

02/09/16
PRESENTATION
ALASKA
PERMANENT
FUND
CORPORATION

<TARGET><BILL></BILL><SUBJECT>02-09-16 PRESENTATION
ALASKA PERMANENT FUND
CORPORATION</SUBJECT><COMM>SFIN29</COMM></TARGET>



**Alaska Permanent Fund
Senate Finance Committee
February 9, 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

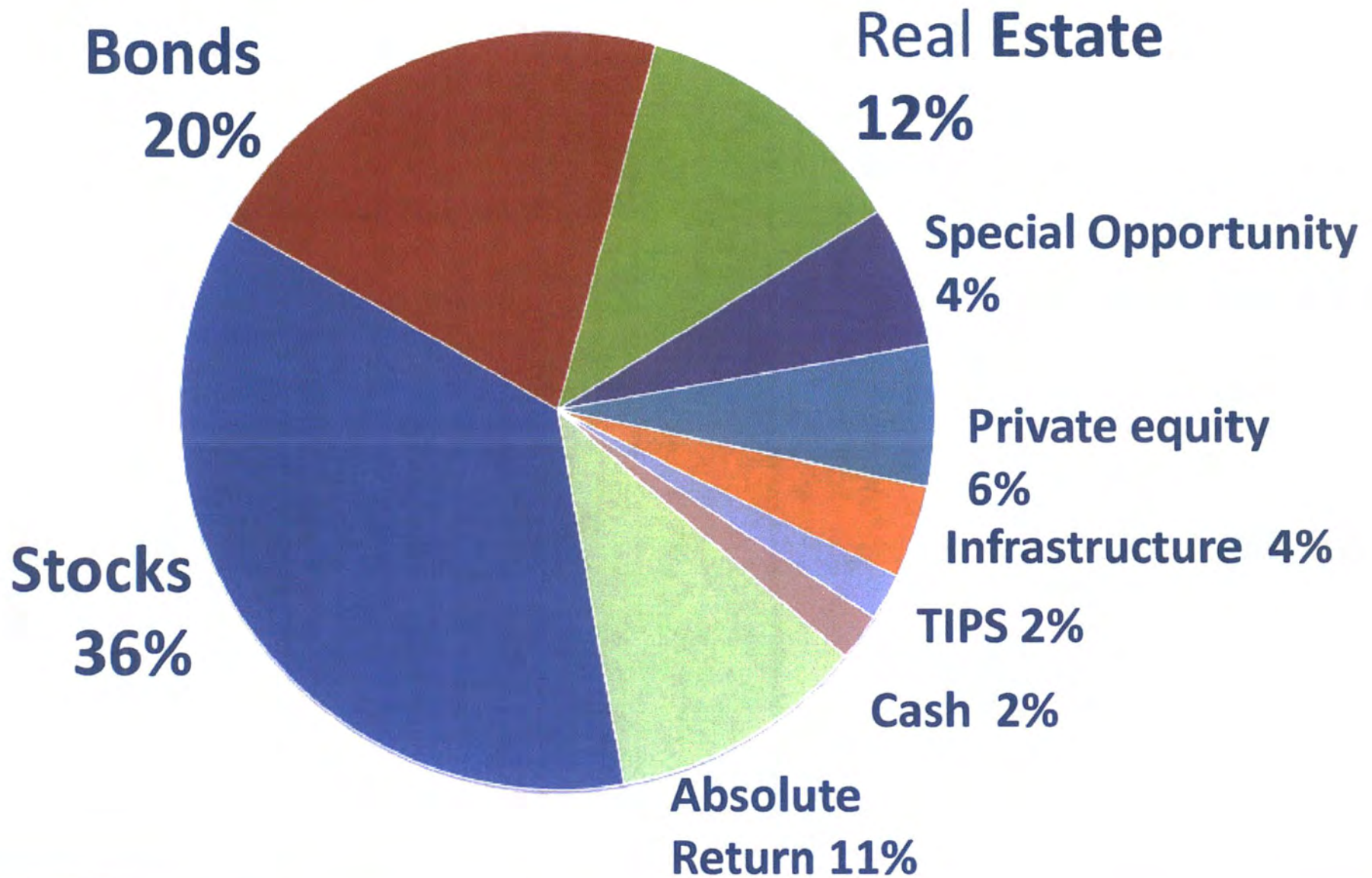
- New resources often arrive long after they are needed due to lengthy budget process

Staff size

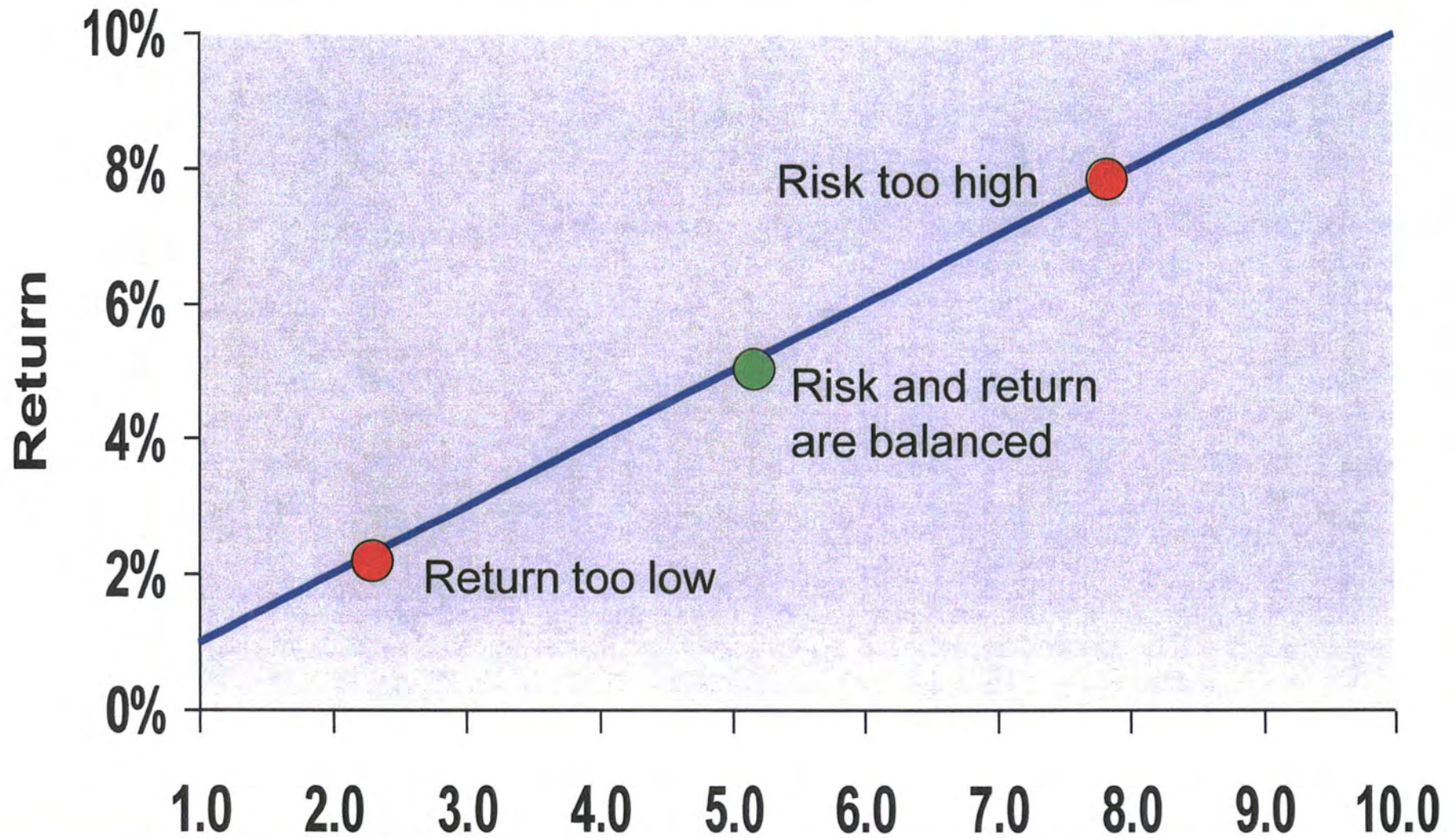
- Small staff limits bench strength, creates gaps during travel and vacancies



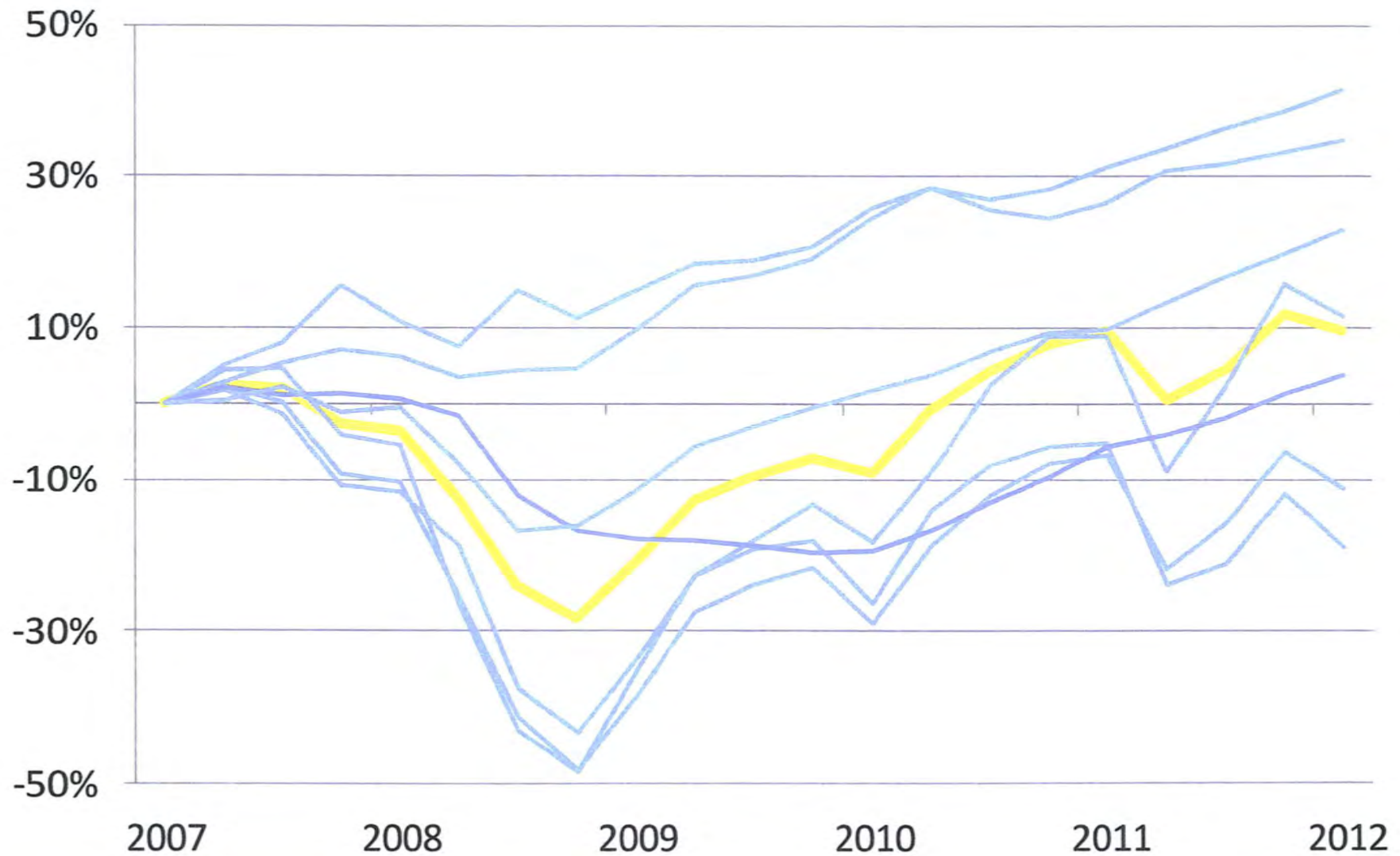
Target Asset Allocation



Risk vs. Return

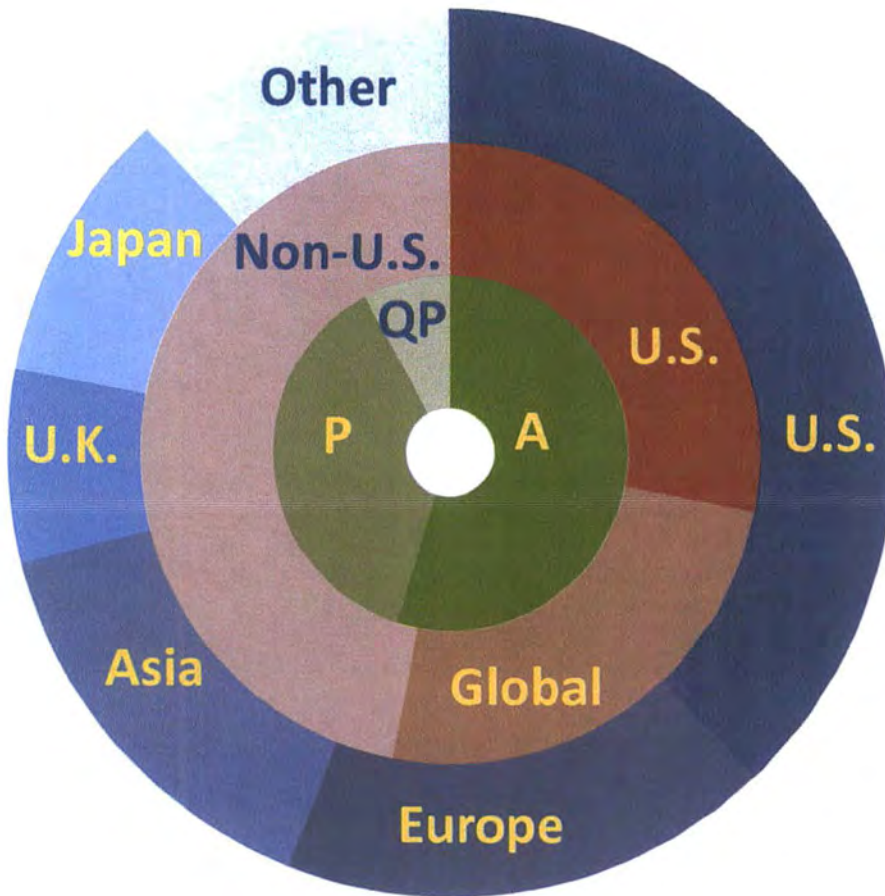


The effect of diversification



Stock Portfolio

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

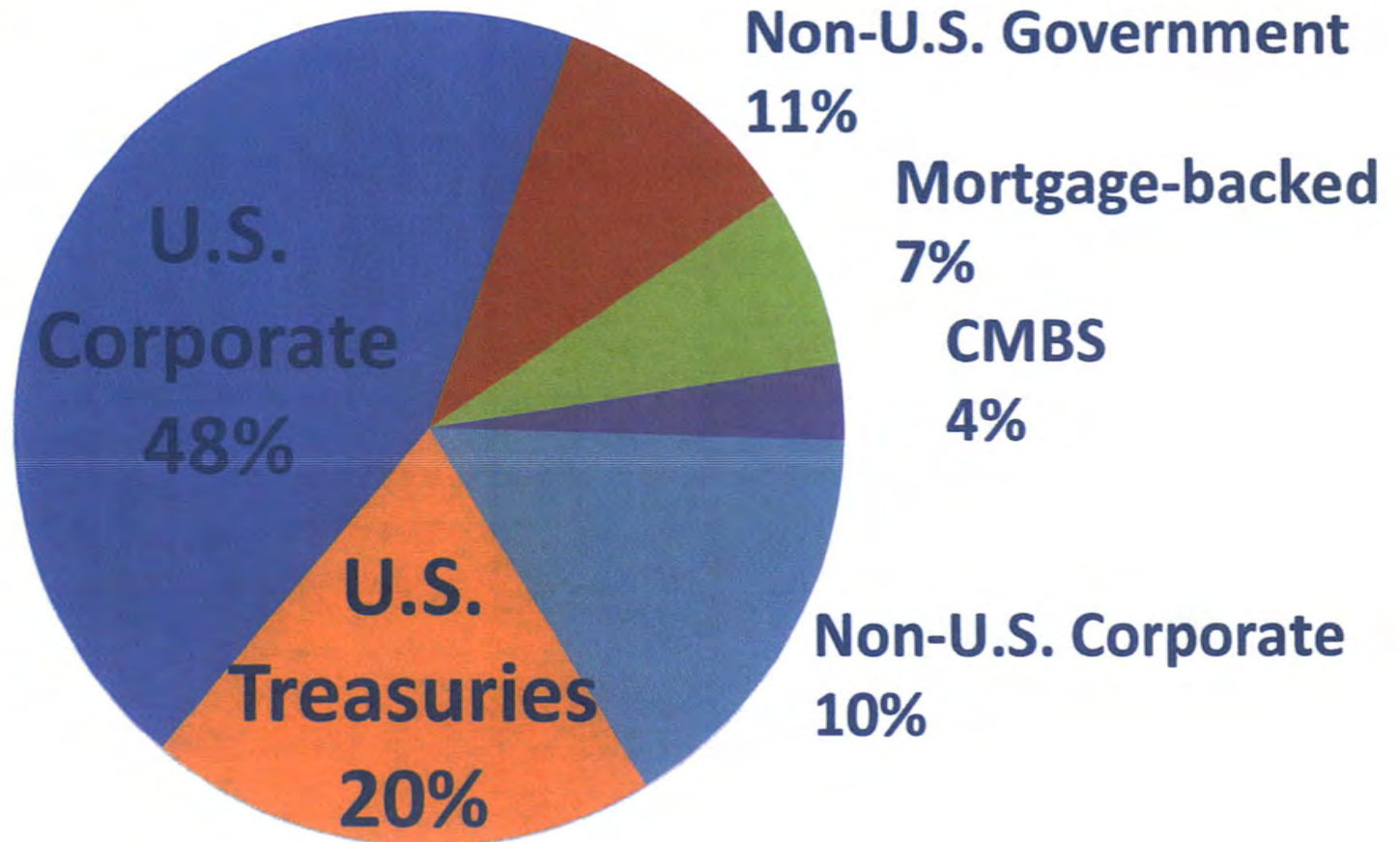


- By country or region
- By mandate:
U.S., Global, Non-U.S.
- By management:
Active, Passive,
Quasi-passive



Bond Portfolio Composition

\$11.1 billion as of
06/30/2015

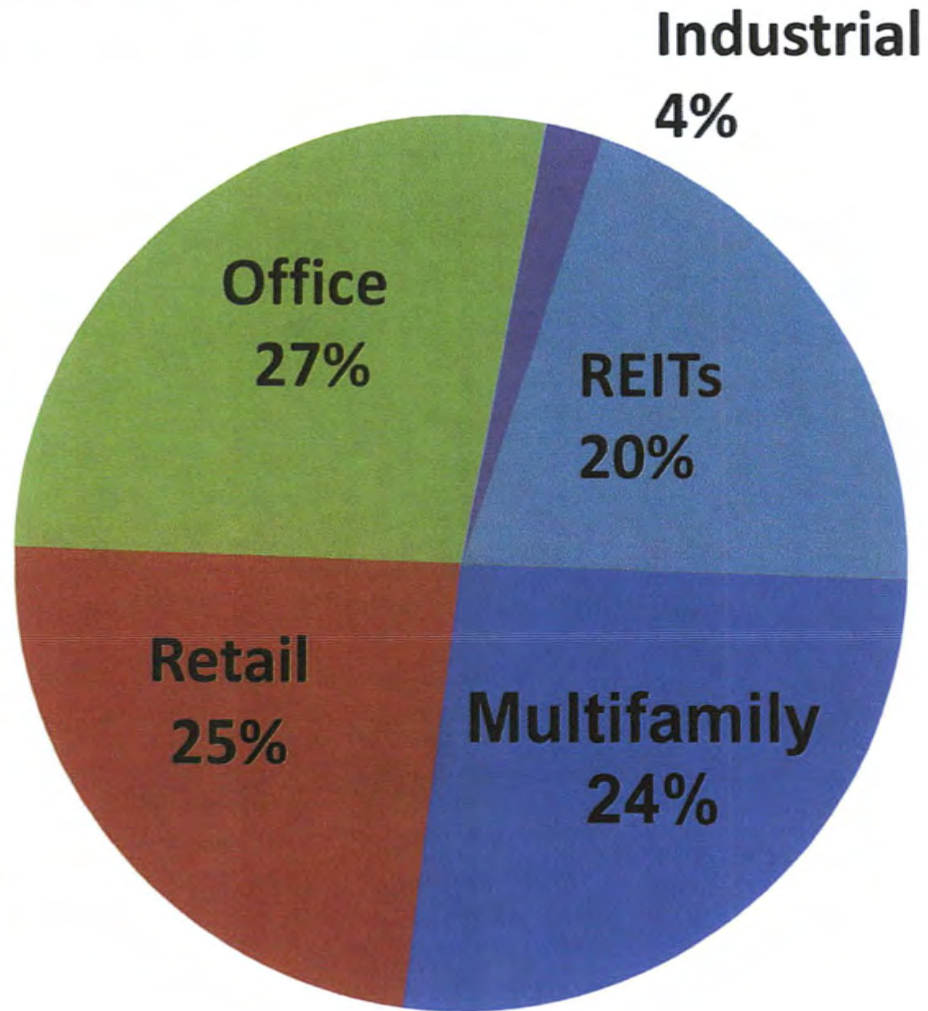


Real Estate

**\$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

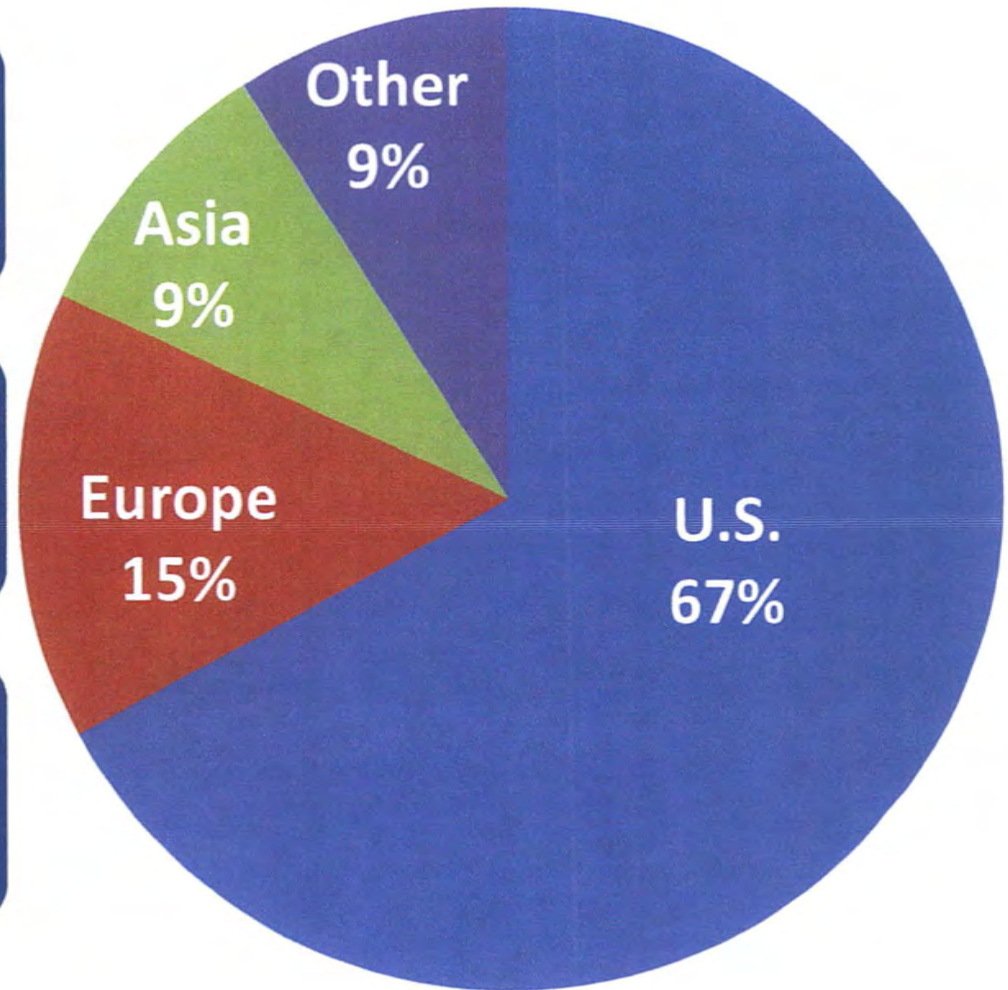


Private Equity

\$3.2 billion as of 06/30/2015

2,800 underlying companies

Co-investment program
implemented in FY2014

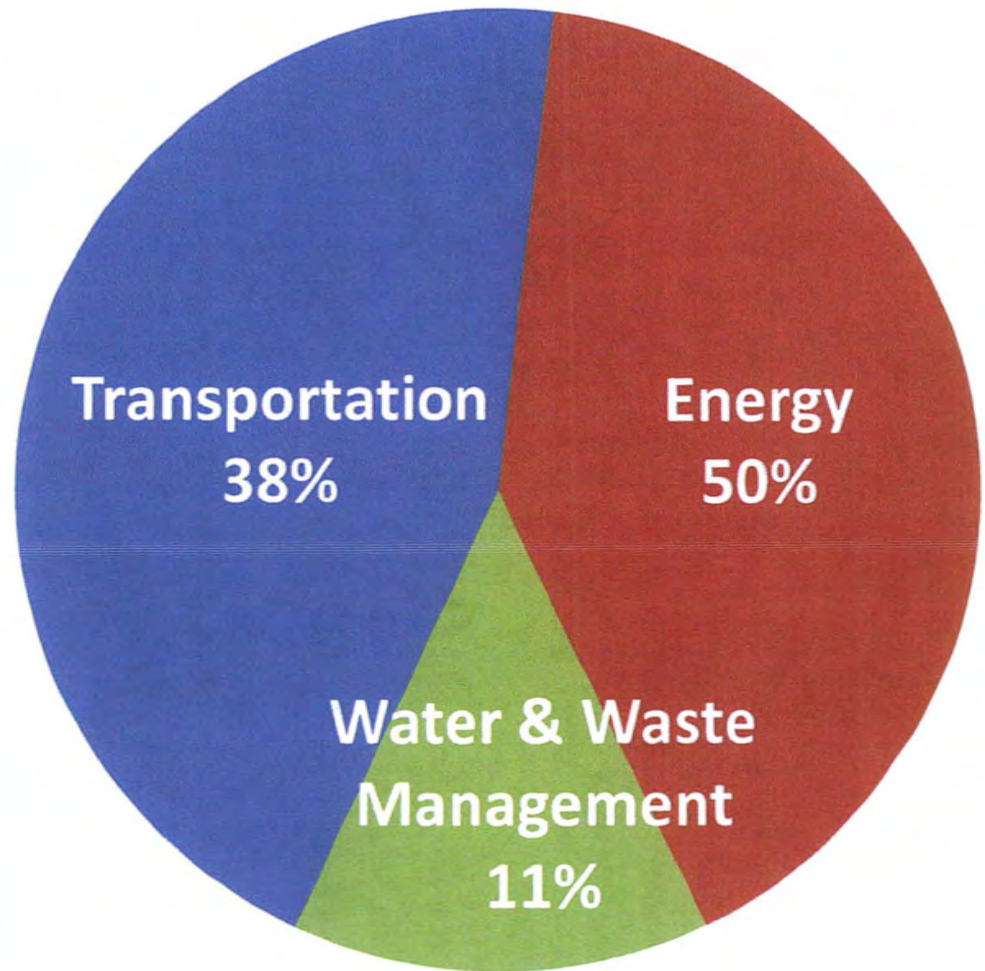


Infrastructure Holdings

\$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

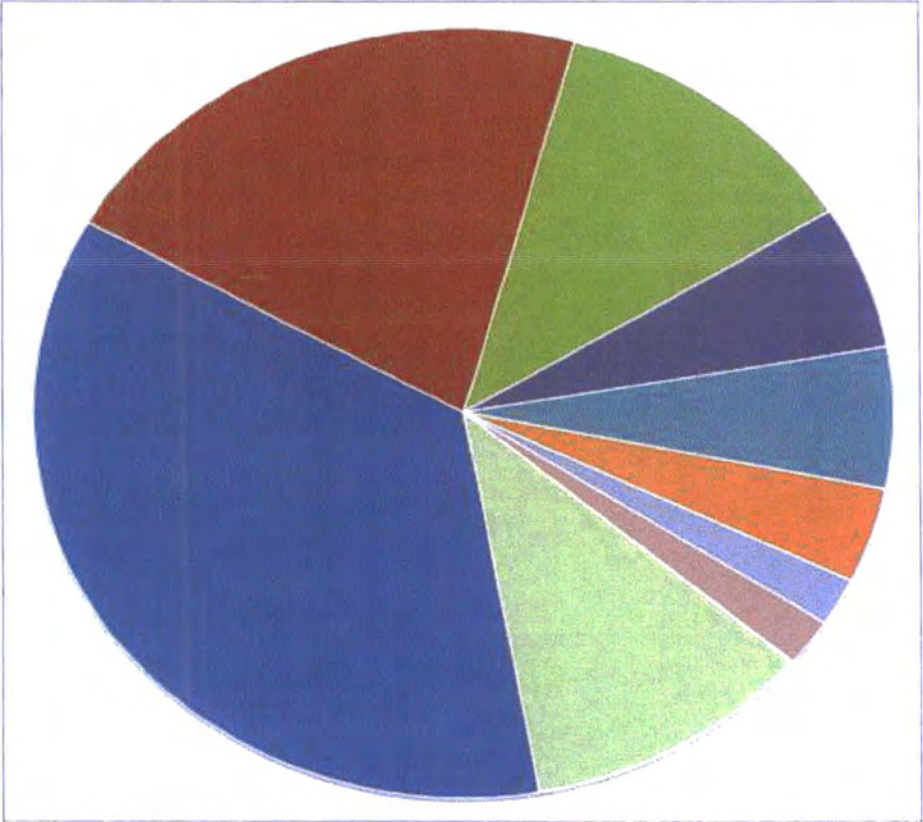


Income in ERA available for
Appropriation

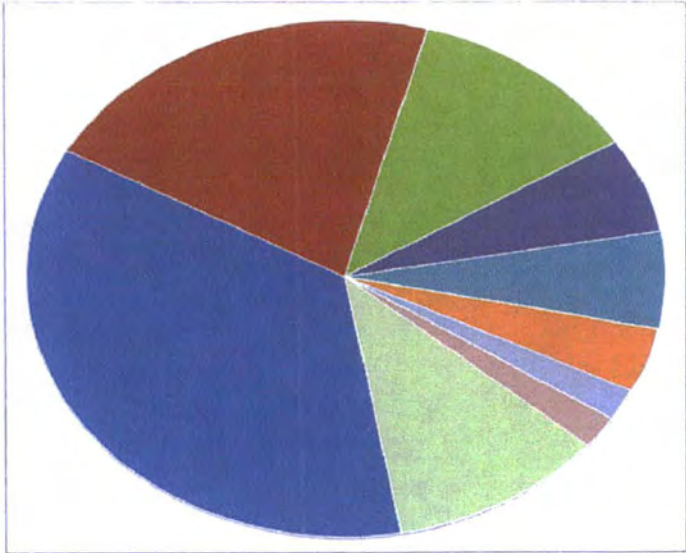


Pro rata share of main fund assets, not cash, are transferred to ERA

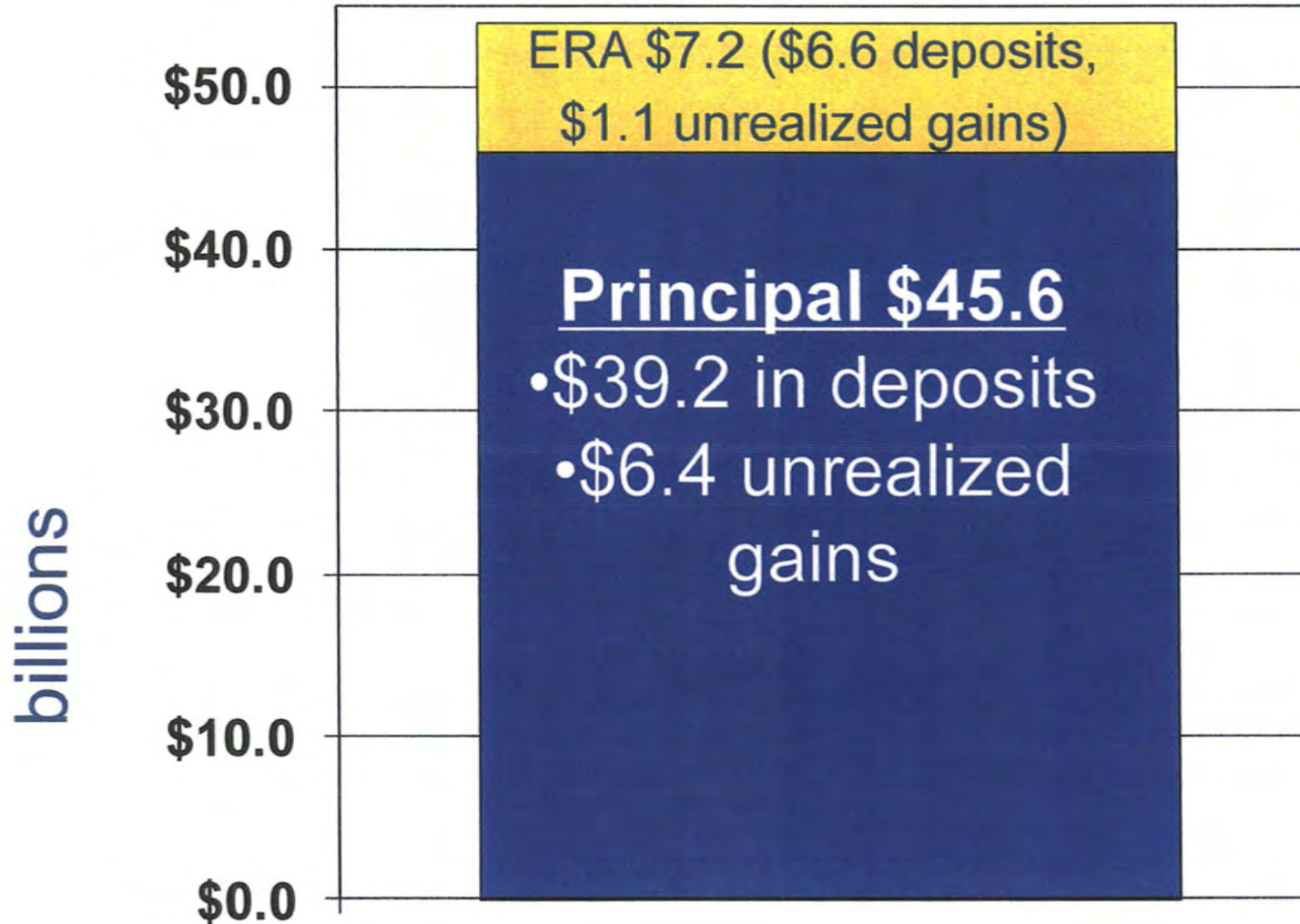
Main Fund allocation



ERA allocation



Fund breakdown

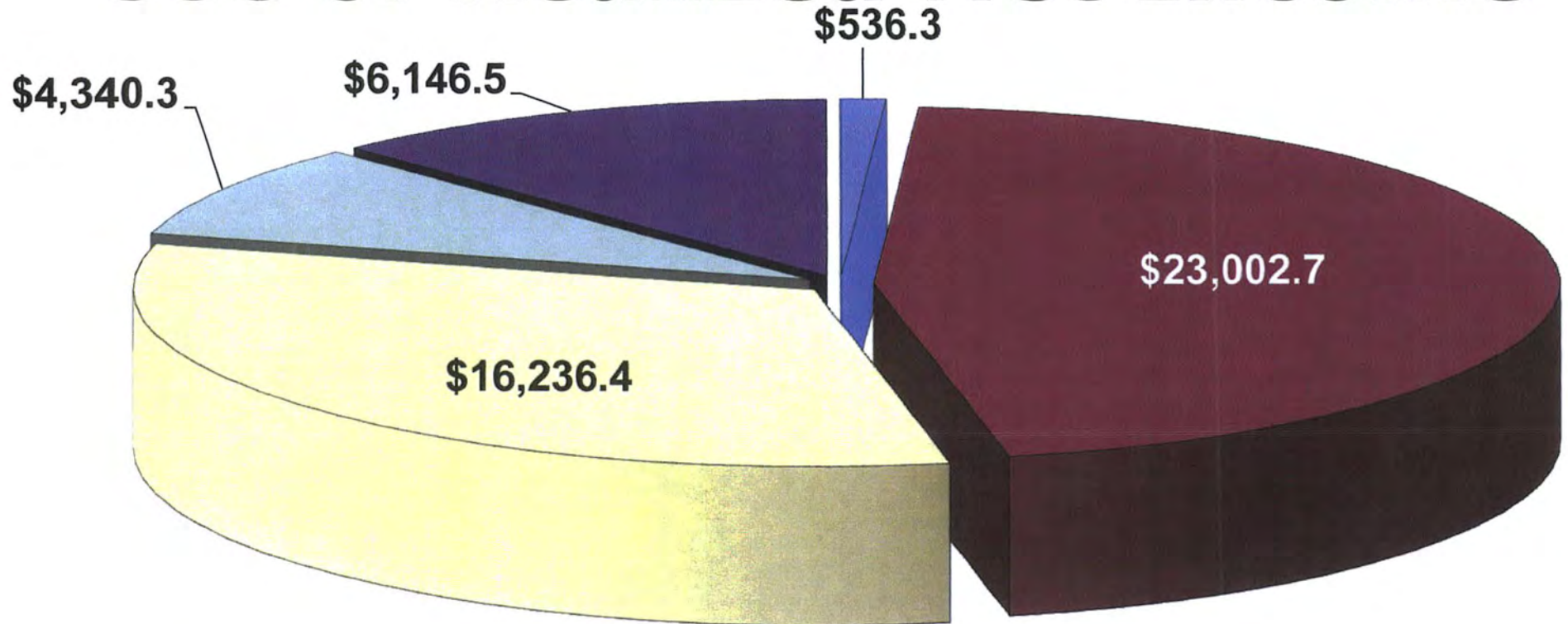


Statutory Net Income

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



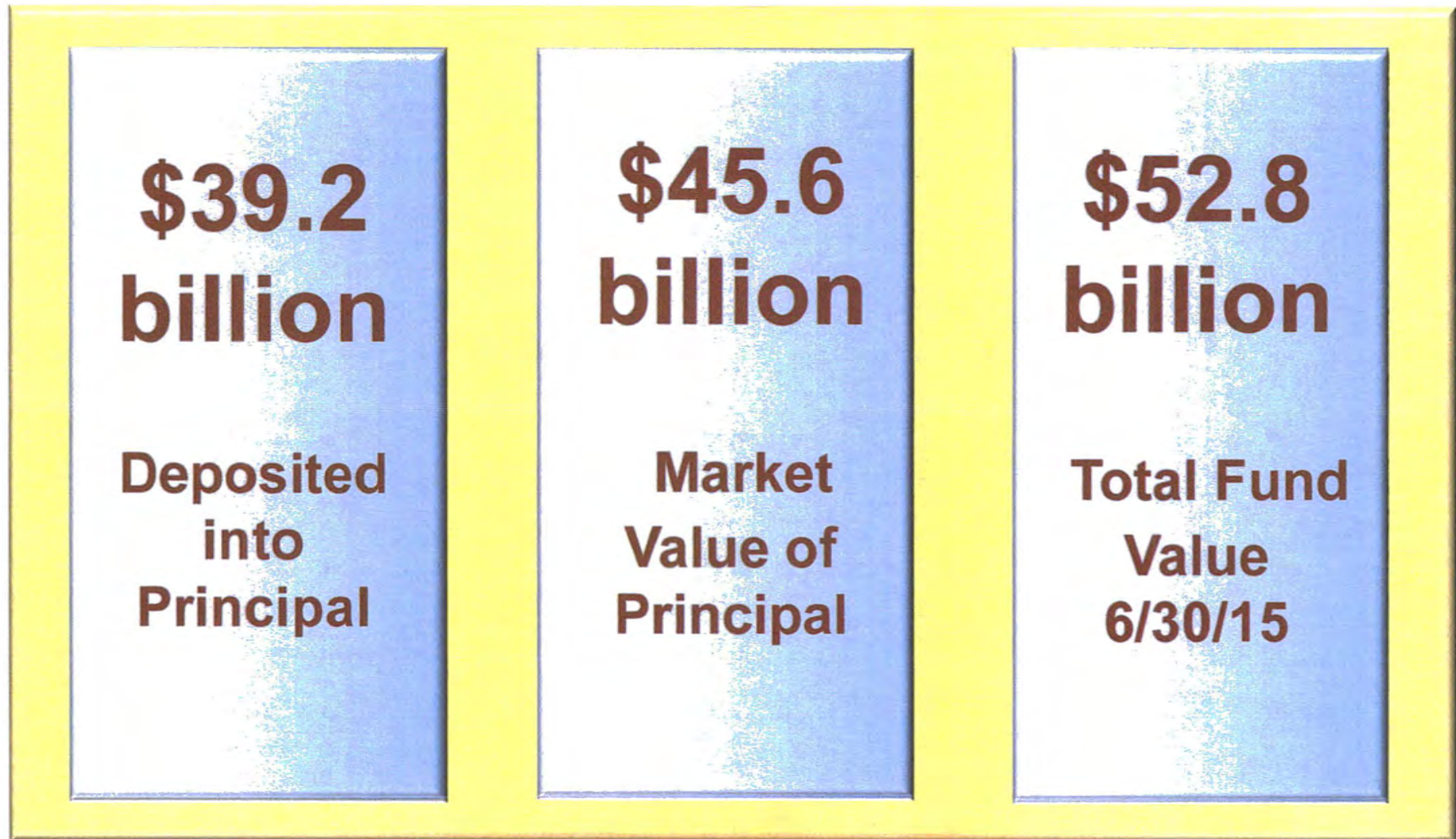
Inflation proofing

- 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

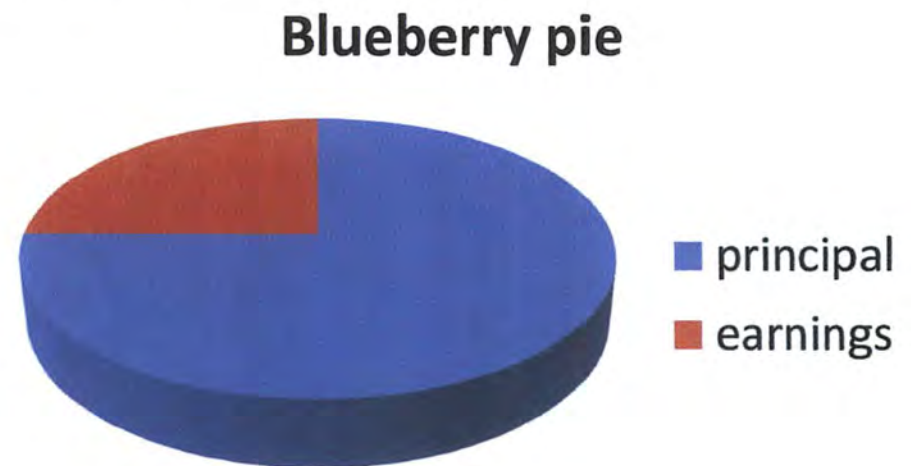


Money in and out, and current value



The Income-Producing Blueberry Pie

- Assume the basic following facts:
 - Fund buys blueberry pie for \$20
 - Earnings reserve reflects 25% of total fund
 - So, \$20 pie was funded with
 - \$15 of principal, and
 - \$5 of earnings



Capital Appreciation

- Assume a horrible storm destroys most of existing blueberry stock
 - Supply goes down, but demand is static
 - Value of our pie appreciates from \$20 to \$40
 - Principal's share now worth \$30 (initial cost \$15)
 - Earnings reserve share now worth \$10
 - But, unless we sell (realize) a portion of the pie,
 - The increased value reflects unrealized gain, not statutory net income
 - No income is transferred from principal to earnings



Harvesting Gains

- Assume we learn blueberry supply will recover in 6 months and our unrealized gains will disappear
- So, we sell the whole pie for \$40
 - \$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 and
 - \$15 of realized gain from principal



Capital Depreciation

- Assume a health report comes out announcing that blueberries cause insomnia
- Demand for our pie is decreased and 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 we sell or hold?



Realizing Losses

- Assume we conclude demand will continue to erode, making it prudent to cut our losses
- So, we sell the whole pie 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%
 - Can we have our cake and eat it too?

