool.	1.4
1/29/01	7/1/00	Treasury revises asset allocation when the 21st Legislature creates a special \$400 million "subaccount" in the CBRF effective July 1, 2000 and establishes a new \$100 million Power Cost Equalization Endowment Fund.	1.7