

ALASKA LEGISLATURE

1476

HOUSE and SENATE FINANCE COMMITTEE FILES, 1995-1996

COMPONENT DETAIL - FY96 OPERATING BUDGET

Component: Alaska Public Utilities Comm
 BRU: Alaska Public Utilities Comm
 Agency: Department of Commerce and Economic Development

Component: A
 BRU: Alaska

	<u>FY94 Act</u>	<u>FY95 CC</u>	<u>FY95Auth</u>	<u>OMB Adj</u>	<u>Gov Org</u>	<u>FY95Auth - Gov Org Comparison</u>	
01 Pers. Serv.	2,463.0	2,682.4	2,616.9	2,616.9	2,615.9		
02 Travel	56.5	53.6	53.6	53.6	53.6		
03 Contractual	801.0	907.3	879.6	879.6	947.8	68.2	7.8%
04 Commodities	63.6	60.7	60.7	60.7	60.7		
05 Equipment	33.4	25.0	25.0	25.0	50.0	25.0	100.0%
06 Lands/Bldgs.	0.0	0.0	0.0	0.0	0.0		
07 Grants, Clms	0.0	0.0	0.0	0.0	0.0		
08 Misc.	0.0	-93.2	0.0	0.0	0.0		
** Total Expend.	3,417.5	3,635.8	3,635.8	3,635.8	3,729.0	93.2	2.6%
1005 GF/Prgm	3,417.5	3,635.8	3,635.8	3,635.8	3,729.0	93.2	2.6%
Perm Full Time	41.0	42.0	42.0	42.0	42.0		
Perm Part Time	0.0	0.0	0.0	0.0	0.0		
Non-Perm	0.0	0.0	0.0	0.0	0.0		

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Conference Co
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Allocate Misc P

Inc contract fo
GF/P

Hardware to s
GF/P

FY96 Govern

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LEGISLATIVE AFFAIRS AGENCY
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MEMORANDUM

January 30, 1995

SUBJECT: Sectional summary of SB 47
(APUC extension and other utility matters)

TO: Senator Tim Kelly
Attn: Josh Fink

FROM: Teresa B. Cramer *TBC*
Legislative Counsel

You have requested a sectional summary of the above-described bill. As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents.

Sec. 1 permits the Alaska Public Utilities Commission (APUC) to exercise the powers expressly granted or reasonably implied by the chapter. The section removes a requirement that the powers of the APUC be liberally construed to accomplish the commission's stated purpose.

Sec. 2 establishes a regulatory cost charge on utilities. Under subsection (a), regulated public utilities pay an annual charge not to exceed .8 percent of in-state gross revenue and exempt public utilities pay the actual cost of services provided by the commission.

Under subsection (b), the commission adopts regulations to set the method for determining the annual amount of the regulatory cost charge. Subsection (c) establishes special rules for utilities selling services at wholesale, local exchange telephone utilities, and electric utilities.

Subsection (d) directs the commission to allocate the total amount of the regulatory cost charge to be paid by electric utilities by using an equal charge per kilowatt hour.

Subsection (e) directs the Department of Revenue to collect and enforce the regulatory cost charge and the Department of Administration to identify how much of the APUC's operating budget lapses into the general fund each year. This will permit the legislature, if it wishes, to appropriate that amount for the following year's budget so that the APUC can set a lower regulatory cost charge for the second year to reflect the surplus from the previous years' collection.

Subsection (f) requires the APUC to allow public utilities to bill their customers for the cost of the regulatory cost charge.

Subsection (g) allows the APUC and the Department of Revenue to adopt regulations.

Subsection (h) defines terms used in the section.

Sec. 3 directs the APUC to consider the amount that a utility pays as a regulatory cost charge when allocating the costs of a hearing.

Sec. 4 provides that the subscribers of small electric and telephone utilities can petition to place the utility under APUC regulation by following the procedures set out in AS 42.05.712(h), which is amended by sec. 12 of the bill.

Sec. 5 permits electric and telephone utilities that do not gross \$500,000 annually to elect to be exempt from regulation under AS 42.05.712. The current threshold is \$325,000.

Sec. 6 permits utilities, other than electric and telephone utilities, that do not gross \$150,000 annually to elect to be exempt from regulation under AS 42.05.712. The current threshold is \$100,000.

Sec. 7 exempts garbage collection utilities that gross \$300,000 or less from rate regulation unless the subscribers petition for regulation under AS 42.05.712(h), amended by sec. 12 of the bill. The current threshold is \$200,000. The section retains the right of subscribers representing 25 percent of the gross revenue of a utility to petition the APUC for rate regulation.

Sec. 8 provides that the subscribers of cable television service utilities can petition to place the utility under APUC rate regulation under AS 42.05.712.

Sec. 9 permits the subscribers of a utility that is exempt from regulation under AS 42.05.711(e), (i), or (k) to use the procedures of AS 42.05.712 in an election imposing regulation.

Sec. 10 establishes a regulatory cost charge for pipeline carriers. Under subsection (a), pipeline carriers pay an annual charge not to exceed .8 percent of in-state gross revenue. A regulatory cost charge may not be assessed unless the pipeline carrier operations are within the jurisdiction of the APUC.

Under subsection (b), the commission adopts regulations to set the method for determining the annual amount of the regulatory cost charge.

Subsection (c) directs the Department of Revenue to collect and enforce the regulatory cost charge and the Department of Administration to identify how much of the

Senator Tim Kelly
January 30, 1995
Page 3

APUC's operating budget lapses into the general fund each year. This will permit the legislature, if it wishes, to appropriate that amount for the following year's budget so that the APUC can set a lower regulatory cost charge for the second year to reflect the surplus from the previous years' collection.

Subsection (d) allows the APUC and the Department of Revenue to adopt regulations.

Subsection (e) defines "gross revenue" as used in this section.

Sec. 11 directs the APUC to consider the amount that a pipeline carrier pays as a regulatory cost charge when allocating the costs of a hearing.

Sec. 12 extends the sunset date for the Alaska Public Utilities Commission until June 30, 1999.

Sec. 13 adjusts the way in which the terms of members of the APUC are staggered to ensure that no more than one commission member's term expires each year.

Secs. 14 and 15 provide that the amendment, in sec. 1, concerning how the APUC's powers are to be interpreted applies only to proceedings begun on or after the effective date of sec. 1, which is set in sec. 15 as July 1, 1996.

Sec. 16 states that, except for sec. 1, the Act takes effect immediately.

TC:klb
95-023.klb

MEMBER

TENTH ALASKA LEGISLATURE
ELEVENTH ALASKA LEGISLATURE
TWELFTH ALASKA LEGISLATURE
THIRTEENTH ALASKA LEGISLATURE
FOURTEENTH ALASKA LEGISLATURE
FIFTEENTH ALASKA LEGISLATURE
SIXTEENTH ALASKA LEGISLATURE
EIGHTEENTH ALASKA LEGISLATURE

ALASKA STATE SENATE



SENATOR TIM KELLY

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SB 47: Relating to the Alaska Public Utilities Commission and the Regulatory Cost Charge

Consensus Provisions from 18th Legislature

Senate Bill 47 (SB 47) is the re-introduction of SB 213 from the 18th Legislature. This legislation accomplishes two primary objectives: 1) It extends the Alaska Public Utilities Commission (APUC) which is currently winding down in its sunset year; and 2) It re-enacts the Regulatory Cost Charge (RCC) which expired on December 31, 1994.

This legislation was the product of numerous and lengthy committee hearings in the last Legislature – in fact, more than 8 substantive hearings in the Senate alone.

Given the unknown but potentially serious ramifications of allowing the APUC to expire, this legislation was introduced as a "consensus" bill in that all provisions contained within have been debated extensively and are either without opposition, or the result of compromise agreed to by all concerned parties and in the best interest of consumer protection. This version is nearly identical to the final version that would have reached the House floor last May 10th had that body not adjourned before it was taken up. It is not exactly identical because the RCC has expired and so rather than repealing its sunset, the entire RCC was re-enacted.

Another bill has been introduced by the Senate Labor & Commerce Committee that will incorporate for the committee's consideration further amendments affecting the APUC and/or RCC.

SECTIONAL ANALYSIS

Section 1: Replaces language granting the commission powers which shall be "liberally construed" with language allowing the commission to do "all things necessary or proper to carry out the purposes and exercise the powers expressly granted or reasonably implied".

This compromise was reached last year in the Senate Finance Committee. Some utilities, namely electricians, felt this grant of power was too broad, and in questions where the commission did not have express authority to act, the legislature should make such policy calls. Others, besides the APUC itself, felt this provision was necessary for the efficient and orderly functioning of the commission in the regulation of utilities for the public interest. This language strikes a balance and was acceptable to all parties concerned.

Sections 2, 3, 10 and 11: Re-enact the RCC for utilities and pipelines without the sunset. This language is identical to the former law with the following exceptions:

There are no sunset provisions for the regulatory cost charges.

This provision was proposed by the auditor and supported by the APUC. Both assert the Commission's sunset review is adequate to address any issues that arise with the Regulatory Cost Charge.

Page 3, lines 11- 13:

Adjusts the allocation of the Regulatory Cost Charge for electric utilities by subtracting the cost of power from their gross revenues.

The auditor recommended the APUC periodically adjust the RCC allocation among utility types to reflect workload on an industry by industry basis utilizing a time-keeping system. However, the commission argued such a change would be complicated and require more staff. ARECA proposed this "rough cut" justice as a simplified and more economical way to achieve the auditor's recommendation.

**Page 2, line 27;
and Page 6, line 4:**

Increases the regulatory cost charge ceiling for public utilities and pipeline carriers from .61 percent to .8 percent.

This change was necessitated when cost of power was subtracted from electric utilities gross revenues before application of the RCC. The RCC rate would need to be increased roughly 30 percent to maintain the same amount of revenue for the commissions operating costs. (Remember, the RCC is a direct pass through on our utility bills, and is itemized as the RCC).

Provisions of SB 47
Page 3

**Page 3, lines 20-24;
and Page 6, lines 15-19:**

Requires the Dept. of Administration to earmark regulatory cost charges over-collected for possible appropriation by the Legislature for the commission's next fiscal year.

Currently, by the time 4th quarter Regulatory Cost Charges charges arrive in July, the new fiscal year has started. If the APUC has over-collected, and they won't know until the 4th quarter receipts arrive, the money lapses into the general fund. This section would allow those over-collected funds to be appropriated back to the APUC thus reducing the next year's RCC.

Sections 4, 8 and 9: Provides that subscribers of small utilities or utilities otherwise exempt from regulation can petition for an election to place the utility under regulation under the same procedures the subscribers of a regulated utility can petition for an election to remove the utility from regulation.

This provision was recommended by the auditor and supported by the commission. Under current statute, 10 percent of the first 5,000 subscribers of a regulated utility and 3 percent of the remaining subscribers may petition for an election to remove a utility within certain revenue parameters from regulation. However, for subscribers to petition for an election to place an unregulated utility under regulation they must gather the signatures of 25% of the subscribers. The auditor recommended the procedures for subscribers to opt-in or opt-out of economic regulation should be easier. These sections provide that opt-in and opt-out procedures are identical.

Sections 5, 6, and 7: Gives more consumers the option to deregulate by raising maximum amount of gross revenues a utility may receive under which the consumers may elect for deregulation.

Currently, electric and telephone utilities that do not gross \$325,000 annually may elect to be exempt from regulation. Section 5 increases that amount to \$500,000. For other utilities the cut-off was raised from \$100,000 to \$150,000, except for garbage collection utilities the amount was raised from \$200,000 to \$300,000.

These provisions were recommended by the auditor and supported by the commission. They increase the consumers options to deregulate.

Section 12: Extends the sunset date of the APUC to June 30, 1999.

Section 13: Staggers the terms of the members of the commission.

Currently, the terms of the consumer seat and the engineering seat expire at the same time. This provision would stagger the terms, though it would not affect the terms of any of the current commissioners.

Section 14 and 15: Provides that the change in the commission's powers as amended in section 1 apply only to proceedings begun on or after the effective date of section 1, which is set in section 15 as July 1, 1996.

Section 16: Except for section 1, the Act has an immediate effective date.

Alaska State Legislature

Senator Tim Kelly, Chair
Senator John Torgerson, Vice Chair
Senator Mike Miller
Senator Jim Duncan
Senator Judy Salo



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MEMORANDUM

TO: Senator Rick Halford, Co-Chair
Senator Steve Frank, Co-Chair
Senate Finance Committee

FROM: Senator Tim Kelly, Co-Chair
Senate Labor & Commerce Committee

DATE: February 1, 1995

RE: Scheduling of SB 47 - Relating to the Alaska Public
Utilities Commission and Regulatory Cost Charge

I respectfully request you schedule SB 47, Relating to the
A.P.U.C. and R.C.C., pending referral.

This bill is scheduled before the Labor & Commerce this Thursday
at 1:30 p.m. It is my intention to move the bill out at that
meeting, and it will be referred to the Finance Committee on
Friday.

As you know, the APUC is currently in its sunset year. If the
Legislature does not take action soon to extend this regulatory
commission, it must stop taking rate cases and other action that,
by statute, often require from 90 days to six months. In
addition, the commission will have to begin informing staff they
will be terminated June 30th.

I have not found any concerned party supporting the A.P.U.C.'s
sunset. In fact, I've heard just the opposite: the A.P.U.C. needs to
be extended soon so as not to disrupt regulatory activity that is
vital for many utilities existence and the public good.

Memo- SB 47

February 1, 1995

Page 2

So you know, I am working in concert with the House to ensure early passage of this legislation. In addition, the Labor & Commerce Committee has introduced another A.P.U.C. bill that will encompass suggested amendments for the Senate's consideration. I have done this in order to avoid delays resulting from potentially contentious amendments with the "consensus" bill currently moving through.

Attached please find my staff's analysis of the bill as well as a sectional analysis from Legislative Legal. If you have any questions, please contact myself or staff, Josh Fink.

Thank you for your consideration.

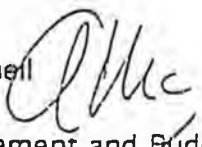
MEMORANDUM

STATE OF ALASKA
Office of the Governor

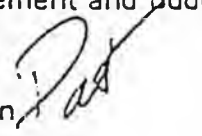
To: All Departments

Date: January 20, 1995

File No: 95fisno.mem/lb

From: Annalee McConnell 
Director
Office of Management and Budget

Subject: Revised 1995 Fiscal
Note Detailed
Instructions

Pat Pourchot 
Legislative Liaison
Office of the Governor

This Administration is committed to up-front, responsible budgeting. Thorough, accurate fiscal notes are an important aspect of that commitment and our cooperative relationship with the Legislature. We appreciate your assistance in doing this job well.

Each year State departments are asked to provide detailed information regarding the fiscal implications of proposed legislation. As in the past, the fiscal note will be used to accomplish this task as prescribed in AS 24.08.035 (attached). To provide the Legislature, the Governor's Legislative Office and OMB's Division of Budget Review (DBR) with timely and objective fiscal data, please follow these instructions when completing and processing fiscal notes.

For legislation proposed to be submitted at the request of the Governor, departments are required to complete a fiscal note form accompanied by a fiscal analysis. Fiscal notes and analysis should be submitted to the Governor's Legislative Office by the due date on your legislative review sheets before final approval of the draft legislation. Draft legislation will not be finalized for introduction until appropriate fiscal information is submitted to the legislative office and reviewed and approved by DBR.

Reminders

At the request of the Criminal Justice Working Group, fiscal notes for legislation impacting Group programs will be reviewed by DBR before distribution to legislative committees. Fiscal notes are still to be delivered to the Governor's Legislative Office, who will then forward them to DBR for review to be completed within 24 hours. If no changes are required, the fiscal notes will then be delivered to the legislative committee.

"Revenue" - Specifying Fund Source Code

Revenue generated as a result of legislation will continue to be reflected under "Revenue." In addition, please specify the revenue's fund source and its code as assigned by DBR. If no funding source code is available, simply state the name of the source. A fund source code will be assigned if the legislation is enacted.

Sunset Legislation

Please remember that fiscal notes extending an entity under sunset review should display the on-going costs of operations and any associated revenue generated by passage of the sunset legislation. These types of fiscal notes should be footnoted to indicate that the expenditures are contained in the proposed operating budget and that the revenues are reflected in revenue projections.

Component Serial Numbers

The Legislature will again be entering fiscal information into BASIS this year. To facilitate data entry, agencies are required to enter the component serial number on each fiscal note prepared. This applies to all legislative fiscal notes prepared by a department throughout the session. A listing of component serial numbers, by serial number and component name, will be provided after FY 96 budget work is completed by DBR.

GENERAL INFORMATION**Requests for Fiscal Notes**

Alaska Statute 24.08.035 provides that before a bill or resolution, except an appropriation bill, is reported from the committee of first referral, a fiscal note must be attached.

The fiscal note will normally be requested by phone by various committees of the Legislature. (Copies of all introduced legislation are available from the Documents Room on the ground floor of the Capitol building, and fiscal note forms will be sent to each department's Legislative Liaison. Additional forms are available from DBR and the Governor's Legislative Office upon request. *DBR will provide the fiscal note form in Excel 4.0 or 5.0 format upon request.*)

Prompt submission of fiscal notes is essential. Unless otherwise requested, the time for delivery of a fiscal note to the legislative committee is not more than five days following the request. Requests made after the 90th legislative day or during a special session require delivery of the fiscal note within two days. The Governor's Legislative Office should receive fiscal notes for distribution with at least a one-day lead time before the requester's due date. *Criminal Justice Working Group fiscal notes should have a two-day lead time.* The Legislative Office is responsible for the distribution of the departments' fiscal notes to the Legislature and DBR.

- 1 **Bill No.** - The fiscal note should specify the version of the bill/resolution for which the fiscal note is prepared (i.e., committee substitute). It is very important to use the correct version of the bill to which the fiscal note applies.
- 2 **Revision Date** - Fill this in if preparing a revised fiscal note. Revised date should match the revised "prepared by" date.



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Electr. Service for 300,000 Alaskans

August 2, 1993

Sen. Tim Kelly
716 W. 4th Ave., Suite 400
Anchorage, AK 99501-2133

Dear Sen. Kelly:

I am pleased to know that you plan to schedule consideration of APUC Sunset Review for early September. Our association has three priority issues we would like for your committee to consider in this review. One of these issues is also raised by the Audit Report.

APUC Powers Liberally Construed

For many years, the APUC has tended to expand the authority it exercises, and the courts have permitted this expansion to take place. The reason for this is the provision in AS 42.05.141(a)(1) that directs that "the powers of the commission shall be liberally construed . . ." This can work either to the advantage or disadvantage of the regulated utility, but in either case, we do not think it is appropriate. We have long believed that a more appropriate directive would be that "the powers of the commission shall be those specifically conferred by the legislature or necessarily implied from those specific grants of authority."

We have long believed that this power to define the role of the commission should rest with the legislature rather than the commission itself, but this issue now takes on much more critical importance. Now that the commission is funded primarily by a variable tax it imposes on the utilities called the "regulatory cost charge," the commission potentially has the resources to fund whatever level of regulation it wishes to develop. No agency of state government should have that kind of power.

Enclosed is a letter from Roger Kempel, our attorney, which details a few recent examples in which the commission and the courts relied on the "liberally construed" language to expand their authority.

We ask that this section be amended so that the legislature reclaims its appropriate authority over the commission.

— Letters on "Liberally
Construed" — CTION

Negotiated Rulemaking

Negotiated rulemaking is authorized at the federal level, and it is being used there with increasing frequency. Without any special authorization, the Alaska Department of Environmental Conservation has also used this technique quite effectively. We think this approach to rulemaking has considerable merit at the APUC as well. The problem in implementing that approach at the commission without legislative directive is that it would violate existing rules of procedure at the commission which presume adversarial proceedings.

The federal energy legislation of 1992 contained a requirement that state regulatory bodies consider implementing "integrated resource planning." Negotiated rulemaking could be particularly useful in complying with that requirement.

Regulatory Cost Charge

This association objects to the whole idea of this special tax on utilities. We think that operations of the APUC should be paid for from unrestricted general revenue funds. However, if one assumes that the RCC will stay in place in some form, our concern is the same as that of the auditor: There has to be some way to make the allocations of cost under the RCC more equitable.

The audit report recommends that a timekeeping system be established which would be used to allocate responsibility for the RCC the next year. The commission objects to this recommendation because they think this timekeeping would increase their costs significantly. Because the industry is paying the commission's bills, we also have to be sensitive to their costs. So although we are in complete agreement with the audit report in how it defines the problem, we are ambivalent about the cure it recommends.

We recommend a more direct approach to solving the problem. Our proposal is to reconsider the amendment submitted by then Rep. Bert Sharp in the House Finance Committee when the RCC as it exists today was being drafted. The Sharp proposal was to adjust the gross electric revenues by deleting the cost of power before the RCC is calculated. The rationale for doing this is that the distribution function of an electric utility, without the cost of the electricity itself added in, is comparable to the service provided by a local telephone exchange. By deleting the cost of power from the calculation, a great deal more fairness between telephone and electric would be introduced into the system.

As the RCC calculation exists now, electric paid 39% of the total in FY 93, and that will increase to 43% of the total for FY 94. By contrast, the audit report estimates that telephone companies account for 45% of the workload while under the FY 94 plan they will be paying only 21% of the RCC. If the Sharp amendment were in place, the share of RCC for electric would drop to approximately 23% while the share for telephone would increase to approximately 27%.

I look forward to discussing these and other proposals which may be under consideration when your committee meets on APUC sunset review.

Sincerely,



David Hutchens

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July 23, 1993

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David Hutchens
Executive Director
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Re: APUC Powers "Liberally Construed"

Dear Dave:

You have asked whether the "liberally construed" language found in AS 42.05.141(a)(1) has any operative effect; that is, whether the Alaska Supreme Court cites or relies upon this statutory language in reaching decisions involving the APUC.

The answer is that both the APUC and the Alaska Supreme Court find it necessary to cite this statutory section in order to create APUC jurisdiction in matters not expressly conferred by the legislature.

The two most recent supreme court cases citing this statutory section of which I am aware occurred just last year. In February 1992, the Alaska Supreme Court issued its opinion in the case of *Far North Sanitation v. APUC*, 825 P.2d 867 (February 7, 1992). In that decision, the court dealt with the question of the APUC's power to order interim refundable rates. The court quoted the APUC's argument that the legislature granted the APUC broad powers to accomplish its purposes and, further, provided that these powers should be liberally interpreted [citing AS 42.05.141(a)(1)] but went on to state that, on the question of whether the APUC has authority to declare a rate interim and refundable after hearing, there is conflicting case law. The court concluded, however, that the APUC had such implied authority, again citing AS 42.05.141(a)(1) and stating:

Alaska's statute mandates that the powers of the APUC be liberally construed.

Far North Sanitation v. APUC at p. 873.

Two months later, the court issued its opinion in *Colville Environmental Services, Inc. v. North Slope Borough*, 831 P.2d 341 (April 24, 1992), this time addressing the power of the APUC to attach conditions to a certificate of public convenience and necessity which conflicted with another state statute (AS 29.35.050). In concluding that the Commission had such power, the court again relied upon the liberally construed statutory language in reaching this result.

David Hutchens
July 23, 1995
Page 2

In reaching its decision in *Colville*, the Alaska Supreme Court cited its earlier 1991 decision in *Homer Electric Association v. City of Kenai*, 816 P.2d 182, again discussing the effect of AS 42.05.141(a) and concluding in part that that section stands for the proposition that the Commission's "powers to adjudicate are plenary, as broad as the specific provisions of the act permit." *HEA v. City of Kenai* at p. 186.

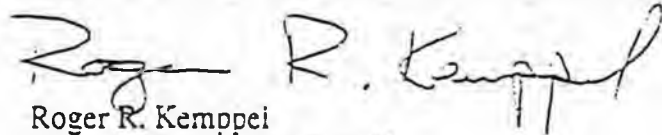
I have not attempted to completely research all of the instances in which the APUC or the courts have relied upon AS 42.05.141 to expand the APUC's specific legislative powers, but I believe that the above cases illustrate that the courts have utilized this section on more than one occasion and have done so quite recently.

You should also note that the cases cited above have been decided both for and against the utility. That is to say that the existence of AS 42.05.141(a)(1) has not always worked to the detriment of the utility, but I do think it is fair to say that it has always worked to expand the APUC's jurisdiction and power beyond that otherwise explicitly granted to it by the legislature.

If you have any further questions or wish me to compile a more exhaustive list of court citations, please feel free to contact me.

Sincerely yours,

KEMPEL, HUFFMAN AND GENDER, P.C.



Roger R. Kempel
General Counsel for ARECA

RRK:lka

"Liberally Construed"

HB 213 would extend the Alaska Public Utilities Commission and the Regulatory Cost Charge that funds it until 1998. An amendment may be proposed to delete the phrase "liberally construed from the Commission's enabling statute. The Commission opposes this amendment.

The current language of Section 42.05.141 of Alaska Statutes, entitled "GENERAL POWERS AND DUTIES OF THE COMMISSION", states in part:

(a) The Alaska Public Utilities Commission may
(1) regulate every public utility engaged or proposing to engage in such a business inside the state, except to the extent exempted by AS 42.05.711, and the powers of the commission shall be liberally construed to accomplish its stated purposes;(emphasis added)

1. Does not expand the powers of the APUC.

In HEA vs. City of Kenai the Supreme Court said:

In sum, we have construed AS 42.05.141(a)(1) to mean that the actual areas in which the APUC may exercise its adjudicatory authority are quite narrow. Within those narrow areas, however, the APUC's powers to adjudicate are plenary, as broad as the specific provisions of the act permit....

This provision presents two guiding principles for determining the extent of the APUC's jurisdiction under specific provisions of the Act. On the one hand, it includes a principle of limitation, restricting the APUC's power to the specific jurisdictional areas of its "stated purposes." On the other hand, it includes a principle of expansion, mandating that the APUC's power to act within its specific areas of jurisdiction "is to be liberally construed." (emphasis added)

2. Benefits utilities.

Routinely the Commission allows interim rates to go into effect without requiring the utility to escrow funds or post a bond under AS 42.05.421(c). It does this by making rates interim refundable, which again benefits the utility. The authority for this is "liberally construed."

"Liberally Construed"

Page 3

whenever a court finds a gap in an agency's power. This forces the legislature back into the regulatory role that they sought to escape by creating the commission in the first place. Removing "liberally construed" from the Commission's powers and duties section would have impacts well beyond statutory construction in the courts.

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AND C. BURCH

July 23, 1993

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David Hutchens
Executive Director
Alaska Rural Electric
Cooperative Association, Inc.
703 W. Tudor Road, Suite 200
Anchorage, AK 99503

Re: APUC Powers "Liberally Construed"

Dear Dave:

You have asked whether the "liberally construed" language found in AS 42.05.141(a)(1) has any operative effect; that is, whether the Alaska Supreme Court cites or relies upon this statutory language in reaching decisions involving the APUC.

The answer is that both the APUC and the Alaska Supreme Court find it necessary to cite this statutory section in order to create APUC jurisdiction in matters not expressly conferred by the legislature.

The two most recent supreme court cases citing this statutory section of which I am aware occurred just last year. In February 1992, the Alaska Supreme Court issued its opinion in the case of *Far North Sanitation v. APUC*, 825 P.2d 867 (February 7, 1992). In that decision, the court dealt with the question of the APUC's power to order interim refundable rates. The court quoted the APUC's argument that the legislature granted the APUC broad powers to accomplish its purposes and, further, provided that these powers should be liberally interpreted [citing AS 42.05.141(a)(1)] but went on to state that, on the question of whether the APUC has authority to declare a rate interim and refundable after hearing, there is conflicting case law. The court concluded, however, that the APUC had such implied authority, again citing AS 42.05.141(a)(1) and stating:

Alaska's statute mandates that the powers of the APUC be liberally construed.

Far North Sanitation v. APUC at p. 873.

Two months later, the court issued its opinion in *Colville Environmental Services, Inc. v. North Slope Borough*, 831 P.2d 341 (April 24, 1992), this time addressing the power of the APUC to attach conditions to a certificate of public convenience and necessity which conflicted with another state statute (AS 29.35.050). In concluding that the Commission had such power, the court again relied upon the liberally construed statutory language in reaching this result.

KEMPEL LTR: "Liberally —
Construed" ✓

**APUC
FY94
overview**

Since statehood in 1959, the Alaska Public Utilities Commission has been working with the hundreds of public utilities in Alaska with the same mission in mind - to ensure continued service, sound management, and fair rates for residents in all corners of the state. The Commission regulates utilities that bring water, electric, gas, and telecommunications into our homes, as well as overseeing services that collect and dispose of our waste. In 1981 the APUC's role was expanded to include oversight of pipeline carriers and pipelines when it merged with the Alaska Pipeline Commission.

Utility commissions were originally created to protect consumers, since most utilities were monopolies. Today, Commissioners are faced with the challenge of evaluating regulations and considering policy changes to encourage competition while continuing to maintain consumer protection as a primary goal.

In situations where monopolies exist, the Commission monitors the utility to ensure fair pricing practices, reasonable service, financial stability, and accountability. The Commission balances the legitimate need for utilities and pipeline carriers to show a profit for their investment, and the public's right to receive fair service for its money. Commissions in all 50 states serve the same general mission, regulating the relationship between the utilities and the consumers they serve.

The Commission achieves this balance by issuing "certificates of public convenience and necessity" to qualified service providers. A certificate essentially acts as a license to operate and details how the utility or pipeline carrier must conduct business with consumers or shippers concerning rates. The Commission establishes rates, terms, and conditions of service while overseeing the practices, services, and facilities of regulated utilities and pipeline carriers. In the next few years, new approaches and a broader perspective will be necessary as the Commission works to address complex issues and to make appropriate regulatory decisions for all Alaskans.

The APUC has jurisdiction over the operations of:

- electric utilities
- natural gas utilities
- refuse (garbage) collection
- wastewater (sewer) treatment
- steam producers
- telephone companies (local and in-state services)
- water utilities
- oil and gas pipeline carriers.

Cellular phone, cable television, and radio common carriers are regulated to a lesser extent.

The Commission has issued 359 certificates of public convenience and necessity (certificates) held by utilities and pipeline carriers.

Approximately one-third of the 358 certificates are for utilities whose services and operations are fully regulated

by the Commission. The authority to regulate some types and sizes of utilities is limited under the law. Many electric utilities in bush communities are exempt from regulation because of their small size. Some cooperatives and government-owned utilities are also exempt because they have alternative means of accountability to the consumer. Of the 359 certificates held, the Commission currently regulates the rates, services, practices, or facilities of 704 utilities and 15 pipeline carriers.

In addition, the Commission is responsible for computing the power costs and resultant state assistance amounts for customers of electric utilities participating in the Power Cost Equalization (PCE) program.

The Commission carries out its regulatory responsibilities through several means. It conducts audits, investigations, public meetings, tariff action meetings, formal adjudicatory proceedings, informal meetings, and conferences; and resolves complaints by telephone, mail, meeting, or adjudication.

The Commission functions as a quasi-judicial body when rendering decisions in formal proceedings and as a quasi-legislative body when promulgating regulations. Its proceedings and determinations are governed by the statutes and regulations of the state.

Funding

Funds to pay for Commission operations have historically been provided through the state's general fund. In 1992 following the legal mandate of the legislature, the Commission enacted regulations allowing it to recover its operating costs through an assessment on the revenues of the utilities and pipeline carriers it regulates. That Regulatory Cost Charge (RCC) shows up as a surcharge on monthly billing statements to consumers and shippers.

The legislature appropriated and the governor approved a FY95 budget of \$3.635 million, funded 100 percent from program receipts, in the form of the Regulatory Cost Charge. There are no unrestricted general funds in the FY95 appropriation. To raise the \$3.7 million for operating costs, the revenue assessment was set at 43 cents per \$100 for all utilities except electric utilities (assessed at .0412 cents per kilowatt hour).

With provisions of the sunset law clouding the Commission's long-term existence and its funding mechanism set to expire even sooner, the APUC has been forced to adapt to an uncertain future at least until corrective action can be taken by the Legislature.

APUC FY94 overview (continued)

Alaska Public Utilities Commission

	FY93	FY94	Percent change
Appropriations			
71000 Personal services	\$2,455,400	\$2,612,500	6%
72000 Travel	57,800	53,600	-7%
73000 Contractual	1,163,500	872,400	-25%
74000 Commodities	43,700	60,700	39%
75000 Equipment	20,400	25,000	23%
TOTALS	\$3,740,800	\$3,624,200	-3%

**Operating
Budget
FY94
(7/1/93
to 6/30/94)**

	Expenditures		
71000 Personal services	\$2,366,884	\$2,462,960	4%
72000 Travel	47,777	56,508	18%
73000 Contractual	913,309	800,962	-12%
74000 Commodities	94,049 ¹	63,615	-32%
75000 Equipment	71,327	33,470	-53%
TOTALS	\$3,493,346¹	\$3,417,515	-2%

Revenue receipts²			
General Fund Program Receipts:	\$3,897,553 ³	\$3,482,122	-11%
TOTAL REVENUES	\$3,897,553	\$3,482,122	-11%

1. Corrected number from FY93 Annual Report.
2. The Commission received revenues under various provisions of its statutes including copying and postage charges (AS 42.05.201) and cost allocations in proceedings (AS 42.05.651/AS 42.06.610).
3. The Commission funding was changed to General Fund Program Receipts in FY93 (3 AAC 47) under the Regulatory Cost Charge program.

The Alaska Public Utilities Commission is working this fiscal year in the shadow of a dilemma. While the Commission remains charged with carrying out its regulatory mandate, its annual funding mechanism was not extended by the last Legislature, nor was the APUC's very existence extended beyond June 1995.

There was no formal opposition to extending the APUC — in fact the state's 1995 budget includes full funding for the Commission. But because no legislative action was taken to the contrary, the Commission fell victim to the state's sunset law and was terminated June 30, 1994. That began the Commission's one-year wind-down period. Under the 1977 Sunset Law, several state boards and commissions are set to periodically and automatically expire unless specifically renewed.

Compounding the confusion is the fact that legislation extending the APUC's authority to levy a Regulatory Cost Charge (RCC) from utilities and pipeline carriers was held up and died on the House floor during the last day of the regular session. Because the Legislature did not act on the RCC issue, which generates 100 percent of the funding for the Commission's approximately \$3.63 million annual budget, there is no mechanism for collecting money after December 31, 1994.

With provisions of the Sunset Law clouding the Commission's long-term existence and its funding mechanism set to expire even sooner, the APUC has been forced to adapt to an uncertain future — at least until corrective action can be taken by the Legislature.

With legal guidance from the State Attorney General's office, the APUC will continue undiminished in pursuit of its regulatory mandate until it is forced to close its office on June 30, 1995 under the sunset law. As the Assistant Attorney General's June opinion to the APUC stated, "We advise that the Commission should continue to perform its statutory duties to the extent possible while developing a plan to phase out its work by the close of the sunset year."

In August the APUC also adopted a policy strongly recommending to the Legislature and the Governor that a simple reauthorization bill be promptly introduced and passed to do just two things: extend the Commission for four years and to make permanent the RCC. Other APUC legislative business could be deferred in the interest of prompt passage of these bills.

The Alaska Public Utilities Commission is doing everything possible to maintain a normal schedule during its wind-down year. However, those things that will be neglected, and the consequences from such neglect, may grow more serious each day.

As the Commission is compelled to complete its affairs the potential disruption may become severe:

1) applications for a certificate of public convenience and necessity, or for changes in service area or transfer of a certificate received after December 31, 1994 may not be processed before June 30, 1995;

APUC: Working in the shadow of the Sunset Law

2) processing of new cases involving utility or pipeline rate changes or new requests may be disrupted. Normally, when a filing is suspended for investigation, the suspension period is five or six months. Therefore, dockets cannot be opened after December 31, 1994 with the normal suspension period. Accelerating the dockets is not an option because utilities and pipeline carriers are entitled to due process; and

3) regulatory proceedings will be suspended for dockets where the regulations may not take effect before the termination date.

The Commission is mandated by law to **conclude** its affairs by June 30, 1995. AS 44.66.010(b). To wrap up as many dockets as possible by that deadline, and to minimize the loose ends, the Commission must, according to statutes, focus its attention on concluding its affairs.

Additionally, under current law the authority to charge the Regulatory Cost Charge (RCC) expires December 31, 1994, halfway through the fiscal year. The Commission has obtained an Attorney General's opinion citing that the Commission can collect the full amount of the annual FY95 appropriation by December 31, 1994, and has adopted regulations to accomplish this. The Commission was directed to submit its FY96 budget request with program receipts as the source, thereby assuming that the RCC will be reenacted.

Sunset extension early in first session of the Legislature is needed to avoid severe disruption of utilities and pipeline carrier regulation. It was only the hurried activity of the closing days of last year's legislative session that prevented action assuring the extension of the Alaska Public Utilities Commission. The Commission looks forward to a prompt and positive resolution of the issues affecting its authority and funding.

APUC: Working in the shadow of the Sunset Law (continued)



**Tamara Alexander (records and
filings supervisor), Balassa
Doughty (documents processor),
Sonia Cornejo (documents
processor)**



**Pat Oldenburg
(administration supervisor)**

REPORT CONCLUSIONS

Policy Issues

This review contains policy issues raised as a result of our evaluation of various commission practices. The final policy decisions affecting those practices require legislative consideration. In debating these decisions the legislative oversight committees should take into consideration the findings and recommendations presented in this report to assist them in evaluating the potential impact of any policy changes.

Report Conclusions

In our opinion, the Alaska Public Utilities Commission is operating in an efficient and effective manner and should continue to regulate public utilities and pipelines. We believe that the public interest is being served by requiring public utilities and pipelines to be certificated by APUC. This process stabilizes demand for the utility service by eliminating competition and thereby allowing economies of scale to operate. Economic regulation by the commission, in place of that competition, ensures that the utilities provide adequate service at the lowest reasonable rates.

We recommend that AS 44.66.010(a)(4) be amended to extend the life of APUC to June 30, 2003. APUC has consistently demonstrated public need; we believe it is in the public's best interest to extend the life of this commission for ten years. However, we recognize that performance issues periodically arise. The Division of Legislative Audit can address these interim issues, if any, through a special audit at the request of the Legislative Budget and Audit Committee.

FINDINGS AND RECOMMENDATIONS

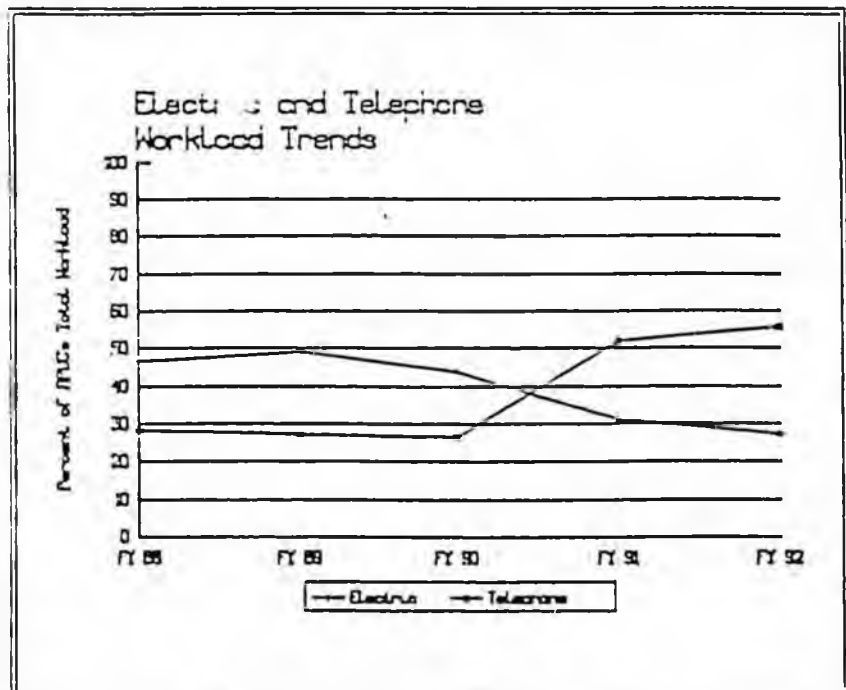
Recommendation No. 1

Alaska Statute 42.05.253 should be amended to require APUC to periodically adjust the regulatory cost charge (RCC) on an industry by industry basis. Further, the automatic repeal date of this statute should be deleted.

In our 1989 sunset audit report we recommended a program receipts budget for APUC, not because it was an alternative funding source but because of the potential benefits that this mechanism could provide. A user fee design can establish a basic fairness in that only those who benefit from the regulatory process bear its cost; it can also encourage consumers to recognize and eliminate unwarranted regulation through deregulation elections. However, these benefits will only be realized to the extent that the RCC program reasonably links the cost-causers with the cost-payers.

For FY 93, the legislature authorized a new RCC program, which passes APUC's costs on to the consumers of regulated utilities. This program allocates costs based upon gross revenues. A single charge factor is used across-the-board for all utilities and all industries. Although we believe that a direct workload-based allocation program is preferable, as outlined in our 1989 report, we also continue to believe that a gross revenue based system could realize these benefits if the rates reflect the workload. However, the single RCC factor used in the current plan sacrifices some of program's potential benefit, in that the cost-payers are not necessarily the cost-causers.

We analyzed APUC's workload to evaluate the alignment of cost-causer to cost-payer. In the absence of verifiable data such as utility or industry codings on payroll time sheets, we were forced to approximate the workload by using rough estimates, which were provided on an unofficial basis by commission staff. They provided estimates of the average relative effort required to perform the ongoing APUC functions such as tariff filings, formal proceedings, certification proceedings, and formal and informal complaints. While we acknowledge that the weighting in these analyses is imperfect, we believe it provides an adequate indication of the



commission's workload. We found that the electric and telephone industries, on a combined basis, have represented approximately 79 percent of APUC's workload. The graph of the two industries illustrates the significance, variation, and trend that complicates setting of RCC rate. The following table compares the commission's estimated FY 93 RCC receipt with the amount calculated based upon the workload over the past three years.

Industry	Flat Rate Allocation			Workload Allocation		Over (Under) Allocation
	Estimated Gross Revenues	RCC Percent	Estimated FY 93 RCC	Percent of Workload	Allocation	
Electric	\$260,673,485	.577%	\$1,504,086	34%	\$1,311,670	\$192,416
Telephone	153,306,332	.577%	884,577	45%	1,736,033	(851,456)
Pipeline	99,532,100	.577%	574,300	4%	154,314	419,986
Gas	99,152,056	.577%	572,107	3%	115,736	456,371
Water	22,955,320	.577%	132,452	4%	154,314	(21,862)
Sewer	17,129,576	.577%	98,838	2%	77,157	21,681
Refuse	15,856,758	.577%	91,493	4%	154,314	(62,821)
Cable	0	.577%	0	3%	115,736	(115,736)
Other	0	.577%	0	1%	38,579	(38,579)
Total	\$668,605,627		\$3,857,853	100%	\$3,857,853	\$ 0

This table demonstrates that, based upon the workload over the past three years, the flat across-the-board rate significantly undercharges telephone and overcharges electric, pipeline and gas utilities. Of course, the over or under allocation amount by industry varies depending on how many years of workload are considered. The use of an across-the-board rate incorrectly assumes that an industry's gross revenues are closely correlated to the workload that it creates. Given the significance of the electric and telephone workload, variation, and trend, we do not believe that the allocation methodology should assume that all workload cycles reverse themselves and that all industries create the same amount of workload in the long run. Therefore, we recommend that the legislature amend AS 42.05.253 to require APUC to periodically adjust the RCC factors to reflect workload on an industry by industry basis.

Notwithstanding the above, we support the current RCC program; we believe that it provides a measure of equity and responsiveness to unwarranted regulation that was lacking prior to the program. Our recommendation is intended to further the equity and regulatory responsiveness objective of this program.

The RCC program was established as a trial program utilizing an automatic repeal of December 31, 1994. As we consider this program to be effective, we recommend that this repeal provision be deleted.

Recommendation No. 2

Alaska Statute 42.05.711 should be amended to make it easier for utility consumers to opt in or opt out of economic regulation.

In the 1989 sunset audit report, we recommended the deregulation of several industries as well as the smaller utilities in each industry. We continue to believe that not all industries need to be regulated and that the cost of regulation may exceed its benefits, particularly for the smaller utilities. With the recent adoption of a user fee approach under the RCC program, the impetus exists to make state government more responsive; what is lacking is a reasonable mechanism to allow consumers to select whether or not they want their utility to be regulated.

Alaska Statute 42.05.711 exempts electric and telephone utilities with revenues less than \$50,000 and refuse utilities with revenues under \$200,000. However, customers can obtain economic regulation by petitioning APUC. Alaska Statute 42.05.711 presently requires 25% of an exempted utility's subscribers to sign the petition. We believe that this is too great an obstacle to overcome and recommend that an election be called if APUC receives a petition demonstrating significant consumer interest. We recommend that the petition and election requirements be modeled after the deregulation election procedures in AS 42.05.712. These procedures call for an election if the petition is signed by 10% of the first 5,000 subscribers and 3% of the subscribers in excess of 5,000. These elections may only be held once every two years for a given utility.

Alaska Statute 42.05.711 also allows deregulation elections to be held for electric and telephone utilities with revenues of less than \$325,000 and other utilities with revenues under \$100,000. We believe that more consumers should be given the option to deregulate by substantially raising the cut-off amount.

In combination, these two changes would allow APUC and the user fee approach of the new RCC program to be more responsive to the regulatory needs of the utility consumer. The regulatory cost/benefit decision should be made by the consumer.

Recommendation No. 3

APUC should establish a timekeeping system.

We initially recommended, in 1979, that the commission implement the time system they had purchased. As part of a 1978 management audit of APUC, Arthur Young & Co. developed a time management system to assist the commission in prioritizing, planning, scheduling, and

monitoring the workflow. In response to our recommendation, the commission concurred that a time management system is a useful administrative tool. They indicated that the time system would be implemented.

In our 1989 sunset audit report we recommended that APUC establish a timekeeping system as an integral part of a direct-allocation RCC program. As the legislature selected an RCC program that was not time based, APUC was not required to implement this recommendation. However, as costs to establish and operate a time system are minimal and the benefits are substantial, we continue to recommend it.

The costs of a timekeeping system are minimal.

- The commission should determine what management reports are needed. While we acknowledge that the 1978 time management system is likely outdated, we recommend that the commission review it to assist them in developing this needs definition.
- Purchase and install "canned" software. There is very inexpensive software on the market that should meet the commission's needs. APUC already has a programmer on staff that could handle the installation.
- The ongoing cost to record time would be insignificant. An employee would need only a few minutes a day to electronically enter their time.
- The time system would also require a small amount of computer and personnel time to accumulate the data and generate periodic management reports.

The benefits of a timekeeping system are substantial.

- A time system would give APUC management a greater ability to prioritize, plan, schedule, and monitor their workload. We believe this information would be invaluable to the commission.
- The legislature is often involved in regulatory matters. Using these management reports, APUC would be better able to estimate the full effect of any regulatory changes.
- There is a potential for increased staff efficiency as a result of time sheet accountability.
- Time sheets would provide a defensible basis for the RCC allocation discussed in Recommendation No. 1. However, regardless of the action taken on Recommendation No. 1, the benefits of implementing a timekeeping system far outweigh the costs.

The nature of the commission's business is very different from most state agencies; they deal with a relatively small number of companies and work on discrete projects. APUC's workload is similar to that in the Attorney General's Office and the Department of Transportation and Public Facilities' maintenance and construction divisions, all of which maintain project time systems.

Recommendation No. 4

APUC should consider how to best ensure commission member access to adequate staff support and advice.

The commission members are inundated with technical information and complex issues. These issues must be thoroughly explored and the commission's decisions must be fully documented. The legislature recognized this difficult task and appropriately established full-time commission members with six-year terms. Nevertheless, there remains a substantial need for staff support and professional advice.

We are concerned that in the instances when commission staff are named as a party in an adjudicatory proceeding, the commission members do not have full access to support staff, professional staff, or legal counsel. The judicial model requires adversarial parties to present the case. APUC staff is frequently designated as a party to a case to provide this necessary balance. The assistant attorney generals advise APUC staff and effectively become a party to the case. Under this judicial model, ex parte communication rules prevent the commission members from directly obtaining assistance or advice from their staff or attorneys; this can only be accomplished if the utility is also present. This may often be impractical.

We believe that the commission would benefit from greater access to their staff and attorneys. The commission should consider how to best ensure full access. We offer the following alternatives:

- A group could be assigned, on a rotational basis, to each case. These individuals would be the party to the case; all others would be available to the commission members.
- Several staff could be assigned, on a rotational basis, directly to the commission. The criteria for selection may vary. The team could include all the professional disciplines, it could target the disciplines currently needed, or it could be a team of executive assistants. The remaining staff would be the party of record.

Although the above approaches have certain drawbacks, we believe that some separation would be achieved thus diminishing the ex parte communication problem. We believe this will enhance the commission's overall efficiency and effectiveness.

Recommendation No. 5

The APUC member's terms of office should be staggered.

The Alaska Public Utilities Commission has five members who are appointed by the governor and confirmed by the legislature in joint session to serve six-year terms. On October 31, 1993 two commission seats become available. Because the potential for

disruption of commission activity would be high with two new members coming in at the same time, we recommend the terms be staggered.

Currently, the terms are scheduled to end as follows:

Consumer seat (1)	October 31, 1993
Engineering seat	October 31, 1993
Legal seat	October 31, 1994
Consumer seat (2)	October 31, 1996
Finance seat	October 31, 1998

We propose this staggering be implemented by modifying the upcoming term of the engineering seat. We propose the following language be added to a temporary or special act:

The term of the Alaska Public Utilities Commission Engineering seat, which is scheduled to begin on November 1, 1993, shall end on October 31, 1995. This adjustment to the normal six-year term, as established under AS 42.05.030(a), is necessary to appropriately stagger commission membership.

WALTER J. HICKEL, GOVERNOR

ALASKA PUBLIC UTILITIES COMMISSION
DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT

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March 1, 1993

Mr. Randy S. Welker, CPA
Legislative Auditor
Legislative Budget and Audit Committee
P.O. Box 113300
Juneau, Alaska 99811-3300

RECEIVED
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LEGISLATIVE AUDIT

Ref: Audit Control No. 08-1404-93

Dear Mr. Welker:

On behalf of the Alaska Public Utilities Commission (Commission), I appreciate the opportunity to respond to your agency's audit of the Alaska Public Utilities Commission (08-1404-93). The Commission concurs with your finding in the "Report Conclusions" that the life of the Commission be extended until June 30, 2003. Therefore, this letter will focus on the Commission's response to your "Findings and Recommendations".

The audit states on page 1 "APUC was created to regulate public utilities so that citizens could enjoy adequate service at the lowest reasonable rates" (emphasis added). The actual ratemaking standard applied by the statute is "just and reasonable".

Recommendation No. 1 Alaska Statute 42.05.253 should be amended to require APUC to periodically adjust the regulatory cost charge (RCC) on an industry by industry basis. Further, the automatic repeal date of this statute should be deleted.¹

The Commission agrees that the program should be made permanent by deleting the automatic repeal date for the Regulatory Cost Charge Program (RCC). Last year the legislature switched the funding source for the Commission from general funds to this regulatory assessment. The Commission expended significant resources in developing regulations and procedures to make the program work and to make compliance by affected entities as straightforward as possible. The program is in place and running smoothly.

However, the Commission cannot support the recommendation to require itemization of the rates under the RCC program by utility/pipeline carrier type. Although in theory the recommendation has some merit, it is not at all clear to the Commission that it would be either practical or cost-effective to attempt to implement it at this time.

¹ To carry out this recommendation fully, the repeal date for AS 42.06.285 (pipeline carrier regulatory cost charge) should also be deleted.

Letter to Mr. Randy Welker, CPA
Page 2 of 3
March 1, 1993

Individual RCC rates would require full and direct allocation of the Commission's costs. The recommendation, if implemented as drafted, would substantially increase the cost of the RCC program. Full cost allocation would be expensive, especially during the year when it was implemented. A permanent increment to the Commission's budget would be required. The Commission would face a new administrative burden of setting individual RCC rates and handling protests to the rates.

One of the key principles guiding the development of the RCC was simplicity. The Commission has been able to absorb the ongoing costs of the RCC program from its existing budget, because the program has been kept simple and workable. Your recommendation for further refinement of the RCC would require the statutory cap of .61% of adjusted gross revenues (AS 42.05.253(a)) to be substantially increased. Based on your estimates by utility type for purposes of discussion, the current authorized budget for the Commission would require increasing the cap to .85% for certain utility groups, at a minimum.

From the perspective of most utility customers facing a regulatory cost charge bill of less than \$20 per year, different rates for different utility types would not have a measurable effect on their total bill.

Recommendation No. 2 Alaska Statute 42.05.711 should be amended to make it easier for utility consumers to opt in or out of regulation.

The Commission agrees in part. Since the legislature reached a policy conclusion that small utilities ought to be provided the statutory option to deregulate by majority vote, it seems appropriate to periodically adjust the gross revenue cutoff levels to maintain this as a realistic option. These gross revenue cutoff levels have not been adjusted since they were enacted in 1980.

Increasing the cut-off from \$325,000 to \$500,000, for example, would allow the members of nine additional economically regulated electric utilities to decide whether to vote for deregulation. They are Bettles, Far North, Gustavus, Manley, Middle Kuskokwim, Napakiak, Northway, PUI and Teller. Middle Kuskokwim is already eligible to vote for deregulation as a cooperative under AS 42.05.711(h). Attachment #1 lists electric and telephone utility gross revenues.

The cut-off for local exchange telephone companies would have to be increased from \$325,000 to approximately \$850,000 in order for any other utility to qualify for the option of voting to deregulate.

The Commission does support increases in the cutoff levels if there

Letter to Mr. Randy Welker, CPA
Page 3 of 3
March 1, 1993

is some compelling evidence that the benefits of regulation are not commensurate with the cost. Although the enactment of the RCC has quantified the cost side, the benefits, although tangible, are still difficult to quantify.

Recommendation No. 2 APUC should establish a timekeeping system.

The Commission agrees that this recommendation is worthwhile to pursue. If accomplished for internal management purposes, the system could be designed relatively economically. However, if the system is required to serve as the basis for billings, such as those recommended in Recommendation #1, it would be substantially more costly. In either case a fiscal note would be required to carry out this recommendation.

Recommendation No. 4 APUC should consider how to best ensure commission member access to adequate staff support and advice.

The Commission agrees.

Commission staff become a party to a proceeding only when designated to be so by Commission order. This decision is typically made by the Commissioners in adjudicatory session soon after a docket is established.

The Commission is familiar with the alternate models for deployment of the staff resources outlined in your report and will continue to entertain possibilities for improvement.

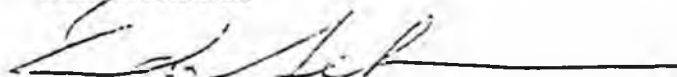
The Commission believes that a simplified method of obtaining counsel to support the Commission under contract is needed for cases where the attorney general represents staff as a party. Extended procurement procedures and the approval of the attorney general to selected the legal contractor both complicate this process.

Recommendation No. 5 The APUC member's terms of office should be staggered.

The Commission agrees. Legislation would be required to accomplish this change.

Thank you for the opportunity to respond.

Sincerely,
Don Schröer



Chairman

FISCAL NOTE

House Fiscal Note
 No. 3 *HB 99*
 Bill Version: HB 99 *Cross-ref*
 (H) Publish Date: 2/1/95

STATE OF ALASKA
 '995 LEGISLATIVE SESSION

Revision Date: _____
 Title: "An Act extending the Alaska Public Utilities Commission and relating to regulatory cost charges."
 Sponsor: House Labor and Commerce
 Requestor: _____

Department Affected: Commerce and Economic Development
 BRU: Alaska Public Utilities Commission
 Component: _____

COMPONENT SERIAL NO. 364

Expenditures/Revenues: (Thousands of Dollars)

OPERATING EXPENDITURES	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01
PERSONAL SERVICES	2,616.9	2,770.3	2,947.0	3,135.0	3,335.0	3,547.8
TRAVEL	53.6	56.7	60.4	64.2	68.3	72.7
CONTRACTUAL	947.8	1,003.3	1,067.4	1,135.5	1,207.9	1,285.0
SUPPLIES	60.7	64.3	68.4	72.7	77.4	82.3
EQUIPMENT	50.0	52.9	56.3	59.9	63.7	67.8
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	3,729.0¹	3,947.5¹	4,199.4¹	4,467.3¹	4,752.3¹	5,055.5¹

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

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

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts	3,729.0	3,947.5	4,199.4	4,467.3	4,752.3	5,055.5
1006 GF/MHTIA						
Other						
TOTAL	3,729.0²	3,947.5²	4,199.4²	4,467.3²	4,752.3²	5,055.5²

Estimate of current year (FY 95) cost: \$ _____

POSITIONS

FULL-TIME	42	43	43	44	45	46
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary.)

¹ Represents ongoing costs of operations as proposed in FY 96 operating budget.

² Represents revenues from the regulatory cost charge mandated by Sections 1 and 3 of HB 99.

This bill extends the life of the APUC until June 30, 1999, and mandates the collection of fees from regulated utilities and pipeline carriers to cover its full authorized budget. Early passage is essential to keep public utilities and pipeline regulation on track. Otherwise, the APUC will shut down June 30, 1995.

Prepared by: Robert A. Lohr, Executive Director
 Division: Alaska Public Utilities Commission
 Approved by Commissioner: William L. Hensley
 Agency: Commerce and Economic Development

Phone: 276-6222
 Date: 1/25/95
 Date: 1/26/95

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SENATE COMMITTEE REPORT

First Committee of Reference

gmr

DATE: 1/25/95

FURTHER: Finance

Date of 5-Day Notice: 1/26/95
(in accordance with Uniform Rule 23)

DATE TURNED INTO OFFICE: 2/2/95

Labor and Commerce Committee considered SB 47

Relating to the Alaska Public Utilities Commission; etc.

*1 FN
+ 1/2 FN*

and recommends:

- be replaced with _____ CS _____
- adopt previous _____ CS _____
- attached amendment(s)
- adopt Letter of Intent by _____ Committee
- further referral to the _____ Committee

Senate Bill:
 same title
 new title
 House Bill:
 technical change
 new: SCR# _____

SIGNING WITH RECOMMENDATIONS:	DP	DNP	NR	AM
<i>Mike Miller</i>	✓			
<i>John Torgerson</i>	✓			
<i>Judith E. Salo</i> * (2)			✓	
CHAIR: <i>Tim Kelly</i>	✓			

NEW FISCAL NOTE(S):

Department	Date	Zero	Fiscal
DOA	<i>1/30/95</i>	✓	
DCED	<i>1/27/95</i>		✓

PREVIOUS FISCAL NOTE(S):*

Department	Date	Zero	Fiscal

APPROPRIATION -- no fiscal note

*include fiscal notes accompanying Governor's bill

SB

51

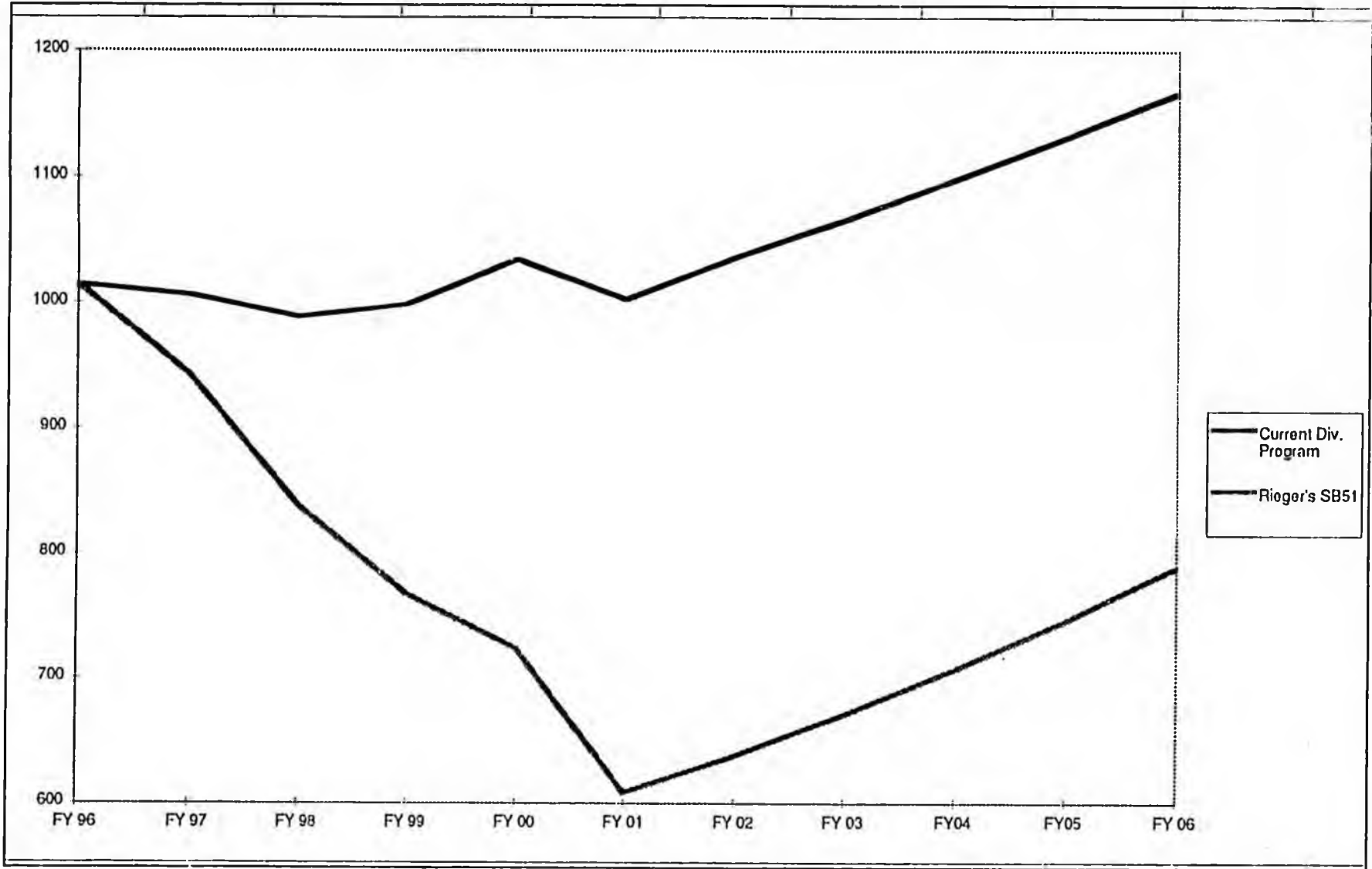
SFIN

FILE

5FC-96

5FC-96
3/29/96
R.H.
Cully

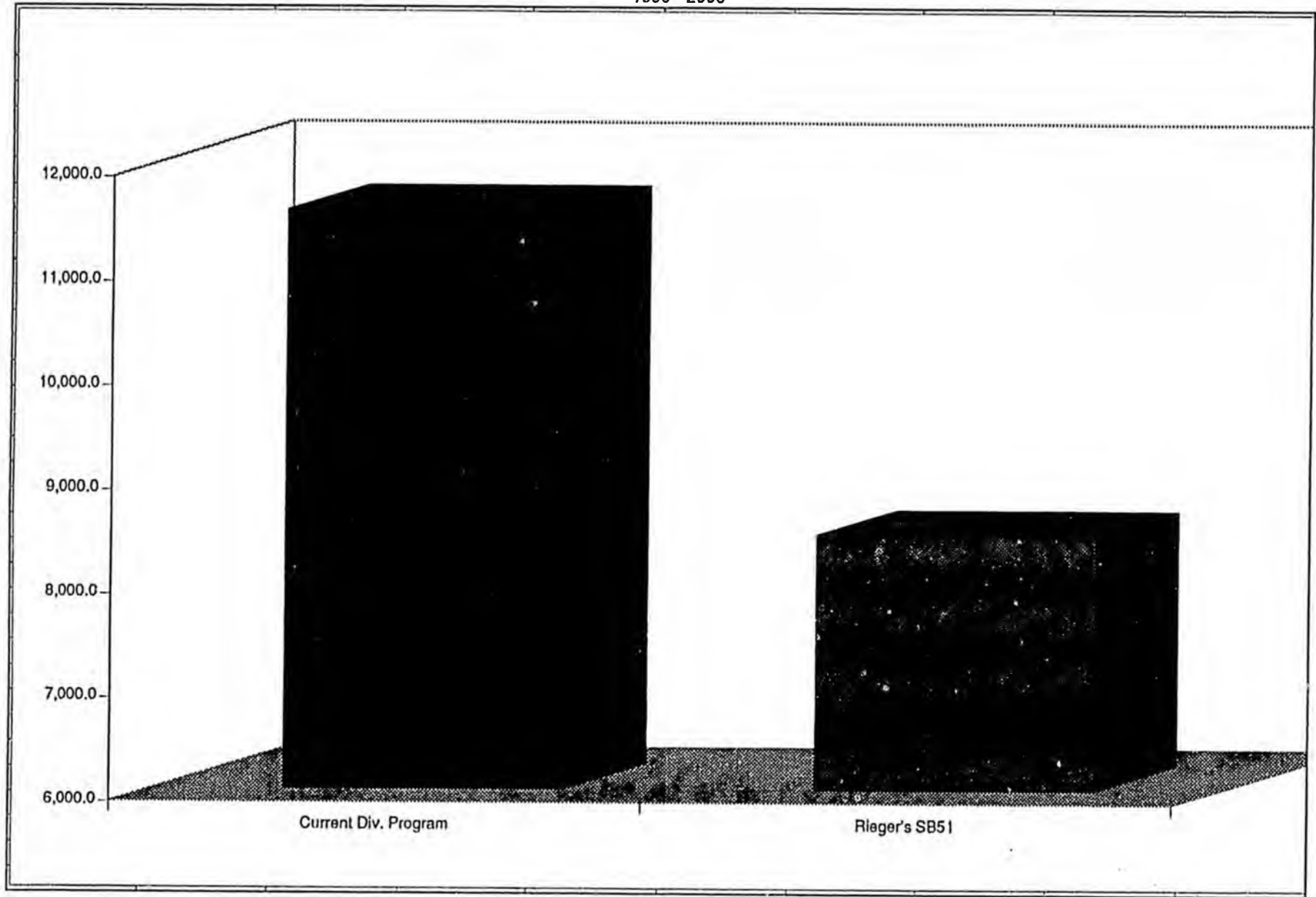
Real 1996 Dollars



Attachment A

Total Permanent
Fund Dividends
1996 - 2006

JFC-96
3/29/96
RH
(14114)





Post-it® Fax Note 7671 Date 3/28 # of pages 1

To *Bettis* From *J. Kelly*

Co/Dept *Mr. Reisinger* Co *HR*

Phone # _____ Phone # *465-2059*

Fax # *465-2069* Fax # *465-1473*

3/29/96
SR

Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS
(in millions)

as of December 31, 1995

GROWTH OF FUND PRINCIPAL						
FY	FY Begin Balance	Appro- priations	Dedicated State Revenue ⁽¹⁾	Inflation- Proofing	FY End Balance	Inflation- Proofing Shortfall
78						
to						
85	4,838	2,700	2,424	817	5,741	
86	5,741		323	216	6,281	
87	6,281	1,264 ⁽²⁾	170	148	7,864	
88	7,864		418	303	8,585	
89	8,585		228	380	9,173	
90	9,173		267	454	9,894	
91	9,894		435	559	10,888	
92	10,888		338	477	11,703	
93	11,703	5 ⁽³⁾	315	362	12,385	
94	12,385	6	210	372	12,973	
95	12,973	8	318	348	13,645	
96	13,645	514 ⁽⁴⁾	218	398	14,775	
97	14,775	9	216	448	15,448	
98	15,448	13	217	499	16,176	
99	16,176	14	229	522	16,941	
0	18,941	16	231	547	17,733	
1	17,733	18	233	572	18,554	
2	18,554	17	239	598	19,409	
3	19,409	19	238	625	20,292	
4	20,292	21	237	653	21,203	
5	21,203	22	229	682	22,138	
6	22,136	24	218	712	23,090	
7	23,090	26	209	742	24,007	
8	24,067	28	203	773	25,072	
9	25,072	31	202	805	26,109	
10	26,109	33	198	838	27,178	
11	27,178	38	195	872	28,280	
12	28,280	39	191	907	29,417	
13	29,417	42	184	943	30,586	
14	30,586	46	178	980	31,790	
15	31,790	50	159	1,018	33,026	
Cumulative Totals Projected						
For FY 1996 - 2015: 4,233 14,132						

USE OF FUND INCOME							
Net Income	Distributions			Reserves			FY
	Inflation- Proofing	Dividends	Per Capita Dividends	General Fund	Add (Delete)	FY End Balance	
2,219	617	653	\$404.00	186	763	763	78
1,021	218	303	\$556.26		501	1,264	85
1,069	148	391	\$708.19		529	529	87
789	303	424	\$826.93		62	591	88
868	360	460	\$873.16	4	44	635	89
916	454	487	\$952.63	4	(30)	605	90
1,030	559	488	\$931.34	4	(24)	581	91
1,036	477	488	\$931.34	5	64	645	92
1,226	362	632	\$949.46	5	320	965	93
1,098	372	558	\$983.90	11	151	1,117	94
1,013	348	565	\$990.30	8	86	1,203	95
1,701	388	631	\$1,049.00		658	1,361	96
1,167	448	636	\$1,030.00		374	1,734	97
1,815	499	645	\$1,022.00		659	2,393	98
1,938	522	678	\$1,051.00		723	3,116	99
2,069	547	732	\$1,110.00		775	3,892	0
2,207	572	725	\$1,071.00		894	4,785	1
2,359	696	803	\$1,164.00		840	5,725	2
2,517	825	864	\$1,228.00		1,009	6,734	3
2,583	653	928	\$1,294.00		1,081	7,815	4
2,568	682	988	\$1,320.00		895	8,710	5
2,727	712	1,006	\$1,349.00		985	9,695	6
2,897	742	1,047	\$1,379.00		1,082	10,777	7
3,079	773	1,091	\$1,411.00		1,187	11,964	8
3,272	805	1,137	\$1,445.00		1,299	13,263	9
3,478	838	1,216	\$1,523.00		1,390	14,653	10
3,894	872	1,301	\$1,604.00		1,485	16,139	11
3,922	907	1,381	\$1,689.00		1,585	17,724	12
4,162	943	1,487	\$1,777.00		1,690	19,414	13
4,414	980	1,589	\$1,869.00		1,799	21,213	14
4,678	1,018	1,696	\$1,984.00		1,915	23,127	15
57,643	14,132	20,571	\$19,436				

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 98:	9.80%	2.77%	7.03%
FY 97: ⁽¹⁾	6.98%	2.99%	3.99%
FY 98 - 2015: ⁽¹⁾	8.42%	3.18%	5.24%

⁽¹⁾ Department of Revenue Fall 1995 Mid-Case Revenue Forecast.

⁽²⁾ Earnings reserve appropriated to principal July 1, 1987 and 1995

⁽³⁾ Transferred to principal from earnings reserve account per AS 37.13.145(d).

⁽⁴⁾ Based on 1995 Callan capital market assumptions.

SENATE BILL NO. 51, ALL SURPLUS EARNINGS IN ERA, AND \$280 OF EXISTING UNREALIZED GAINS REALIZED EACH YEAR FROM 1997-2004

SENATE FINANCE COMMITTEE

SB 51 DISPOSITION OF PERMANENT FUND INCOME

PLEASE SIGN IN BELOW

NAME: Jim Kelly
Co./DEPT./TITLE: Dir of Communications PHONE: _____
ADDRESS: ABFC ZIP: _____
Do you wish to testify? Yes No Respond to questions

NAME: _____
Co./DEPT./TITLE: _____ PHONE: _____
ADDRESS: _____ ZIP: _____
Do you wish to testify? Yes No Respond to questions

NAME: _____
Co./DEPT./TITLE: _____ PHONE: _____
ADDRESS: _____ ZIP: _____
Do you wish to testify? Yes No Respond to questions

NAME: _____
Co./DEPT./TITLE: _____ PHONE: _____
ADDRESS: _____ ZIP: _____
Do you wish to testify? Yes No Respond to questions

Revision Date: _____ Dept. Affected: Revenue
 Title: An Act Relating to Income of the Permanent BRU: APFC
Fund and Providing for an Effective Date. Component: APFC
 Sponsor: Senator Rieger/Pearce
 Requestor: Senate Finance COMPONENT SERIAL NO. 109

Expenditures/Revenues:

(Thousands of Dollars)

OPERATING EXPENDITURES	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
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						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY96) cost \$ _____

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

No fiscal impact.

Prepared by: Byron I. Mallott, Executive Director
 Division: Alaska Permanent Fund Corporation
 Approved by Commissioner: [Signature]
 Agency: Department of Revenue

Phone: 465-2047
 Date: 3/26/96
 Date: _____

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2/14/95 #1
 (S) STA, FIN

FISCAL NOTE

STATE OF ALASKA
 1995 LEGISLATIVE SESSION

BILL NO. SB 51

Revision Date: _____ Dept. Affected: Revenue
 Title: An Act Relating to Income of the Permanent Fund and Providing for an Effective Date BRU: APFC
 Component: APFC
 Sponsor: Senator Rieger/Pearce
 Requester: (S)STA COMPONENT SERIAL NO. 109

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01
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						
1006 GF/MHTIA						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY95) cost: \$ _____

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

No fiscal impact.

Prepared by: Martin R. Pihl, Acting Executive Director Phone: 465-2047
 Division: Alaska Permanent Fund Corporation Date: 2/13/95
 Approved by: _____
 Commissioner: Deborah Vogt Date: 2/13/95
 Agency: Revenue

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SB 51

FISCAL NOTE

No. 1

Bill Version: SB 51

STATE OF ALASKA
1995 LEGISLATIVE SESSION

BILL (S) Publish Date: 3/3/95

Revision Date: _____ Dept. Affected: _____ Revenue _____
 Title: An Act Relating to Income of the Permanent Fund and Providing for an Effective Date BRU: APFC
 Component: APFC
 Sponsor: Senator Rieder/Pearce
 Requester: (S)STA COMPONENT SERIAL NO. 109

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01
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						
1006 GF/MHTIA						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY95) cost: \$ _____

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

No fiscal impact.

Prepared by: Martin R. Pihl, Acting Executive Director Phone: 465-2047
 Division: Alaska Permanent Fund Corporation Date: 2/13/95
 Approved by: _____
 Commissioner: Deborah Voigt Date: 2/13/95
 Agency: Revenue

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Alaska State Senate

SENATOR STEVE RIEGER
District I

Senate Finance Committee
Chair, Senate Transportation Committee

Legislative Budget and Audit Committee
Administrative Regulation Review Committee
Legislative Council



During Session:
State Capitol, Room 516
Juneau, Alaska 99801
(907) 463-3879

716 West 4th Avenue, Suite 530
Anchorage, Alaska 99501
(907) 258-8185

Information on SB 51 – Relating to income of the permanent fund

- **Sponsor Statement** by Senator Steve Rieger
- **Editorial** – "Real Dollars Now Means Real Dividends Later" by Tim Bradner, *Anchorage Daily News*, January 8, 1995
- **Trustee's Position on SB 51** – Alaska Permanent Fund Corporation
- **Alaska Population Projections**, March 1992
- **Report by Ibbotson Associates, Inc.** – Asset Allocation Study for the Alaska Permanent Fund
- **Executive Summary** – Knowles/Ulmer Policy Transition Teams' Report, January 1995

Alaska State Senate

SENATOR STEVE RIEGER
District 1

Senate Finance Committee
Chair, Senate Transportation Committee

Legislative Budget and Audit Committee
Administrative Regulation Review Committee
Legislative Council

During Session:
State Capitol, Room 516
Juneau, Alaska 99801
(907) 465-3879

716 West 4th Avenue, Suite 530
Anchorage, Alaska 99501
(907) 258-8188

Sponsor Statement

SB 51 – An Act relating to the income of the Permanent Fund

Senate Bill 51 places into statute the concept of "real earnings" and applies that concept to the provisions for the uses of Permanent Fund earnings.

Concept of Real Earnings

There are several ways in which income of a fund can be calculated. When all cash receipts are counted without regard to the effects of inflation, the earnings are often referred to as "*nominal earnings*." In contrast, "*real earnings*" are the amount by which nominal earnings exceed inflation.

For any long-term preservation of a fund, and particularly in times of any significant inflation, the concept of real earnings is extremely important to the management of an endowment fund. Any endowment which is designed to last for a sustained period of time must be concerned about its purchasing power and earning power. Inflation tends to erode a fund; to offset this a fund must grow (in nominal terms) at the same rate as inflation just to preserve its purchasing or earning power. In this context, a fund can afford only to pay out earnings which are in excess of the rate of inflation – real earnings.

Appropriateness for the Permanent Fund

I believe that voters, in establishing the Permanent Fund, intended for the Fund to be truly permanent in the sense that its purchasing power and earning power should not be eroded over time. In this context, a real earnings approach is most appropriate for the Permanent Fund. The only money which should be put on the table for use each year is real earnings.

SB 51 - An Act relating to the income of the Permanent Fund
Sponsor Statement
Page Two

In contrast, under present statutes all of the *nominal* earnings are put on the table for appropriation each year. The Legislature then allocates the earnings to dividends, inflation-proofing, and the earnings reserve account. With SB 51, the inflation-proofing would be automatic and the Legislature would provide for the allocation of real earnings between the dividends and the earnings reserve account.

Effect on Permanent Fund Earnings Reserve

Since there would be no further need to reserve earnings for inflation-proofing, the required size of the Permanent Fund Earnings Reserve (PFER) is not as great. There would, however, be a reason to retain some amount in the PFER to cover 5-year averaging provisions, such as the rule on dividends, regardless of whether the real earnings concept is used. SB 51 is silent on the issue of the PFER and does not require any change from present PFER policy.

Effect on Dividends

The bill leaves untouched the underlying formula for calculation of dividends. This formula prescribes a payment of approximately half of earnings. However, since the earnings on which dividends are based are real earnings rather than nominal earnings, the underlying formula will indicate a slower rate of long-term growth in dividends, and could indicate a temporary drop in the amount transferred to the dividend fund, depending on the Permanent Fund's actual performance in the next few years.

It should be pointed out that the amount actually transferred to pay dividends each year has been made by legislative appropriation. Even with SB 51, the legislature maintains its ability to appropriate an amount different from that prescribed by the underlying formula. The legislature may choose to pay an amount higher than the formula indicates, but SB 51 is designed to deter appropriations greater than the fund's *total* real earnings performance.

Other Changes

One additional change, although minor, is that the effect of inflation on the fund will be calculated using the average annual balance of the Fund, rather than the Permanent Fund's present practice of using the balance as of the end of the year.

Summary

The overall effect of SB 51 will be that the Permanent Fund will be made more **permanent**, because the question of inflation-proofing will be removed from the annual process of allocating earnings. Earnings will be more realistic, as they are reflective of the actual economic earnings of the Fund. However, the effect of converting to a real earnings basis for the annual allocation process will also lower the amount put on the table for appropriation each year. The result of passing SB 51 will be better protection for the Fund, and a better representation to the State of the maximum amount which properly could be used each year.



TIM BRADNER

Real dollars now means real dividends later

One of the most sensible public policy proposals I've heard recently is state Sen. Steve Rieger's idea for requiring the Alaska Permanent Fund to report its annual profits in real, or inflation-adjusted, dollars, rather than the nominal, or inflation-eroded dollars, as is now the practice.

The idea has merit not only because it is sound from a financial point of view — most big endowment funds look at their earnings this way — but it solves some problems in the way the fund must manage its income.

In effect, Rieger's plan would change the procedure the legislature set up more than a decade ago when it passed the law setting out how fund profits are to be used in paying the annual permanent fund dividend to Alaskans and making payments into the corpus of the fund to offset inflation.

The direction legislators gave was for the fund to pay dividends first and inflation-proofing second. Over time, this could cause a shortfall in the amount of profits available for inflation-proofing.

BRADNER: Accounting in real dollars makes sense

Continued from Page C-1

Under the current formulas, which pay dividends first, there may not be enough to pay both dividends and inflation-proofing. Latest estimates by the Permanent Fund Corp. are that the shortfall will start about 2000, and eventually will reach hundreds of millions of dollars yearly.

Either inflation proofing will be shorted by this amount, or money to inflation proof will have to be taken from the permanent fund earnings reserve, the account of accumulated profits not used for dividends or inflation proofing. That reserve now totals about \$1.2 billion. In the meantime the state may want these reserves for public services. The legislature may, in fact, take them.

Allowing inflation to erode the fund to sustain

the growth of the dividend is shortsighted. If we solve the problem now we could not only sustain dividends for our children and grandchildren, but also help pay for public services and keep their taxes low.

In effect, Rieger's plan would reverse the priority of paying dividends first and for inflation second. By reporting the fund's profits in real, inflation-adjusted dollars, the "inflation-proofing" automatically occurs first. The dividend will be paid on the basis of inflation-adjusted earnings. Rieger argues this is the way to really protect the permanent fund for future generations and I agree with him.

A second attraction the Anchorage Republican's idea has is that it would make room, after a few years, for the permanent fund to make a substantial amount of money available

for the general state treasury, helping narrow the fiscal gap.

This happens because when the fund manages itself on real instead of nominal dollars, there not only will be enough money for dividends but some left over for the general treasury to help keep taxes low when oil revenue declines. This won't eliminate the need for budget cuts, but it make cuts more manageable without major tax increases.

Obviously this extra money has to come from somewhere. It comes, in fact, from dividends that might not grow as fast as they will under the current formula. Dividends could even dip for a short time before starting to grow again. The legislature could choose to avoid this dip by using some money from the earnings reserve to support the dividend.

What I really like about

this is that it's a far better way to put the dividend on a more rational base, and to have the permanent fund make more of a contribution toward covering the fiscal gap, than other proposals on the table like capping the dividend at present levels or even rolling it back.

Rieger's plan will be more easily accepted by the public. The amount of money for dividends still grows, although more slowly. More important, the fund is effectively protected against inflation, which means those dividends really will be there, as the politicians like to say, for future generations.

|| Tim Bradner writes for an Alaska economic reporting service. His private clients include petroleum companies. His opinion column appears every fourth Sunday.

Anchorage Daily News 1/8/95



RECEIVED FEB 28 1995

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

MEMORANDUM

DATE: February 27, 1995

TO: Senator Steve Rieger

FROM: Byron I. Mallott *Byron I. Mallott*
Executive Director

SUBJECT: Trustees' Position on SB 51

This is to inform you that the Board of Trustees did discuss Senate Bill No. 51 at their meeting on February 24. They stated that they did not intend to take a position on the bill itself, but that they were supportive of any changes to existing law which would enhance their ability to protect the principal of the Permanent Fund. Certainly, that portion of SB 51 which makes inflation-proofing the highest priority use would be such a change.

There is another portion of the bill which would change the dividend formula by basing it on "real" income rather than "net" income. That proposal falls outside the scope of what previous boards -- as well as the current board -- view as their area of responsibility.

I would request that the Board be given the opportunity to comment again at a later date if the bill undergoes any substantive changes as it moves through the legislative process.

As always, the staff of the Corporation would be pleased to respond to any requests for financial analysis of any legislative proposal relating to the Permanent Fund.

c: Board of Trustees
Pat Pourchot, Governor's Legislative Director
Jim Kelly, Research & Liaison Officer

ALASKA
POPULATION PROJECTIONS

1990 - 2010

State of Alaska

Walter J. Hickel, Governor

Department of Labor

Nancy Bear Usera, Commissioner

Administrative Services Division

David Teal, Director

**Research and Analysis
Chuck Caldwell, Chief**

Prepared by Demographics Unit

**Gregory Williams, State Demographer
Bob Elliott, Economist
Kristen Tromble, Statistical Technician**

Publications Unit

**J. Penelope Goforth, Editor
Jim Fowler, Graphic Artist
In Ruby, Typesetter**

**November 1991
Second Printing March 1992**

Table F.
Annual Projections and Components Of Change
For the Total Population of Alaska, 1990-2010.

Part A. Middle Series

Calendar Year	↓ July 1 Population	Population change July 1 to July 1						
		Net Change	Natural increase	Births	Deaths	Net Migration	In	Out
1990	553,600	—	—	—	—	—	—	—
1991	574,000	20,400	9,654	11,826	2,172	10,746	57,654	46,908
1992	593,100	19,100	10,017	12,283	2,266	9,083	57,720	48,637
1993	607,500	14,400	10,320	12,676	2,356	4,080	54,733	50,653
1994	622,300	14,800	10,506	12,942	2,436	4,294	56,174	51,880
1995	637,300	15,000	10,690	13,204	2,514	4,310	57,451	53,141
1996	652,500	15,200	10,849	13,437	2,588	4,351	58,769	54,418
1997	668,000	15,500	11,004	13,678	2,674	4,496	60,207	55,711
1998	683,900	15,900	11,194	13,949	2,755	4,706	61,737	57,031
1999	700,000	16,100	11,398	14,241	2,843	4,702	63,088	58,386
2000	716,500	16,500	11,608	14,545	2,937	4,892	64,650	59,758
2001	732,800	16,300	11,853	14,878	3,025	4,447	65,613	61,166
2002	749,000	16,200	12,092	15,217	3,125	4,108	66,664	62,556
2003	764,900	15,900	12,333	15,551	3,218	3,567	67,505	63,938
2004	780,700	15,800	12,572	15,878	3,306	3,228	68,522	65,294
2005	796,200	15,500	12,775	16,182	3,407	2,725	69,365	66,640
2006	811,400	15,200	12,968	16,477	3,509	2,232	70,193	67,961
2007	826,200	14,800	13,169	16,770	3,601	1,631	70,887	69,256
2008	840,700	14,500	13,331	17,034	3,703	1,169	71,685	70,516
2009	854,700	14,000	13,476	17,268	3,792	524	72,274	71,750
2010	868,300	13,600	13,593	17,474	3,881	7	72,947	72,940

Calendar Year	July 1 Population	Rate per 100 mid year population (%)						
		Average Annual Change	Natural Increase	Births	Deaths	Net Migration	In	Out
1990	553,600	—	—	—	—	—	—	—
1991	574,000	3.62	1.68	2.06	0.38	1.87	10.04	8.17
1992	593,100	3.27	1.69	2.07	0.38	1.53	9.73	8.20
1993	607,500	2.40	1.70	2.09	0.39	0.67	9.01	8.34
1994	622,300	2.41	1.69	2.08	0.39	0.69	9.03	8.34
1995	637,300	2.38	1.68	2.07	0.39	0.68	9.01	8.34
1996	652,500	2.36	1.66	2.06	0.40	0.67	9.01	8.34
1997	668,000	2.35	1.65	2.05	0.40	0.67	9.01	8.34
1998	683,900	2.35	1.64	2.04	0.40	0.69	9.03	8.34
1999	700,000	2.33	1.63	2.03	0.41	0.67	9.01	8.34
2000	716,500	2.33	1.62	2.03	0.41	0.68	9.02	8.34
2001	732,800	2.25	1.62	2.03	0.41	0.61	8.95	8.35
2002	749,000	2.19	1.61	2.03	0.42	0.55	8.90	8.35
2003	764,900	2.10	1.61	2.03	0.42	0.47	8.83	8.36
2004	780,700	2.04	1.61	2.03	0.42	0.41	8.78	8.36
2005	796,200	1.97	1.60	2.03	0.43	0.34	8.71	8.37
2006	811,400	1.89	1.60	2.03	0.43	0.28	8.65	8.38
2007	826,200	1.81	1.59	2.03	0.44	0.20	8.58	8.38
2008	840,700	1.74	1.59	2.03	0.44	0.14	8.53	8.39
2009	854,700	1.65	1.58	2.02	0.44	0.06	8.46	8.39
2010	868,300	1.58	1.57	2.01	0.45	0.00	8.40	8.40

Source: Alaska Department of Labor, Research & Analysis, Demographics Unit



Alaska Permanent Fund Corporation

P.O. Box 25500 Juneau, Alaska 99802-5500

(907) 465-2047

January 13, 1994

Senator Randy Phillips
Legislative Budget & Audit Committee, Chairman
State Capitol Building, Room 103
Juneau, AK 99801-1182

Dear Senator Phillips:

Thank you for providing us with Ibbotson's report on the asset allocation of the Alaska Permanent Fund Corporation (APFC). We are pleased to provide this initial response to the report. Communication on this issue will continue as the board commences its annual review of APFC's asset allocation at the February 3 meeting in Juneau.

Since April 1993, the APFC has been involved with a significant portfolio restructuring program under the direction of the Board of Trustees. Upon completion, the APFC will place significantly less emphasis on passive investment and more on active management of the equity securities portfolio. This program has been undertaken with our investment consultant, Callan Associates, Inc. (Callan), providing recommendations and advice at each step of the program. Once completed, a number of the issues mentioned in the Ibbotson Associates Asset Allocation study will have been addressed.

After reading the Ibbotson report, Callan made the following observations:

1. Recent performance has been good because the board and staff have done a good job of adopting sound strategic allocation policies and employing good managers.
2. Movement toward current strategic targets at an accelerated pace may be particularly important since much of the strong performance over the past several years is attributable to extraordinary bond returns which are unlikely to continue given the current low level of interest rates. Obviously, we all agree with this

assessment and you, through significant funding of global portfolios in recent months, have already essentially reached the strategic target allocations.

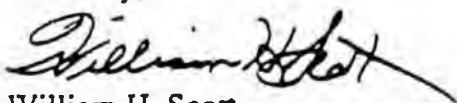
3. Diversification within the domestic equity portfolio could be improved with a greater commitment to the small and mid-cap sector. Callan shares this view and your staff recognizes the under-representation in this area and plans to address it through the hiring of two small/mid-cap domestic equity managers in the first half of 1994.
4. Diversification within the fixed-income portfolio could be improved with explicit allocations to major segments such as mortgages. As discussed at length at our recent meeting, the effects of statutory limitations on fixed-income management must be carefully considered. The use of derivative securities, lower-rated bonds and non-US\$ denominated bonds are all influenced by current (statutory) restrictions. In addition, managing liquidity to meet annual dividend requirements is increasingly affecting the fixed-income portfolio. Nonetheless, broader diversification of the fixed-income effort warrants further discussion and already has been scheduled for the upcoming board meeting. As an aside, I was pleased to see that Ibbotson recognized the fee savings and good performance that has been achieved to date. It also is important to note that at least over the past several years an allocation to mortgages would have hindered performance.
5. Ibbotson's expected equity returns are extraordinarily high relative to the firm's expected bond returns. While I sincerely hope that they are correct, the very large premiums and the high absolute levels may result in an underestimation of near-term risk associated with more aggressive strategies. Relatedly, we, staff and the board have all acknowledged that heavier equity commitment would result in greater expected returns over the long run but we all also recognize that shorter-term consistency in returns is particularly important to the Fund since the annual dividend is potentially at issue. Finally, it is important to note that the "aggressive" alternative suggested results in full utilization of the statutory equity maximum of 50%.
6. Ibbotson very clearly advises that the board control asset allocation at a more micro level than it has in the past. Specially, the study advises that the board set specific allocations within the fixed-income and domestic equity areas and make extensive use of specialists in the international area. The directions suggested are contrary to the board's movement toward providing less restrictive guidelines to its managers, particularly the global managers. I think that this is an important issue that already has been discussed at length during 1993 and warrants continued close monitoring

and review as we gain experience with the current structure. My current view is that the board's basic asset allocation plan, while theoretically vulnerable to the actions of the managers, will not be adversely affected. Each manager has indicated that it is highly unlikely that they would make sudden dramatic shifts from domestic to international portfolios. We, therefore, will be able to identify any potential problem before it undermines the program. You are continuing to use some specialists internationally and are planning to add specialists in domestic mid-cap securities. In sum, Ibbotson's management structure comments are important and I agree that the structure, particularly the domestic structure, should be on the board's agenda for 1994.


The staff of the APFC agree with Callan's remarks. Should the Legislative Budget & Audit Committee (LB&A) like to discuss in greater detail these conclusions, we recommend that myself and a representative of Callan Associates, Inc. be invited to appear before the Committee. The APFC would be pleased to make the necessary arrangements.

We would like to express our appreciation for LB&A's efforts and those of Ibbotson in conducting this review. It is always helpful to receive more than one independent view of this most important subject of asset allocation. In addition, we would be pleased to have Ibbotson present their report to the Board of Trustees at its meeting on February 3, 1994 at the APFC offices in Juneau.

Sincerely,



William H. Scott
Executive Director



ASSET ALLOCATION STUDY
FOR
THE ALASKA PERMANENT FUND

Prepared by Ibbotson Associates, Inc.
January, 1994



Summary of Recommendations

Currently, the Alaska Permanent Fund is a well diversified portfolio that has enjoyed tremendous success in recent years. This success is mainly due to the Board's knowledge of the importance of asset allocation and its commitment to diversification. This has resulted in the Fund earning high rates of return at relatively conservative levels of risk. The Fund is well positioned to reap the benefits of diversification, having made investments in many different asset classes, both domestic and international. Also, the Fund appears to be efficiently managed, employing reputable and capable managers for both its equity and fixed income assets. The Fund has been able to manage its substantial fixed income portfolio entirely in-house, keeping administrative costs and outside management fees to a minimum. Several important issues must be addressed, however, in order to ensure the Fund's continued success.

Our analysis suggests the Permanent Fund should alter its asset allocation policy in order for the Fund to enjoy returns similar to those it has earned in recent years. Specifically, the Board should consider the following actions:

- ▶ Revise its current three-year target asset mix to include a larger allocation to domestic mid and small capitalization equities, European, Pacific Rim and emerging market equities, and mortgage-backed securities.
- ▶ Adopt a more aggressive investment style by allocating a larger percentage of Fund assets to equity assets and real estate.
- ▶ Revise its equity management plan by setting specific allocations for international and domestic mid and small capitalization equity managers.
- ▶ Set specific target allocations across fixed income sectors.

By implementing these changes, the Board can help ensure that the Permanent Fund will achieve the highest expected return for its chosen risk level. This will help the Board achieve its statutory goals of maximizing total Fund return and providing the maximum amount of disposable income to Alaska's citizens.

This report presents recommendations concerning the Alaska Permanent Fund. The first section provides background information on the procedures we used to perform the asset allocation study. The second section suggests improvements for those portfolios, and outlines a third portfolio suited to a more aggressive investment philosophy. The final section provides guidance on several important implementation issues.

I. Analyzing an Investment Portfolio

A first step in analyzing an investment portfolio is determining whether the portfolio adequately compensates the investor for taking risk. Ideally, the portfolio is *efficient* in providing return to the investor; i.e., the portfolio provides the most return possible for the amount of risk taken. In reality, however, few portfolios accomplish this objective.

Defining Asset Classes

In order to analyze the Fund's portfolio, we had to decide which assets to include in the Fund's investment universe. Currently, the Fund invests in 12 different asset classes that comprise six main categories. The benchmarks used to represent each asset class in our analysis are listed in Appendix A at the end of this report. The asset classes used in our study are as follows:

U.S. Equity Assets

Large Capitalization
Mid/Small Capitalization

Non-U.S. Equity Assets

Canada
Europe
Pacific
Emerging Markets

Other Assets

Real Estate

Non-U.S. Fixed Income Assets

Intermediate-Term Government/Corporate Bonds
Long-Term Government/Corporate Bonds
Mortgage-Backed Securities

Non-U.S. Fixed Income Assets

Non-U.S. Government Bonds

Cash

U.S. Treasury Bills



Forecasting Return

We also had to forecast three estimates for each asset class: expected return, expected risk (as measured by standard deviation), and expected return correlation between assets. Summary tables of our forecasts are provided in Appendix B. It is important to note that our return, risk, and correlation forecasts are *long-term* -- they apply to an investment horizon of 10 years or more. Our forecasts are passive in nature and, therefore, would not change dramatically if we were to recalculate them a year from now. Consequently, the portfolio allocations we recommend will remain stable over a very long time period, and will require few changes over a long-term investment horizon.


The basis for our equity return forecasts is the risk-free rate of return and the historical premium, called an equity risk premium, that is demanded by investors for holding risky assets. We use the historical premium because the amount by which common stocks have outperformed risk-free government bonds has been consistent over time. The long-term equity risk premium for large capitalization domestic equities over the period January 1926 to September 1993 was 7.25 percent. Also, many researchers have found that, as the risk of an investment increases, so does its expected return. For this reason, we forecast the expected return of other equity asset classes, such as domestic small capitalization equities and international equities, to have greater expected returns.

The basis of our fixed income return forecasts is the current risk-free rate of return, as proxied by the current yield on a risk-free government bond with a maturity matching the investment time horizon. Currently, this rate is 6.31 percent, the current yield on 20-year U.S. Treasury bond. To this rate, we add the appropriate maturity premium (additional return required by investors for relinquishing the use of their money for long time periods) and default premium (additional return that compensates investors for buying bonds that have default risk, such as corporate bonds) for each class of bonds for which we are forecasting returns.

For international fixed income assets, we forecast returns as if the assets were denominated in U.S. dollars. Since currency fluctuations are expected to average to zero over time, any short-term currency gains or losses will not affect the long-term return on international assets. Currency fluctuations do increase risk, however, and are accounted for in our risk forecasts of non-U.S. fixed income assets.

Forecasting Risk

When forecasting the risk of an asset, we typically assume that the future will equal the past. Therefore, we forecast risk by calculating the historical standard deviation using a long time period over which we have reliable data, and data that is representative of possible future scenarios. Although investment risk can be quantified in a number of



ways for asset allocation purposes, we believe that risk is best modeled as the annual volatility of returns, and standard deviation provides an estimate of how much actual returns may deviate from the average, expected return over time. We use shorter time periods only when we can identify a permanent and dramatic process shift in the behavior of an asset class, such as the late 1960s when bond market volatility increased noticeably from its observed volatility during the previous 40 years.

Forecasting Return Correlation


Return and risk are not the only factors that determine how a portfolio performs. The correlation between the returns of two assets also plays an important role in portfolio performance. Correlation measures how much the returns of two assets tend to move together or move separately. If the returns move together, the assets are positively correlated. If they move in opposite directions, the assets are negatively correlated. If no pattern can be detected in the way the assets' returns move, the assets have a return correlation of zero.

Portfolios comprised only of assets that have high, positive correlations with each other are not well diversified. This tends to exaggerate both upside and downside volatility, and the risk of the portfolio. On the other hand, portfolios with assets that have low or negative return correlations will provide more stable returns because, even though some assets may perform poorly, other portfolio assets will perform better, serving to reduce portfolio volatility. The benefits of diversification, therefore, are a direct result of relatively low return correlations among portfolio assets.

When forecasting return correlation, we again typically assume that the future will equal the past. The basis for our forecast of return correlation is, therefore, the historical correlation between assets, observed over the longest time period for which reliable data is available.

Determining the Fund's Current Allocation

The amount of the Fund currently allocated to each asset class was determined by using information in the Fund's 1993 Annual Report, with supplemental information provided by William L. Means, the Fund's Chief Investment Officer. Market values of all investments came from the Annual Report, while Mr. Means provided clarification regarding the amount currently invested in equities of domestic companies with capitalizations larger than \$1 billion (large capitalization equities), the amount currently invested in equities of companies with capitalizations of \$1 billion or less (mid and small capitalization equities), and the amount currently invested in domestic government and corporate bonds with maturities ranging from one to seven years (intermediate-term),



and more than seven years (long-term). The Fund's current allocation, and its expected return and standard deviation is given on page 5.

Determining the Fund's Three-Year Target Allocation

The Permanent Fund's investment manual provided information regarding the three-year target allocation, although some guidelines were too broad for our purposes. For example, the manual lists a 10 percent target allocation for international equities, but gives no country-specific allocations. In this case, we assumed the Fund would increase its international equity exposure to 10 percent, while maintaining the current proportion invested among sectors. Also, the target allocation constrains the amount invested in non-domestic fixed income assets to 10 percent or less, but provides no specific number. We assumed the amount invested in international debt would decrease in proportion to the total decrease in the amount allocated to all fixed income assets. The Fund's three-year target allocation, and its expected return and risk, is listed on the following page.

Current and Three-Year Target Portfolios

Asset Class	Current Allocation (%)	3-Year Target Allocation (%)
U.S. Large Capitalization Stocks	21.17	24.00
U.S. Mid/Small Capitalization Stocks	0.65	6.00
Canadian Stocks	0.03	0.04
European Stocks	2.54	4.28
Pacific Region Stocks	2.94	4.97
Emerging Market Stocks	0.42	0.72
Real Estate	6.69	10.00
Cash	4.64	0.00
Intermediate Govt/Corp Bonds	30.86	25.32
Long-Term Govt/Corp Bonds	25.27	20.74
Mortgage-Backed Securities	3.94	3.24
Non-U.S. Government Bonds	0.85	0.69
Expected Return (%)	8.53	9.93
Standard Deviation (%)	7.57	9.91



II. Asset Allocation Recommendations

The next step in our analysis was to improve the Fund's current and target portfolios by increasing their expected return while keeping expected risk at a constant level.

Allocation with Risk of the Current Portfolio

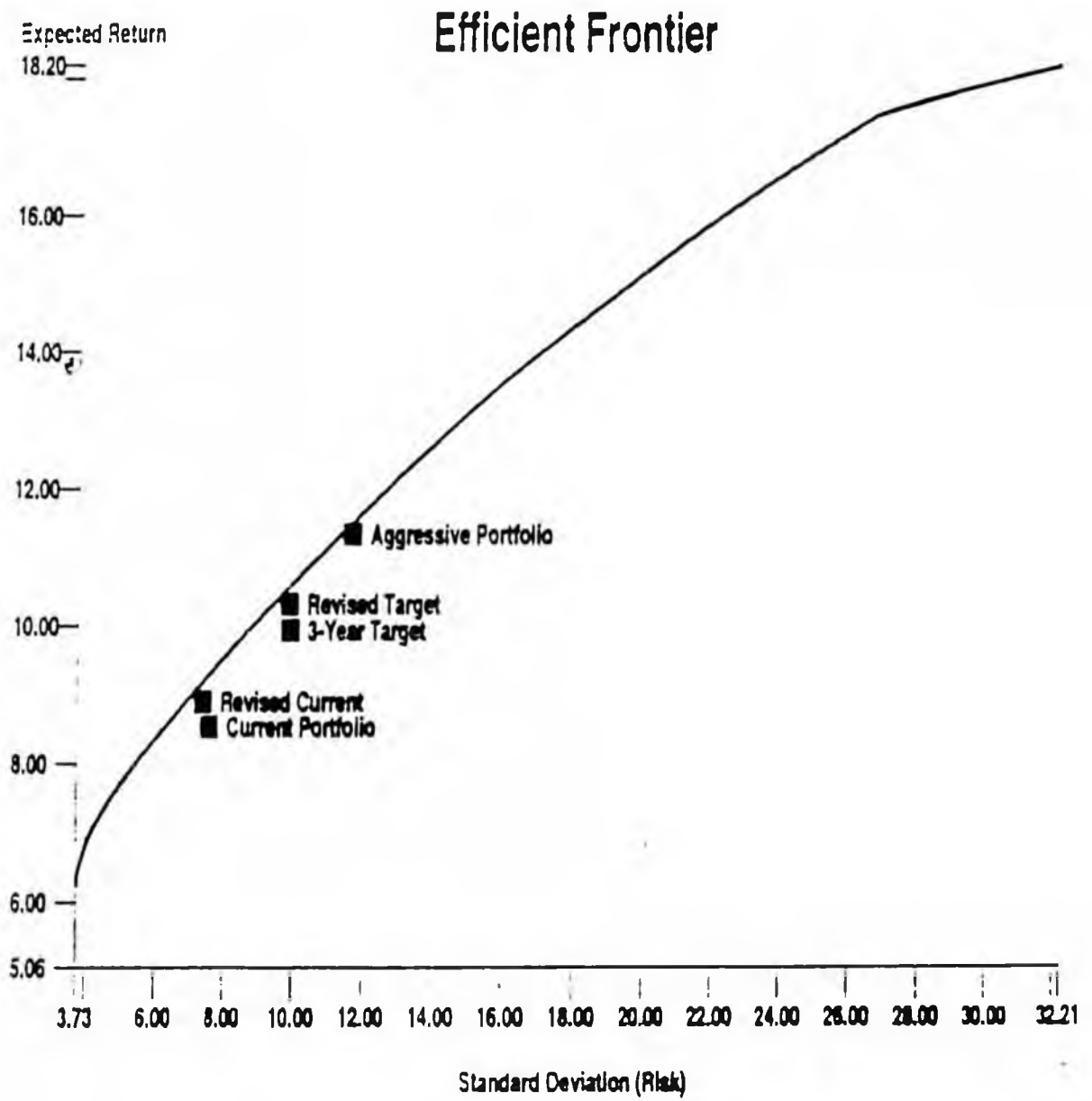
As shown in the graph on page 7, the Fund's current portfolio does not provide the maximum amount of expected return for the amount of risk taken. For example, the portfolio labeled "revised current" provides a higher expected return and slightly less risk than the current portfolio. (The graph is titled "Efficient Frontier" because the line in the graph represents those portfolios which are the most efficient in providing return to the investor; i.e., those portfolios provide the maximum return for a given level of risk.) The allocations for both the current and revised portfolios, as well as their expected returns and standard deviations, are shown on page 8.

The current portfolio need not be drastically changed in order to achieve a higher expected return. In fact, the percent of the portfolio invested in equities (approximately 35 percent, including real estate) and in fixed income assets (approximately 65 percent), is the same in both the current and revised portfolios. Rather, the composition of the equity and fixed income portions need only change. By shifting part of the equity portion from large capitalization stocks to mid and small capitalization and international stocks, and part of the fixed income portion from cash and long-term bonds to intermediate-term bonds and mortgage-backed securities, the Fund can achieve a higher expected return while taking less risk.

Although these changes represent shifts from safer assets to more risky ones, the overall risk of the portfolio actually decreases. This is because domestic mid and small stocks, mortgage-backed securities, and international stocks have low correlations with many of the other portfolio assets.

Allocation with Risk of the Target Portfolio

The graph on page 7 shows that the Fund's target portfolio also does not provide the highest possible expected return for the amount of risk taken. Although both the allocations of the target and revised target portfolios are equally divided between equity and fixed income assets, the revised target portfolio has a significantly higher expected return and less risk. The composition of both portfolios, along with their expected returns and standard deviations, is given on page 8.



**Current and Recommended
Portfolio Allocations**

Asset Classes	Allocations				
	Current Portfolio (%)	Revised Current (%)	3-Year Target (%)	Revised Target (%)	Aggressive Portfolio (%)
U.S. Large Cap Stocks	21.17	11.00	24.00	16.00	18.00
U.S. Mid/Small Cap Stocks	0.65	4.00	6.00	8.00	10.00
Canadian Stocks	0.03	0.00	0.04	0.00	0.00
European Stocks	2.54	3.50	4.28	6.00	7.50
Pacific Region Stocks	2.94	4.00	4.97	7.00	10.50
Emerging Market Stocks	0.42	2.50	0.72	3.00	4.00
Real Estate	6.69	10.00	10.00	10.00	10.00
Cash	4.64	1.00	0.00	1.00	1.00
Intermediate-Term Govt/Corp Bonds	30.86	40.00	25.32	30.00	18.00
Long-Term Govt/Corp Bonds	25.27	12.00	20.74	5.00	6.00
Mortgage-Backed Securities	3.94	12.00	3.24	14.00	15.00
Non-U.S. Govt Bonds	0.85	0.00	0.69	0.00	0.00
Expected Return	8.53	8.89	9.93	10.31	11.33
Standard Deviation	7.57	7.40	9.91	9.89	11.69

The superior tradeoff between risk and return of the revised target portfolio can be accomplished by shifting a larger portion of Fund assets into domestic mid and small capitalization stocks, international stocks, mortgage securities, and real estate. Again, these riskier assets have low correlations with many other portfolio assets, and therefore provide enhanced diversification benefits.

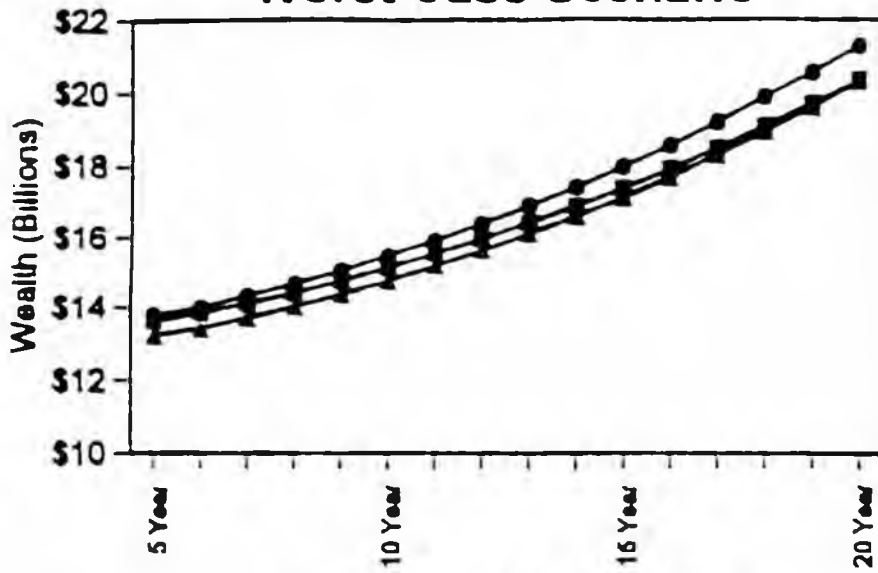
Allocation of a More Aggressive Portfolio

Although we have analyzed and suggested improvements to both the current and target portfolios, we have not yet commented on whether either portfolio is appropriate for the Fund. Ideally, a portfolio provides enough return to meet the goals of the investor while maintaining a level of risk that is comfortable for the investor. By setting a three-year target portfolio that has an increased allocation to equity assets, the Board has indicated that it is comfortable with a more aggressive investment philosophy. In our opinion, such an aggressive investing strategy is appropriate and necessary for achieving the Fund's statutory goals of maximizing total return and providing the maximum amount of disposable income to the citizens of Alaska. Consequently, we believe the Fund should consider the benefits of investing in the "aggressive portfolio," also shown in the graph on page 7.

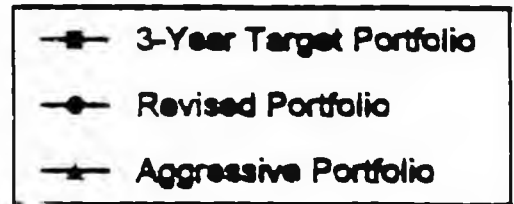
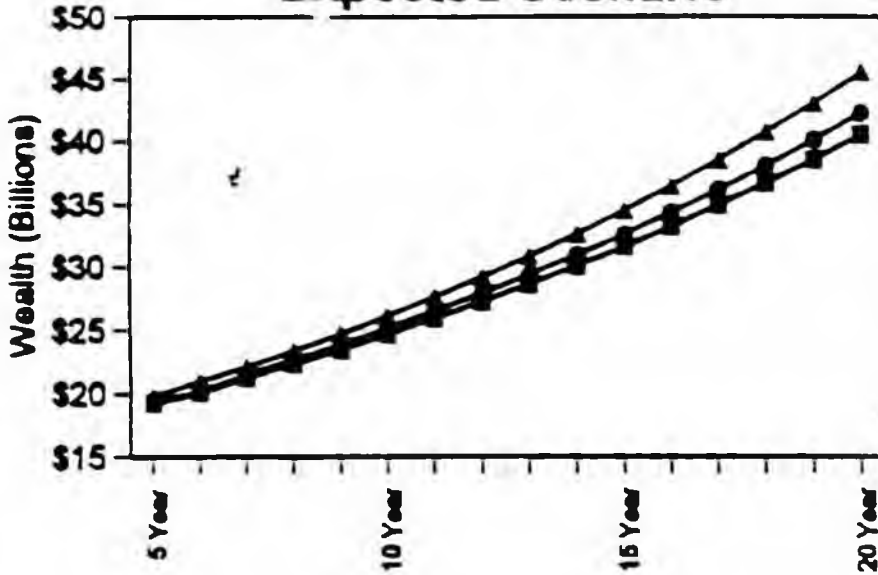
In recent years, the Fund has enjoyed relatively high returns, particularly on its fixed income investments. These high returns were due, in part, to rather unique market conditions, such as a dramatic decline in U.S. interest rates. These market conditions, however, are not expected to continue in the future, as evidenced by the returns expected on the current and target Fund portfolios. The potentially lower returns earned by both these portfolios are important factors to consider, because such low returns will inevitably lead to lower dividend payments to Alaskans. Our recommended aggressive portfolio, however, with its significant allocations to international equities and mortgage-backed securities, has an expected return in the range of the Fund's recent returns. The allocation of this aggressive portfolio, along with its expected return and standard deviation, is provided on page 8.

The graphs on the following page can help to compare the expected performance of each portfolio. The graphs show expected wealth values under the target, revised target, and aggressive portfolios for five-, ten-, and twenty-year investment horizons. Although the Board may consider the aggressive portfolio too risky, the graph shows that the majority of this portfolio's volatility is due to its broad range of possible high, positive returns, not negative ones. For all investment time horizons, the aggressive portfolio has a higher expected wealth value under the best- and expected-case scenarios. Only under the worst-case scenario does the aggressive portfolio underperform the target portfolio, while the revised target portfolio performs better than the target portfolio in all cases.

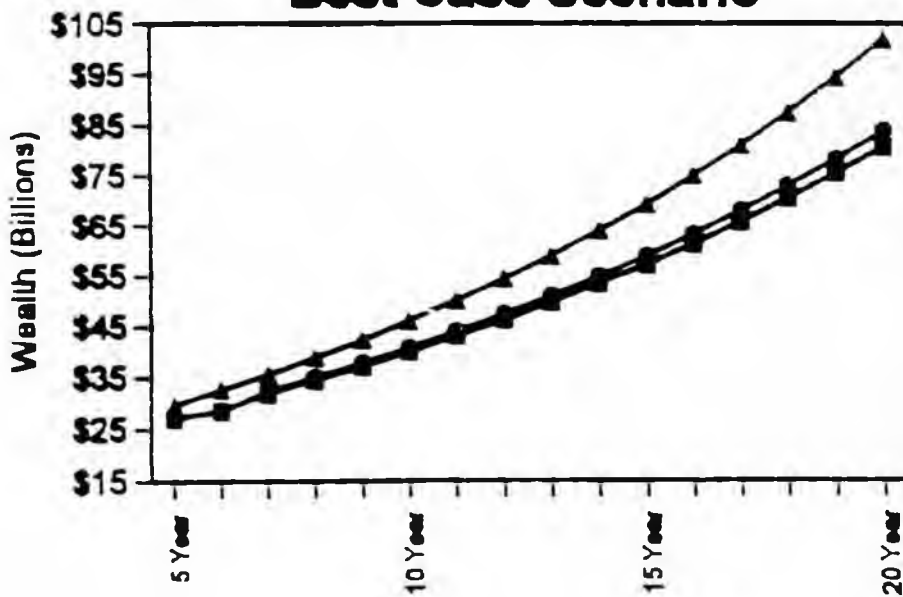
Worst Case Scenario



Expected Scenario



Best Case Scenario





Testing Our Recommended Portfolios

To ensure the validity of our recommended portfolios, we tested those portfolios and the Fund's current and target portfolios for *stability*. A stable portfolio is one that performs well under a variety of possible future market conditions; i.e., the portfolio provides adequate return for the amount of risk taken under conditions that differ from our forecasts. We tested the portfolios using "worst-case" scenarios where the return of one or more assets is lower than expected and the risk is higher than expected. The following scenarios were used, both individually and in combination, to test our recommended portfolios:

- U.S. equity risk premium decreases to 5 percent
- Mid and small capitalization equity return decreases to 15 percent
- Europe equity return decreases to 10 percent
- Europe equity standard deviation increases to 26 percent
- Pacific equity return decreases to 10 percent
- Pacific equity standard deviation increases to 34 percent
- Emerging market equity return decreases to 10 percent
- Return between long-term and intermediate-term bonds increases to 1 percent
- Intermediate-term bond standard deviation increases to 6 percent
- Mortgage-backed securities return decreases to 6 percent
- Mortgage-backed securities standard deviation increases to 11 percent
- Real estate standard deviation increases to 25 percent
- Correlation between U.S. stocks and U.S. bonds increases 30 percent
- Correlation between U.S. stocks and non-U.S. stocks increases 30 percent

Under these scenarios, our recommended portfolios provided higher returns with less risk than either the Fund's current or target portfolios. For example, the improved target portfolio had 10 basis points more return and less risk than the current target portfolio when tested under the assumption that all international markets had the lower returns and higher risks outlined above. This indicates that the revised portfolios will perform better over the long run, despite possible extreme underperformance of some markets.



III. Implementation Issues

Whichever portfolio the Board chooses, several issues must be addressed by the Board to ensure maximum Fund performance. The single most important issue is the degree of adherence to the chosen allocation. Research has suggested that the asset allocation decision accounts for over 90 percent of the variability of returns on a portfolio, and is the single largest determinant of portfolio performance.¹ Consequently, individual security selection and active security management, the two factors commonly assumed to contribute the most to the return of a portfolio, actually account for only a small amount of portfolio return variability. Therefore, adherence to the chosen allocation is *crucial* to the future performance of any investment portfolio, including the Permanent Fund. Accordingly, the Board must decide whether the current investment strategy of the Fund accommodates a strict adherence to the chosen allocation. We address this issue separately for equity and fixed income assets in the following two sections.

Equity Assets

As of April 1993, the Board decided to use active managers only for domestic mid/small capitalization stocks and all international equities. Since our recommended portfolios are based on passive benchmarks, we believe that the long-term performance we forecast can be achieved through the use of passive managers, although it is certainly possible for active managers to meet or exceed that performance. For this reason, we believe the Board's decision to retain active managers is appropriate, *as long as each manager is given only that portion of Fund assets that is recommended in the chosen allocation, and is required to invest those assets in the specific, recommended asset class.*

This stipulation is in direct contrast to the Board's new global investment strategy as outlined in the Fund's 1993 Annual Report. The new strategy allows active international equity managers to decide when and where to invest Fund assets, essentially *shifting* the asset allocation decision from the Board to the manager. As mentioned earlier, asset allocation, not security selection or active market timing, is the largest determinant of portfolio performance. Under the planned strategy, the Fund's equity allocation will shift continuously, violating the most crucial aspect of strategic asset allocation: maintaining a stable asset mix which was chosen based on long-term forecasts and needs of the fund. For this reason, we suggest a slightly modified strategy where the Board hires managers that have a specific style of investing. For example, under this modified strategy, the European equity allocation would be managed by a manager who specializes in European equities. This type of management strategy would allow the Board to retain control over the equity allocation of the Fund.

¹ Gary P. Brinson, Brian D. Singer, and Gilbert L. Beebower, "Determinants of portfolio performance II: An update," *Financial Analysts Journal*, May-June 1991.


The Fund's domestic equity managers also have similar control over the asset allocation decision. Currently, the performance of each domestic equity manager is evaluated by using a benchmark portfolio that consists of 80 percent large capitalization equities and 20 percent mid and small capitalization equities. The equity managers, however, are not specifically required to invest 80 percent of their Fund allocation in large capitalization stocks and 20 percent in mid and small capitalization stocks. A manager could alternate between large cap and mid and small cap stocks, and still *average* an 80 percent large cap and 20 percent mid and small cap investment. This manager could potentially be 100 percent invested in large cap stocks when the return in the mid and small cap market is high, and vice-versa. Again, this causes the overall equity allocation of the Fund to change continuously, and shifts control of the asset allocation decision to individual managers. Because the asset allocation decision is so important to the overall performance of the Fund, we feel the Board should set specific domestic equity allocations, and select managers who specialize in each asset class. This will ensure the maximum expected return for the Fund's equity investments.

Fixed Income Assets

Currently, the Fund's fixed income assets are passively managed in-house by the Fund's Chief Investment Officer, and are generally treated as a single asset class. Our analysis, however, treats the fixed income category as five distinct asset classes, because each contributes unique benefits to the overall portfolio. Treasury bills, for example, provide more liquidity than the other assets, and are, consequently, the least risky. Also, mortgage-backed securities perform differently from government or corporate bonds. For this reason, each fixed income asset class must be considered separately in the asset allocation decision.

Currently, the Board treats all fixed income assets as a single asset class and provides only a broad allocation directive. This essentially shifts the asset allocation decision to the fixed income manager. While the current allocation across fixed income assets may be appropriate when viewed in isolation, that same allocation may be inappropriate when viewed in the context of the overall portfolio. The Board has a comprehensive perspective on the Fund and, as such, should determine the Fund allocation to each asset class. For this reason, we suggest that the Board set specific target allocations for fixed income asset classes. In this way, the Board maintains control over the Fund's asset allocation and ensures maximum overall Fund performance.

Prior to beginning our study, several Board members and senators voiced concern over the Fund having only one manager for the entire fixed income portfolio. We feel that a single, capable manager, such as the current manager, can manage a large, passive fixed income portfolio with few problems, as long as that portfolio has only a small allocation to mortgage-backed securities. However, if a larger proportion of funds was invested in



mortgage-backed securities (as is our recommendation), it may be required to hire additional staff. This is because mortgage-backed securities are more complex to analyze, and the holders of mortgage securities continually receive principal and interest payments which must be accurately recorded. All our recommended portfolios contain substantial allocations to mortgage-backed securities. Consequently, we suggest that the Board hire an outside manager to manage the mortgage portfolio, or, at the very least, hire additional support staff.

Conclusion

Although the Permanent Fund has an excellent performance history, the Fund faces new and uncertain investment challenges in the coming years. The Board, realizing the importance of asset allocation to overall Fund performance, has created a target allocation to meet those challenges. However, as our analysis reveals, the Board can implement a better allocation for the Fund, one that has higher expected return and less risk than the Fund's target portfolio. Also, the Board can implement a new investing policy, one emphasizing an adherence to the chosen allocation. By doing so, the Board will help ensure the maximum expected performance of the Fund over the long-term investment horizon, thereby providing the highest possible income to the State's citizens and fulfilling its obligation to those citizens.



Appendix A: Benchmarks Used in Asset Allocation Study

<u>Asset Class</u>	<u>Benchmark Description</u>
U.S. Large Capitalization Equity	S&P 500: A market capitalization-weighted index of 500 of the largest stocks of companies domiciled in the United States.
U.S. Mid/Small Capitalization Equity	Russell 2000 Index: A market capitalization-weighted index of the stocks of the bottom two thirds of the largest 3,000 publicly traded companies domiciled in the United States.
Canada Equity	Morgan Stanley Capital International Canada Total Return Index: A market capitalization-weighted index of 81 large Canadian stocks.
Europe Equity	Morgan Stanley Capital International Europe Total Return Index: A market capitalization-weighted index of large stocks from Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Netherlands, Norway, Spain, Sweden, Switzerland, and the United Kingdom.
Pacific Equity	Morgan Stanley Capital International Pacific Total Return Index: A market capitalization-weighted index of large stocks from Australia, Hong Kong, Japan, Malaysia, New Zealand, and Singapore.
Emerging Markets Equity	IFC Emerging Market Composite Index: A broad-based, market capitalization-weighted index of stocks listed in countries with a per capita GDP below an annually-disclosed figure. Currently, 20 countries are represented in the Composite index.
Cash	U.S. 90-Day Treasury Bills: Published by Salomon Brothers in <i>International Bond and Money Market Performance</i> .



IT Govt/Corp Bonds

Lehman Brothers Intermediate-Term Government/Corporate Bond Total Return Index: A portfolio of U.S. government issues (>\$100 million par value) and investment grade corporate debt (>\$50 million par value) with an average maturity of 4.42 years as of November 29, 1993.

LT Govt/Corp Bonds

Lehman Brothers Government/Corporate Bond Total Return Index: A portfolio of U.S. government issues (>\$100 million par value) and investment grade corporate debt (>\$50 million par value) with an average maturity of 10.81 years as of November 29, 1993.

Mortgage-Backed Securities

Lehman Brothers Mortgage-Backed Securities Total Return Index: An index of all fixed-rate securities backed by mortgage pools of the Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), and the Federal National Mortgage Association (FNMA). The index has an average maturity of 5.39 years.

Non-U.S. Bonds

Salomon Brothers Non-U.S. 1+ Bond Index: A market capitalization-weighted index of bonds from Australia, Canada, Germany, Japan, Netherlands, Switzerland, and the United Kingdom with one year or more to maturity. The average maturity of bonds in the index is 6.95 years.

Real Estate

Wilshire Real Estate Securities Total Return Index: A market capitalization-weighted index of approximately 85 real estate investment trust and real estate operating companies.



Appendix B: Forecasts Used in Asset Allocation Study

Forecasts of Expected Return and Standard Deviation

Asset Class	Expected Return	Standard Deviation
U.S. Large Cap Stocks	13.56	20.61
U.S. Mid/Small Cap Stocks	18.03	32.95
Canada Stocks	13.73	24.64
Europe Stocks	13.98	22.69
Pacific Stocks	15.11	28.24
Emerging Market Stocks	21.38	47.00
Real Estate	9.90	13.63
Cash	4.61	2.73
IT Govt/Corp Bonds	5.89	4.10
LT Govt/Corp Bonds	6.37	7.22
Mortgage-Backed Securities	7.45	9.28
Non-U.S. Govt Bonds	6.01	14.75

GOVERNOR TONY KNOWLES
LIEUTENANT GOVERNOR FRAN ULMER

Executive Summary

KNOWLES/ULMER

POLICY

TRANSITION

TEAMS'

REPORT

JANUARY 1995

Fiscal Policy

The Knowles/Ulmer Administration asked the Fiscal Policy team to build on the ideas from other public forums to develop guidelines for a responsible fiscal plan to guide the state into the 21st century, and to make recommendations on how to achieve the broad public support necessary for their implementation.

RECOMMENDATIONS

- Continue to articulate a "vision" of the state's financial future—the administration's views on the appropriate role of government and the values and criteria that should guide our public policy decisions—and recognize the threat the fiscal gap poses to ourselves and our children.
 - Make a commitment to develop a plan to bring annually recurring revenues into balance with state spending.
 - Integrate the cabinet into the plan and process, i.e., the commissioners should all be speaking in concert and actively involved in the plan's development.
 - Convey the message that sound fiscal management equals good government and good government means good politics.
 - The team emphatically endorses the Knowles/Ulmer campaign pledge to cap total state spending (except for education funding) at the FY 95 level.
 - Continue with an unwavering policy of budget sustainability and develop an annual report card to inform the public about the success of the administration's actions to protect Alaska's fiscal future.

- Give average citizens a direct voice in shaping the future and invite the public to help develop a shared vision for Alaska and the role of government in their lives.
 - Develop a strategy for inviting public input into fiscal decisions and collect baseline information on public attitudes regarding the fiscal gap.
 - Implement a strategy for educating the public on Alaska's fiscal situation and our choices for the future. Effective forums might include: newspaper inserts, town meetings, market research, industry groups, social service groups and local government bodies.
 - Ask the legislature to participate in every step of the outreach process.
 - Make government more open to the public through better use of communication systems, including electronic media (video conference, internet, Alaska Online, etc.).
 - As part of a long-term strategy, the administration should budget for public participation in reexamining the respective roles of state and local governments, setting goals and benchmarks for Alaska, and deciding the role of the Permanent Fund in the state's fiscal future.

- Create an annually updated five-year fiscal plan.
 - Work with and inform the legislature in a timely manner of any changes the administration wishes to make in the FY 96 budget, and announce that a fiscal plan will be in place by the time the FY 97 budget is proposed.
 - Develop a five-year plan and a comprehensive reporting framework that encompasses all aspects of state spending and revenues, including "off-budget items" such as Permanent Fund earnings, Permanent Fund dividends, cash reserves, public corporations, etc. Include deferred maintenance and the operating and maintenance costs of capital projects in the plan.

- Resolve legal questions surrounding the use of the Constitutional Budget Reserve funds, the setting of specific revenue and expenditure targets (including Permanent Fund dividends), development of a debt policy (including school debt reimbursement), an overall reserves policy employing triggers for instituting an income tax, and a cash-flow management plan.
 - Implement the five-year plan and keep the public informed of Alaska's fiscal situation and progress toward reaching fiscal stability. Although no consensus was reached, one approach recommended was to set up a budget commission or blue ribbon task force to act as a conduit between the executive branch, legislature and the public to develop a long-term fiscal strategy for Alaska.
 - Capitalize cash reserves to the greatest extent possible.
 - Pass legislation to automatically inflation-proof the Permanent Fund by distributing only real earnings for dividends.
 - Explore means of controlling personnel costs.
 - Examine various public services for potential privatization.
 - Evaluate all entitlement programs on an ability-to-pay basis.
- Form partnerships for economic development and intergovernmental alliances.
 - Emphasize partnerships between the executive and legislative branches, state and local governments, and the public and private sectors.
 - Create a spirit of cooperation between the state of Alaska and the federal government.
 - Eliminate unfunded mandates on local governments.
 - Reexamine the state's petroleum tax and royalty regime with the intention of maintaining Alaska's competitiveness.
 - Improve federal relations and understanding of Alaska issues, particularly with respect to oil and gas development, and adopt a "Visit Alaska" program to allow members of Congress to see the state in order to make more informed decisions.
 - Maintain the economic viability of resource development by ensuring that efforts aimed at increasing revenues from resource industries are made via an income tax on jobs rather than through increased business taxes. (The team noted that non-petroleum resource development actually ends up costing the state money in comparison to revenues generated.)
 - Make serious efforts at regulatory reform to reduce government red tape.
 - Organize programs to streamline the delivery of state government services.
 - Make state government as cost-efficient as possible by adopting a customer-oriented approach to public service delivery.
 - Develop and begin to implement meaningful, real-world performance measures of the effectiveness of government programs.
 - In order to provide incentives to agencies, commissioners should be allowed to use part or all of their cost savings for investments that will increase future productivity.
 - An employee recognition and cash reward system should be developed and funded for employee ideas that save money.
 - Join in a partnership with local governments to thoroughly evaluate the delivery of services to the public. Ensure that public services are delivered at the most appropriate level of government to meet the needs of the citizenry in the most cost-effective manner possible, even if government roles need redefinition.

Alaska State Senate

SENATOR STEVE RIEGER
District 1

Senate Finance Committee
Chair, Senate Transportation Committee

Legislative Budget and Audit Committee
Administrative Regulation Review Committee
Legislative Council

During Session:
State Capitol, Room 516
Juneau, Alaska 99801
(907) 465-1879

716 West 4th Avenue, Suite 530
Anchorage, Alaska 99501
(907) 258-8188

TO: Senator Rick Halford
Co-Chair, Senate Finance Committee

FROM: Senator Steve Rieger *A*

DATE: March 9, 1995

RE: SB 51 - "An Act Relating to the Income of the Permanent Fund"

I respectfully request that you calendar the above referenced bill in the Senate Finance Committee at your earliest convenience. I am attaching a bill packet for distribution to member's files.

Thank you for your consideration of this matter.

*3/27/95 packet
placed in
Sen. Rieger's
file
per Steve
(per Steve)*

Alaska State Senate

SENATOR STEVE RIEGER

District 1

Senate Finance Committee
Chair, Senate Transportation Committee

Legislative Budget and Audit Committee
Administrative Regulation Review Committee
Legislative Council

During Session:
State Capitol, Room 516
Juneau, Alaska 99801
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716 West 4th Avenue, Suite 530
Anchorage, Alaska 99501
(907) 258-8188

SENATE BILL 51

-AN ACT RELATING TO THE INCOME OF THE PERMANENT FUND-

- SPONSOR STATEMENT
- PERMANENT FUND TRUSTEES' POSITION PAPER, 2/25/95
- PERMANENT FUND PROJECTIONS, January, 1995
- ALASKA POPULATION PROJECTIONS, March 1992
- IBBOTSON REPORT- Asset Allocation Study of the Alaska
Permanent Fund Report dated January, 1994
- "Real Dollars Now Means Real Dividends Later" by Tim Bradner
Anchorage Daily News, January 8, 1995
- EXECUTIVE SUMMARY - Knowles/Ulmer Policy Transition Teams'
Report, dated January, 1995

Alaska State Senate

SENATOR STEVE RIEGER
District I

Senate Finance Committee
Chair, Senate Transportation Committee

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PERMANENT FUND PROJECTIONS:

The attached projections from the Alaska Permanent Fund Corporation show the effect of different earnings assumptions on the size of the Permanent Fund, as well as the amount of each year's earnings and transfers to the dividend fund, through the year 2000.

The first forecasts provided by the Permanent fund Corporation are based on recent investment performance and long-standing assumptions which the Corporation has used regarding nominal earnings and inflation.

At my request, the Permanent Fund Corporation also did additional runs, which reflect the higher earnings assumptions suggested in the Ibbotson Associates' report (enclosed). The Ibbotson report was commissioned by the Legislative Budget and Audit Committee and completed January 1994. This report recommends a target portfolio which is higher-yielding than its present portfolio because of a greater amount of assets invested in higher-yielding securities. This return was estimated by Ibbotson to be 10.31%. The attached projections include assumptions of 10.31% nominal earnings and 6% inflation; and assumptions of 10.31% nominal earnings and 4% inflation. Finally, the projections are stated in nominal dollars and inflation-adjusted dollars.



Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (in millions)

as of January 31, 1999

GROWTH OF FUND PRINCIPAL

FY	FY Begin Balance	Appropriations	Dedicated State Revenues*	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
8	0		54		54	
9	54		24		139	
10	139		344		483	
11	483	300	385		1,768	
12	1,769	300	400		2,969	
13	2,969	400	421	231	4,021	
14	4,021	300	388	151	4,838	
15	4,838	300	368	235	5,741	
16	5,741		323	218	6,281	
17	6,281	1,264 **	170	148	7,864	
18	7,864		418	303	8,585	
19	8,585		228	360	9,173	
20	9,173		267	454	9,894	
21	9,894		435	559	10,888	
22	10,888		338	477	11,703	
23	11,703	5 ***	315	382	12,385	
24	12,385	6 ***	210	372	12,973	
25	12,973	5	212	344	13,534	
26	13,534	2	198	515	14,253	
27	14,253	7	194	542	14,998	
28	14,996	7	185	570	15,757	
29	15,757	8	168	598	16,532	
30	16,532	6	160	1,002	17,698	
31	17,699	6	145	1,071	18,921	
32	18,921	7	130	1,143	20,201	
33	20,201	7	117	1,218	21,546	
34	21,545	8	105	1,298	22,958	
35	22,958	9	94	1,383	24,444	
36	24,444	10	87	1,472	26,012	
37	26,012	11	81	1,568	27,669	
38	27,669	12	76	1,668	29,421	
39	29,421	13	70	1,770	31,273	
40	31,273	14	67	1,880	33,234	

Cumulative Totals Projected
For FY 1995 - 2010: 2,932 18,892

USE OF FUND INCOME

Net Income	Distributions			Reserves		FY
	Dividends	Per Capita Dividends	Inflation-Proofing	General Fund	Add = FY End (Delete) Balance	
2					1	78
8					7	79
32	12				12	30
150	28				59	81
368	71	\$1,000.00			188	82
471	108	\$388.15	231	110	110	83
530	178	\$331.28	151		288	84
658	217	\$484.00	235		208	85
1,021	303	\$588.28	218		501	86
1,088	381	\$708.18	148		528	87
789	424	\$828.83	303		82	88
868	488	\$872.16	380	4	44	89
918	487	\$882.83	454	4	(36)	90
1,030	488	\$831.34	558	4	(24)	91
1,038	488	\$831.34	477	5	84	92
1,228	532	\$948.48	382	5	328	93
1,088	588	\$882.88	372	11	181	94
950	588	\$842.88	344	14	258	95
1,252	588	\$888.00	515		181	96
1,325	608	\$878.00	542		188	97
1,402	627	\$888.00	570		188	98
1,483	688	\$1,027.00	598		211	99
1,748	738	\$1,134.88	1,002		(11)	0
1,888	812	\$1,282.88	1,071		(34)	1
1,988	878	\$1,278.00	1,143		(82)	2
2,081	948	\$1,381.00	1,218		(84)	3
2,198	1,023	\$1,428.88	1,298		(132)	4
2,318	1,082	\$1,482.00	1,383		(188)	5
2,448	1,143	\$1,537.00	1,472		(188)	6
2,578	1,288	\$1,582.88	1,568		(288)	7
2,713	1,271	\$1,888.88	1,668		(288)	8
2,857	1,338	\$1,708.88	1,770		(288)	9
3,007	1,410	\$1,770.00	1,880		(287)	10
32,178	14,881	\$21,822	18,837	14		

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 88	3.49%	2.81%	3.88%
FY 98 - 99	3.11%	3.75%	4.36%
FY 2009 - 10	3.00%	5.00%	3.00%

* Department of Revenue Fall 1984 Low-Cost Revenue Forecast.
 ** Earnings reserve appropriated to Fund principal by the Legislature July 1, 1987.
 *** Transferred to principal from earnings reserve account per AS 37.13.145(d).
 **** Based on capital market assumptions adopted by the Trustees in March 1984.

STATUS QUO WITH PER CAPITA DIVIDENDS



Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (in millions)

as of January 31, 1995

GROWTH OF FUND PRINCIPAL

FY	FY Begin Balance	Appropriations	Dedicated State Revenues*	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
91			54		54	
92	54		34		139	
93	139		344		483	
94	483	300	385		1,769	
95	1,769	300	400		2,969	
96	2,969	400	421	231	4,021	
97	4,021	300	368	151	4,838	
98	4,838	300	368	235	5,741	
99	5,741		323	218	5,281	
00	5,281	1,264**	170	148	7,364	
01	7,364		418	303	8,585	
02	8,585		228	360	9,173	
03	9,173		267	454	9,894	
04	9,894		435	559	10,888	
05	9,894		435	559	10,888	
06	11,703		315	362	12,385	
07	12,385		210	372	12,973	
95†	12,973	5	212	344	13,534	
96	13,345	5	204	497	13,738	
97	13,241	5	184	479	13,931	
98	13,428	5	174	485	14,110	
99	13,600	7	160	492	14,269	
00	13,460	5	138	488	14,411	
01	13,595	5	123	769	14,534	
02	13,711	5	105	778	14,629	
03	13,810	5	89	781	14,729	
04	13,395	5	78	786	14,808	
05	13,968	5	54	790	14,872	
06	14,031	5	54	794	14,931	
07	14,086	5	47	797	14,983	
08	14,135	5	41	807	15,030	
09	14,179	5	37	802	15,072	
10	14,218	5	32	808	15,110	

Cumulative Totals Projected:
For FY 1995-2010: 1,738 10,683

USE OF FUND INCOME

Net Income	Distributions			General Fund	Reserves	
	Dividends	Per Capita Dividends	Inflation-Proofing		Add (Delete)	FY End Balance
2					1	
3					7	
12					12	
29					29	29
268		29	\$1,000.00		71	185 244
471		108	\$388.15	231	110	110 354
530		175	\$331.29	151		203 557
558		217	\$404.00	235		208 763
1,021		303	\$588.28	216		501 1,264
1,069		391	\$708.19	148		329 529
739		424	\$828.93	303		32 591
368		460	\$873.18	360	4	44 535
316		487	\$922.83	454	4	(30) 506
1,030		489	\$931.34	559	4	(24) 581
1,030		489	\$915.84	559	4	(24) 581
1,226		532	\$949.48	362	5	320 965
1,098		558	\$983.90	372	11	151 1,117
950	558	\$942.00	344	14	29	1,146
1,206	559	\$921.00	497		145	1,250
1,231	564	\$918.00	479		157	1,362
1,256	561	\$888.00	485		178	1,490
1,280	575	\$888.00	492		182	1,619
1,422	610	\$923.00	486		(9)	1,519
1,425	624	\$923.00	769		(28)	1,406
1,425	637	\$924.00	776		(48)	1,282
1,423	649	\$924.00	781		(68)	1,144
1,418	660	\$921.00	786		(85)	995
1,411	658	\$902.00	790		(94)	844
1,403	656	\$882.00	794		(103)	693
1,395	653	\$883.00	797		(112)	543
1,386	649	\$843.00	800		(120)	392
1,377	645	\$823.00	802		(127)	243
1,367	641	\$805.00	805		(135)	94
21,374	9,899	\$10,277	10,683	14		

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 95-	5.49%	2.61%	3.68%
FY 96-99:	3.11%	3.75%	4.36%
FY 00-2010:	3.00%	6.00%	3.00%

Constant/Real dollars

In times of any inflation, the value of the dollar erodes over time. Adjusting future nominal amounts to constant 1995 dollars removes the effects of inflation from the future projections.

* Department of Revenue Fall 1994 Low-Cost Revenue Forecast.

** Earnings reserve appropriated to Fund principal by the Legislature July 1, 1987.

*** Transferred to principal from earnings reserve account per AS 37.13.145(d).

**** Based on capital market assumptions adopted by the Trustees in March 1994.

STATUS QUO IN REAL 1995 DOLLARS



Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (in millions)

as of January 31, 1995

GROWTH OF FUND PRINCIPAL

FY	FY Begin Balance	Appropriations	Dedicated State Revenues*	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
78	0		34		34	
79	54		34		139	
80	139		344		483	
81	483	500	385		1,769	
82	1,769	300	400		2,969	
83	2,969	400	421	231	4,021	
84	4,021	300	366	151	4,838	
85	4,838	300	368	235	5,741	
86	5,741		323	216	6,281	
87	6,281	1,264	170	148	7,864	
88	7,864		418	303	8,585	
89	8,585		228	360	9,173	
90	9,173		257	454	9,884	
91	9,884		425	559	10,868	
92	10,868		338	477	11,703	
93	11,703	5	315	362	12,385	
94	12,385	5	210	372	12,973	
95	12,973	5	212	344	13,534	
96	13,534	5	198	515	14,252	
97	14,252	7	194	542	14,995	
98	14,995	7	185	568	15,758	
99	15,758	3	169	597	16,530	
00	16,530	5	160	1,001	17,696	
01	17,696	5	145	1,071	18,919	
02	18,919	7	130	1,143	20,200	
03	20,200	7	117	1,219	21,544	
04	21,544	8	105	1,299	22,958	
05	22,958	9	94	1,383	24,442	
06	24,442	10	87	1,472	26,010	
07	26,010	11	81	1,568	27,667	
08	27,667	12	78	1,665	29,419	
09	29,419	13	70	1,768	31,277	
10	31,277	14	57	1,880	33,231	

Cumulative Totals Projected:
For FY 1995-2010: 2,023 18,034

USE OF FUND INCOME

Net Income	Distributions			Reserves		FY
	Inflation-Proofing	Per Capita Dividends	General Fund	Add (Delete)	FY End Balance	
2						78
3						79
12						80
28						81
71						82
108	231	108	\$388.15	110	110	83
175	151	175	\$331.29		203	84
217	235	217	\$404.00		208	85
303	216	303	\$538.26		501	86
391	148	391	\$708.19		529	87
424	303	424	\$826.93		52	88
480	380	480	\$873.16	4	44	89
489	454	489	\$962.83	4	(30)	90
489	559	489	\$931.34	4	(24)	91
488	477	488	\$915.84	5	64	92
532	362	532	\$949.48	5	320	93
558	372	558	\$983.90	11	151	94
521	344	521	\$877.00	14	65	95
490	515	490	\$800.00		244	96
462	542	462	\$731.00		326	97
424	568	424	\$650.00		428	98
441	597	441	\$681.00		480	99
427	1,001	427	\$622.00		385	0
443	1,071	443	\$630.00		446	1
461	1,143	461	\$643.00		511	2
463	1,219	463	\$668.00		582	3
508	1,299	508	\$680.00		658	4
538	1,383	538	\$732.00		720	5
608	1,472	608	\$790.00		788	6
688	1,568	688	\$852.00		857	7
727	1,665	727	\$917.00		933	8
783	1,768	783	\$967.00		1,014	9
884	1,880	884	\$1,062.00		1,101	10

36,589 18,034 8,873 \$12,293 16

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 95-	6.49%	2.51%	3.88%
FY 96-99****	8.11%	3.75%	4.36%
FY 2000-10:	9.00%	5.00%	3.00%

* Department of Revenue Fall 1994 Low-Cost Revenue Forecast.
 ** Earnings reserve appropriated to Fund principal by the Legislature July 1, 1987.
 *** Transferred to principal from earnings reserve account per AS 37.13.145(d).
 **** Based on capital market assumptions adopted by the Trustees in March 1994.



Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (in millions)

as of January 31, 1995

GROWTH OF FUND PRINCIPAL

FY	FY Begin Balance	Appropriations	Dedicated State Revenues	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
83			54		54	
84	54		34		139	
85	139		344		483	
86	483	300	385		1,769	
87	1,769	300	400		2,969	
88	2,969	400	421	231	4,021	
89	4,021	300	388	151	4,838	
90	4,838	300	368	235	5,741	
91	5,741		223	216	6,281	
92	6,281	1,254	170	148	7,864	
93	7,864		418	303	8,585	
94	8,585		228	360	9,173	
95	9,173		267	454	9,894	
96	9,894		435	559	10,888	
97	9,894		435	559	10,888	
98	11,703	5	315	362	12,385	
99	12,385	5	210	372	12,973	
00	12,973	5	212	344	13,534	
01	13,045	5	204	498	13,737	
02	13,241	5	184	478	13,931	
03	13,427	5	174	485	14,108	
04	13,599	7	160	481	14,287	
05	13,459	5	138	488	14,410	
06	13,594	5	123	789	14,533	
07	13,710	5	108	778	14,638	
08	13,809	5	88	781	14,728	
09	13,894	5	78	788	14,808	
10	13,967	5	64	790	14,871	
11	14,030	5	54	794	14,930	
12	14,085	5	47	797	14,982	
13	14,134	5	41	800	15,028	
14	14,178	5	37	802	15,070	
15	14,217	6	32	804	15,109	

Cumulative Totals Projected:
For FY 1995 - 2010: 1,738 10,681

USE OF FUND INCOME

Net Income	Distributions			Reserves	
	Dividends	Per Capita Dividends	Inflation-Proofing	General Fund	Add (Delete) FY End Balance
2					1
3					7
32	12				12
150	28				28
368	71	\$1,000.00			71
471	108	\$388.15	231	110	110
530	175	\$331.29	151		203
658	217	\$404.00	235		208
1,021	303	\$558.28	218		501
1,058	391	\$708.19	148		528
788	424	\$328.93	303		52
868	480	\$873.16	380	4	44
918	487	\$982.83	454	4	(30)
1,030	488	\$831.14	559	4	(24)
1,030	488	\$915.84	559	4	(24)
1,228	532	\$848.48	332	5	128
1,098	558	\$883.90	372	11	151
950	521	\$877.00	344	14	65
1,209	472	\$771.00	498		235
1,241	428	\$878.00	478		303
1,277	380	\$882.00	485		381
1,317	381	\$570.00	491		414
1,482	348	\$508.00	488		314
1,510	340	\$484.00	789		343
1,538	334	\$478.00	778		370
1,566	330	\$481.00	781		388
1,595	327	\$438.00	788		424
1,623	338	\$448.00	790		438
1,651	348	\$483.00	794		451
1,578	380	\$481.00	797		484
1,704	371	\$468.00	800		478
1,729	382	\$478.00	802		488
1,755	383	\$483.00	804		501

23,825 5,052 8,816 10,881 14

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 88:	5.49%	2.51%	3.98%
FY 88 - 89:	3.11%	3.75%	4.36%
FY 00 - 2010:	3.00%	5.00%	3.00%

Constant/Real dollars

In times of any inflation, the value of the dollar erodes over time. Adjusting future nominal amounts to constant 1995 dollars removes the effects of inflation from the future projections.

- * Department of Revenue Fall 1994 Low-Case Revenue Forecast.
- ** Earnings reserve appropriated to Fund principal by the Legislature July 1, 1987.
- *** Transferred to principal from earnings reserve account per AS 37.13.145(d).
- **** Based on capital market assumptions adopted by the Trustees in March 1994.

SB 51 IN REAL 1995 DOLLARS