

HJR

19

HOUSE COMMITTEE REPORT

4.22.05

(7)
Date Referred to Committee: April 19, 2005

FURTHER REFERRALS: Judiciary
Finance

Date of Committee Action: April, 22, 2005

The HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS considered:

HJR 19

HOUSE JOINT RESOLUTION NO. 19

CONST. AM: PERMANENT FUND P.O.M.V.

Proposing amendments to the Constitution of the State of Alaska relating to and limiting appropriations from the Alaska permanent fund based on an averaged percent of the fund market value.

Recommends it be replaced with HCS or CS for _____ (_____)
For Senate Bills with new title: Technical Title New Title: HCR _____ Same Title New Title

- attach amendments
- add new referral to _____ Committee
- Letter of Intent _____ Committee

List of Abbrev for Depts.:
ADM
CED
COR
CRT
EED
DEC
DFG
GOV
HSS
LEG
LAW
LWF
MVA
DNR
DPS
REV
DOT
UA

NEW FISCAL NOTES				
*Assigned by Chief Clerk's Office				
List by Dept(s):	*FN#	Fiscal	Indet.	Zero
REV	1			✓
GOV	2	✓		

PREVIOUS FISCAL NOTES				
List by Dept(s):	FN#	Fiscal	Indet.	Zero

Signing with recommendations	Printed Last Name	DP	DNP	NR	AM
	Rokceburg	(4)		(1)	
	SAMUELS	X			
	MOSES	X			
	Gruenberg				✓
Chair:	Weybrauch				
Chair:					



ALASKA STATE LEGISLATURE

WAYS AND MEANS COMMITTEE

Representative Bruce Weyhrauch, Chair

Sponsor Statement for HJR 19

House Joint Resolution 19 proposes changing Alaska's Constitution to require inflation proofing of the entire Permanent Fund and to limit the payouts from the fund.

Many large endowments and public funds use a system known as "percent of market value" payouts, or POMV, to provide payouts while still protecting both the principal and earnings of a fund. POMV limits payouts to a set percentage of the fund's market value, often 5 percent. This has shown to be the maximum sustainable payout rate that will still maintain a fund's real value over time.

However, under current law only the principal of the Permanent Fund is protected and inflation-proofed. The earnings reserve account is not considered part of the principal, is not inflation-proofed and is open to appropriation. In addition, payouts are computed as a portion of the Fund's earnings. This means that if the Fund were to have little or no earnings in a single year, a payout for dividends or other State spending would not be allowed.

Moving to a POMV system and adding the earnings reserve to the Fund would not only provide inflation proofing of the entire fund, but would provide a more reliable and predictable payout each year, regardless of the Fund's performance in an individual year. This would make it more likely that the State could continue the Permanent Fund Dividend program in the future, an outcome that is heartily supported by many Alaskans.

Making these changes in the Constitution, rather than in Alaska Statutes adds an additional layer of protection to the fund because the Constitution can only be changed with a vote of the people.

If passed, HJR 19 would place an initiative on the next statewide election ballot that would propose the following three changes to Alaska's Constitution:

- Remove the provision that "all income be deposited in the general fund unless otherwise provided by law"
- Add a provision that would not allow appropriations for the Fund to exceed 5 percent of the average market value of the Fund over five years
- Add a provision that would consider the money in the earnings reserve account to be part of the Permanent Fund

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HJR 19
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
 Title Const. Am: Permanent Fund P.O.M.V RDU AK Permanent Fund Corporation
 Component AK Permanent Fund Corporation
 Sponsor House Ways and Means
 Requester House Ways and Means Component No. 109

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
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						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

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

Estimate of any current year (FY2005) cost: 0.0
 Mark this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

HJR 19 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 preceding five years.

HJR 19 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.

Prepared by: Michael Burns, Executive Director/CEO Phone 907-465-2047
 Division Alaska Permanent Fund Corporation Date/Time 04/20/05
 Approved by: _____ Date 4/20/2005
 Agency _____

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HJR19
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: OOG
 Title Proposing amendments to the RDU Elections
Constitution of the State of Alaska Component Elections
 Sponsor House Ways and Means
 Requester House Ways and Means Component No. 21

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Personal Services						
Travel						
Contractual	0.0	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						
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CHANGE IN REVENUES ()						
-------------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	0.0	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 (FY2005) cost: 0.0
 Mark this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary.)*
 If this amendment appears on the 2006 ballot, the cost of providing information about this issue in the Official Election Pamphlet, as required by AS 15.58 is \$1.5 (in thousands). Should the addition of this question require printing an 8 1/2 by 18 inch ballot the cost will increase to \$22.0.

Prepared by: Gumesindo Rosales, Elections Special Assistant Phone 465-4611
 Division: Division of Elections Date/Time 4/21/05 1:38 PM
 Approved by: Laura A. Glaiser, Director Date: 4/21/2005
 Agency: Office of the Lt. Governor, Division of Elections



Alaska Permanent Fund Corporation

Financial projection comparison of the Alaska Permanent Fund (median case) under status quo versus POMV spending limit beginning in FY05. Under each scenario only the dividend (under current statutory calculation) is paid out.

All \$ values in millions except the per person dividend

Current Statutes	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY05 - FY15 Totals
Contributions & appropriations (after payouts)	24,654	25,680	26,690	27,658	28,640	29,647	30,684	31,742	32,821	33,921	35,040	
Unrealized gains (losses) on invested assets	2,548	2,717	2,895	3,084	3,282	3,489	3,707	3,934	4,173	4,423	4,685	
Realized earnings account (after payouts)	2,113	2,772	3,337	3,799	4,258	4,806	5,387	6,006	6,664	7,366	8,111	
Total market value end of year (after payouts)	<u>29,316</u>	<u>31,169</u>	<u>32,923</u>	<u>34,541</u>	<u>36,180</u>	<u>37,942</u>	<u>39,777</u>	<u>41,682</u>	<u>43,659</u>	<u>45,710</u>	<u>47,836</u>	<u>47,836</u>
Total lump sum dividend appropriation	607	691	886	1,082	1,170	1,168	1,229	1,290	1,352	1,417	1,484	12,378
Per person dividend under current statute	\$950	\$1,080	\$1,380	\$1,680	\$1,800	\$1,780	\$1,860	\$1,930	\$2,000	\$2,070	\$2,150	\$18,680
Transfer status quo inflation proofing (realized earnings to Principal)	624	650	676	700	725	751	777	804	831	859	887	8,283
POMV spending limit information												
POMV 5% spending limit	1,309	1,332	1,384	1,464	1,551	1,620	1,682	1,743	1,805	1,867	1,930	17,689
less AFPC management costs	48	50	51	53	55	56	58	60	61	63	65	620
Net 5% POMV limit available for appropriation	1,261	1,282	1,333	1,411	1,497	1,564	1,624	1,684	1,744	1,804	1,865	17,068
Total lump sum dividend payout (current formula)	607	691	886	1,082	1,170	1,168	1,229	1,290	1,352	1,417	1,484	12,378
% of dividend to the POMV payout limit	46%	52%	64%	74%	75%	72%	73%	74%	75%	76%	77%	69%
Per person dividend under current statute	\$950	\$1,080	\$1,380	\$1,680	\$1,800	\$1,780	\$1,860	\$1,930	\$2,000	\$2,070	\$2,150	\$18,680

Assumptions:

1. POMV assumes a 5% payout limit, which is first used to fund APF administrative costs; and then only the dividend (current statutory calculation) is paid out.
2. Additional POMV monies above the dividend to the 5% limit is not spent, but left in the Fund to earn additional income.
3. POMV payout assumes calculation methodology is 5% of the ending market value (pre payout) for the first five of the last six fiscal years.
4. Callan Associates 2004 Capital Market Assumptions, APFC 2004 asset allocation, Fall 2004 revenue forecast and APF financial statements through 6/30/04. All payouts are assumed to happen at fiscal year end, all dollar values in millions except the per person dividend.

Alaska Permanent Fund Corporation



Financial projection of the Alaska Permanent Fund (median case)
under the POMV spending limit beginning in FY05.

All \$ values in millions except the per person dividend

	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY05 - FY15 Totals
POMV - 5% (beginning in FY05)												
Total Market Value End of Year (after payouts)	28,662	29,876	31,084	32,234	33,370	34,523	35,703	36,904	38,126	39,368	40,630	40,630
5 year average market value lagged one year	26,189	26,637	27,683	29,275	31,027	32,403	33,635	34,869	36,103	37,348	38,609	
POMV 5% spending limit	1,309	1,332	1,384	1,464	1,551	1,620	1,682	1,743	1,805	1,867	1,930	17,689
less AFPC management costs	48	50	51	53	55	56	58	60	61	63	65	620
Net 5% POMV limit available for appropriation	1,261	1,282	1,333	1,411	1,497	1,564	1,624	1,684	1,744	1,804	1,865	17,068
Split 50/50												
50% of net POMV approp for public services	631	641	666	705	748	782	812	842	872	902	933	8,534
50% of net POMV approp for dividend program	631	641	666	705	748	782	812	842	872	902	933	8,534
equates to per person dividend	\$990	\$1,000	\$1,030	\$1,080	\$1,130	\$1,170	\$1,210	\$1,240	\$1,270	\$1,300	\$1,330	\$12,750
Split 60/40												
40% of net POMV approp for public services	504	513	533	564	599	626	650	674	698	722	746	6,827
60% of net POMV approp for dividend program	757	769	800	846	898	938	974	1,010	1,046	1,083	1,119	10,241
equates to per person dividend	\$1,202	\$1,209	\$1,245	\$1,305	\$1,372	\$1,420	\$1,460	\$1,498	\$1,536	\$1,573	\$1,609	\$15,429
Split 70/30												
30% of net POMV approp for public services	378	385	400	423	449	469	487	505	523	541	560	5,121
70% of net POMV approp for dividend program	883	897	933	988	1,048	1,095	1,137	1,179	1,221	1,263	1,306	11,948
equates to per person dividend	\$1,411	\$1,419	\$1,461	\$1,532	\$1,610	\$1,666	\$1,712	\$1,757	\$1,801	\$1,844	\$1,887	\$18,098

Assumptions:

1. POMV assumes lump sum available for appropriation is paid out after accounting for APF expenses.
2. POMV payout assumes calculation methodology is 5% of the ending market value (pre payout) for the first five of the last six fiscal years.
3. Callan Associates 2004 Capital Market Assumptions, APFC 2004 asset allocation, Fall 2004 revenue forecast and APF financial statements through 6/30/04. All payouts are assumed to happen at fiscal year end, all dollar values in millions except per person dividend.



Alaska Permanent Fund Corporation

"The need for change"

1969: The boom begins



September 1969—Alaska receives \$900 million from the Prudhoe Bay oil lease sale.

The Operating Budget for that fiscal year (FY70) was \$173 million.

Using the information and testimony gathered during meetings held across the state, the Legislature decided to invest in Alaska, through capital projects and state programs.

By 1975 people were asking, "What happened to the \$900 million?" The implication was that the money had been wasted, and Alaskans began to accept the idea of saving for the future.

1974: Start of pipeline construction

With the promise of more oil money on the horizon, Alaska's leaders brought a plan before the people of Alaska to save a portion of the State's oil wealth.



"Just as a wise and prudent family sets aside money in a savings account for the future, so should Alaska's state government set aside a rainy day fund to benefit this and future generations of Alaskans."

1976 Voter's Guide

Statement in favor of the proposed constitutional amendment

1976—1980: What should we do with the Fund?

~~Development
Bank~~

or

Investment
Fund

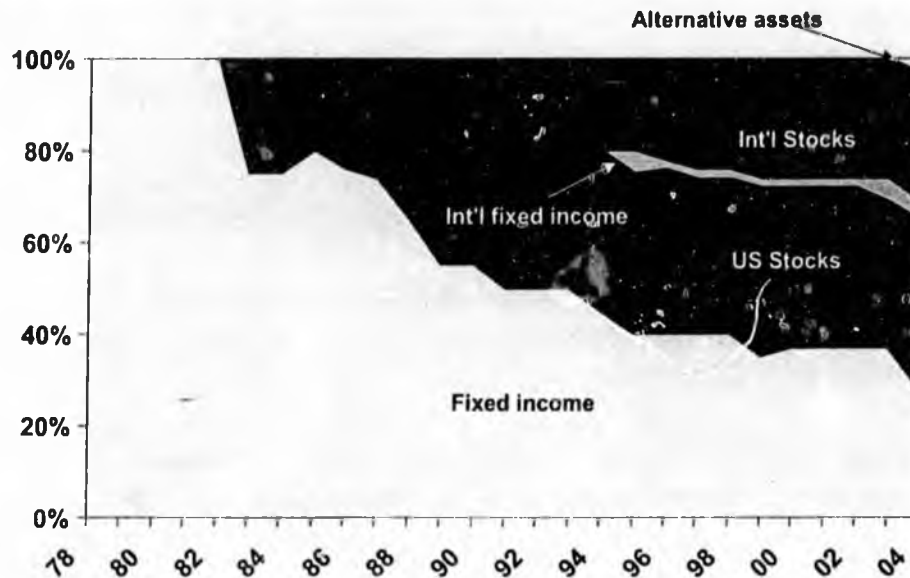
“... to benefit all generations...”

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.

As the Trustees manage the Fund, they must balance the rights of current generations against those of future generations. Neither the protection of the Fund for the future nor the payouts to current generations should take precedence.

The Fund, then and now



1980

2005

Investments:

Bonds

Bonds, stocks, real estate, and alternative investments

Payout method:

Based on realized income

Still based on realized income

Inflation proofing:

Statutory calculation and transfer to principal

Still use statutory calculation and bookkeeping transfer

Return and income calculations

Recognized method

Total return
- Inflation

Real return

Alaska method

Total Return
- Unrealized gains/losses

Realized income
- Amerada Hess income

Statutory income

The need for change

As the markets have changed over the last 25 years, so have the Fund's investments. As a result, the payout structure that worked in 1980 no longer fits with how the Fund is managed today.

It made sense to base payouts on realized income when the fund was invested entirely in bonds. But now that a significant portion of the Fund's assets accumulate unrealized gains, this current payout structure does not allow current generations of Alaskans to take full advantage of the Fund's growth.

At the same time, the Legislature may expend all of the Fund's accumulated earnings. In some years this has left the Fund vulnerable to overspending. As the Legislature contemplates the use of earnings for government services, the Fund's Board of Trustees believe that it is important to limit spending within sustainable yield to preserve the Fund's value over time.

What is POMV?

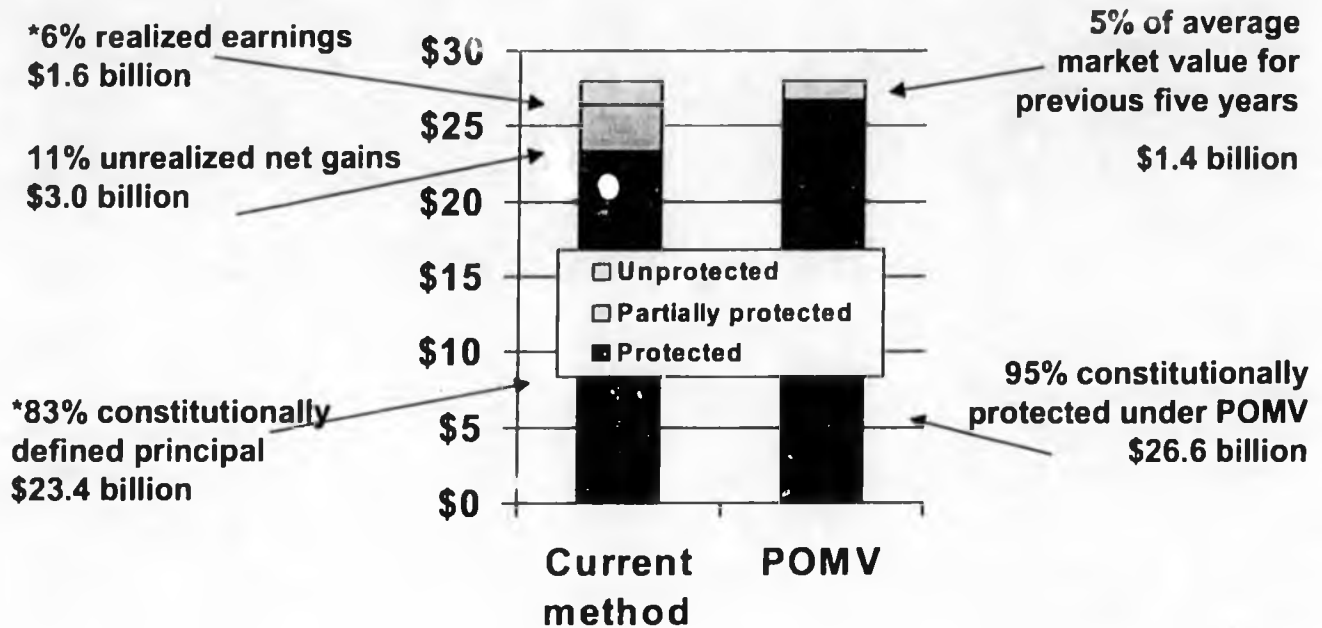
POMV is a spending limit for the Permanent Fund that is compatible with the Fund's investments. It is not a fiscal plan for the state.

Under POMV, no more than 5 percent of the Fund's market value, averaged over five years, may be withdrawn each year.

Under the current system, all realized earnings are available for spending from the Fund.

POMV v Status quo in FY2004

POMV protects more of the Fund from overspending than is protected under the current structure.



* Values as of June 30, 2004 and do not reflect \$581 million PFD payment or \$170 million inflation proofing transfer from realized earnings to principal.

What about inflation proofing?

Currently a transfer is made each year to offset the effect of inflation on the Fund's principal. The earnings of the Fund (17% of the Fund on June 30, 2004) are not inflation-proofed.

	FY94 to FY03 actual	FY05 to FY14 projected
Total return	7.8%	7.6%
Inflation rate	2.5%	2.6%
Real rate of return	5.3%	5.0%

If no more than 5% is withdrawn from the Fund each year, the gains that result from inflation will remain in the Fund. This will inflation proof the entire Fund, and preserve its purchasing power for future generations.

Who uses POMV?

- Anchorage Fairbanks, North Slope Borough and Sitka residents voted to use POMV for municipal trust accounts.
- Private foundations such as the Rasmuson Foundation and the Ford Foundation are required by the IRS to pay out at least 5% of their market value.
- 83% of colleges and universities polled by the National Association of College and University Business Officers use some form of a POMV payout method.

What are Alaskans asking?

- **Will this change leave the principal unprotected?**

If the markets were to perform poorly for several years in a row, it is possible that a small part of what used to be known as principal would be available for appropriation by the Legislature. However, the Legislature is not obligated to withdraw the full 5 percent available under POMV. In addition, POMV would provide better protection when the Fund rises in value, as it has for 25 of the last 28 years.

- **How will POMV affect my dividend?**

It is up to the Legislature to determine whether a new dividend calculation is appropriate under POMV, and if so what that dividend amount would be.

- **Is POMV a raid on the Permanent Fund?**

No. The Legislature already has the authority to spend the Fund's realized earnings, and does spend a portion of the earnings each year when for Permanent Fund Dividends. POMV would change how the amount available for spending is determined.

- **Why fix the Permanent Fund if it isn't broken?**

The Trustees believe that the current structure is broken. Earnings are not inflation-proofed, the Fund is vulnerable to overspending and the payout structure is not compatible with the standard asset allocation for an institutional fund. POMV would address all of these issues.

Testimony on HJR 19, POMV Resolution
House Judiciary Committee
April 26, 2005

Good afternoon, Madam Chair and members of the committee. For the record, I am Mike Burns, CEO of the Alaska Permanent Fund Corporation and I am joined by Laura Achee, the corporation's Research and Communications Liaison.

I know that the Legislature has become well acquainted with the finer points of a Percent of Market Value payout method over the last several years. So instead of explaining the mechanics in great detail, I would like to touch on the main points of why the Trustees believe POMV is the best way to manage the Fund and then take any questions the committee may have.

First of all, I would like to emphasize that the Trustees do not see POMV as a "fiscal plan." POMV would not allow the Legislature greater access to the earnings of the Fund, and in fact in most years would lower the amount available for appropriation compared to our current system. The Trustees believe that implementation of POMV and the use of Permanent Fund earnings for state government are two separate issues.

POMV is

1. Predictable - but much more importantly
2. it is Understandable by the people of Alaska - is it any wonder that people are confused and easily misled by the arcane nature of our Fund's distribution formula?

We manage the Fund on a Real Return methodology - this is quite simply

Total return of the Fund

(Inflation)

Real Return

This is how public and private foundations, pension funds and endowments, trustees, directors and managers view their fiduciary duty and assignment.

What is broken? The current statutory "Realized Income Based Distribution Formula" is. This is the culprit!!

As opposed to the "Real Return" methodology, we are using the confusing and misunderstood formula or the Alaska version of "Return" and "Income."

Income

Dividends, interest, rent

+/- Gains/Losses Real & unrealized

- operating expenses

- appropriations

Accounting net income

- unrealized net income

realized net income

- Amerada Hess

Statutory net income used in the distribution formula

Confusing, out of date and unworkable are but a few of the adjectives that come to mind. How did we get to this apex of confusion?

When the Fund was created it was prudent to restrict its investment authority to a "Bond only" strategy -

That being the case, it is important to remember that a bond portfolio generates income in two ways -

- interest or coupon income received
- capital gains from bonds sold at appreciated prices

These are both traditional realized income and the distribution formula based upon this concept made perfect sense - **at the time.**

However, because the Fund's asset allocation now incorporates investments that generate significant unrealized gains as well as realized income, the current payout methodology and protection of principal no longer serve the Fund as well as they once did. The Trustees believe that only a percent of market value payout limited by the sustainable yield from the Fund can provide the necessary protection for the future while allowing current generations their equitable share of Fund earnings. Furthermore, they believe that the only way to ensure full protection for the Fund is to place this limit in the Constitution.

The percent of market value proposal is simple: no more than 5% of the market value of the Fund, averaged over the previous five years, may be appropriated from the Fund. This leaves a minimum of 95% of the Fund protected from spending in any given year.

As I noted earlier, POMV is not a fiscal plan. And with \$50 + oil your interest in and focus on a fiscal plan may well be elsewhere. But is this not the opportune time to modernize and increase the transparency of the Fund so that it can not only be managed in harmony with its distribution formula, but also be understood by Alaska's when other decisions must be made.

Modernization

Clarity

Better protection

I urge the committee members to support this proposal and I am prepared to answer any questions that you may have.