

SJR

18

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: 3
Bill Version: CSSJR18(STA)
() Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
Title Constitutional Amendment RDU AK Permanent Fund Corporation
Permanent Fund Appropriations Component AK Permanent Fund Corporation
Sponsor Senate Rules Committee
Requester Senate Judiciary Committee Component No. 109

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

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

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

FUND SOURCE (Thousands of Dollars)

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

Estimate of any current year (FY2004) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

SJR18 would ask the voters at the next general election whether to approve an amendment to the Constitution of the State of Alaska that would limit appropriations from the Permanent Fund to no more than 5% of the average year-end market values of the fund for the preceding five years.

SJR18 would not affect the budgeted costs to manage and invest the Permanent Fund, nor would it change the amount of income earned by Permanent Fund investments.

See the attached schedules for financial projections and analysis of the Fund comparing the "Status Quo" to a 5% percent-of-market-value (POMV) spending limit.

Prepared by: Robert D. Storer, Executive Director Phone (907) 465-2047
Division Alaska Permanent Fund Corporation Date/Time 1/18/04 8:51 AM
Approved by: Steve Porter, Deputy Commissioner Date 1/18/2004
Agency Department of Revenue



Alaska Permanent Fund Corporation
 SJR 18 - Financial projection comparison of the Alaska Permanent
 Fund under status quo versus POMV spending limit beginning in
 \$ millions

Status Quo	-----projected-----												
	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	
Total Return	15.25%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%
Contributions & appropriations (after payouts)	23,300	24,179	25,042	25,922	26,824	27,748	28,688	29,652	30,628	31,623	32,668	33,725	
Unrealized appreciation/depreciation on invested assets	3,451	3,898	4,284	4,634	4,958	5,262	5,546	5,824	6,100	6,371	6,639	6,905	
Realized earnings account (after payouts)	850	1,341	1,943	2,516	3,041	3,591	4,180	4,809	5,480	6,200	7,000	7,942	
Total market value end of year (after payouts)	<u>27,601</u>	<u>29,417</u>	<u>31,268</u>	<u>33,072</u>	<u>34,823</u>	<u>36,600</u>	<u>38,414</u>	<u>40,245</u>	<u>42,133</u>	<u>44,084</u>	<u>46,087</u>	<u>48,165</u>	
Annual realized income	1,311	1,602	1,796	1,969	2,129	2,280	2,430	2,586	2,743	2,909	3,089	3,284	
Dividend (lump sum) - status quo	561	499	560	739	925	1,027	1,113	1,226	1,297	1,367	1,477	1,542	
Transfer status quo Inflation-proofing (ER to principal)	0	613	635	657	680	703	727	751	776	801	828	855	

POMV - 5% (beginning in FY05)	-----projected 5% POMV beginning in FY05-----											
	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Total Return		7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%
Total Market Value End of Year (after payouts)	<u>27,601</u>	<u>28,605</u>	<u>29,621</u>	<u>30,654</u>	<u>31,686</u>	<u>32,710</u>	<u>33,739</u>	<u>34,782</u>	<u>35,840</u>	<u>36,912</u>	<u>38,025</u>	<u>39,153</u>
5 year average market value lagged one year		26,224	26,669	27,674	29,191	30,843	32,061	33,146	34,243	35,346	36,453	37,572
POMV Payout available for appropriation in lump sum		1,311	1,333	1,384	1,460	1,542	1,603	1,657	1,712	1,767	1,823	1,879

Assumptions:

- Both scenarios show payouts net of inflation.
- POMV payout assumes calculation methodology is 5% of the ending market value (pre payout) for the first five of the last six fiscal years.
- Callan Associates 2003 Capital Market Assumptions, APFC 2003 asset allocation, Fall 2003 revenue forecast, financial statements through 12/31/03. All payouts are assumed to happen at fiscal year end, all dollar values in millions.
- Per SB 100, currently there is no FY04 Inflation-proofing appropriation, and \$354 million of FY04's projected Inflation-proofing of \$523 was pre-funded in FY03.

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: SJR 18
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: OOG
 Title Constitutional amendment relating to limiting RDU Elections
appropriations from State of AK and inflation-proofing the APF Component Elections
 Sponsor Rules
 Requester Senate Judiciary Component No. 21

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
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 (FY2004) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2005 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: Leonard G. Jones
 Division: Division of Elections
 Approved by: Laura A. Glaiser, Director
 Agency: Office of the Lt. Governor, Division of Elections

Phone 465-3051
 Date/Time 1/16/04 10:36 AM
 Date 1/16/2004



Alaska Permanent Fund

An overview of POMV

- the 5% solution -

ACCOUNTABILITY

TO ALASKANS, FOR ALASKANS



Trustees' proposal

The APFC Board of Trustees proposes
a constitutional amendment
to limit annual Fund spending
to five percent
of the Fund's total market value.

POMV

ACCOUNTABILITY

TO ALASKANS, FOR ALASKANS



What is POMV?

POMV, or "Percent of Market Value," is a formula that limits spending to a set percent of a fund's total market value.

The set percent is based on the expected difference between total annual return on investments and the rate of inflation.

8% projected average annual return

-3% projected average annual inflation

5% maximum annual sustainable payout

retained in the Fund for inflation proofing

ACCOUNTABILITY

TO ALASKANS, FOR ALASKANS



"To benefit all generations..."

AS 37.13.020 (1)

...the Fund should provide
a means of conserving a portion
of the state's revenue from mineral resources
to benefit all generations of Alaskans.



POMV protects the Fund

- **Protects the entire Fund** by eliminating the distinction between principal and earnings
- **Protects the option** of an annual distribution (i.e. dividends)
- **Protects the Fund for future generations** by restricting spending

ACCOUNTABILITY

TO ALASKANS, FOR ALASKANS



POMV payout formula

1. Compute the Fund's
FY04 five-year
average market value

\$25.9 billion

average market value FY00-FY04

x .05

2. Multiplying by 5 percent
= the FY05 payout

= \$1.3 billion

FY05 payout

ACCOUNTABILITY

TO ALASKANS, FOR ALASKANS



POMV constitutional amendment

SJR 18 and HJR 26

- APFC Board of Trustees supports the resolutions as written.
- The single difference between the resolutions is a line of intent language found only in HJR 26.
- The Board urges the Senate Judiciary Committee to pass this resolution in January.

ACCOUNTABILITY

TO ALASKANS, FOR ALASKANS



Why we need POMV

For the present

- Ensure the option of an annual payout
- Make payout amounts more stable from year to year
- Make payout method compatible with investment strategy

For the future

- Prevent overspending in the good years
- Maintain purchasing power for the entire Fund

ACCOUNTABILITY

TO ALASKANS, FOR ALASKANS

HOME | ABOUT THE APFC | CONTACT US | HOW THE FUND WORKS | STOCKS | BONDS | REAL ESTATE |

ALASKA PERMANENT FUND

ACCOUNTABILITY

POPULAR PAGES

- Dividend
- Board
- Staff
- FAQ
- Resolutions
- Corporate Gov.
- Invest. Policy
- Asset Allocation
- History
- Permanent Fun Guide
- Contact Us
- Employment
- 5-year outlook
- Sitemap

SECTIONS

- Financials
- Investments
- Publications
- The APFC
- Fund Law
- POMV
- Internships
- Alaska
- Lesson Plans
- Press Room

REPORTS

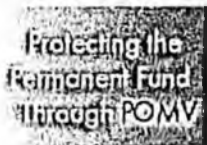
QUARTERLY



ANNUAL REPORT



POMV



FUND HISTORY

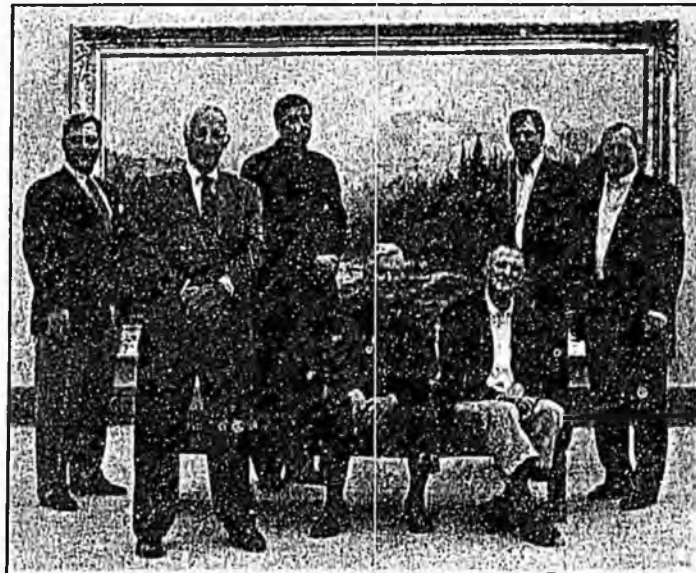


QUESTIONS AND ANSWERS ON POMV

The Board of Trustees of the Alaska Permanent Fund Corporation is supporting a new structure for the Permanent Fund that will determine how much money may be paid from the Fund each year. This method is called a "percent of market value" system also known as the "5% solution."

Why POMV?

The Board of Trustees is charged, according to Alaska law, with managing the Fund for all generation, which means we are responsible for assuring long-term benefits and saving the Fund for future generations. POMV meets both needs. The "5% solution" (or POMV) is not a new idea.



- The Alaska Permanent Fund Board of Trustees has supported this change for a number of years.
- Many large endowments and foundations across the country use a similar system, including Yale and Columbia University foundations, the Ford Foundation, the Pew Charitable Trusts and even Alaskan funds such as the Rasmuson Foundation.

How would POMV work?

Each year, the total market value of the Fund (principal and earnings combined) would be averaged over the previous five years. Five percent of that average would be available to be withdrawn from the Fund.

How is POMV different?

Fund balances at the end of each fiscal year

billions

Realized income account

The chart at the left shows the ending balance of the Fund for each of the last four fiscal years. Under the current system, the Permanent Fund is divided into two parts.

The first part is the principal of the Fund, the money that is invested in assets such as stocks, bonds and real estate, and cannot be spent.

The second part is realized earnings, which is the cash that the Fund receives as income from investments or as profits from the sale of investments. *Realized earnings may be spent.*

It's important to understand that the realized earnings are not sitting in a savings account, but are in fact reinvested into the same assets as the reserved part of the Fund. This allows the realized earnings to continue to gain value and earn money until they are withdrawn from the Fund.

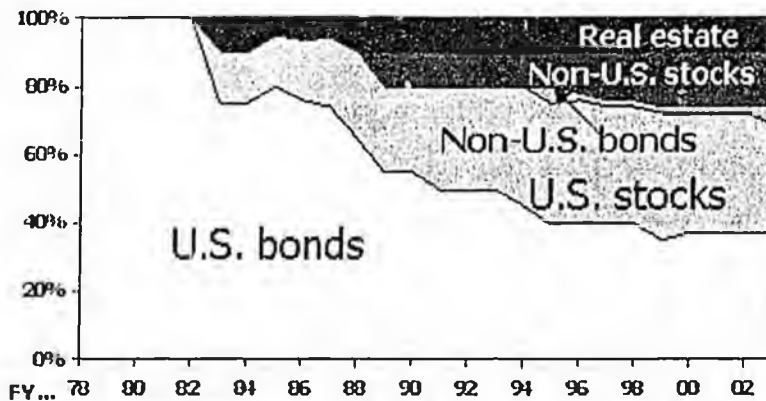
The APFC uses the amount of the Fund's realized earnings each year to calculate the Permanent Fund Dividend, and pays the dividend out of the realized earnings account. The Legislature then transfers a calculated amount of money each year from the earnings to the principal to inflation-proof the Fund.

In years where the markets are good and there are a lot of realized earnings, there is often money left over in the earnings account after the dividend is paid. This was the case on June 30, 2000, when \$3 billion was still in the account after money had been withdrawn to pay dividends in October and inflation proof the Fund.

But in other years there might not be realized earnings in the account. This scenario came close to occurring when the markets were down during the fall of 2002, and it looked like there might not be enough in the account to pay dividends or inflation proof the Fund in 2003.

Why POMV now?

In 1980, the Permanent Fund was invested entirely in bonds. Bonds provide stable and predictable



cash earnings each year, and basing the method for paying money from the Fund on earnings made sense.

Now, the Fund is invested in stocks and real estate in addition to bonds. While stocks and real estate sometimes provide cash

earnings, most of their benefit is in the ability to rise in value. But the Permanent Fund doesn't receive cash income from the rise in value until these assets are sold. This means that it is possible for the overall value of the Fund to rise without producing any realized earnings, and therefore no money that may be spent from the earnings reserve account.

Basing the amount available for payout on the value of the Fund rather than its earnings makes sense in light of how the Fund is invested today. It allows Alaskans to take advantage of any increase in the value of the assets that the Fund owns without having to sell the assets.

What about inflation?

Inflation is an increase in the cost of goods or services over time. If the value of the Fund does not increase by at least the same amount, then future generations will not be able to buy as much with their Fund dollars as we can today.

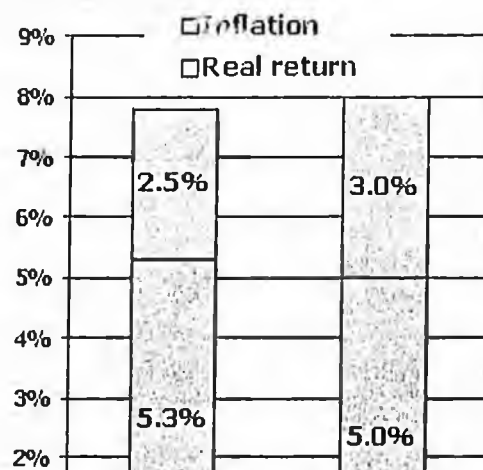
Under the current system, part of the Fund is inflation proofed using a formula that puts money into the principal where it cannot be spent. But this process requires a vote of the Legislature each year, and does not inflation-proof the entire Fund. In addition, pressure on the Legislature to balance the state budget in years when oil-revenues are low could put inflation proofing at risk.

When the Board of Trustees makes decisions regarding how the money in the Fund will be invested, its goal is a five percent real rate of return over inflation. This means that if inflation for a particular year is expected to be three percent, then the goal is a return of eight percent:

$$\begin{array}{r}
 8\% \quad \text{projected rate of return} \\
 - 3\% \quad \text{projected rate of inflation} \\
 \hline
 5\% \quad \text{real rate of return}
 \end{array}$$

This equation shows that if five percent is withdrawn from the Fund, over time enough money is left behind to automatically inflation proof the entire Fund.

Why five percent?



The Board of Trustees believes that five percent is the maximum amount that can be paid out of the Fund each year without harming the Fund in the future. This is called "sustainability," and to withdraw more could place the future health and earning potential of the Fund in jeopardy.

As you can see in the chart at the left, over the last ten

years the Fund earned a 7.8 percent total return, which produced a 5.3 percent real rate of return after inflation. While past performance isn't a guarantee of future performance, it does show that the Board of Trustees was realistic when it chose a target 5 percent real rate of return.

What about years where the market goes down - won't allowing a payout cut into the value of the Fund?

POMV does not require a five percent payout each year, it simply says that no more than five percent may be paid out. However, Alaskans and the Alaska economy have come to depend on an annual dividend, and decision makers might want to have the option of paying dividends even in bad years.

The protection that POMV would provide from overspending the Fund in good years outweighs the risk of withdrawing money from the Fund in bad years.

What do you mean by "protection from overspending?"

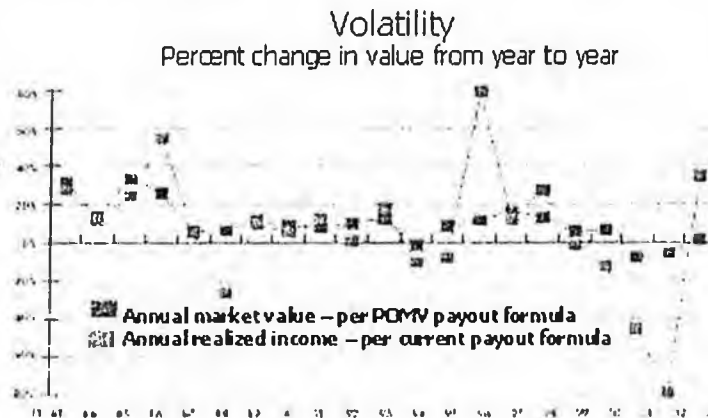
Under current law, realized earnings of the Permanent Fund go into the Earnings Reserve Account where they are available for appropriation. Permanent Fund dividends and inflation proofing are calculated and paid from those earnings. In a good year there is often money left behind in the Earnings Reserve Account after dividends are paid, and the Legislature may withdraw this money at any time.

Over the Fund's history, the Legislature has placed the extra money back into the Permanent Fund, but the law does not require

this. As we saw in the chart showing the balance of the Permanent Fund for the last four years, in 2000 and 2001 more than five percent of the value of the Fund was available in the Earnings Reserve Account and could have been appropriated.

The volatility graph above provides another illustration of how POMV would smooth out the effects of both the good years and the bad. The purple line represents the overall value of the Fund. This graph is not in dollars, but represents how much the value changes from year to year. As you can see, while the value of the Fund has grown from \$700 million to \$25 billion over the last 22 years, the rate of growth has been very steady.

Conversely, the blue line represents the realized earnings of the



Fund. In 1996 earnings shot up dramatically, leaving a lot of money behind in the earnings reserve that could have been withdrawn from the Fund. In 2002 we see the opposite effect, with earnings falling dramatically and almost wiping out the earnings reserve.

The current system bases payouts on the blue line. POMV would base the amount available for withdrawal from the Fund on the purple line, creating greater stability from year to year.

Will POMV make money available to spend on government services?

Currently, any earnings left over after the dividend is paid and the Fund is inflation proofed are available for spending on anything the Legislature chooses, including government services.

How much will my dividend be under POMV?

The Board of Trustees has not made any recommendations regarding how much of the five percent available for appropriation should go to dividends. Alaska's decision makers must determine what part of that five percent would go to dividends and what part would go to other uses, if any.

Where are we now?

There are two resolutions in the Legislature right now that would propose the necessary Constitutional change to enact POMV, SJR 18 and HJR 26. First, the Legislature must approve one of these resolutions, and the Governor must sign it. If this happens a question would be placed on the ballot in November 2004 asking the people of Alaska to approve changing from the current system to a POMV payout method.

REQUEST PUBLICATIONS | SUBMIT QUESTIONS | SUBSCRIBE TO E-MAIL LIST

THE
FOLLOWING
DOCUMENT(S)
ARE
POOR
ORIGINAL
COPIES

pls distribute

465-5241

January 21, 2004

To Senate Judiciary Committee members:

Re: SJR18

I am a long-time advocate for 5 POMV payout because it inflation-proofs the entire permanent fund and because it makes the fund's payout policy compatible with its evolved investment strategy to include real estate and equities rather than only the income producing investments originally allowed.

Implementing POMV must be kept simple and comparable to the existing dividend program to gain voter acceptance as required for a constitutional amendment. Dedicating 80% of the annual payout to dividends in the Constitution will assure voters that their dividend program will continue in a manner comparable to the current earnings-based formula. Government will gain access to 20% of the annual payout and be assured of a predictable, sustainable revenue stream. Best of all, we will, after years and years of chatter, take a critical first step toward solving our fiscal dilemma.

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

235-3725

mgrt@xyz.net



Alaska State Legislature

Please enter into the record my testimony to the Senate Judiciary
committee name

Committee on SJR 18 Date, January 21, 2004
bill # / subject

I do not support SJR 18, because I feel that it does not contain provisions for inflation proofing, or for paying dividends. From the way SJR 18 is worded, it appears as if SJR 18 was written to use our PFD's as a source of revenue to pay for financing our state government! It was a very clear and resounding NO in the 1999 advisory vote. We don't want representatives touching our permanent dividend funds. Please vote NO on SJR 18 and vote yes on SJR 19.

Signed: Laurie Churchill
Testifier

self
Representing (optional)

PO Box 7043 Nikiski, AK 99635
Address

907-776-3499

Phone number

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 2
 Bill Version: SJR 18
 (S) Publish Date: 5/7/03

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
 Title Constitutional Amendment: BRU Permanent Fund Corp
Permanent Fund Appropriations Component Permanent Fund Corp
 Sponsor Senate Rules
 Requester Senate State Affairs Component No. 109

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

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

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

FUND SOURCE (Thousands of Dollars)

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

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

SJR 18 would ask voters in the next general election whether to approve a constitutional amendment that would limit annual appropriations to no more than 5% of the average year-end market value of the Fund for the preceeding five years.

SJR 18 would not affect the budgeted costs to manage and invest the Permanent Fund, nor would it change the amount of income earned by Permanent Fund investments.

See the attached schedule for financial projections of the Fund comparing the "Status Quo" to a 5% POMV spending limit.

Prepared by: Robert D. Storer, Executive Director Phone (907)465-2047
 Division Alaska Permanent Fund Corporation Date/Time 4/25/03 5:00 PM
 Approved by: William Corbus, Commissioner Date 4/29/2003
 Agency Department of Revenue



Alaska Permanent Fund Corporation
 SJR 18 FN #2 Pg 2 of 2 - Financial projection comparison of the Alaska Permanent Fund
 under status quo versus POMV spending limit, beginning in FY05.

\$ millions

Status Quo	-----projected-----										
	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13
Total Return	-3.42%	7.38%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%
Principal - end of year (after payouts)	22,348	23,268	24,149	25,057	25,988	26,937	27,910	28,899	29,899	30,918	31,956
Realized earnings reserve (after payouts)	633	398	648	1,102	1,581	2,028	2,446	2,886	3,358	3,865	4,487
Unrealized earnings reserve	(632)	118	610	960	1,232	1,468	1,708	1,929	2,135	2,332	2,434
Total earnings reserve - end of year (after payouts)	0	516	1,258	2,062	2,813	3,496	4,154	4,816	5,493	6,197	6,921
Total Market Value End of Year (after payouts)	<u>22,349</u>	<u>23,784</u>	<u>25,407</u>	<u>27,118</u>	<u>28,801</u>	<u>30,433</u>	<u>32,065</u>	<u>33,715</u>	<u>35,392</u>	<u>37,115</u>	<u>38,876</u>
Annual net income	(851)	1,620	1,775	1,897	2,026	2,152	2,275	2,397	2,521	2,647	2,776
Dividend (lump sum) - Status Quo	686	510	409	442	597	766	887	979	1,059	1,131	1,209
Transfer status quo Inflation-proofing (ER to principal)	102	590	612	635	659	683	707	732	758	783	810

* The APFC FY03 projected dividend, paid to Alaska citizens in October, 2003 is subject to available earnings reserve. The volatility in the stock market has taken earnings reserve to zero or below several times this fiscal year. If the earnings reserve balance is zero or negative on 6/30/03, no dividend distribution will be paid to the Department of Revenue.

POMV - 5% (beginning in FY05)	-----projected 5% POMV beginning in FY05 -----										
	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13
Total Return			7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%
Total Market Value End of Year (after payouts)		<u>23,784</u>	<u>24,581</u>	<u>25,429</u>	<u>26,307</u>	<u>27,186</u>	<u>28,078</u>	<u>28,978</u>	<u>29,881</u>	<u>30,795</u>	<u>31,717</u>
Annual net income			1,775	1,834	1,898	1,963	2,028	2,094	2,161	2,228	2,295
POMV Payout available for appropriation in lump sum			1,235	1,243	1,274	1,329	1,380	1,426	1,473	1,520	1,568
5 year average market value			24,706	24,854	25,480	26,576	27,608	28,526	29,463	30,409	31,363

Assumptions: Callan Associates 2003 Capital Market Assumptions, APFC 2003 asset allocation, Spring 2003 revenue forecast, financial statements through 3/31/03. All payouts are assumed to happen at fiscal year end, all dollar values in millions.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: SJR 18
 (S) Publish Date: 5/7/03

Revision Date/Time (Note if correction): _____ Dept. Affected: Office of the Governor
 Title Constitutional Amendment relating to BRU Elections
limiting appropriations from and inflation-proofing the APF... Component Elections
 Sponsor Senate Rules Committee
 Requester Senate State Affairs Component No. 21

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual		1.5				
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	1.5	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	0.0	1.5	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2004 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: Lauri Allred
 Division: Division of Elections
 Approved by: Laura A. Glaiser, Director
 Agency: Office of the Lt. Governor, Division of Elections

Phone 465-5347
 Date/Time 4/28/03 1:33 PM
 Date 4/28/2003

**Testimony before the
House Special Committee on Ways & Means
Clark S. Gruening
April 22, 2003**

Mr. Chairman and members of the House Special Committee on Ways & Means, thank you for the opportunity to discuss with you HJR 26, a proposed constitutional amendment for inflation-proofing the Alaska Permanent Fund.

Before speaking to how this proposal changes the way the Permanent Fund is inflation-proofed, I'd like to make some brief comments about how the Board came to recommend this change.

For 23 of the Fund's 27 years of existence, the APFC has been governed by a six-member Board of Trustees. Protecting the Fund against inflation has been the highest public policy goal of the Trustees since the original Board was appointed in 1980. The first Board testified to the legislature that the greatest threat to the permanence of the Fund is inflation. In response, the legislature adopted statutory inflation-proofing in 1982.

In more recent years, the Board has examined the use by various large endowments and public funds of a formula approach to determine the method and size of payouts from these funds. This approach is generally referred to as "percentage of market value" payouts or "POMV" for short.

The purpose of placing this formula in the state constitution is to protect the long-term real value of the Fund and to provide consistent and predictable distributions for the long-term. After considerable review and discussion, the Board recommended in February of 2001, a constitutional change in the form of

HJR 15 and SJR 13 which received committee hearings but did not come to the floor for a vote.

As in the prior proposal, the language in HJR 26 provides a spending limit on what can be currently spent or, in legislative parlance, appropriated. The existing constitutional language establishing the Alaska Permanent Fund only prohibits the appropriation of principal. In other words, anything but "principal" is income and can be spent.

Since the first Board of Trustees, 23 years ago, the Permanent Fund corporation has calculated principal as a notational number that simply equals the sum of the constitutionally mandated 25 percent of mineral deposits and the non-mandated (or voluntary) deposits the legislature has chosen to make. Principal does not vary or move up or down with the market.

Unlike the present statutory provision for inflation-proofing, HJR 26 provides for inflation-proofing of the entire Fund. But clearly, one of the most important reasons to support the proposal is that it would maximize distributions over the long term by establishing a percent of market value spending limit. By eliminating the distinction between principal and income, this proposal would also avoid the situation where market volatility on the down side prevents any distribution from the fund for any purpose, whether for dividends or anything else.

This is significant because since 1982, Alaska's fiscal picture has changed dramatically. The Alaska Permanent Fund can be reasonably expected to produce more future state revenue than any single Alaska resource – more than oil or natural gas, more than fishing or any other natural resource.

Whatever future decisions are made by the legislature or the voters regarding the use of Fund earnings, the five percent payout of market value limit will assure complete and protected inflation-proofing while providing predictable and sustainable distributions over the long term.

In managing Alaska's fishery stocks, the only sensible choice is to avoid taking too much of any fish stock so that, over the long term, the harvest is maximized. Of course, over-harvesting can reap short-term rewards of more fish, but the inevitable result is, at best, fewer fish, and at worst, permanent impairment or destruction of a fisheries stock. The same is true for managing distributions from a large investment fund like the Alaska Permanent Fund.

I want to close by emphasizing two key points regarding the Board's proposed constitutional amendment. The first point is that if Alaska is going to have a Fund that is truly permanent, we must take those steps necessary to ensure permanence. This means investing for future generations as well as current generations. This will require commitment to basic principles of long-term investing.

But the critical flip side of a sound long-term investment strategy is a sound, sustainable, and predictable distribution plan – a plan that will sustain and provide benefits to each generation of Alaskans.

The second and last point I want to leave you with is that if the Permanent Fund is going to continue to serve each generation of Alaskans it has to be able to make distributions so that current generations receive some benefit while not

"over harvesting" the fund so that there is little or nothing left for future generations.

We all want to avoid, at all costs, defaulting to the position where the Constitutional Budget Reserve (or "CBR") is today. Within the next three to four years, the CBR is destined for extinction. As the investment horizon of the CBR steadily shortens, it will be necessary to keep the assets of the CBR in very short-term and less-profitable investments.

I believe that as the day of the CBR's demise grows near, the Trustees and staff of the Fund may have to seriously consider a shorter investment horizon for a significant portion of the Fund.

So, whether we liken the Alaska Permanent Fund to a resource industry like Alaska's fisheries, one thing is clear: the Alaska Permanent Fund can continue to import significant new money into our state year after year.

Properly invested and protected, the Alaska Permanent Fund will successfully convert the non-renewable petroleum wealth of our State into a permanent and substantial stream of revenue for generations after the last barrel of oil has been pumped.

Legislative passage and voter approval of the Board's proposed amendment would protect the ability of the Fund to be managed for the long-term and to continue to pour money into the Alaska economy over the long-term.

The proposed constitutional change before you in the form of HJR 26 is more compatible with the Fund's diversified, long-term investment strategy of achieving a five percent real rate of return over time. The present constitutional

language was designed over a quarter century ago for a Fund that was invested 100 percent in bonds.

I believe that succeeding generations will rightly view this proposed amendment with the same degree of appreciation and admiration as the original one Alaskans overwhelmingly approved 27 years ago. The Trustees believe that this proposal for complete and protected inflation-proofing makes ultimate good sense for Alaska's Permanent Fund and for Alaska's future.

ALASKA PERMANENT FUND CORPORATION

RESOLUTION OF THE BOARD OF TRUSTEES OF THE
ALASKA PERMANENT FUND CORPORATION RELATING TO A
CONSTITUTIONAL AMENDMENT LIMITING APPROPRIATIONS FROM
AND INFLATION-PROOFING THE ALASKA PERMANENT FUND
BY ESTABLISHING A PERCENT OF MARKET VALUE SPENDING LIMIT

RESOLUTION 03-05

Preserving the real value of the money deposited into the Alaska Permanent Fund ("Fund") over the long term has been a public policy priority of the Board of Trustees ("Board") since the original Board was appointed over 20 years ago. In response to the Board's concerns in 1982 about the effects of inflation on the value of the Fund, the legislature adopted statutory inflation-proofing that same year. That change has successfully protected (by statute) the principal of the Fund for the past 20 years. After several years of review, the Board believes it is now time for the People of Alaska to make another decision that would: 1) constitutionally protect the current purchasing power of the whole Fund (both principal and income) against inflation; and 2) improve the rules governing distributions from the Fund.

To accomplish these goals, the Board has examined the use by various large endowment and public funds of a formula approach to establish appropriate limits on the size of payouts from those funds. This formula approach, generally referred to as a "percent of market value" ("POMV") spending limit, is applied by those funds in a manner that assures that, on average, only *real* income of a fund (i.e. income *net of inflation*) can be spent, thereby assuring that the real value of the contributions paid into the fund will not be touched. Because a POMV spending limit would provide for distributions from the Fund that are

predictable and limited, the Board believes that its use is in the best interest of the Fund and of the people of the State of Alaska.

The Board further believes that the best way to implement a POMV spending limit methodology for determining a level of distributions from the Fund that is predictable and limited is to amend the constitutional provision that established the Fund (Article IX, section 15 of the Alaska Constitution). Providing for a POMV spending limit in this manner would assure all Alaskans that the real value of the contributions to the Fund will be preserved for all time.

At the Board's request, APFC staff has presented a draft constitutional amendment for further discussion by the Board which, if adopted by the people of the State of Alaska, would provide for the following:

1. an annual limit on appropriations from the Fund of up to five percent of the total market value of the Fund, averaged over a period of five years;
2. using a five year period that allows the legislature and the governor to know before a fiscal year begins the exact amount that will be available for distribution from the Fund;
3. Fund income is part of the Fund, rather than being subject to appropriation by the legislature, as currently provided;
4. assures that the current statutory earnings reserve account established by AS 37.13.145 becomes part of the Fund when the constitutional amendment takes effect; and
5. the current references to "principal" and "income" are removed, as POMV ensures protection of the principal over the long-term through a constitutional spending limit.

The Board believes that this approach effectively balances the goal of providing for an annual distribution from the Fund that is predictable and limited with the long-term goal of protecting the real value of contributions to the Fund.

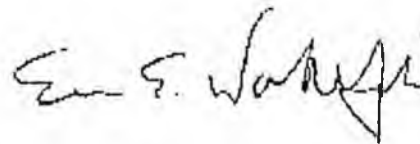
In addition, the Board believes strongly that implementing a POMV spending limit approach by constitutional amendment is such an important public policy goal that proposals for incorporating any other amendments to Article IX, section 15 which might in any way either lessen the chances of approval of such an amendment by the voters or undermine the legal status of the Fund should be rejected by the legislature.

Finally, the Board recognizes that implementation of a POMV spending limit methodology by constitutional amendment may necessitate changes to existing statutes that deal with the formula for determining and distributing the amount of the Fund that may be spent each year, including, but not necessarily limited to, payment of Permanent Fund Dividends and inflation-proofing the Fund. In anticipation of voter approval of a constitutional amendment providing for a POMV spending limit, the Board is hopeful that the legislature and the governor will work together to develop appropriate legislation to harmonize existing statutory provisions with the operation of the amendment and/or to adopt such new statutes as they may consider desirable. In this regard, the Board and APFC staff stand ready to provide any information or other assistance that may be helpful.

NOW, THEREFORE, BE IT RESOLVED by the Board of Trustees that the legislature of the State of Alaska, in consultation with the governor and the Board, are urged to consider and approve the proposal (dated 4/14/03) for a constitutional amendment that would implement a POMV spending limit mechanism that would provide an annual distribution from the Fund that is predictable and limited.

BE IT FURTHER RESOLVED by the Board of Trustees that the proposal for such an amendment be limited solely to implementation of the foregoing goal.

PASSED AND APPROVED by the Board of Trustees of the Alaska Permanent Fund Corporation this 14th day of April 2003.



Eric E. Wohlforth

Chair, Board of Trustees

ATTEST:



Robert D. Storer, Corporate Secretary

Methods to determine funds available for appropriation:

**Five key differences between the
Status quo and the proposed
Percent of Market Value (P.O.M.V.)**

A presentation by the Alaska Permanent Fund Corporation
to the House Ways and Means Committee
April 21, 2003



Five key differences between the status quo and POMV

1. POMV offers constitutional inflation-proofing protection of the entire Fund. The status quo statutorily inflation-proofs Fund principal.
2. POMV is a spending limit. It limits funds available for appropriations to real income over time. Under the status quo, the entire earnings reserve may be appropriated.
3. During volatile markets, POMV offers greatly improved stability in year-to-year amounts available for appropriation as compared to the status quo.



Differences between the status quo and POMV

4. POMV is compatible with the Fund's diversified, long-term investment strategy of achieving a 5% real rate of return over time. The status quo was designed a quarter century ago for a Fund invested 100% in bonds.
5. Predictable annual appropriations are provided under POMV. Under the status quo, it is not known whether funds will be available for appropriation in any given year.





Alaska Permanent Fund Corporation
HJR 26 - Financial projection comparison of the Alaska Permanent Fund
under status quo versus POMV spending limit, beginning in FY05.
\$ millions

Status Quo	-----projected-----											
	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	
Total Return	-3.42%	7.38%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%
Principal - end of year (after payouts)	22,348	23,268	24,149	25,057	25,988	26,937	27,910	28,899	29,899	30,918	31,956	
Realized earnings reserve (after payouts)	633	398	648	1,102	1,581	2,028	2,446	2,886	3,358	3,865	4,487	
Unrealized earnings reserve	(632)	118	610	960	1,232	1,468	1,708	1,929	2,135	2,332	2,434	
Total earnings reserve - end of year (after payouts)	0	516	1,258	2,062	2,813	3,496	4,154	4,816	5,493	6,197	6,921	
Total Market Value End of Year (after payouts)	22,349	23,784	25,407	27,118	28,801	30,433	32,065	33,715	35,392	37,115	38,876	
Annual net income	(851)	1,620	1,775	1,897	2,026	2,152	2,275	2,397	2,521	2,647	2,776	
Dividend (lump sum) - Status Quo	686	510	409	442	597	766	887	979	1,059	1,131	1,209	
Transfer status quo Inflation-proofing (ER to principal)	102	590	612	635	659	683	707	732	758	783	810	

POMV - 5% (beginning in FY05)	-----projected 5% POMV beginning in FY05-----										
	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13
Total Return			7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%	7.60%
Total Market Value End of Year (after payouts)		23,784	24,581	25,429	26,307	27,186	28,078	28,978	29,881	30,795	31,717
Annual net income			1,775	1,834	1,898	1,963	2,028	2,094	2,161	2,223	2,295
POMV Payout available for appropriation in lump sum			1,235	1,243	1,274	1,329	1,380	1,426	1,473	1,520	1,568
5 year average market value			24,706	24,854	25,480	26,576	27,608	28,526	29,463	30,409	31,363

Assumptions: Callan Associates 2003 Capital Market Assumptions, APFC 2003 asset allocation, Spring 2003 revenue forecast, financial statements through 3/31/03. All payouts are assumed to happen at fiscal year end, all dollar values in millions.



Alaska Permanent Fund Corporation

Calculation of annual effective rates of 5% POMV spending limit
\$ millions

	<u>FY05</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08</u>	<u>FY09</u>	<u>FY10</u>	<u>FY11</u>	<u>FY12</u>	<u>FY13</u>
Payout based on 5 year moving average	1,235	1,243	1,274	1,329	1,380	1,426	1,473	1,520	1,568
Ending market value (after payout)	24,581	25,429	26,307	27,186	28,078	28,978	29,881	30,795	31,717
Ending market value (pre payout)	25,816	26,672	27,581	28,515	29,458	30,404	31,354	32,315	33,285
Effective payout rate *	4.78%	4.66%	4.62%	4.66%	4.69%	4.69%	4.70%	4.71%	4.71%
	<u>FY05</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08</u>	<u>FY09</u>	<u>FY10</u>	<u>FY11</u>	<u>FY12</u>	<u>FY13</u>
Payout based on 5 year moving average	1,235	1,243	1,274	1,329	1,380	1,426	1,473	1,520	1,568
less APFC costs to manage the Fund	38	39	41	42	43	44	46	47	49
5% available for spending after deducting APFC costs	1,197	1,203	1,233	1,287	1,337	1,382	1,427	1,473	1,520
Effective rate after deducting APFC costs *	4.64%	4.51%	4.47%	4.51%	4.54%	4.55%	4.55%	4.56%	4.57%
APFC costs to manage the Fund in %	0.16%	0.16%	0.16%	0.16%	0.16%	0.16%	0.16%	0.16%	0.16%

* Note: The effective rate is defined as the payout over the ending market value of the Fund (pre-payout) expressed as a percentage.