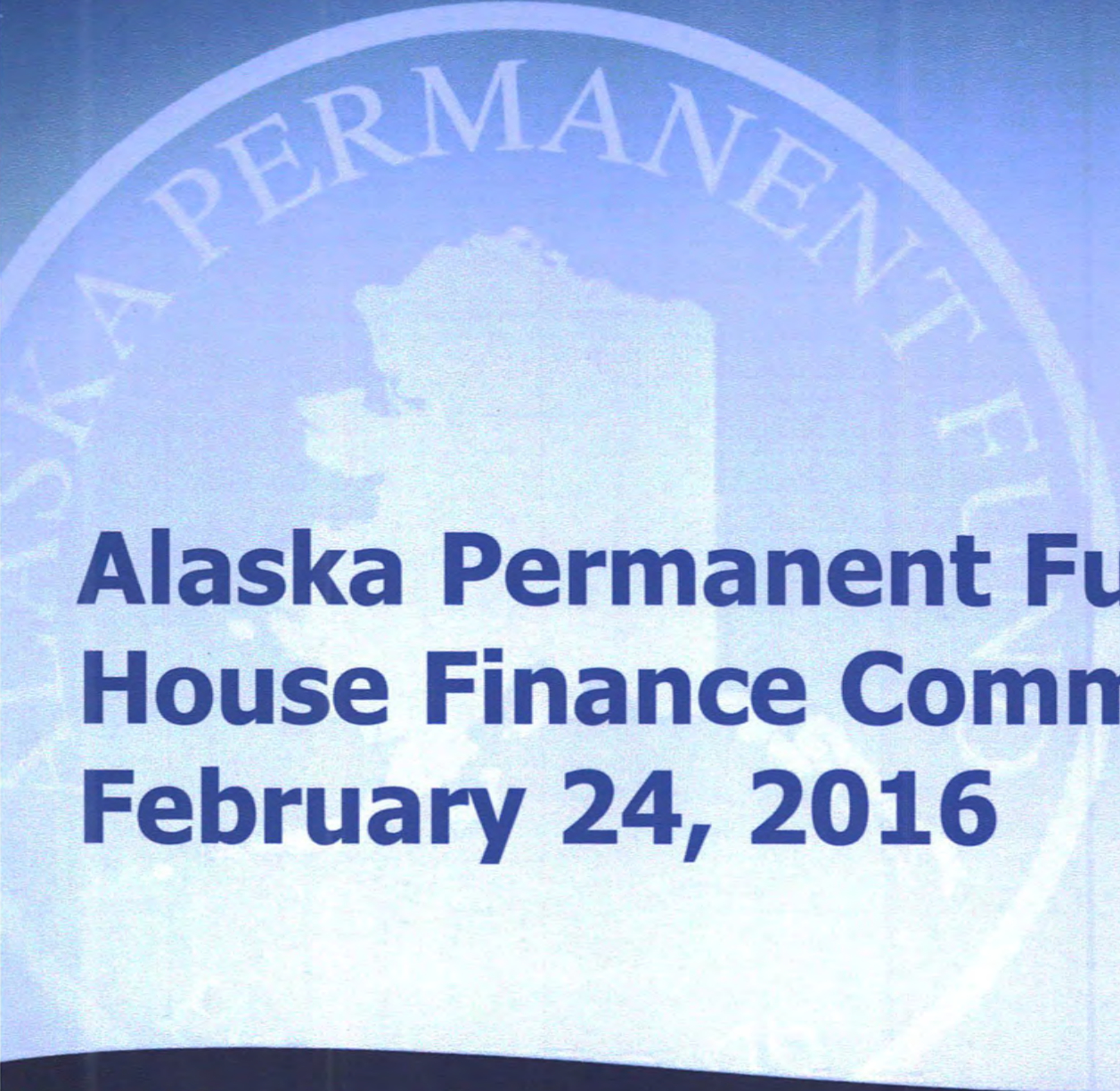


**02/24/16**

**PRESENTATION  
INVESTMENTS  
& STRUCTURE  
OF THE  
PERMANENT  
FUND**

<TARGET><BILL></BILL><SUBJECT>02-24-16 PRESENTATION  
INVESTMENTS and STRUCTURE OF THE PERMANENT  
FUND</SUBJECT><COMM>HF IN29</COMM></TARGET>

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**Alaska Permanent Fund  
House Finance Committee  
February 24, 2016**



Alaska Permanent Fund Corporation

# 1969: The debate begins

**Alaska receives  
\$900 million in  
Prudhoe lease  
sale bonuses**

**Prior year state  
budget: \$112  
million**



# 1976 voters guide

***“Alaska’s state government [should] set aside a rainy day fund to benefit this and future generations of Alaskans.”***

Alaska State Chamber of Commerce

## ***Alaska Voters Agreed:***

*By a margin of 75,588 to 38,518, voters decided to create the permanent fund*



# The Alaska Constitution

Article IX, Section 15, provides:

At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the **principal** of which **shall be used only for those income-producing investments specifically designated by law** as eligible for permanent fund investments. *All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law* [Effective February 21, 1977].



# From 1976 to 1980, Alaskans debated the Fund's purpose:

~~Development bank~~

or

Investment fund



# **1980: Investment Fund Concept adopted, and with it:**

## **Senate Bill 161**

Created the Alaska Permanent Fund Corporation to manage the investments of the Fund, separate from the state's other investments managed by the Department of Revenue. This bill also created a Board of Trustees to oversee the Fund and started the legal list of allowed investments.

## **Senate Bill 122**

Created the Permanent Fund Dividend program.



# APFC Board of Trustees

- Six board members
- Two state members
- Four public members
  - Appointed by Governor
  - Experience in finance, investments, or business management
  - May only be removed “for cause”



# Statutory investment rules evolve

- Evolution from legal list to prudent-investor
- Starting in 2005: “Prudent-investor rule” guides investment of Fund assets
  - Duty of care
  - Duty of loyalty
- The Board will maintain a reasonable diversification of assets



# Fund Advantages

## Size

- Access to investments
- Ability to negotiate fee savings

## Time Horizon

- No set liability



# Fund Challenges

## Location

- Business travel to financial centers
- Recruitment from financial centers

## Flexibility

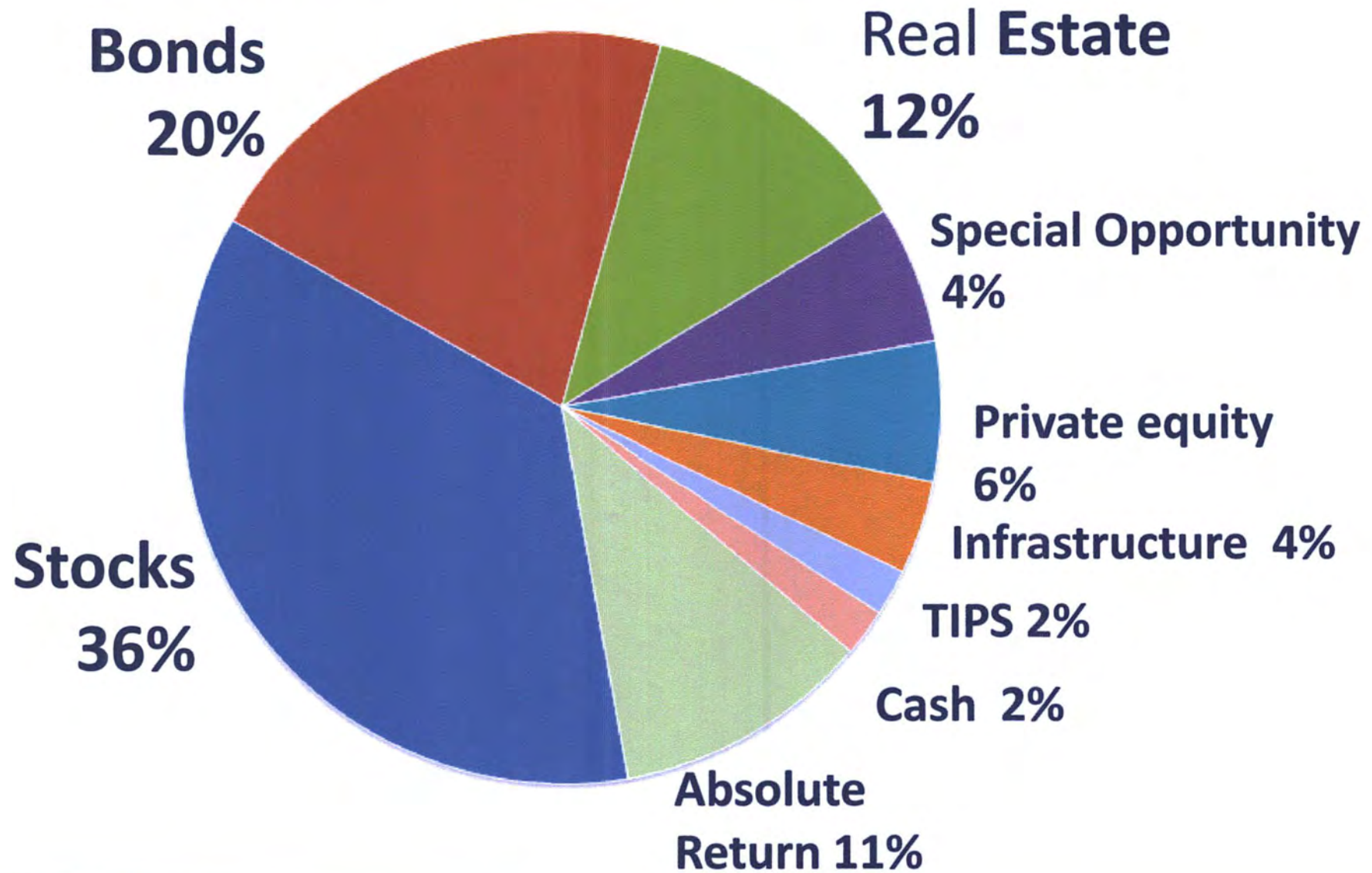
- New resources often arrive long after they are needed due to lengthy budget process

## Staff size

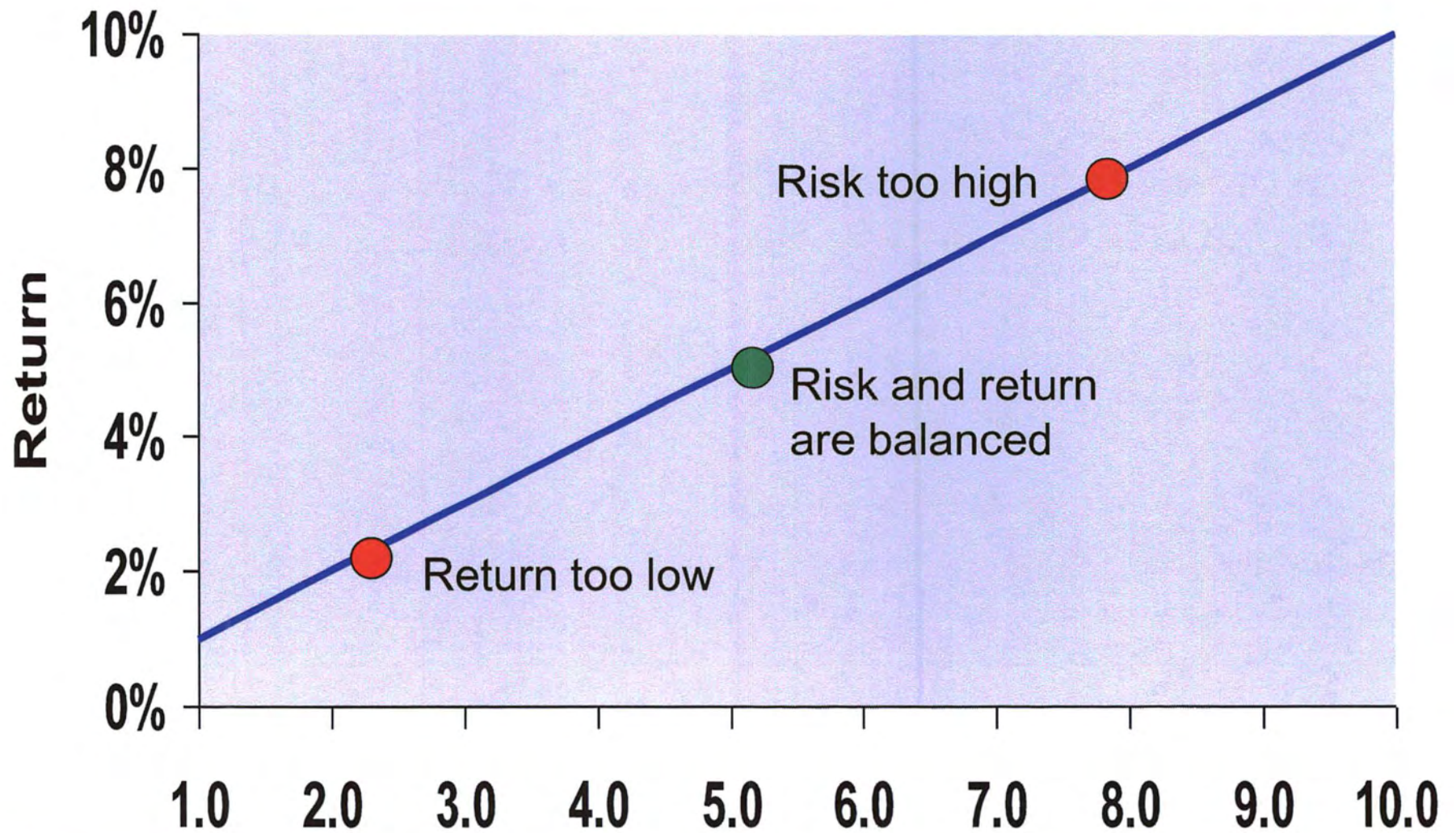
- Small staff limits bench strength, creates gaps during travel and vacancies



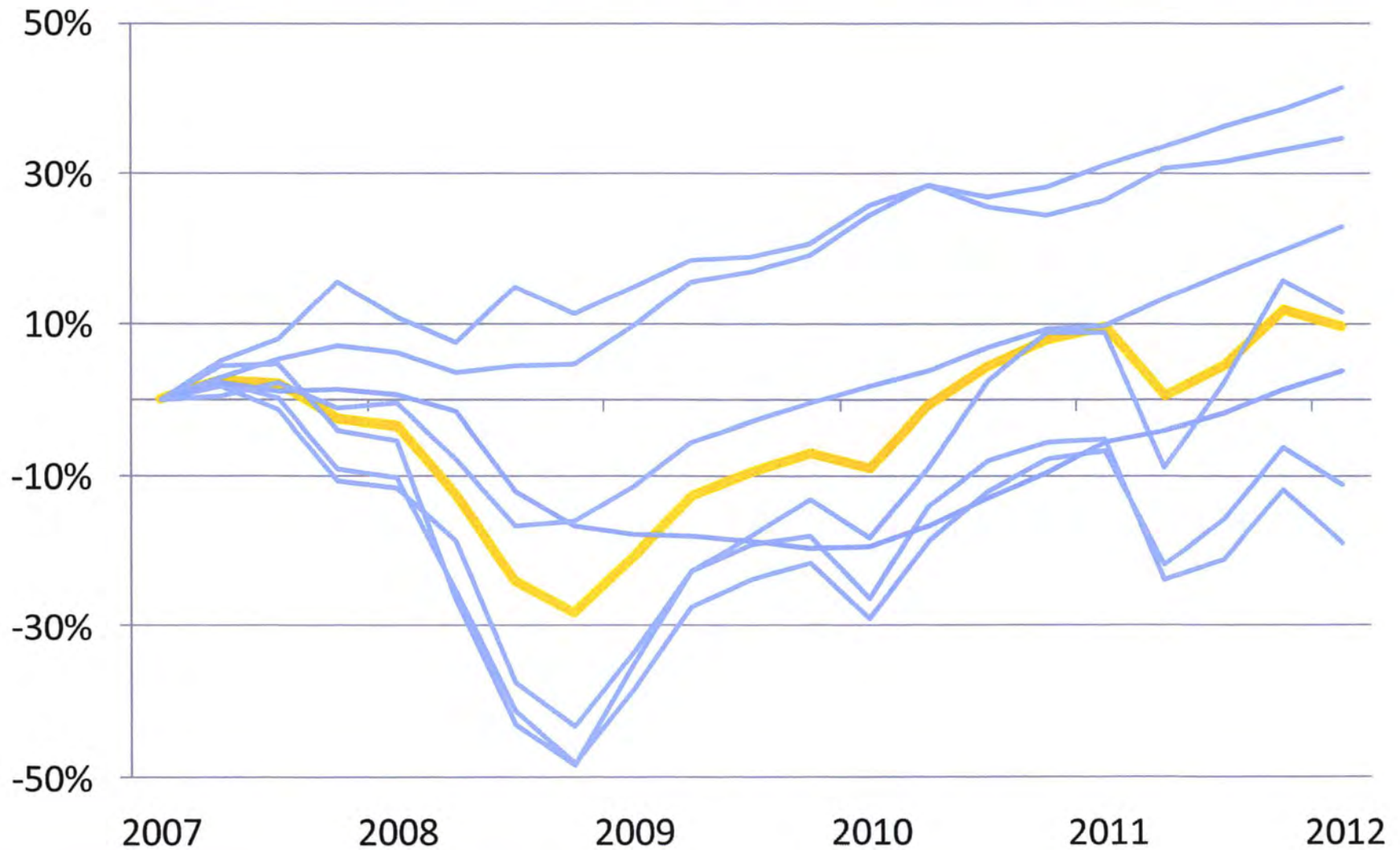
# Target Asset Allocation



# Risk vs. Return

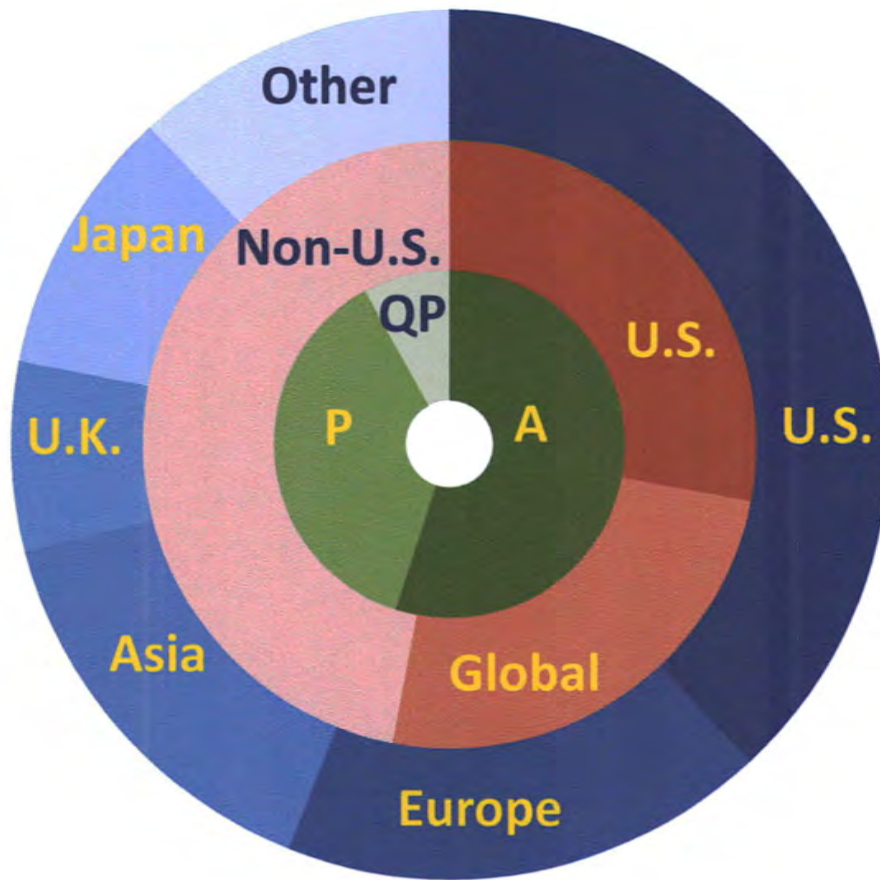


# The effect of diversification



# Stock Portfolio

**\$20.9 billion as of  
06/30/2015**

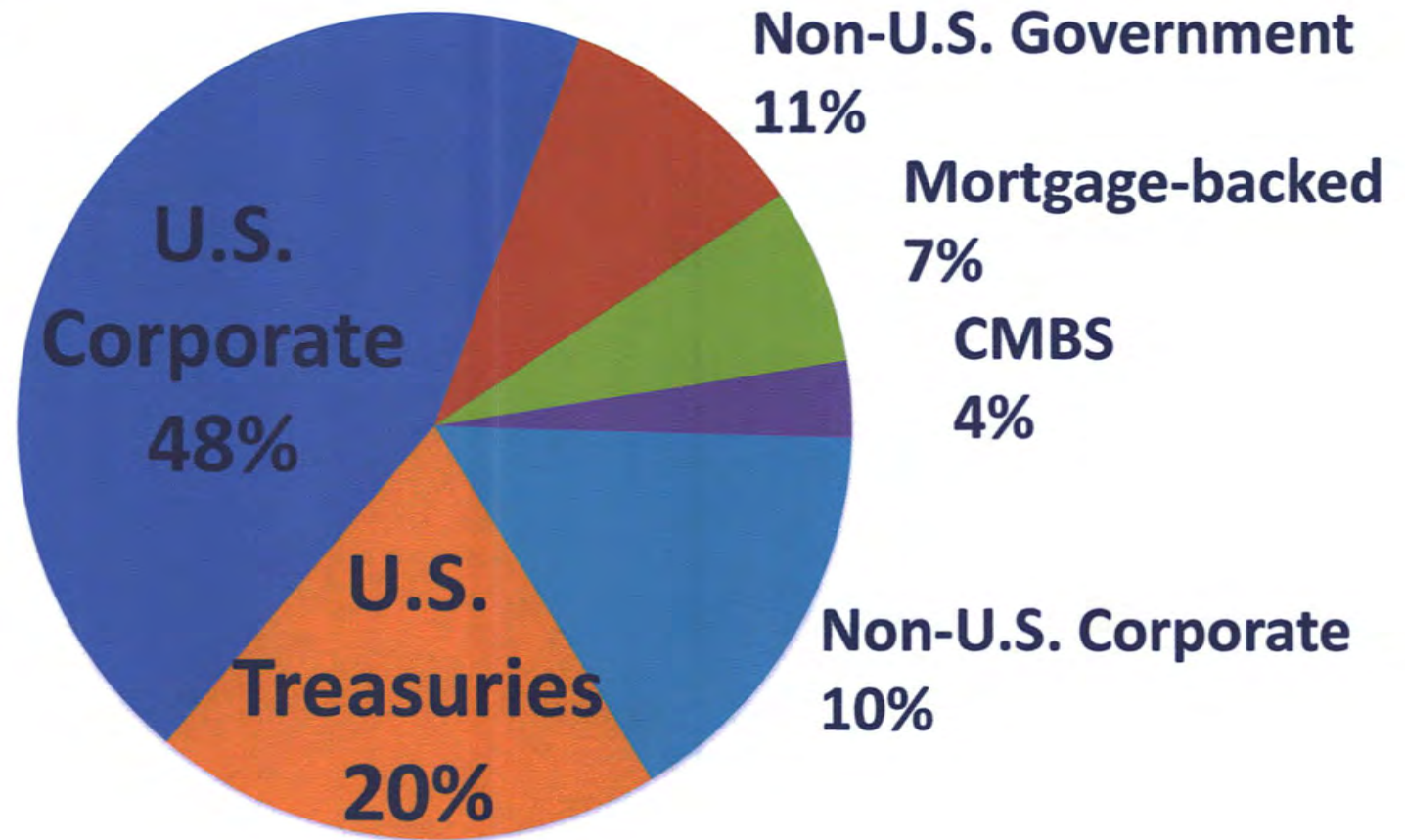


- By country or region
- By mandate:  
U.S., Global, Non-U.S.
- By management:  
Active, Passive,  
Quasi-passive



# Bond Portfolio Composition

\$11.1 billion as of  
06/30/2015

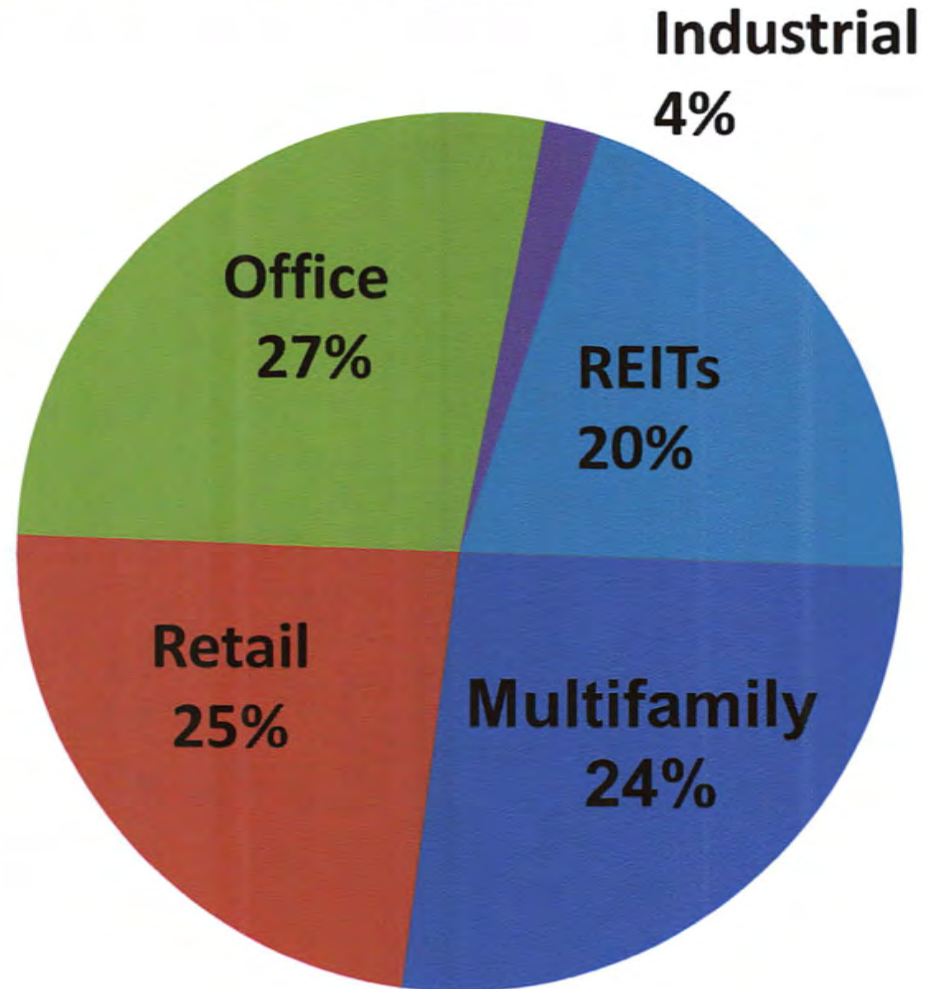


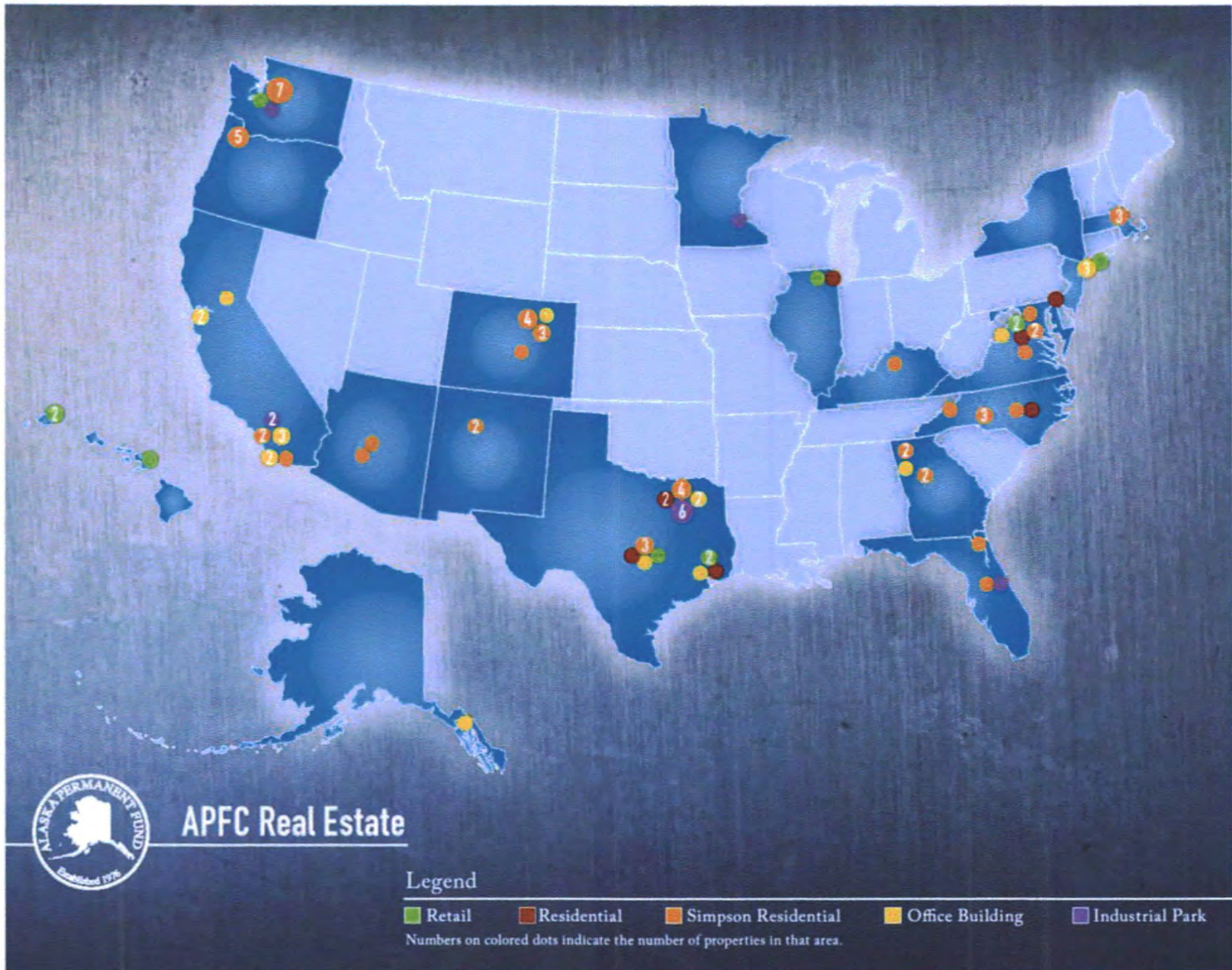
# Real Estate

**\$6.5 billion as of  
06/30/2015**

**58 directly held  
properties**

**Exposure to  
Europe growing**





# Tysons Corner Center



# Absolute Return

**\$5.3 billion as of 06/30/2015**

**Externally Managed-\$2.5 billion**  
**Internally Managed-\$2.8 billion**

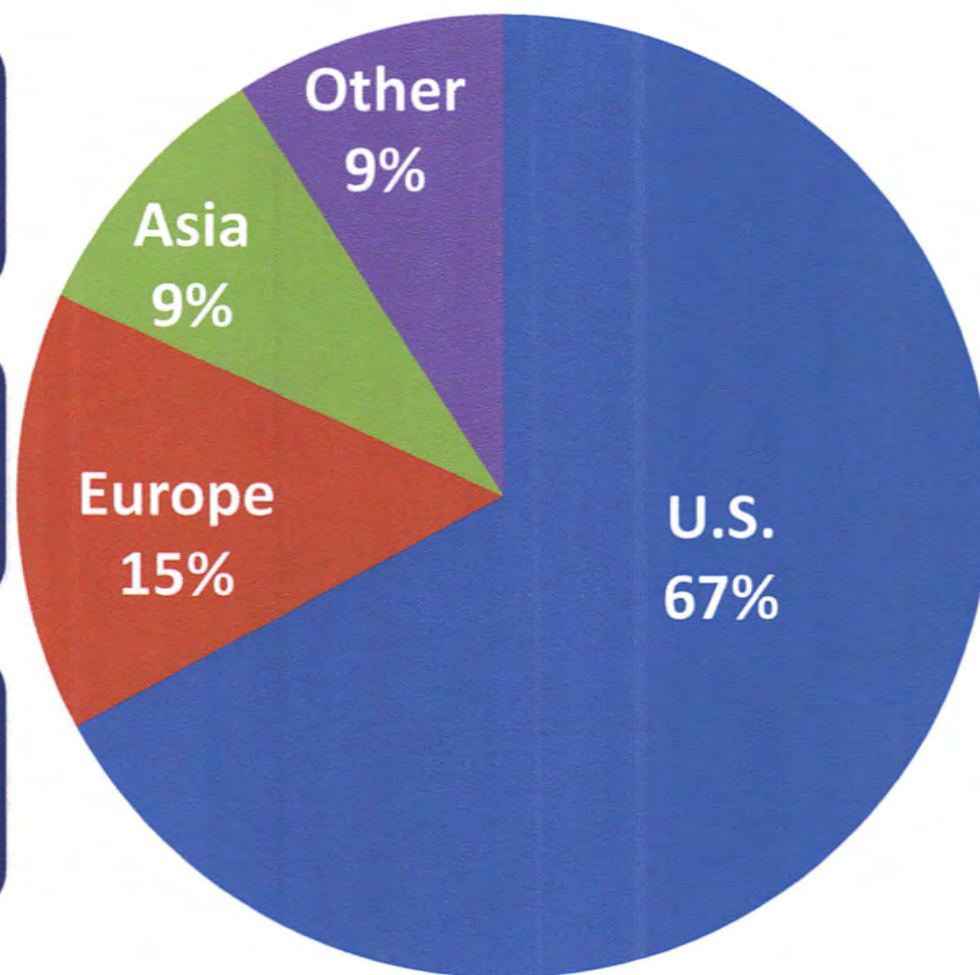


# Private Equity

\$3.2 billion as of 06/30/2015

2,800 underlying companies

Co-investment program  
implemented in FY2014

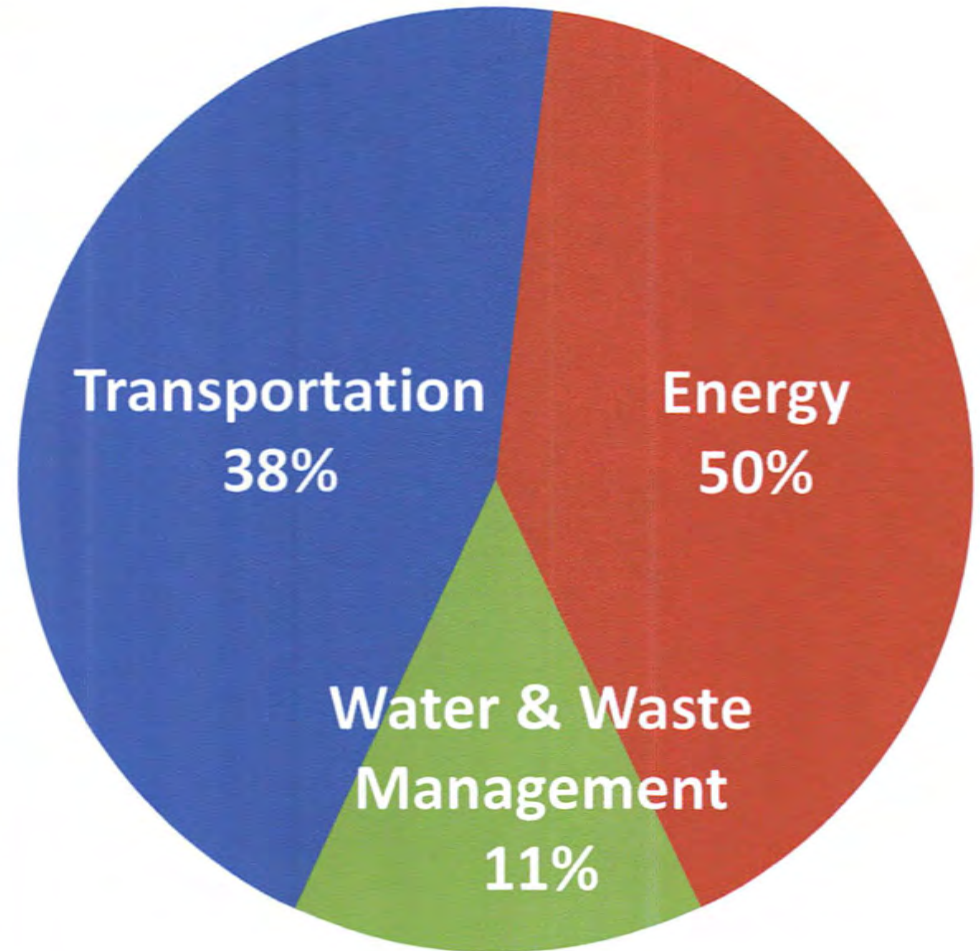


# Infrastructure Holdings

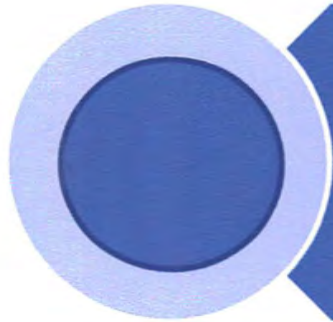
\$1.5 billion as of  
06/30/2015

Properties in the U.S., U.K.,  
India, Argentina and Canada

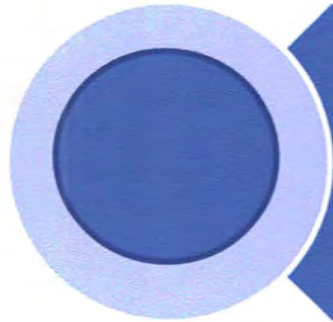
Co-investment program  
implemented in FY14,  
currently at \$35 million



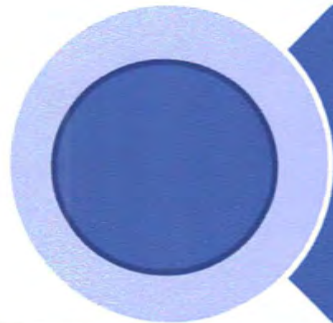
# Special Opportunities



Direct investments in private companies-examples: Juno Therapeutics and Denali Therapeutics



Direct investments in specialized funds-examples: Dyal and Blackstone funds



\$1.9 billion as of 06/30/2015



# Statutory Net Income

Principal (income-producing investments)



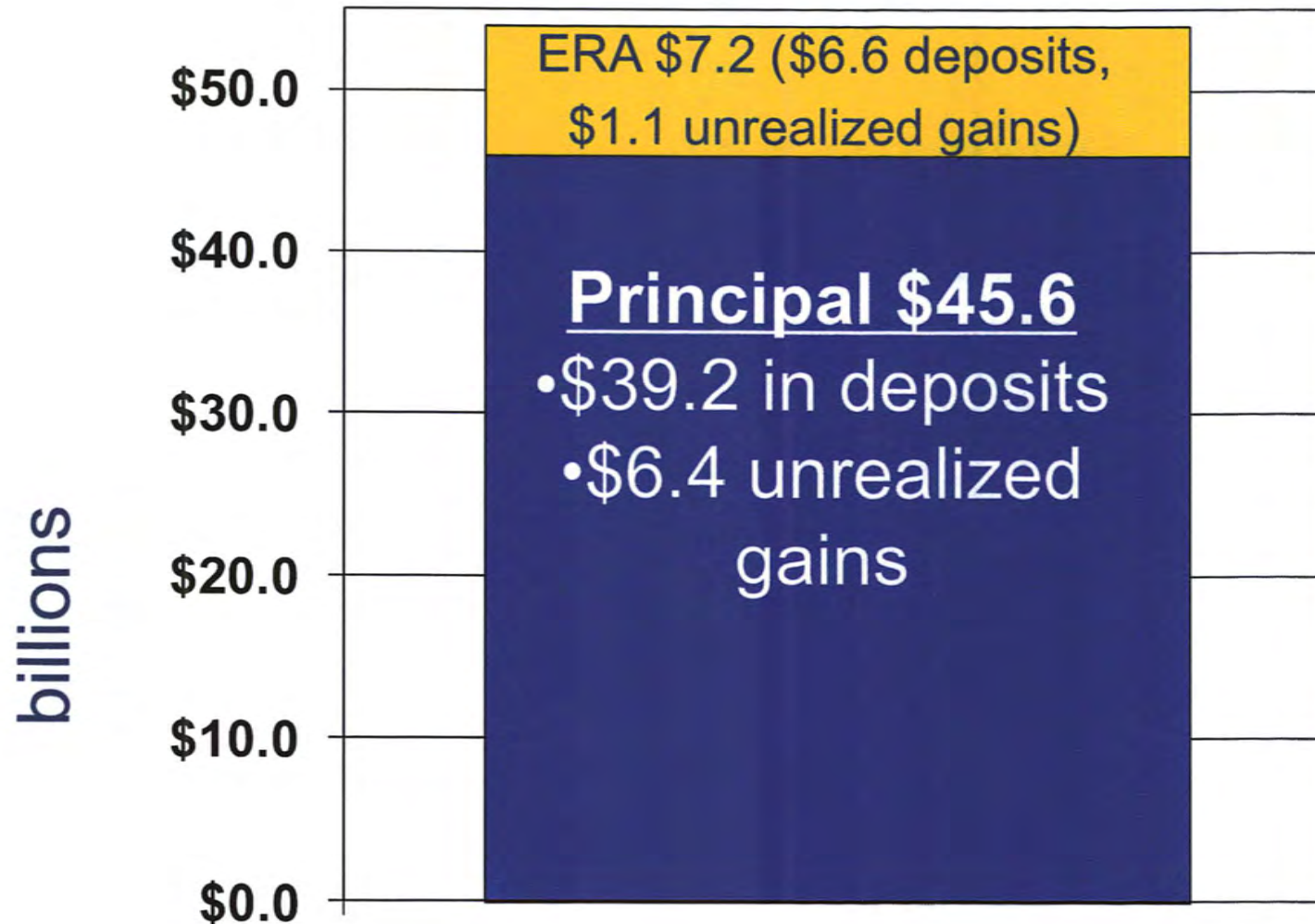
Net Income gets deposited into the ERA



Income in ERA available for  
Appropriation

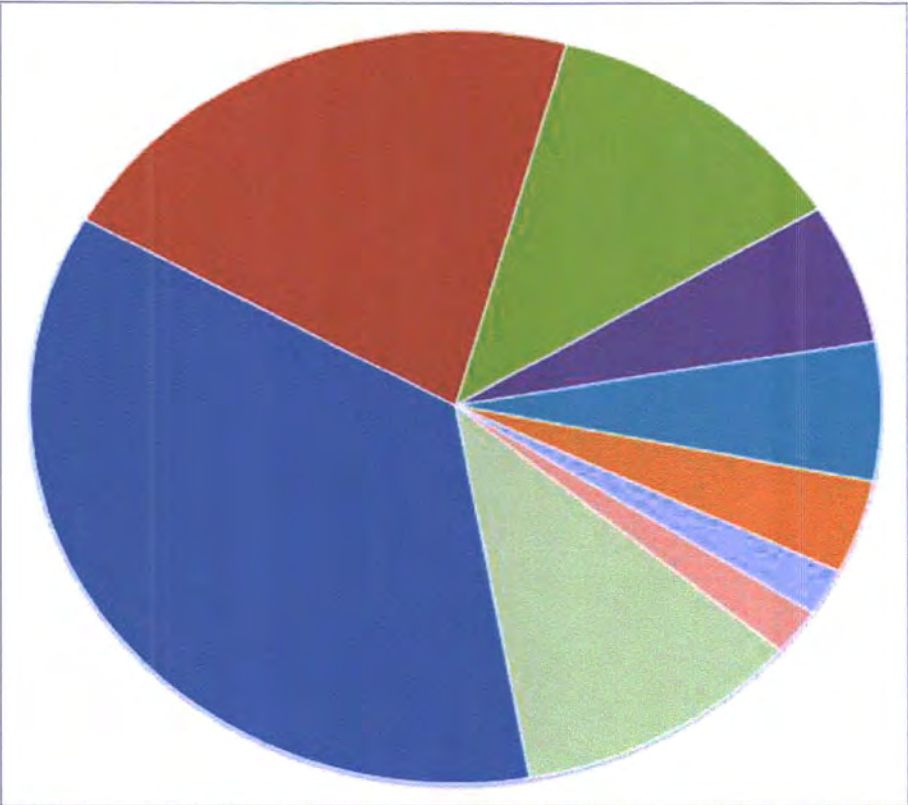


# Fund breakdown

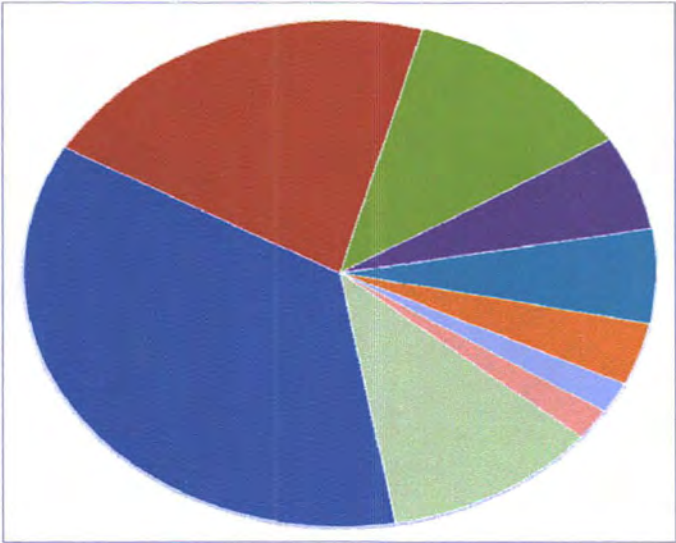


# Pro rata share of main fund assets, not cash, are transferred to ERA

## Main Fund allocation



## ERA allocation

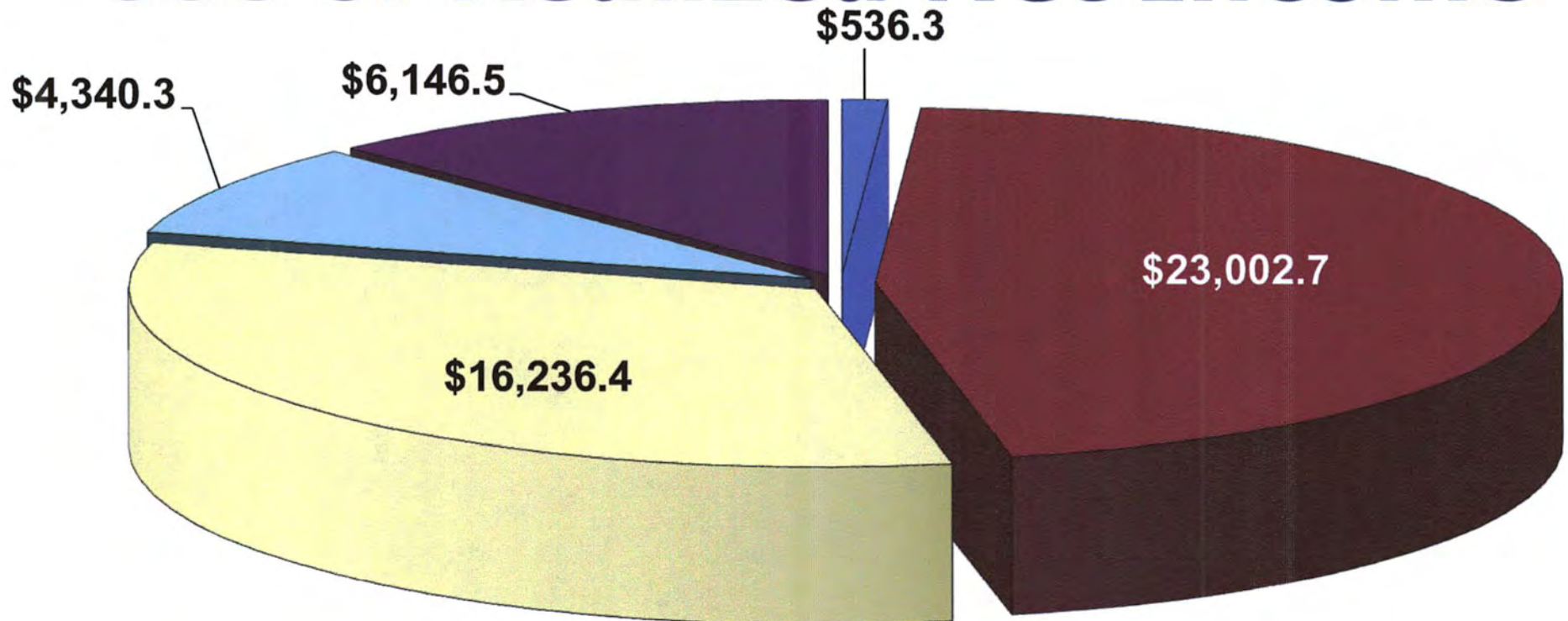


# Statutory Net Income

Fiscal Year	Realized Net Income	Realized Return
2005	\$1,754	6.30%
2006	\$2,689	8.66%
2007	\$3,428	9.96%
2008	\$2,938	7.77%
2009	(\$2,475)	-7.86%
2010	\$1,590	4.91%
2011	\$2,143	5.96%
2012	\$1,568	4.02%
2013	\$2,927	6.97%
2014	\$3,530	7.52%
2015	\$2,907	5.67%



# Use of Realized Net Income



- General fund
- Dividend appropriations
- Inflation proofing transfer to principal
- Special appropriations to principal
- Undistributed realized income balance



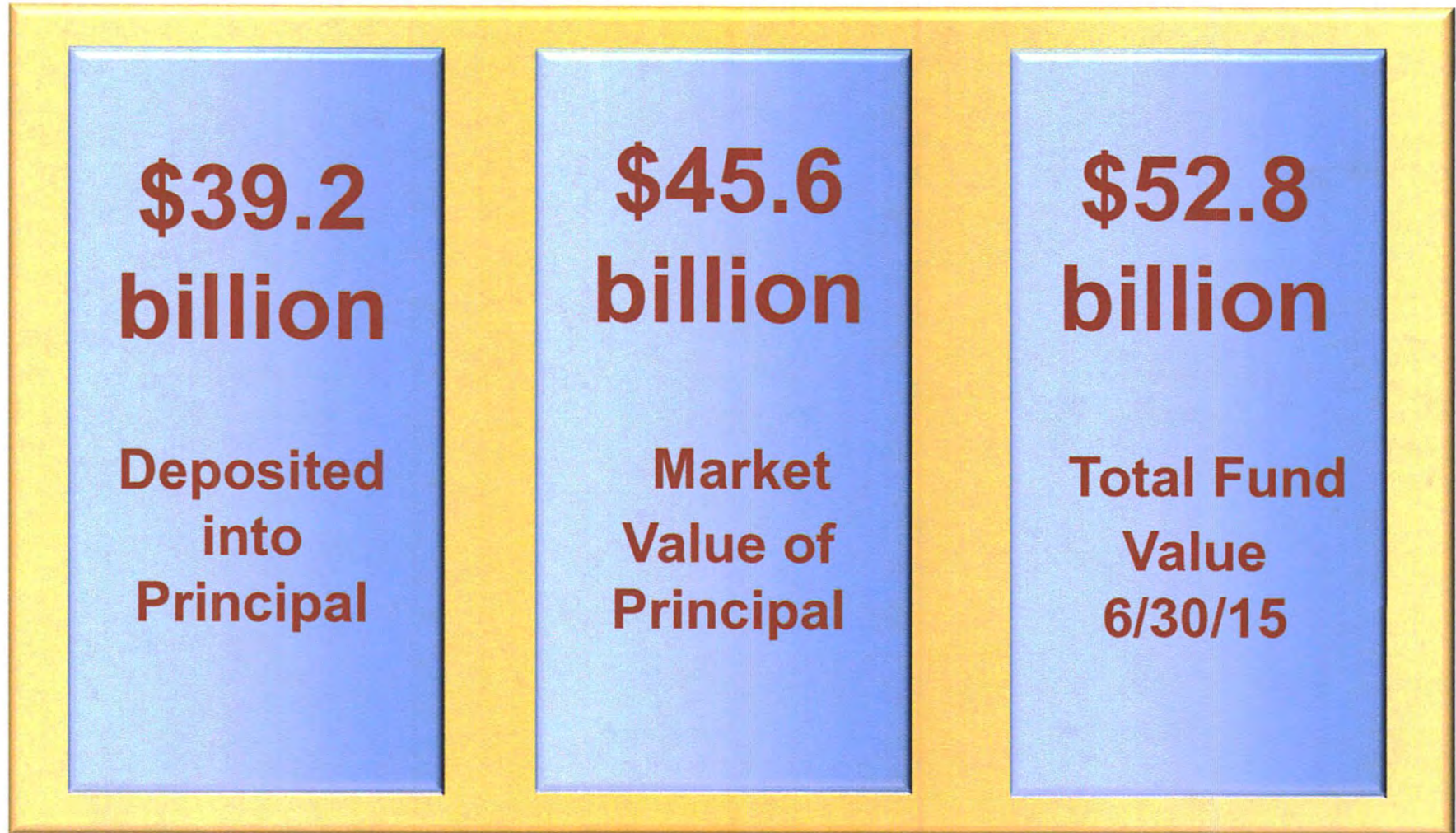
# Inflation proofing

- Provides a deposit back to corpus
- Maintains purchasing power of corpus
- Added \$16.2 billion to corpus
- Based on value of corpus on June 30 and inflation rate for prior two calendar years

Fiscal Year	Transfer
2005	\$641
2006	\$856
2007	\$860
2008	\$808
2009	\$1,144
2010	\$0
2011	\$533
2012	\$1,073
2013	\$743
2014	\$546
2015	\$624



# Money in and out, and current value



# Principal vs. Earnings Reserve

- The Fund buys an investment for \$20
  - Earnings reserve reflects 25% of total fund
  - \$20 investment was funded with
    - \$15 of principal
    - \$5 of earnings



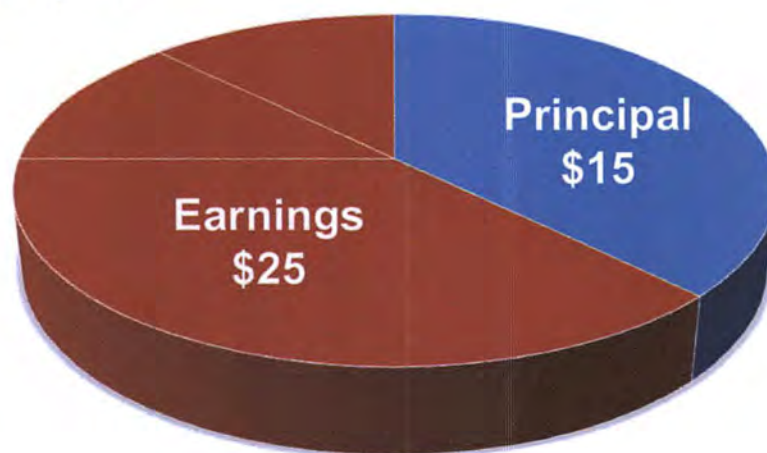
# Capital Appreciation

- The value of the investment appreciates from \$20 to \$40
  - \$20 in unrealized gains are distributed proportionally
    - Principal's share now worth \$30
    - Earnings reserve's share now worth \$10
  - Unless APFC sells (realizes) a portion of the investment,
    - The increased value reflects unrealized gain, not statutory net income
    - No income is transferred from principal to earnings



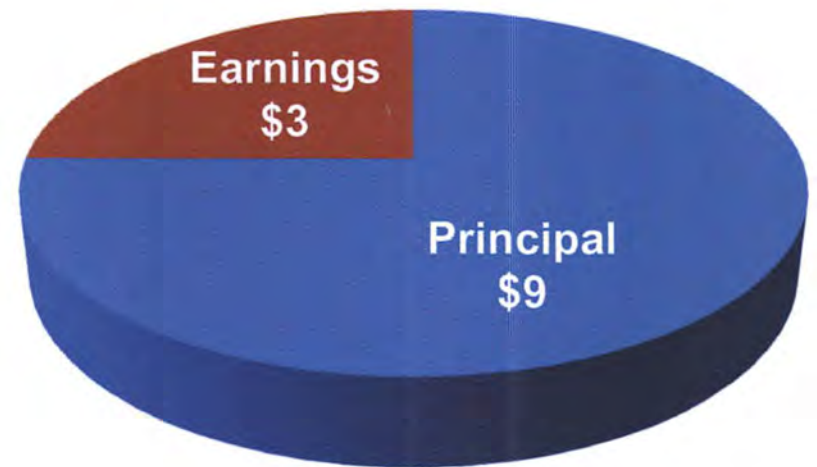
# Harvesting Gains

- APFC sells the investment for \$40, and the \$20 unrealized gain is realized
  - \$15 remains in principal to cover its cost
  - \$15 realized gain is transferred to earnings reserve
  - Earnings reserve now has \$25
    - \$5 original cost
    - \$5 of its realized gain
    - \$15 of realized gain from principal



# Capital Depreciation

- The value drops from \$20 to \$12
  - principal investment is valued at \$9, reflecting unrealized loss of \$6
  - Earnings investment is valued at \$3, reflecting unrealized loss of \$2
- Should APFC sell or hold?



# Realizing Losses

- Assume we conclude it is prudent to sell the investment for \$12
  - \$12 is returned to principal from sale proceeds
  - \$3 is moved to principal from earnings reserve
  - Leaving earnings reserve with a loss of \$8
- Note: with a long-term time investment horizon, this activity is rare (example-2009)



# ERA Going Forward:

- Liquidity Consideration:
  - Some APFC asset classes, like private equity, are illiquid, making a portion of the ERA illiquid
  - Yet all of the ERA is “available for appropriation”
- Volatility Consideration:
  - Permanent Fund and ERA are subject to ups and downs experienced by capital markets
  - Going forward, is a long-term time horizon for ERA workable?



# ERA Going Forward:

- Counterweight:
  - Net Income in ERA is immediately invested alongside main fund
  - allowing the nominal value of this income to remain deployed and continue earning income until it is appropriated
  - Over the last ten years, the Fund's annualized return was 6.4%

