

ALASKA LEGISLATURE

1593

HOUSE and SENATE FINANCE COMMITTEE FILES, 1997-1998

Thirty written comments regarding DCRA's Provisional Report were received by the extended deadline.<sup>13</sup> In addition, LBC member Kevin Waring verbally requested that DCRA address certain issues in its final report.

Written comments on DCRA's Provisional Report were submitted by:

1. Carl Glanville, resident of Anchor Point (one-page letter dated October 28);
2. Bob Henrichs, resident of Cordova (two-page letter dated November 1);
3. Bob Henrichs, President of the Copper River Prince William Sound Native Fishermen's Association (two-page letter dated November 1);
4. Donald P. Kompkoff, Sr., President, Chenega Bay IRA Council (one-page undated letter, received on November 8);
5. Stephen C. Planchon, Executive Director, Mental Health Trust Land Office, Alaska Department of Natural Resources (one-page letter dated November 6, 1996);
6. Mark H. Wittow, Attorney for Alaska Gulf Coast Adventures, Inc. (two-page letter dated November 5);
7. James T. Brennan, Attorney for the CBY (eighteen-page letter dated November 8, with 3 attachments comprising 17 pages);
8. Benna Mae Hughey, member of the Board of Directors of CAC, Corporate Secretary of CAC, Acting Office Manager of the Valdez Native Tribe and IHS Health Program Director for the Valdez Native Tribe (one-page letter dated November 12);
9. Rick Nelson, member of the Board of Directors of CAC (one-page letter dated November 12);
10. Gilbert Ollestad, member of the Board of Directors of CAC, CAC shareholder, retired commercial fisherman and longshoreman (one-page letter dated November 12);
11. John E. Willis, Camp Manager of the East Icy Bay logging camp operated by Ben A. Thomas, Inc., (one-page letter dated November 8);
12. Shane Stephenson, charter pilot who resides in Yakutat (two-page letter dated November 4);
13. David Dengel, Assistant City Manager of the City of Valdez (one-page letter dated November 1, with attachments comprising two pages);
14. Carroll Kompkoff, President, The Tatitlek Corporation (two-page letter dated November 12);
15. D. J. Burnham, resident of Cape Yakataga (three-page undated letter received November 12);
16. Gary P. Kompkoff, Chief, Native Village of Tatitlek (two-page letter dated November 9);
17. W. Scott Janke, City Manager of the City of Cordova (two-page letter dated November 12 with attachments consisting of four pages);
18. Derenty Tabios, Executive Director, Chugachmiut (four-page undated letter received November 12);
19. James Sinnett, Planning Director, Chugach Heritage Foundation (one-page undated letter received November 12);
20. Georgianna Lincoln, Alaska State Senator (one-page letter dated November 7);

<sup>13</sup> Three of the letters among those listed were submitted as requests to extend the original November 8 deadline for comment on DCRA's Provisional Report. Those consisted of the letter from Bob Henrichs (written as a resident of Cordova), the letter from Bob Henrichs (written as President of the Copper River Prince William Sound Native Fishermen's Association) and the letter from the Chenega Bay IRA Council. Those three letters were included in the context of comments on DCRA's Provisional Report because: (a) they offered general views against extending Yakutat's boundary beyond the 141st meridian; and (b) subsequent comments were not received by November 12 from the Chenega Bay IRA Council or Mr. Henrichs, either as an individual or as President of the Copper River Prince William Sound Native Fishermen's Association (although Mr. Henrichs did submit subsequent comments on behalf of the Native Village of Eyak Tribal Council).

21. Steven C. Planchon, Executive Director, Mental Health Trust Land Office, Alaska Department of Natural Resources (two-page letter dated November 12);
22. Mark Stahl, Manager, Lands and Resources Department for Chugach (three-page letter dated November 12);
23. Charles W. Totemoff, President & CEO of Chenega Corporation (two-page letter dated November 12);
24. Ralph J. Swarthout, holder of mining leases in the Cape Yakataga area (two-page letter dated November 12);
25. David Morgan, Acting City Manager of the City of Whittier (two-page letter dated November 11, with 9 exhibits comprising 27 pages);
26. John Christensen, Chairman of the Board, CAC (two-page letter dated November 12);
27. John F. C. Johnson, member of the Board of Directors of CAC (one-page letter dated November 12);
28. Bob Henrichs, President, Native Village of Eyak (one-page letter dated November 1);
29. Patty Brown-Schwalenberg, Executive Director, Chugach Regional Resources Commission (three-page letter dated November 8, 1996);
30. Philip Blumstein, attorney for CAC (two-page letter dated November 12, transmitting 57 pages of comments accompanied by 19 exhibits comprising 131 pages; also incorporated by reference was the administrative record of the proceedings before the LBC on the CBY's petition to incorporate the CBY which consists of 4,685 pages and 6 video tapes).

**LBC Hearings and Decisional Session Scheduled.** The LBC scheduled three hearings on the CBY annexation proposal. The first was scheduled to begin at 10:00 a.m. on Saturday, December 14, 1996 in the Cordova Library Meeting Room. The second hearing was scheduled to begin at 10:30 a.m. on Sunday, December 15, 1996. It too was scheduled to be held at the Cordova Library Meeting Room with teleconference sites at the logging camps in East Icy Bay and West Icy Bay. The third hearing was scheduled to begin at 6:00 p.m. on Sunday, December 15, 1996 at the Alaska Native Brotherhood (ANB) Hall in Yakutat. The LBC scheduled its decisional session for Monday, December 16, 1996, beginning at 8:00 a.m. at the ANB Hall in Yakutat.

Notice of the hearings and decisional session was given in accordance with 19 AAC 10.550. Specifically, notice was provided as follows:

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| 11/12/96 | Notice was mailed by DCRA to 139 individuals and organizations (8.5-inch by 14-inch format).  |
| 11/12/96 | Notice was published for the first time in the <i>Anchorage Daily News</i> (2-column by 6-inch format).   |
| 11/14/96 | Notice was posted (8.5-inch by 14-inch format) at the Browning Timber - West Icy Bay logging camp at the following locations: cookhouse bulletin board, office, Homeguard mail boxes and above the timecard box. Additionally, requests that public service announcements concerning the hearings be broadcast from November 22 - December 15, 1996, were mailed to the following radio stations serving the Prince William Sound and Yakutat areas: KCAW-FM, KCHU-AM, KJFP-FM and KLAM-AM. |
| 11/15/96 | Notice was posted (8.5-inch by 14-inch format) at the following locations in Yakutat: Mallott's General Store, Monti Bay Foods, KJFP Radio Station, Yakutat Hardware, U.S. Forest Service offices, City/Borough Hall, ANB Hall, Yakutat Lodge, Glacier Bear Lodge, U.S. Post Office and Key Bank of Alaska. Additionally, a request to broadcast public service announcements concerning the hearings from November 22 - December 15, 1996, was mailed to KVAK-AM in Valdez.                |
| 11/19/96 | Notice was posted (8.5-inch by 14-inch format) at the following locations in Cordova: City Hall bulletin board, Post Office bulletin board, and Library bulletin board.   |

- 11/20/96 Notice was posted (8.5-inch by 14-inch format) at the following locations at the Ben Thomas, Inc. - Icy Bay East logging camp: office, cookhouse, commissary, and bunkhouse.
- 11/21/96 Notice was published for the second time in the *Anchorage Daily News* (2-column by 6-inch format).
- 11/25/96 Notice was published for the first time in the *Alaska Administrative Journal*.
- 11/26/96 Notice was published for the third time in the *Anchorage Daily News* (2-column by 6-inch format).
- 12/02/96 Notice was published for the second time in the *Alaska Administrative Journal*.
- 12/09/96 Notice was published for the third time in the *Alaska Administrative Journal*.

**DCRA Final Report.** Pursuant to 19 AAC 10.530(d), DCRA released its Final Report concerning the CBY annexation proposal on November 22, 1996. The report, consisting of 31 pages, was delivered to the Petitioner and both respondents on that date. The report was also mailed to 139 others November 22, 1996. Additionally, the report was mailed to three others on November 25, 1996.

**LBC Hearings.** The LBC conducted its first hearing in Cordova on Saturday, December 14, 1996. Participation at the hearing was allowed by teleconference from sites at the Valdez City Hall, the Valdez offices of the Prince William Sound Economic Development Council, the Anchorage offices of Preston Gates and Ellis, the offices of the City and Borough of Yakutat, the residence of Nancy Barnes in Juneau, the residence of Paula Terrel in Juneau and the residence of Joe Burnham in Anchorage. Additionally, arrangements were made to broadcast the hearing over radio station KJFP in Yakutat. The hearing lasted approximately 6 hours.

The LBC conducted its second hearing in Cordova on Sunday morning, December 15, 1996. Participation at the hearing was allowed by teleconference from sites at the FAA building at Cape Yakataga, the CBY offices in Yakutat, the Ben Thomas, Inc., logging camp at East Icy Bay, the Anchorage residence of Joe Burnham and at Ben Thomas' residence in Woodland, Washington.<sup>14</sup> The hearing lasted approximately 2 hours.<sup>15</sup>

The LBC conducted its third hearing in Yakutat on Sunday, December 15, 1996. The hearing. The hearing was recessed at 12:45 a.m. on Monday and reconvened at approximately 8:10 a.m. that day. The third hearing lasted approximately 7.5 hours.

Immediately following the conclusion of the third hearing, the LBC convened a decisional session to act on the petition. The LBC deliberated for approximately two hours during which it reached the findings and conclusions set out in Section III.

14 Arrangements had been made to allow participation from the Browning Timber Camp at West Icy Bay. However, John Schmidt, who was to serve as the site coordinator, was unavailable. Additionally, arrangements had also been made to allow Jim Keeline, a resident of Icy Bay who was in Minnesota on business, to participate. However, Mr. Keeline failed to initiate the teleconference link.

15 Due to the failure of long-distance telephone service with Yakutat, the hearing ended when the Petitioner's Representative, participating by teleconference from the CBY offices, was approximately 1 minute and 30 seconds into his closing statement. The LBC recessed the meeting to be continued with the closing statements by the Petitioner and Respondents, and the reply by the Petitioners beginning at 6:00 p.m. that day at Yakutat.

### SECTION III - FINDINGS AND CONCLUSIONS

Based on the evidence in the record of this proceeding, the LBC hereby makes the findings and conclusions set out in this section.

#### A. Regarding Maximum Local Self-Government with a Minimum of Local Governmental Units.

Article X, § 1 of Alaska's constitution promotes maximum local self-government with a minimum of local governmental units. More than two decades ago, the Alaska Supreme Court ruled that Article X, § 1 favors upholding borough formation whenever the requirements for such were minimally met. Further, the Court concluded that Article X, § 1 encourages borough incorporation. With respect to these points, the Court stated:

*The appellants argue that neither the geography nor the transportation standard is satisfied by the record evidence. Our review of the record has been undertaken in light of the statement of purpose accompanying article X, the local government article, of the Alaska constitution. Section 1 declares in part:*

*The purpose of this article is to provide for maximum local self-government with a minimum of local government units, and to prevent duplication of tax-levying jurisdictions. . .*

*We read this to favor upholding organization of boroughs by the Local Boundary Commission whenever the requirements for incorporation have been minimally met.*

\*\*\*\*  
*Aside from the standards for incorporation in AS 07.10.030, there are no limitations in Alaska law on the organization of borough governments. Our constitution encourages their creation. Alaska const. Art. X, § 1. And boroughs are not restricted to the form and function of municipalities. They are meant to provide local government for regions as well as localities and encompass lands with no present municipal use.*

Mobil Oil Corporation v. Local Boundary Commission, 518 P.2d 92, 99, 101 (Alaska 1974)

Earlier this year, the LBC addressed Article X, § 1 in the context of the proposal to detach Lake Louise from the Matanuska-Susitna Borough. The LBC stated in that regard as follows:

*Article X, § 1 of the Constitution of the State of Alaska calls for maximum local self-government. That section of the constitution has been viewed by the Alaska Supreme Court as encouraging the creation of borough governments. Further, the Supreme Court reads the provision to favor upholding organization of boroughs by the Local Boundary Commission whenever the requirements for incorporation have been minimally met.*

*The Commission finds that, as a matter of public policy, great importance should be placed on the constitutional provision calling for maximum local self-government. The Commission further finds that detachment of territory from an organized borough to the unorganized borough results in a serious diminution of local self-government. Consequently, both the factors and the standard set out in the previously listed provisions of 19 AAC 10.270(a) will be prejudicially affected by any proposal to detach territory from an organized borough to the unorganized borough.*

*Based on the foregoing findings, the Commission concludes that any detachment from an organized borough to the unorganized borough is to some degree contrary to the provisions of Article X, § 1 of Alaska's constitution. Approval of the detachment petition as presented would, in fact, remove local self-government from Lake Louise. This would not, however, be the case if the territory were being detached to become part of another organized borough or part of a city government within the unorganized borough.*

Statement of Decision in the Matter of the Petition for Detachment from the Matanuska-Susitna Borough of the Lake Louise Area, Encompassing an Estimated 648 Square Miles, page 4, January 12, 1996.

The conclusions concerning Article X, § 1 reached by the Alaska Supreme Court in Mobil Oil and by the LBC regarding the Lake Louise detachment are not limited to borough incorporation and detachment, but are applicable to borough annexation as well.

Article X, § 1 concerns the opportunities of Alaskans to provide for and participate in local self-government. It also implies that citizens have an obligation to contribute to local self-government.

In the present proceedings, the LBC regards its decision as a choice among three alternative structures for local governance of the unincorporated area proposed for annexation by the CBY:

- approval of annexation of all or part of the area included in the CBY's petition;
- rejection of the CBY's annexation petition in favor of the status quo; or
- rejection of the CBY's annexation petition in anticipation of the area's incorporation into a future Prince William Sound borough, most likely based in or dominated by Valdez.

Approval of the annexation would enhance the ability of the CBY to exercise self-government over an area where its residents have demonstrated important personal interests affecting their lives. Additionally, the individuals who reside in the area proposed for annexation would realize greater ability to exercise local self-government. Residents of the area would be participants in the CBY's municipal government structure. They would also assume obligations as citizens to support local governmental services.

There is a history of significant land use and resource management conflicts in the area proposed for annexation. It appears fairly certain that additional land use conflicts will arise in the future. As such, there is a need for much greater planning in the area. The territory proposed for annexation is in need of other local government services as well.

The CBY annexation would extend essential *municipal* services and powers to an area that currently lacks such services or depends entirely on the State for them. These services and powers include: education, zoning, planning, land use regulation, emergency medical services, police protection, tax assessment, and tax collection.

It is also appropriate to consider Article X, § 1 in the context of a hypothetical Prince William Sound borough. This is particularly fitting since representatives of the Prince William Sound region testified before the LBC in this proceeding that a petition for incorporation of a Prince William Sound borough may be filed in as few as four to six months. Expressions of support for a Prince William Sound borough have been given by the City of Cordova, the Chugach Alaska Corporation, City of Whittier, Chenega Bay IRA Council, and others. The LBC views such expressions as credible interest in creating an organized borough to serve the region. However, it is noteworthy that the City of Valdez "*does not support the formation of a Prince William Sound Borough at this time.*" (May 9, 1996 letter from David Dengel, Assistant City Manager, City of Valdez). Given the lack of municipal support for borough formation by the City of Valdez, the prospect of forming a Prince William Sound borough – with or without Valdez – is limited. If Valdez is included in a proposal to form a Prince William Sound borough, its voters may oppose the proposal in sufficient numbers to defeat it. If Valdez is excluded from a Prince William Sound borough, the proposal may fail to meet the applicable standards for borough formation.

If a Prince William Sound borough were formed that included the area currently proposed for annexation, the area would be relatively remote and isolated from the populated areas of the borough. This would be particularly the case if the borough in question included the community of Valdez. In that case, Valdez would likely be the administrative center of the borough.

Residents of the area from the 141st meridian to Cape Suckling would have far less ability to participate in and influence local government in a Prince William Sound borough than they would in the CBY. That view, however, should not be construed as a general policy of promoting boroughs with smaller populations in order to offer residents a greater voice. In the case at hand, the choice is simply between the CBY or a hypothetical Prince William Sound borough.

In addition to the numerical strength of representation, consideration should be given to commonality of interests. The interests of a Prince William Sound borough would be much more diverse than are the interests of the CBY. There is a strong correlation between common interests and responsive local government.

Further, the pending annexation proposal is a more immediate fulfillment of Article X, § 1 when compared to a hypothetical Prince William Sound borough. If approved by the LBC and legislature, annexation could take effect as early as March 1997.<sup>16</sup> In contrast, if a petition for incorporation of a Prince William Sound borough were filed, incorporation would probably not occur until at least June 1998.

Based on the foregoing, the LBC concludes that Article X, § 1 of Alaska's constitution favors the inclusion of the area in question within an organized borough. The principles embodied in Article X, § 1 would be best implemented by annexation of the area in question to the CBY. Such will have the more immediate effect of extending local self-government to the territory in question. Further, it will give the residents of the area in question a greater voice in the affairs of their local government. Additionally, the area in question has a greater commonality of interests with the CBY than it does with the more diverse Prince William Sound region.

## **B. Regarding Common Interests.**

Article X, § 3 of Alaska's constitution provides as follows:

*The entire State shall be divided into boroughs, organized or unorganized. They shall be established in a manner and according to standards provided by law. The standards shall include population, geography, economy, transportation, and other factors. Each borough shall embrace an area and population with common interests to the maximum degree possible. The legislature shall classify boroughs and prescribe their powers and functions. Methods by which boroughs may be organized, incorporated, merged, consolidated, reclassified, or dissolved shall be prescribed by law.*

16 Tacit approval by the legislature under the provisions of Article X, § 12 of Alaska's constitution would be forthcoming no later than March 8, 1997. Assuming legislative approval is granted, annexation would take effect under the provisions of 19 AAC 10.630 after the CBY provided documentation to DCRA that it has complied with 42 U.S.C. 1973c (Voting Rights Act of 1965). Upon adoption of the decisional statement, the annexation proposal became ripe for submission of a federal Voting Rights Act preclearance request by the CBY to the U.S. Justice Department. The Justice Department typically takes about 65 days to act on such requests.

Additionally, 19 AAC 10.160 provides that annexation to an organized borough may occur only if the social, cultural, and economic characteristics and activities of the people in an area proposed for annexation are interrelated and integrated with the characteristics and activities of the people in the existing borough. It further requires that the communications media and the land, water, and air transportation facilities throughout the proposed post-annexation boundaries of the borough will allow for the level of communications and exchange necessary to develop an integrated borough government.

The respondent CAC and others opposed to annexation placed great emphasis on the 141st meridian as a boundary representing the proper division between the Yakutat and Prince William Sound regions. In particular, CAC relied heavily on its border with the Sealaska Corporation as an appropriate measure of social, cultural, historical and economic differences between the two regions.

The LBC recognizes the significance of the area in question to the CAC. The CAC is, by far, the largest single private landowner in the area proposed for annexation. It owns the surface and subsurface estate of 58,223 acres between Cape Suckling and the 141st meridian. In addition, it has selected an additional 32,079 acres for conveyance in the territory proposed for annexation. However, the ties between Native regional corporate boundaries and borough government boundaries in Alaska is limited.

As noted in DCRA's Provisional Report (Appendix B, pages 1 - 9), few existing and model borough boundaries correlate directly with the boundaries of Native regional corporations. A number of existing and model boroughs include portions of more than one Native regional corporation. Some Native regional corporations include all or portions of more than one existing or model borough. For example, Sealaska has landholdings in five organized boroughs as well as the unorganized borough.

The LBC considered the significance of other formally established boundaries based on the 141st meridian in the context of proper borough jurisdictional boundaries in this proceeding. Those included State house election districts, State judicial districts, regional educational attendance areas, recording districts, census districts, local emergency planning districts and economic development organizations. The LBC found that, at least in this matter, such boundaries were not particularly suitable as the basis for a borough government.

The LBC found that historical use of the area proposed for annexation has overlapped between the Yakutat and the Prince William Sound regions. Evidence was provided to the LBC of strong historical links between the area proposed for annexation and the Prince William Sound region, particularly the Cordova and Eyak areas. However, Yakutat appears to have even stronger historical links to the area proposed for annexation.

*In the context of setting borough boundaries, contemporary and future ties to the area proposed for annexation were found to be more relevant than historical ties.* The LBC notes that the area in question is presently subject to subsistence use, commercial fishing, tourism, recreational activities, timber extraction, and mineral development. Those activities are expected to continue for the long-term future. This is particularly the case with commercial fishing, tourism and recreational activities. The future also offers the prospect of greater mineral development. Further, the area may be affected by exploration for and development of onshore and offshore oil and gas deposits.

As with the historical use, various aspects of current use of the area are oriented in different directions. For example, logging, commercial fishing and subsistence activities in the area proposed for annexation are clearly linked more with Yakutat than with Cordova or other portions of Prince William Sound. On the other hand, guided commercial sports fishing and hunting activities appear to be connected more with Cordova. It is unknown at this point whether exploration for and development of oil and gas deposits will occur in the area. If such does occur, it is uncertain whether the Prince William Sound region or Yakutat will serve as the center of such activities.

Yakutat clearly has far greater ties to the Icy Bay area than do the communities of Prince William Sound. Yakutat's ties to the far western reaches of the territory proposed for annexation appear to be somewhat attenuated. However, the LBC stresses that the territory stretching from the 141st meridian to Cape Suckling is a cohesive geographic area. As such, it would be poor public policy to place that cohesive area into more than one organized borough.

For purposes of determining the most appropriate *borough boundaries*, the LBC must consider the strength of the current and future ties to the area by comparing Yakutat to the entire Prince William Sound region (as opposed comparing Yakutat to Cordova). In that context, the LBC concludes that the interests of the residents of the Prince William Sound region are more diverse than the interests of the residents of the CBY. The LBC further concludes that the people who live in and otherwise use the area proposed for annexation have a greater intensity of common interests with Yakutat than with the hypothetical Prince William Sound borough. Consequently annexation of the area in question to the CBY is supported by Article X, §3 of Alaska's constitution.

Further, the LBC concludes that the social, cultural, and economic characteristics and activities of the people in the territory proposed for annexation are sufficiently interrelated and integrated with the characteristics and activities of the people in the City and Borough of Yakutat. Additionally, the communications media and the land, water, and air transportation facilities throughout the proposed post-annexation boundaries of the City and Borough of Yakutat will allow for the level of communications and exchange necessary to develop an integrated borough government. Thus, the standards established by 19 AAC 10.160 are satisfied.

### **C. Regarding the Post-Annexation Size and Stability of the Population of the CBY.**

19 AAC 10.170 requires that the population of the proposed borough after annexation must be sufficiently large and stable to support the resulting borough.

The number of people in the area proposed for annexation is minimal. It is obvious that if the area were annexed to the CBY, the population of the expanded borough will remain sufficiently large and stable to support borough government. It is also readily apparent that if this area were included in a hypothetical Prince William Sound borough, that it too would meet the applicable standard.

The LBC concludes that the standard set out in 19 AAC 10.170 is satisfied.

**D. Regarding the Human and Financial Resources Necessary to Provide Essential Borough Services on an Efficient, Cost-Effective Level.**

19 AAC 10.180 requires that the economy within the proposed post-annexation borough boundaries include the human and financial resources necessary to provide essential borough services on an efficient, cost-effective level. "Essential borough services" are those "mandatory and discretionary activities and facilities that are determined by the commission to be reasonably necessary to the territory and that cannot be provided more efficiently and more effectively either through some other agency or political subdivision of the state, or by the creation or modification of some other political subdivision of the state . . ." (19 AAC 10.990(7))

It is abundantly clear that the CBY possesses the human and financial resources needed to provide essential borough services on an efficient, cost-effective level. Financial projections prepared by DCRA reasonably indicate that the CBY will spend on the order of \$130,000 annually to serve the area proposed for annexation. DCRA's projections also reasonably demonstrate that the CBY will take in some \$162,000 to \$200,000 in additional annual revenues as a result of annexation. Thus, the annexation is unlikely to be a financial drain on the CBY. Further, evidence provided to the LBC indicates that the CBY has a healthy financial position that has allowed it to accrue fund balances in excess of \$3 million.

The LBC also considered the standard at issue in the context of a hypothetical Prince William Sound borough. The LBC found that the proposed annexation to the CBY would have no meaningful impact on the financial viability of a future Prince William Sound borough. The LBC also found that the CBY would have less human and financial resources to serve the area proposed for proposed for annexation compared to a Prince William Sound borough.

Notwithstanding, the CBY clearly has the human and financial resources needed to serve the area in question on an efficient and cost-effective basis. Since its incorporation, the CBY has demonstrated that it has the financial ability to provide services and the willingness to tax its residents. Thus the LBC concludes that the standard set out in 19 AAC 10.180 is satisfied.

**E. Regarding Boundary Issues In the Context of Natural Geography, Areas Necessary for Full Development of Services, Model Boundaries, and Education.**

State law requires that the post-annexation boundaries of a borough conform generally to natural geography. (19 AAC 10.190) The LBC finds that the Malaspina Glacier, the western edge of which lies near the 141st meridian, is a significant barrier and natural geographic feature. As such, the use of the 141st meridian as the current western corporate boundary of the CBY is not arbitrary in the context of this standard. However, the LBC finds further that the natural geography of the area proposed for annexation is similar to that within the current boundaries of the City and Borough of Yakutat (i.e., the area extending northward from Cape Fairweather).

19 AAC 10.190 also requires that the post-annexation boundaries of a borough must include all land and water necessary to provide the full development of essential borough services on an efficient, cost-effective level. As noted previously, evidence in this proceeding was persuasive that the area proposed for annexation is cohesive. As such, the area from the Malaspina Glacier to Cape Suckling

should not be placed within the jurisdiction of multiple organized boroughs. It is particularly important that land use planning decisions encompass the entire coast from Cape Suckling to the 141st meridian.

State law provides that absent a specific and persuasive showing to the contrary, the LBC may not approve a borough annexation beyond the model borough boundaries adopted by the LBC and identified in the 1992 Interim Report on Model Borough Boundaries. (19 AAC 10.190(c)) The western model borough boundary of the CBY was set at the 141st meridian following action taken by the LBC in 1992 concerning the petition for incorporation of the CBY.

The LBC has stated in previous decisions that the 1961 legislature, in providing for a single residual unorganized borough encompassing all of the state not within organized boroughs, failed to adhere closely to the requirement of Article X, § 3 that each borough – organized and unorganized – embrace an area and population with common interests to the maximum degree possible. That circumstance was the genesis for the establishment of model borough boundaries by the LBC.

Model borough boundaries were meant to be a means of preventing and solving borough boundary problems throughout the state. They were intended to save the LBC, DCRA and prospective petitioners needless effort by guiding interested parties as to what might reasonably be expected with respect to borough boundaries. Model borough boundaries were meant to promote the purpose of Article X, § 1, not frustrate it by perpetuating an absence of local government in the unorganized borough. They were not intended to thwart legitimate borough boundary proposals.

The LBC is unwilling to doom the area in question or any other area of the unorganized borough to an absence of local government for an indefinite period of time while it awaits some action on formation of a borough, if a pending annexation or incorporation petition satisfies constitutional, statutory, and regulatory standards.

Model borough boundaries should not be overturned lightly. A great deal of time and effort went into the establishment of model borough boundaries. In this particular case, strong evidence of the area's social, cultural, economic, geographic, transportation and other ties to the Yakutat region has been provided. The LBC considers such evidence to be sufficiently specific and persuasive to allow the extension of the CBY's corporate boundaries to Cape Suckling.

The LBC notes, however, that approximately 184 square miles of the territory proposed for annexation lie within the model borough boundaries of the Copper River region. Virtually no attention has been given to that area in this proceeding by the CBY. In fact, when asked, the CBY expressed no objection to the exclusion of the 184 square miles in question. Thus, the LBC finds that the requisite specific and persuasive showing to allow annexation by the CBY of the 184 square miles within the model borough boundaries of the Copper River region has not been achieved.

State law also provides that the LBC will consult with the Department of Education in the process of balancing all standards for annexation to a borough. (19 AAC 10.190(d)) The LBC, through its DCRA staff, has consulted extensively with the Department of Education concerning the current CBY annexation proposal. The Department of Education has taken no position with regard to the pending CBY annexation proposal.

However, the Department of Education did take a position concerning the inclusion of the area extending to Cape Suckling in the CBY in the context of the earlier incorporation proceedings. On October 14, 1991, Jerry Covey, then-Commissioner of the Department of Education, announced that he had made a determination pursuant to AS 14.17.139 that "formation of the new school district, as described in the proposed City and Borough of Yakutat, would be in the best interest of the state and the proposed City and Borough of Yakutat School District."<sup>17</sup>

In summary, the LBC has determined that CBY boundaries extending to Cape Suckling would conform generally to natural geography. Such boundaries would also include all land and water necessary to provide the full development of essential borough services on an efficient, cost-effective level. Further, a specific and persuasive showing has been made to allow the CBY to extend its corporate boundaries to Cape Suckling on the west, exclusive of approximately 184 square miles lying within the model borough boundaries of the Copper River region. The LBC has consulted adequately with the Department of Education in the process of balancing all standards for annexation to a borough. Thus, the LBC concludes that the standards set out in 19 AAC 10.190 are satisfied with the exclusion of territory lying within the model borough boundaries of the Copper River region.

**F. Regarding the Balanced Best Interests of the State, the Territory to be Annexed, and all Political Subdivisions Affected by the Annexation.**

State law provides that territory that meets the annexation standards specified in 19 AAC 10.160 - 19 AAC 10.190 may be annexed to a borough by the legislative review process if the LBC also determines that annexation will serve the balanced best interests of the State, the territory to be annexed, and all political subdivisions affected by the annexation. (19 AAC 10.200)

Although the annexation of the area to the CBY is reasonably projected to reduce the State's education costs slightly more than \$180,000 annually, those fiscal implications are minimal when compared to the fulfillment of the principles of Article X, § 1 of Alaska's constitution. Maximum local self-government is a highly positive factor affecting the best interests of the State, the territory to be annexed and the political subdivisions affected by the proposal.

Again, the LBC considered this standard in the context of a hypothetical Prince William Sound borough. The LBC found in that regard that the administrative headquarters of a Prince William Sound borough would likely be far removed from the area proposed for annexation. As such, the area from Cape Suckling to the 141st meridian would likely receive scant attention from a Prince William Sound borough. Areas that are far removed from their administrative centers often suffer diminished communications and contact.

The LBC considered the effects of annexation on the interests of the CAC and others opposed to annexation. The LBC has found no prospect of substantial harm to those interests. If the CBY continues to function as it has, it will promote a balanced use of fisheries, timber, and other resources. It is unlikely that such would be any different if CAC were dealing with a Prince William Sound borough.

17 CBY incorporation record at 2896.

## SECTION IV RECOMMENDATION

During its deliberations, the LBC considered the alternative of approving the annexation to the CBY *only* if the territory were not included within a Prince William Sound organized borough within two years. However, that option was rejected by the LBC.<sup>18</sup>

As a result of the conclusions reached in this case, on December 16, 1996, the LBC inherently amended the CBY's petition for annexation to exclude the estimated 184 square miles petitioned for annexation that lie within the model borough boundaries of the Copper River region. The LBC approved the petition for annexation with the amended boundaries by a unanimous vote among the five members present.

The Local Boundary Commission hereby recommends to the First Session of the Twentieth Alaska Legislature, the annexation, to the City and Borough of Yakutat, of the territory described below. This recommendation is offered in accordance with the provisions of Article X, Section 12 of the Constitution of the State of Alaska.

The territory recommended for annexation is described as follows:

Beginning at the southern tip of Cape Suckling at North 59° 59' 24" Latitude and West 143° 53' 36" Longitude, the true point of beginning;

Thence due north to the ridge line of the Suckling Hills at North 60° 01' 27" Latitude, West 143° 53' 36" Longitude;

Thence northeasterly, along a straight line, to the Northwest corner of protracted T. 16 S., R. 13 E., Copper River Meridian;

Thence due east along the protracted township line separating T. 16 S. and T. 15 S., Copper River Meridian, to the northwest corner of T. 16 S., R. 21 E.;

Thence due south along the protracted township line separating R. 20 E. and R. 21 E., Copper River Meridian, to the southwest corner of T. 16 S., R. 21 E.;

Thence due east along the protracted township line separating T. 16 S. and T. 17 S., Copper River Meridian, to the northwest corner of T. 17 S., R. 25 E.;

Thence due south along the protracted township line separating R. 24 E. and R. 25 E., Copper River Meridian, to the southwest corner of T. 17 S., R. 24 E.;

<sup>18</sup> A motion to conditionally approve annexation as described was made by Commissioner William Walters. However, the motion failed to be seconded by another member of the LBC. Commissioner Walters found that the economic development of the area proposed for annexation will be more closely tied to the Prince William Sound region than to the City and Borough of Yakutat. Nevertheless, in the absence of a specific time line for a Prince William Sound borough to provide this area the local government services required by Article X, § 1 of the Alaska constitution, Commissioner Walters joins in the decision of the other Commissioners.

Thence due east along the protracted township line separating T. 17 S. and T. 18 S., Copper River Meridian, to the International Boundary between the United States and Canada on the 141st Meridian;

Thence due south along the 141st Meridian to its point of intersection with North 58° 48' 30" Latitude in the Gulf of Alaska;

Thence due west along a straight line to North 58° 48' 30" Latitude, West 143° 53' 36" Longitude in the Gulf of Alaska;

Thence due north, to the Southern tip of Cape Suckling, the true point of beginning.

With respect to the portion of the territory proposed for annexation that extends into the Gulf of Alaska, notwithstanding the foregoing description, the corporate jurisdictional limits of the City and Borough of Yakutat will extend only to the limits of the State of Alaska's jurisdiction under AS 44.03.010.

Annexation will result in the following corporate boundaries for the City and Borough of Yakutat.

Beginning at the southern tip of Cape Suckling at North 59° 59' 24" Latitude and West 143° 53' 36" Longitude, the true point of beginning;

Thence due north to the ridge line of the Suckling Hills at North 60° 01' 27" Latitude, West 143° 53' 36" Longitude;

Thence northeasterly, along a straight line, to the Northwest corner of protracted T. 16 S., R. 13 E., Copper River Meridian;

Thence due east along the protracted township line separating T. 16 S. and T. 15 S., Copper River Meridian, to the northwest corner of T. 16 S. R. 21 E.;

Thence due south along the protracted township line separating R. 20 E. and R. 21 E., Copper River Meridian, to the southwest corner of T. 16 S., R. 21 E.;

Thence due east along the protracted township line separating T. 16 S. and T. 17 S., Copper River Meridian, to the northwest corner of T. 17 S., R. 25 E.;

Thence due south along the protracted township line separating R. 24 E. and R. 25 E., Copper River Meridian, to the southwest corner of T. 17 S., R. 24 E.;

Thence due east along the protracted township line separating T. 17 S. and T. 18 S., Copper River Meridian, to the International Boundary between the United States and Canada on the 141st Meridian;

Thence following, in a generally southeasterly direction, the International Boundary of the United States and Canada, to the Peak of Mt. Fairweather at the International Boundary of the United States and Canada, in T. 35 S., R. 47 E., Copper River Meridian;

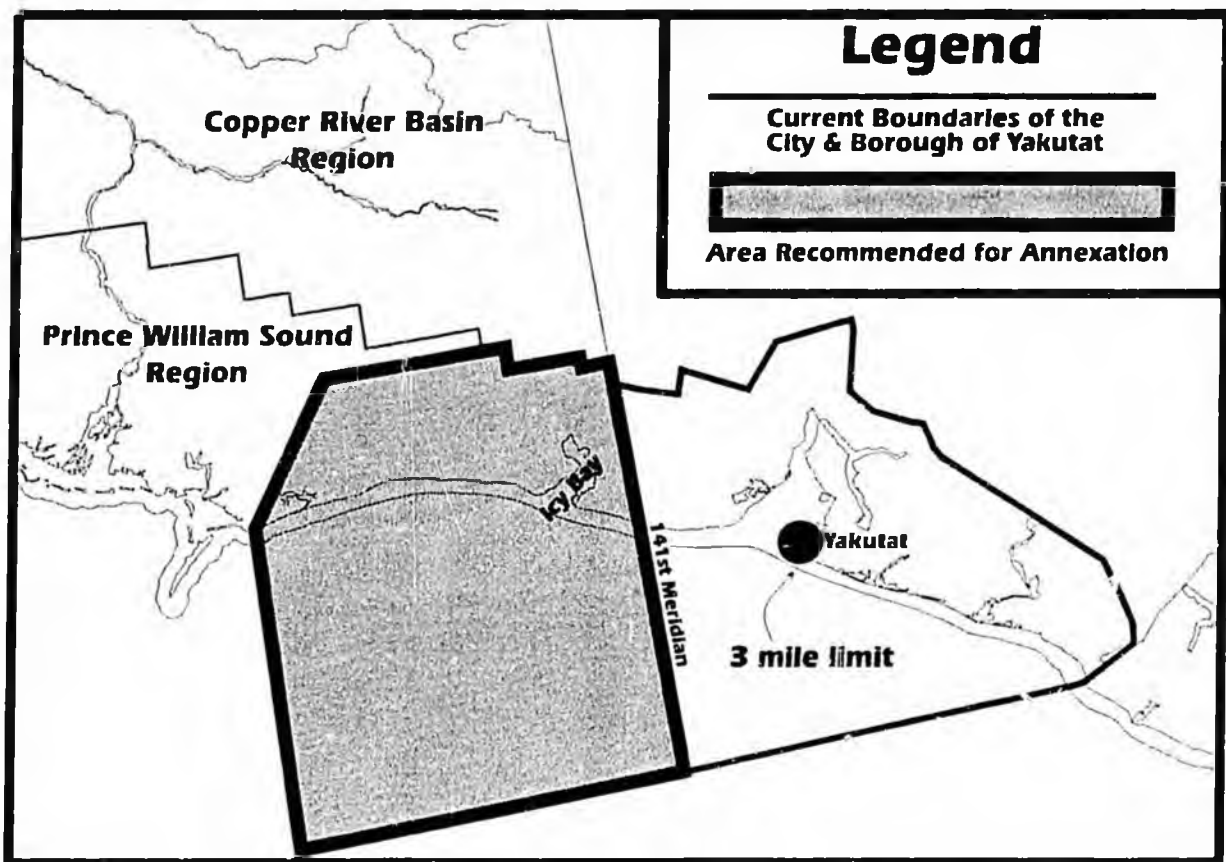
Thence southwesterly in a straight line to Cape Fairweather, at North 58° 48' 30" Latitude, West 137° 56' 45" Longitude in T. 36 S., R. 45 E., Copper River Meridian;

Thence due west along a straight line to a point in the Gulf of Alaska at North 58° 48' 30" Latitude, West 143° 53' 36" Longitude.

Thence due north, to the Southern tip of Cape Suckling, the true point of beginning.

With respect to the portion of the City and Borough of Yakutat that extends into the Gulf of Alaska, notwithstanding the foregoing description, the corporate jurisdictional limits of the City and Borough of Yakutat extend only to the limits of the State of Alaska's jurisdiction under AS 44.03.010.

A map showing the existing boundaries of the City and Borough of Yakutat and the territory approved for annexation appears below.







## CHAPTER IV POLICY ISSUES AND CONCERNS

Current policy issues and concerns that the Commission wishes to bring to the attention of the Legislature include:

- ⊕ mandatory borough formation;
- ⊕ matters relating to detachment of territory from existing organized boroughs;
- ⊕ continued interest in dissolution of cities; and
- ⊕ the lack of limitations on the authority of municipalities to levy certain taxes.

### **Mandatory Borough Formation**

A need exists to develop a coherent, uniform public policy regarding establishment of organized boroughs throughout Alaska. The haphazard evolution of Alaska local self government has contributed to inconsistencies and disparities in local taxation and provision of local services. As noted in Chapter II, the Commission discussed this broad issue in a forum conducted in February to discuss select provisions of Article X of Alaska's Constitution.<sup>19</sup>

The LBC is aware that Senator John Torgerson has prefiled a bill with the First Session of the Twentieth Legislature to promote borough formation (SB 30). If enacted, SB 30 would:

- ✓ allow the incorporation of additional third class boroughs;
- ✓ require DCRA to prepare third class borough incorporation petitions for each area defined by model borough boundaries; in doing so, DCRA

would be required to conduct at least one public hearing in every community with a population of 500 or more;

- ✓ require DCRA to estimate the value of taxable property in the areas defined by model borough boundaries on or before January 1, 1998;
- ✓ require filing of petitions with the LBC for the incorporation of boroughs in areas with taxable property of:
  - ☑ \$550 million or more by July 1, 1998;
  - ☑ \$350 million to \$549,999,999.99 by July 1, 1999;
  - ☑ \$75 million to \$349,999,999.99 by July 1, 2000;
  - ☑ \$74,999,999.99 or less by July 1, 2001.
- ✓ provides that the LBC may ask DCRA to alter a borough incorporation petition within 6 months of the filing of a petition;
- ✓ requires the LBC to accept a petition when it determines that the proposal meets the incorporation standards;
- ✓ requires the Division of Elections to conduct a borough incorporation election 31 to 120 days after being notified that the LBC accepted a petition;

<sup>19</sup> See the discussion on the Commission's February, 1996, Forum on Local Government Article of Constitution.

- ✓ provides that if voters reject borough incorporation, the area becomes a separate unorganized borough; property in the new unorganized boroughs that lies outside of home rule and first class cities would be subject to a 6-mill State property tax beginning January 1 of the year following certification of the election;
- ✓ requires DCRA to develop alternative tax structures for the unorganized boroughs and to submit draft legislation concerning such by January 1, 1999.

LBC has taken no position on this bill at this time.

### **Issues Relating to Detachment from Organized Boroughs**

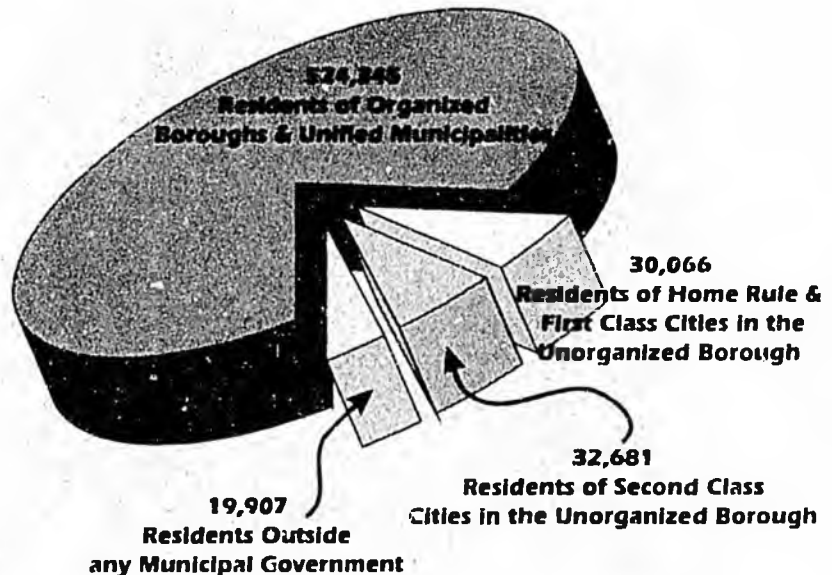
During 1996, the merits of the petitions for detachment of Lake Louise from the Matanuska-Susitna Borough and North Pole from the Fairbanks North Star Borough were both extensively debated before the Commission. The fact that the North Pole detachment was rejected and the Lake Louise petition approved by the Commission serves to underscore the basic premise of the Commission that each petition is unique and is examined on its specific merits.

Lake Louise's small population and relatively insignificant tax base belie the fundamental issues of statewide importance involved in its proposed detachment from the Matanuska-Susitna Bor-

ough.<sup>20</sup> Some of those issues were beyond the scope of the Commission while others were not. This section discusses some of the key policy issues relating to the detachment proposals.

### **Promotion of Maximum Local Self-Government**

Alaska's Constitution (Article X, Section 1) promotes maximum local self-government. By definition, detachment from an organized borough to the unorganized borough — as would be the case with Lake Louise — was viewed by the Commission as an abdication of local self-government. To address that issue, the Commission initially approved detachment, but only on the condition that Lake Louise first be included within another organized borough. The LBC also considered the option of forming a second class city to serve the local government needs of the community.



20 The area has a population of 57 residents and encompasses less than one-half of one percent of the total property tax base of the Matanuska-Susitna Borough.

Statewide, just over 96.5% of all Alaskans (587,092 of 607,800) live within at least one municipal government. Approximately 86% (524,345) reside within Alaska's 13 organized boroughs and 3 unified municipalities. About 5% (30,066) live in the 5 home rule cities and 13 first class cities in Alaska's unorganized borough. Just under 5.4% (32,681) live in Alaska's 81 active second class cities in the unorganized borough. The remaining 3.3% (19,907) live without any functioning municipal government.

Nearly sixteen percent of Alaskans (96,443) live within both a city government and an organized borough. Of those, 83,107 live in 7 home rule cities and 8 first class cities within organized boroughs. The remaining 13,336 live in 34 second class cities within organized boroughs.

**Promotion of Maximum Common Interests Within Boroughs**

Alaska's Constitution (Article X, Section 3) requires that each borough embrace an area and population with common interests to the maximum degree possible. The Commission concluded that this principle applied to the unorganized borough, not just organized boroughs.

The Commission found that Lake Louise had more in common with Glennallen and the remainder of the Copper River Basin than it did with the rest of the Matanuska-Susitna Borough. However, because the Copper River Basin is but a small part of Alaska's huge residual unorganized borough "established" under AS 29.03.010, the Commission had difficulty applying this principle in the Lake Louise case. Similar difficulties would arise in any detachment from an organized borough to the unorganized borough. The difficulty stems from the fact that the area and population in the unorganized borough — which stretches intermittently

northward from Metlakatla to Arctic Village, westward to Nome and southwesterly to the tip of the Aleutian Islands — have limited common interests.

It appears that greater compliance with the Common Interests Clause of Article X, Section 3 of Alaska's Constitution could be achieved with respect to the unorganized borough if AS 29.03.010 were amended to divide the single unorganized borough into multiple unorganized boroughs — each embracing an area and population with common interests to the maximum degree possible. The foundation for such an effort already exists in the form of model borough boundaries established by the Commission a few years ago. Additionally, boundaries of regional educational attendance areas — which have largely been in place for two decades — might also serve as a guide in the formal subdivision of the unorganized borough.

**Requirement for "Local Contributions" Under AS 14.17.025 After Detachment**

AS 14.17.025 requires boroughs (as well as home rule and first class cities in the unorganized borough) to make a "local contribution" in support of their schools. In the case of the Matanuska-Susitna Borough, the required local contribution amounts to "the equivalent of a four mill tax levy on the full and true value of the taxable real and personal property in the district as of January 1 of the second preceding fiscal year, as determined by the Department of Community and Regional Affairs under AS 14.17.140 and AS 29.45.110."

The Department of Education interprets that provision to require municipalities to include taxable property that has been detached from a municipality in the calculation for the local contribution for a period of two years after detachment has occurred. Thus, if Lake Louise detaches, the Department of Education main-



**Glennallen High School**

tains that Matanuska-Susitna Borough's contribution for the following two years would be based on calculations which include the value of taxable property at Lake Louise. Yet, the Borough would apparently be unable to levy taxes on the property in question once it detaches. The amount in question with respect to Lake Louise is estimated to be approximately \$93,000 over the two years. It is a relatively insignificant amount in comparison to the Borough's total annual contribution of more than \$8 million. However, the Commission viewed the circumstances as unfair to the Matanuska-Susitna Borough unless the Borough were reimbursed by the newly incorporated city. The Commission was also concerned with precedent, since the issue could be much more significant in the context of other detachments.

### **Equity Issues**

As it has done for the past several years, the Commission continues to encourage the legislature to address fundamental issues concerning equity in the delivery of services. In the view of the Commission there is clearly a growing need to examine certain existing State laws and policies.

For example, there are inequities in the manner in which regional service delivery in Alaska is structured. In 1963, the Legislature mandated the formation of eight boroughs. Today, those eight boroughs encompass about 80% of Alaska's population. The residents and property owners in the mandatory boroughs typically pay substantial local taxes for basic services. In contrast, areas of the state that lie outside any local government pay no taxes. Some of those areas enjoy services comparable to the services in the mandatory boroughs. Further, some of these areas have resources at least comparable to boroughs formed under the 1963 Mandatory Borough Act.

Education typically constitutes the greatest financial expenditure by organized boroughs. Provision of that service by organized boroughs is mandated by State law. Disparities exist in funding for education between municipal school districts and regional educational attendance areas. For example, because of requirements for local contributions, some municipal school districts receive State and federal aid amounting to only about two-thirds of their defined level of "basic need" for education.<sup>21</sup> Regional educational attendance areas receive a higher level of State funding, in part, because they are not required to contribute financial support for

<sup>21</sup> The level of basic need is determined under AS 14.17.021.

education. Further, some regional educational attendance areas receive funding not available to other districts due to geographic location (e.g., National Forest Receipts).

While the legislature more than 30 years ago mandated that the major populated areas of the state form boroughs, it has since gradually eliminated most of the incentives to form boroughs. Consequently Alaskans have two strikingly different forms of regional service delivery.

By raising these equity issues, the Commission is not advocating mandatory organization of the rest of the state. However, given the certainty of further reductions in State revenues, attention to these issues is warranted.

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## **Continued Interest in City Dissolution**

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Interest in dissolving city governments continues. As described in Chapter II, LBC staff responded to active or potential city dissolution proposals relating to eleven second class cities.

Generally this interest appears to reflect a desire to return to more traditional ways of governance. However, the potential exists for interest in dissolution of municipal governments throughout the state.

Many of the policy issues noted in the previous discussion concerning detachment from organized boroughs are relevant to this issue as well. Just as there are incentives to detach from boroughs (or to remain part of the unorganized borough), there are incentives to dissolve cities (or to remain unincorporated).

For example, communities can often enjoy a substantial level of services without the civic and financial responsibilities of city government. Unincorporated communities in the unorganized

borough may receive state revenue sharing (AS 29.60.130 - .140), capital project matching grants (AS 37.06.020) and education that is fully funded by the state (AS 14).

Unincorporated communities may also receive police protection through the State Troopers or the Village Public Safety Officer program. Additionally, State agencies and the legislature may fund projects such as water and sewer facilities without requiring local contributions. The number of cities in Alaska may decline if communities can enjoy such privileges without assuming the responsibility for local government.

Beyond these somewhat abstract policy issues, the Commission wishes to raise a specific concern relating to dissolution of cities. Under current law (AS 29.06.520), the State succeeds to the assets, liabilities, duties, powers and rights of the cities if they dissolve (unless another municipal government becomes the successor). The Commission takes the position that the State should not assume responsibility for local services and other liabilities and that these should be transferred to a local successor.

As the successor under the law, the State assumes liabilities of the dissolved cities. Of course, liabilities are not necessarily limited to debts and contracts. As the successor, the State may find itself legally exposed to risks related to the improper operation and construction of water and sewer systems, bulk fuel storage tanks, landfills, and other public facilities. The risks may be minimized by conveying properties back to the local communities. However, because the State is necessarily included in the chain of title for properties of dissolved municipalities, it appears that the State may not be able to escape all exposure to liabilities. The Commission believes that it would be even better to avoid having the state assume liabilities altogether.

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## **Lack of Limitations on Authority of Municipalities to Levy Certain Taxes**

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For the past four years, the Commission reported to the legislature that concerns have been expressed over the lack of reasonable limits on the authority of municipalities to levy taxes. Such concerns continued to be expressed during the year just ended. While the recently-incorporated Cities of Pilot Point and Egegik were most often cited as examples of the need for reasonable limitations, the Commission is aware of several other local governments that also levy substantial taxes on natural resources. These resources are not limited to fisheries, but include oil and gas properties, mining properties, timber and other natural resources.

Because Pilot Point is cited so frequently in arguments regarding this issue, the Commission offers details below concerning the tax levy of that particular government. In doing so, however, the Commission stresses that it does not intend to single out the City of Pilot Point for judgment as to the reasonableness of its taxes.

The City of Pilot Point levies a 3% sales and use tax on commercial fish harvests within its municipal boundaries. In FY '95, the City of Pilot Point collected \$690,721 from its sales tax on commercially harvested fish. (Alaska Taxable 1995, page 16) Thus, the tax generated about \$7,348 for each person in Pilot Point. This per capita tax revenue is in stark contrast to the \$503 per capita average of all taxes collected by the other municipal governments in Alaska which do not have education powers. General law cities may exercise whatever powers are not

prohibited by state law. However, in practice, fiscal constraints effectively serve to limit the number of services provided by most cities. However, since the City of Pilot Point encompasses a significant tax base the City is not subject to the financial constraints typically faced by remote second class cities.

As directed by the Alaska Supreme Court, the Commission is reconsidering its decision to approve incorporation of the City of Pilot Point. On June 27, 1996 the Commission's staff issued a provisional report regarding the reconsideration of the incorporation of Pilot Point. During the course of the reconsideration proceedings, the City of Pilot Point submitted a brief describing public services which would be provided by the City with the revenue generated by its tax. Those services included "upgrading of airport facilities". (July 12, 1995 Brief, City of Pilot Point, at 5) However, when the community's runway deteriorated during the final months of 1996, the City requested that the State of Alaska fund repairs to the facility on an emergency basis. It is troubling to the Commission when municipalities justify extremely high tax revenues by pledging to enhance local services and facilities, but claim poverty and seek additional funding from the State of Alaska to restore local infrastructure.

The Commission is keenly aware that as state funding for local services continues to decline, the ability of Alaska's 164 municipal governments to raise revenues will become more critical. Therefore, any attempt to address this issue fairly will no doubt prove to be as difficult as it will be controversial. The Commission raises this issue again only to ensure that the legislature is aware of sentiments concerning this matter. ■

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Presentation:

PFD

Corporation

**HFIN**

**FILE**

# **\$20 Years, \$20 Billion Building an Investment Policy for the Next 20 Years**

Exploring options for the Permanent Fund

8:00 - 9:30 a.m.

Wednesday, February 12

*Joint Finance & Legislative Budget & Audit Committee Hearing*

• • •

*Senate Finance Committee Room*

## **The Yale Model**

Superior returns for the present; safeguards for the future

## **The New Mexico Experience**

Voters say yes to 65% equities ceiling & new distributions policy  
based on average market value

## **Inside Tomorrow's Portfolio**

More investment options than ever

## **Balancing Risk and Return**

How they do it in the Pacific Northwest

## **What it Means for the Fund**

Michael O'Leary, the Fund's investment consultant,  
examines the implications of investment policy options  
and changes to the Fund's asset allocation

**A Permanent Fund Forum  
February 12, 1997**

**“20 Years, \$20 Billion:  
Building an Investment Policy for the Next 20”**

Last year some legislators asked why the Fund isn't earning more relative to other large funds. Similar questions were raised by the Long-Term Financial Planning Commission. The simple answer is that the Fund is performing exactly as it was designed, carefully preserving a significant portion of Alaska's oil revenues for the benefit of present and future generations, based on an investment list determined in statute by the Alaska legislature.

This is a position of comfort for the Alaska Permanent Fund Corporation (APFC) and the Fund's shareholders, the residents of Alaska. It's a position that Alaskans can understand and one that has worked well – with some legislative adjustments – over the past 20 years. The Fund's conservative investment policy has ensured that our state's oil resources will continue to produce significant revenue streams and its corpus will remain intact and safe.

But the more complex answer is yes, the Fund likely could produce a larger, consistent, long-term revenue stream. For example, compared with similar institutions like the state's pension funds, the Fund's historic performance is just average or slightly below-average. There are alternative asset allocations and alternative distribution policies that could significantly enhance the Fund's overall performance. These policies all carry an element of increased risk and management cost.

To help the legislature gain a deeper perspective into the Fund's potential, and the various alternatives available, the APFC is putting together a forum entitled “20 Years, \$20 Billion: Building an Investment Policy for the Next 20.” This forum will examine how the investment world has changed over the past two decades, how it is likely to change in the next 20 years, and how institutions similar to the Alaska Permanent Fund are developing individualized policies to fulfill their own particular public policy needs.

This forum is purely informational. It is not the APFC's role to set or inappropriately influence policy. The right to establish policy belongs exclusively to the residents of Alaska and their elected representatives. It is, however, the APFC's role to respond to specific requests for information – like those raised during the last legislative session – and to present information to assist in furthering the public debate over the future of the Fund.

The APFC has no desire to change public policy. It does, however, have a very keen interest in any policy changes the legislature may deem appropriate. The Fund has grown to such a magnitude that it needs sufficient lead time to respond to major policy changes.

It is the APFC's hope that this forum will provide meaningful and timely information on the role of the Fund in Alaska's fiscal future, its potentialities and its appropriate levels of performance.

The forum will be held the morning of February 12, 1997 in the Senate Finance Committee Room (Rm 532) of the State Capitol Building in Juneau, Alaska (exact time TBA.) Panelists at the forum will include:

- **Richard J. Franke**, Chairman of the Board, Yale Endowment
- **Duane M. Johnson**, Portfolio Manager New Mexico State Investment Council
- **Denis S. Karnosky, Ph.D.**, Managing Partner Asset Allocation, Brinson Partners
- **W. Dan Smith**, Investment Manager, Oregon Investment Council (LATE NOTE: Mr. Smith has notified the APFC that he has just been scheduled to testify before the Oregon State Legislature, so will be unable to attend the forum in Juneau.)

The moderator for the forum will be Michael O'Leary, Executive Vice President, Callan Associates. Callan Associates is the APFC's performance measurement, manager search and asset allocation consultant.

This is an educational, not an advocacy, event. Its purpose is to inform Alaska public policy makers about the key investment issues faced by the Board of Trustees as they build an investment policy for the Fund's next 20 years.

The panel has been chosen to provide the following perspectives:

- Mr. Franke will describe the reasons for the superior investment performance of the Yale Endowment. Yale's 10-year total return ranks in the top one percent of all large institutions. He will also discuss Yale's income distribution formula which has been carefully designed first, to safeguard their fund's value against inflation; and second, to balance the demands of the present generation of beneficiaries against the claims of future generations.
- Mr. Johnson will share New Mexico's recent experience in which on November 5, 1996, the voters of New Mexico approved an amendment to their state Constitution allowing up to 65% of the \$7 billion New Mexico Permanent Funds to be invested in stocks, and changing the method of making distributions to the beneficiaries from payment of all interest and dividends to one based on the funds' average market value.
- Dr. Karnosky will provide the long-term performance record of various investment asset classes. His presentation will include both an historical perspective and a consideration of how asset allocation in a global portfolio like the Alaska Permanent Fund's may look different in the future.
- Mr. Smith will present the investment policy and philosophy of a large institutional investor in the U.S. Northwest comparable in size to the Alaska Permanent Fund (\$23 billion versus \$20 billion), but somewhat different in terms of asset allocation and their approach to balancing risk and return.

Each panelist will make a 12-15 minute presentation and respond to questions.

**RICHARD J. FRANKE,  
CHAIRMAN, YALE INVESTMENT COMMITTEE**

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Mr. Franke was born in Springfield Illinois in 1931, graduating from Springfield High School. He received a BA in history from Yale University in 1953 and then entered the U.S. Army, where he spent two years as a military officer. After discharge from the Army, he attended Harvard Business School, receiving his MBA in finance in 1957.

He spent his entire business career as an investment banker with John Noveen & Co. He began as a summer intern while in business school and after graduating, entered the Noveen training program. He worked his way up through various levels of management, specializing in the underwriting and origination phases of the business. He was made a Vice President in 1965, Executive Vice President and Director in 1969, Chief Administrative Officer in 1970, President and Chief Executive Officer from 1974-89. In 1988, he was elected Chairman and Chief Executive Officer and served until his retirement in June of 1996.

He has held various leadership positions in industry-related organizations, such as the Securities Industry Association and the Bond Club of Chicago. In addition to his business and professional activities, Mr. Franke maintains an active interest in the humanities and in higher education. In 1990 he was appointed to the President's Committee on the Arts and the Humanities, and he currently serves on the boards of the Illinois Humanities Council, the other central Association of Chicago, the Lyric Opera of Chicago, and the Newberry Library.

In 1990 as Chairman of the Illinois Humanities Council, Mr. Franke spearheaded the development of the Chicago Humanities Festival, now an annual event that brings together Chicago's premier cultural institutions in a literary and artistic celebration of the Humanities. In recognition of his leadership and service, the Illinois Humanities Council named Mr. Franke recipient of the Council's Public Humanities Award in May 1994. In February 1995, he testified before a Congressional Appropriations Subcommittee to support federal findings for the humanities and the arts. In January he became chair of Americas United to Save the Arts and Humanities (AUSAH), a national cultural advocacy organization made up of business and community leaders.

He has a special concern for the education and serves as Senior Fellow of the Yale Corporation and Chairman of the Yale Investment Committee. He is also a Trustee of the University of Chicago where he serves on the Executive and Investment Committee and chairs the University Visiting Committee for the Humanities. He also serves on the Harvard Business School Board of Directors of the Associates. He has held several board positions at the North Shore Country Day School in Winnetka, Illinois as Treasurer and President of the Board as well as Chairman of the school's major fundraising campaign.

He exemplifies a commitment to education in a life long activity and was a participant in the First Stanford Executives program in the Humanities. His interest in the study of Western civilization spans many years. He helped to organize a study group, coordinated by a University of Chicago professor, that focuses on the words of leading philosophers, historians and artists from ancient to modern times.

**DUANE M. JOHNSON**  
**PORTFOLIO MANAGER**  
**NEW MEXICO STATE INVESTMENT COUNCIL**

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Duane M. Johnson, Portfolio Manager, joined the New Mexico State Investment Council in 1986. He is the co-manager of over \$4.1 billion in fixed income assets. Duane is also the special-projects director for the Investment Office, and prepared all of the internal analysis for the Council and the state Legislature on the recently approved constitutional amendment. This amendment has rewritten all of the controlling documents for the State Investment Council and redefined the two permanent funds managed by the Council as total rate of return funds. Duane has also managed the alternative investments portfolio (monthly venture capital) since its inception in 1987. This program has been so successful (over 25% annual IRR over the last 8 years) that it is currently being expanded to 3 percent of the Fund's market value (about \$240 million).

Previously, Duane spent 20 years as a United States Air Force officer, where he served as a pilot, test pilot, staff officer, test director and commander. From 1983 to 1986, he was a consultant with an aviation consulting firm which provided services to commercial airline operators and governmental agencies.

Duane received his MBA in Finance and General Management from the University of New Mexico (Summa Cum Laude), and his BS in Physics (with distinction) from Pacific Lutheran University.

**DENIS S. KARNOSKY, PH.D.**  
**MANAGING PARTNER, ASSET ALLOCATION**  
**BRINSON PARTNERS**

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**Academic**

Blackburn College, BA  
University of Missouri, MA  
Duke University, Ph.D

**Experience**

As Managing Partner of the Asset Allocation Group of Brinson Partners, Inc., Dr. Karnosky is responsible for the management of asset allocation activity. These responsibilities include the development and management of asset allocation policy and strategy, performance analysis and development of new products and systems. As chairman of the firm's Asset Allocation Committee, he oversees asset allocation for multi-asset clients across U.S. stocks and bonds, non-U.S. stocks and bonds, private markets real estate and cash equivalents. He is also a member of the firm's senior management team that develops and coordinates overall business and investment strategy.

Dr. Karnosky has research and senior policy making experience in the U.S. government, including the Federal Reserve System, the U.S. Treasury and several foreign countries. He has held the positions of Deputy to the Under Secretary for Monetary Affairs and Director of the Office of Monetary Policy analysis in the Treasury Department. He has also served as an economic advisor to the National Bank of Austria and the General Confederation of Italian Industry. He has written and lectured extensively on economic issues, with an emphasis on the fundamental role of asset markets in the economy.

Prior to joining the firm in 1987, Dr. Karnosky directed risk management research and development for several financial service firms.

**Professional affiliation and significant roles**

- Chairman of Brinson Partners, Inc., Asset Allocation Committee
- Chairman of Brinson Partners, Inc's Research and Development Committee
- Member of the following Brinson Partners, Inc's Investment Committees, Senior Investment Emerging Markets, Risk Management, U.S. equity, U.S. Fixed income, Non-U.S. and Private Markets.
- Member of Board of Directors of Brinson Partners, Inc.

**Publications**

- Karnosky, Dr. Denis S, and Singer, Brian D. "Global Asset Management and Performance Attribution" The Research Foundation of the Institute of Chartered Financial Analysis. (February, 1994)
- Karnosky, Dr. Denis S. "Global Investing in a CAPM Framework," The CAPM Controversy: Policy and Strategy Implications for Investment Management. AIMR, (October, 1993)
- Karnosky, Dr. Denis S. and Singer Brian "A General Framework for Global Currency Management," Securities Analysis Journal (March, 1991).

**MICHAEL J. O'LEARY, JR.  
EXECUTIVE VICE PRESIDENT  
CALLAN ASSOCIATES INC.**

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Michael J. O'Leary, Jr., CFA, is an Executive Vice President and shareholder. Mike has national oversight responsibility for Callan's plan sponsor consulting practice. He is a member of Callan's Client Policy Review and Management Committees. He also serves as chairman of Callan's Manager Search Committee.

Prior to first joining Callan's Chicago in 1984, Mike held positions as an investment research analyst, director of research and director of portfolio management and defined contribution plan product management for major trust companies in Chicago and Hartford.

In 1988, Mike joined Mercer Asset Planning in Denver, where he headed their investment consulting practice in the Denver office and also served on the firm's National Practice Committee.

Mike rejoined Callan in 1990 and established the firm's Denver office. Throughout his portfolio management and consulting career, Mike has worked extensively with major corporate and public funds. In addition to ongoing performance evaluation, he has led numerous asset/liability and asset allocation studies. He has conducted for his clients, more than 80 manager search projects across all major asset categories. He has advised clients on optimization of their management structures and a wide variety of special projects, including: securities lending, brokerage recapture programs, custodial searches, and alternative investments.

Mike received his Bachelor's degree from Fordham University and is a Chartered Financial Analyst. He has taught investments at the graduate level and has spoken frequently before professional and industry groups.

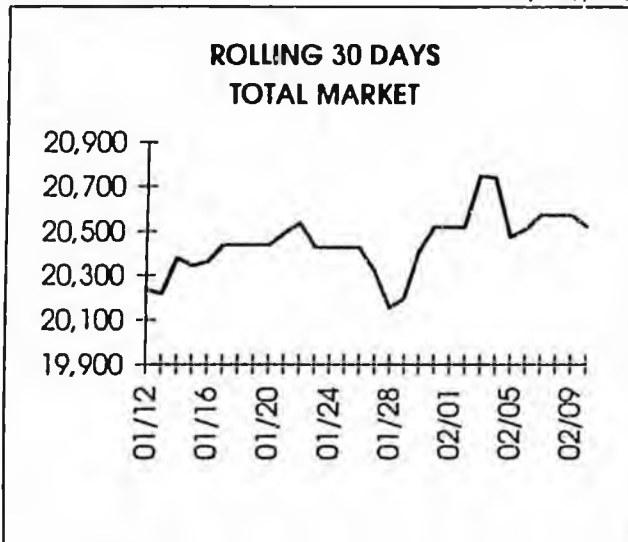
**ALASKA PERMANENT FUND  
DAILY POSITION  
2/10/97**

DAILY UNAUDITED* CUSTODIAN POSITION	COST	%	MARKET	%	UNREALIZED GAIN(LOSS)
BNY - MARKETABLE DEBT	8,897,800,000	49%	8,949,400,000	44%	51,600,000
BNY - DOMESTIC EQUITIES	5,444,890,000	30%	7,566,700,000	37%	2,121,900,000
BBH - FOREIGN EQUITIES	2,126,600,000	12%	2,430,500,000	12%	303,900,000
REAL ESTATE	1,401,200,000	8%	1,437,400,000	7%	36,200,000
ALASKA CD'S	135,000,000	1%	135,000,000	1%	0
<b>TOTAL</b>	<b>18,005,400,000</b>	<b>100%</b>	<b>20,519,000,000</b>	<b>100%</b>	<b>2,513,600,000</b>
PRIOR DAY TOTALS					2,559,000,000

**CHANGE FROM PRIOR DAY** (45,400,000)

\* Custodians report trade date positions which are adjusted where possible for pending trades. However, due to occasional lags in transactions reporting, total cost shown may vary from actual cost. This effect is more pronounced when large scale portfolio liquidations and fundings occur.

TOTAL INVESTED FUNDS	COST	MARKET	UNREALIZED GAIN(LOSS)
JANUARY 1996	16,300,700,000	18,732,400,000	2,431,700,000
FEBRUARY 1996	16,600,200,000	18,826,000,000	2,225,800,000
MARCH 1996	16,697,900,000	18,749,400,000	2,051,600,000
APRIL 1996	16,837,200,000	18,891,800,000	2,054,600,000
MAY 1996	17,019,400,000	19,081,000,000	2,061,600,000
<b>JUNE 1996</b>	<b>17,085,600,000</b>	<b>19,210,700,000</b>	<b>2,125,100,000</b>
JULY 1996	17,319,600,000	18,813,200,000	1,493,600,000
AUGUST 1996	17,467,600,000	19,072,400,000	1,604,800,000
SEPTEMBER 1996	17,273,700,000	19,354,000,000	2,080,300,000
OCTOBER 1996	17,199,000,000	19,406,200,000	2,207,200,000
NOVEMBER 1996	17,406,100,000	20,192,200,000	2,786,100,000
DECEMBER 1996	17,617,500,000	20,035,300,000	2,417,800,000
JANUARY 1997	17,955,100,000	20,518,100,000	2,563,000,000



## EXHIBIT I

### Yale Endowment Investment Philosophy Equity Bias

Consider the growth of \$1.00 invested in various U.S. asset classes from December 31, 1925 to December 31, 1995:

Inflation	\$	9
Treasury bills		13
Treasury bonds		34
Large company stocks		1,114
Small company stocks		3,822

**EXHIBIT II**  
**Yale Endowment**  
**A Comparison of 1976 to 1996**

	<u>Dec. 1976</u>	<u>Dec. 1996</u>
Size	\$ .58 Billion	\$ 5.25 Billion
<b>Asset Class</b>	<b>Percentage</b>	<b>Percentage</b>
Domestic Equity	68%	23%
Foreign Equity	.0%	13%
Private Equity	.0%	18%
Absolute Return	.0%	23%
Real Estate	5%	12%
Fixed Income	21%	12%
Other (cash, etc.)	<u>6%</u>	<u>-1%</u>
<b>Total</b>	100%	100%
<b>Historical Rates of Return</b>		
1 year	13%	26%
3 year	7%	18%
5 year	4%	17%
10 year	5%	14%
<b>Actual Payment to University</b>	\$ <u>36 Million</u>	\$ <u>170 Million</u>

## EXHIBIT III

### Spending Rule Calculation for Fiscal Year 1996/1997

Yale's spending rule uses a long-term spending rate of 5.0 percent combined with a smoothing rule which adjusts spending gradually to changes in Endowment market value. Annual spending is limited to the weighted average of 70 percent of the previous year's spending, adjusted for inflation, plus 30 percent of the targeted long-term spending rate applied to the previous year's market value.

#### Inputs

Endowment Value at Decemer 31, 1995	\$	4,368,844,019
Spending in Fiscal Year 1995/1996	\$	169,124,190
Inflation		3.55%

#### Step One:

Take 30% of targeted long-term spending rate (5.0%) applied to previous year's Endowment value

$$= (0.3) * (0.5) * (\text{Endowment Value at December 31, 1995}) \quad + \quad \$ 65,532,660.29$$

#### Step Two:

Take 70% of last year's spending adjusted for inflation

$$= (0.7) * (1 + \text{inflation rate}) * (\text{Spending in Fiscal 1995/1996}) \quad + \quad \$ 122,589,669.41$$

#### Step Three:

Adjust for spending from gifts received in Fiscal 1996/1997

$$+ \quad \underline{\$2,641,853.80}$$

Total Spending for Fiscal Year 1996/1997 Budget:

$$\underline{\underline{\$190,764,183.50}}$$

*PRESENTATION*  
 BY  
 THE NEW MEXICO STATE INVESTMENT OFFICE  
 TO  
 THE ALASKA STATE LEGISLATURE  
 AND  
 THE ALASKA PERMANENT FUND CORPORATION

February 12, 1997

I. THE HISTORY OF NEW MEXICO'S PERMANENT FUNDS

**C**hart 1 New Mexico is an enabling act state (entered the Union in 1912) and in anticipation of statehood, was given 13.4 million acres of Federal land between 1898 and 1912. The 1898 Ferguson Act also created the first of our two permanent funds, the Land Grant Permanent Fund (LGPF), and established controlling conditions for its investment. The 1910 Enabling Act superseded the Ferguson Act, and is the current controlling document for the LGPF. The LGPF has 20 beneficiaries, the largest of which is the public schools. The Severance Tax Permanent Fund (STPF) was created by an act of the state Legislature in 1973.

II. NEW MEXICO'S PERMANENT FUND PROBLEMS

**C**hart 2 The fundamental problem for the Funds was that they were not growing with inflation. The statutory and constitutional method of making distributions from the Funds was to distribute monthly all interest and dividends, which then created differing objectives for the Legislature and the State Investment Council. The Legislature wanted more immediate payouts to use on state budgets, and the Council, by the late 1980's becoming more and more aware of its fiduciary responsibility to preserve the Funds for future generations, wanted to move more into equity to combat inflation. For the last decade or more, raising taxes has been a very unpalatable option for the Legislature. The easiest course of action was to force more distributions from the Funds by influencing the asset allocation decision. The two Permanent Funds were regarded as current-income Funds, and the need to protect them against inflation was largely ignored in favor of generating maximum current-year and next-year payouts for the state's general operating fund.

**C**hart 3 In the early- to mid-1980's when contributions were nearly 20% of the Funds' values each year, inflation was not considered much of a negative.

**C**hart 4

**C**hart 5 By 1988, the three major weaknesses of this distributions method were evident to the Council staff. First, only about 6% of the Funds were in equity, and as a result the Funds were distributing too much each year (approaching 10% of the Funds' market values in the mid-1980's) and were losing real value. The second drawback was that the Funds were capable of earning much higher total returns to benefit the current beneficiaries, and finally, better diversification would actually decrease risk while at the same time producing better returns. We were doing well on performance, but we didn't have our Funds allocated to the right assets.

**C**hart 6

CHART 7

The Council had identified three primary objectives for the Funds:

- 1) To preserve the Funds for future generations by growing the Funds at a rate at least equal to the rate of inflation;
- 2) To distribute the real (inflation adjusted) return to New Mexico citizens;
- 3) To maximize total returns within acceptable levels of risk in order to increase the benefits for both current and future New Mexicans.

It was obvious that these objectives were not being met.

### III. FOCUSING ON THE PROBLEMS

CHART 8

Two factors brought the problems to the attention of the legislative leadership. First, the outdated distributions scheme, which depended upon contributions and high interest rates to maintain current payouts, and second, long-term structural declines in both the general level of interest rates and contributions beginning in the early 1980's. By 1994, the Funds were growing rapidly, but distributions were declining for the first time ever, and just at a time when the budget needs of the state were increasing exponentially.

CHART 9

CHART 10

### IV. THE NEW MEXICO SOLUTIONS

The key to solving these problems was education. All affected parties must be involved. It only takes one influential and disaffected party to scuttle any constitutional amendment. The first attempt to amend the Constitution in 1994 met with failure because of one such influential member of the executive branch.

The first step was to gain credibility with all the affected parties. A Permanent Funds Advisory Committee was appointed by the Governor to study the problems and recommend solutions. The Committee was staffed with reputable private citizens from the state who had experience in endowment fund management and theory. When the Committee published its final report, the State Investment Council endorsed the findings, and recommended amending the Constitution. No attempt was made to do anything radically different than the majority of the endowment funds in the US. When discussing changes to the governing documents for permanent funds, most people become very conservative.

It was obvious that the payout policy needed to be disconnected from the investment decisions, especially where it impacted asset allocations. Solutions needed to be found where the Investment Council and the Legislature could become part of the same team and work together for the same objectives. The most logical answer was to tie payouts to the Funds' growth and performance so that distributions would increase only when the Funds' market values increased. About 70% of the endowments in the US have reached this same conclusion.

CHART 11

The Committee's recommendations were:

CHART 12

1. **Changes to the distribution policy:**

- a. Change the payout to a fixed-percentage of the Fund. This percentage should be based on the expected long-term average real (inflation adjusted) return on investments;
- b. Use a 5-year average market value to smooth out market value fluctuations; and
- c. Adopt a transition period to ease the changeover to the new distributions method.

The payout percentage selected was 4.7% of the most-recent five-years' average market values. This figure was arrived at both by considering what other endowment funds distributed and from an analysis of average long-term total returns for stocks and bonds since 1945. Several historical periods from 20 to 50 years were factored in to obtain an average total return for a 50% equity / 50% bond portfolio of 9.2% and an inflation rate of 4.5%. This produced a 4.7% real return.

The 5-year smoothing period was selected because it provided relatively stable distributions as well as adding a conservative factor. Actual distributions should be about 4.25% of the most recent year's market value over time.

The transition period guarantees a 2% growth in annual distributions until the 4.7% formula produces a higher number.

CHART 13

2. **Changes to the investment restrictions:**

- a. Authorize a limit of 65% in equity securities;
- b. Authorize up to 15% in international securities;
- c. Authorize small- and mid-capitalization stocks.

CHART 14

The recommended investment limits were based on surveys of average asset allocations among endowment funds in the US. The objectives here were both higher returns and better diversification.

## V. THE EDUCATION PROCESS AND RESULTS

A serious program to educate the beneficiaries, the legislative membership, and the voters was then conducted. A private citizen's committee was formed to focus on the voters. The educational effort included identifying and explaining the problems, and offering a package of constitutional and statutory changes to solve the problems. This package of changes had to offer something for all affected parties. The Investment Council and staff spent over a year traveling

CHART 15

the state and holding public meetings to obtain voter support. Presentations or mailings were made to every organized group that could be identified, and to all radio and TV stations and newspapers in the state. With only one or two small-town exceptions, all were supportive when we had a chance to present our case.

CHART 16

The results of this effort were that all of the beneficiaries endorsed the Constitutional Amendment, the Legislature passed the Amendment overwhelmingly (unanimously in the 70-member House, and with only three dissenting votes in the 42 member Senate) and the legislative leadership also committed to getting the measure in the first position on the General Election Ballot. In the 1996 General Election, Constitutional Amendment #1 was approved with nearly 68% of the vote.

The Investment Council is now in the process of revising the state statutes to reflect the constitutional changes, and obtaining the approval of Congress for the necessary changes to the Enabling Act. The support for these changes continues to be strong in the Legislature and in New Mexico's congressional delegation.

## VI. CONCLUSIONS AND LESSONS LEARNED

We believed our proposal was the right thing to do for all of the beneficiaries, and we had good supporting data to sell it with. It was not easy, but we did it. All of New Mexico's present and future citizens will benefit from reduced taxes. The principal lessons:

CHART 17

1. Study the issues thoroughly, and involve both respected citizens and professional consulting advice in the process;
2. Recommend solutions that are in line with average endowment fund practices;
3. The solutions must offer advantages for all affected parties;
4. Obtain support from the leadership of all affected parties;
5. One influential disaffected party can defeat the initiative;
6. Don't pay too much attention to the nay-sayers - there will be some;  
and finally,
7. Publicize the problems and solutions using all available media..

CHART 15

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*NEW MEXICO STATE INVESTMENT COUNCIL*

FEBRUARY 12, 1997

*PRESENTATION*

TO THE

ALASKA STATE LEGISLATURE

AND THE

ALASKA PERMANENT FUND CORPORATION

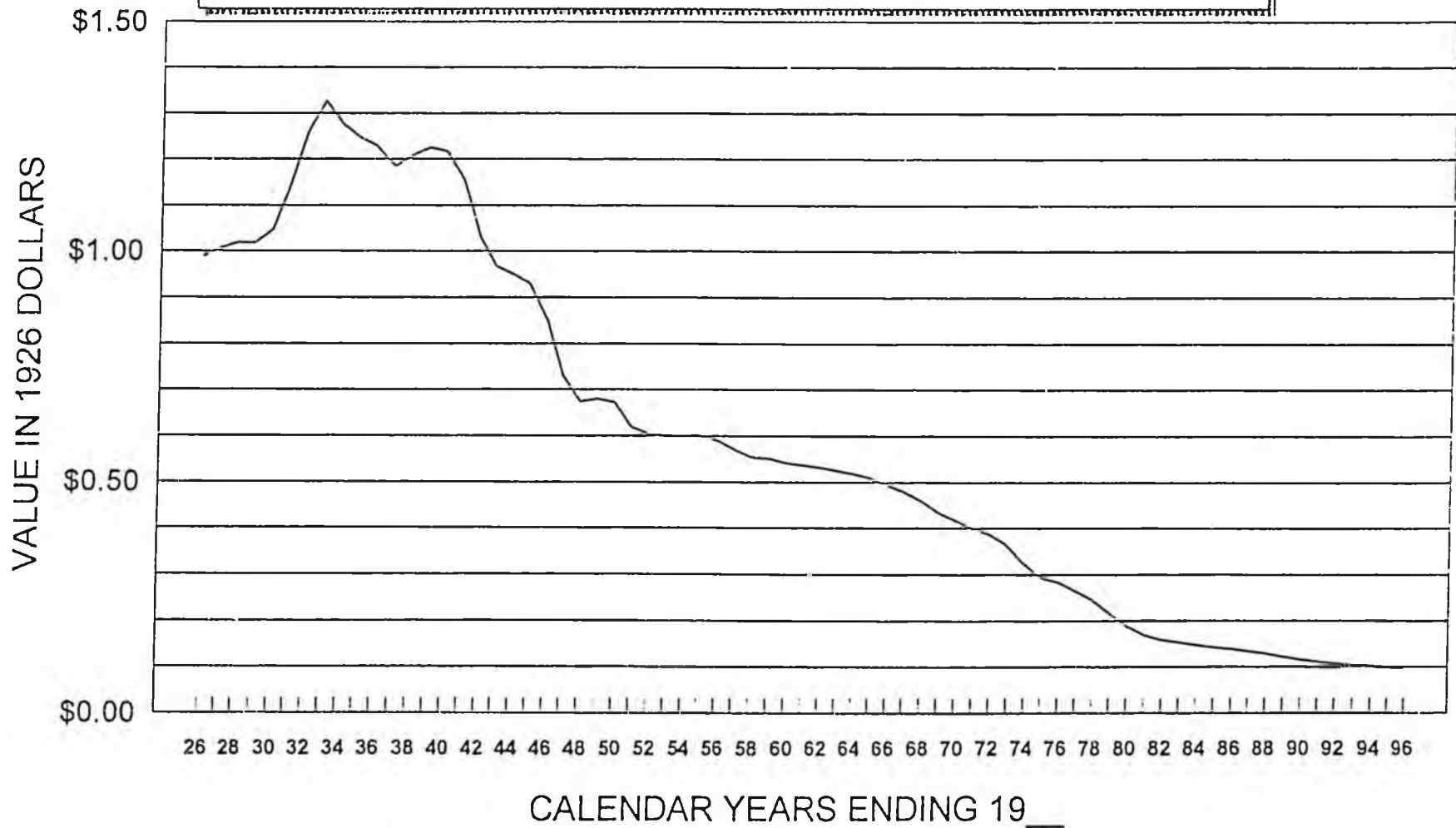
WHERE DOES THE  
MONEY GO?  
TO THE BENEFICIARIES!

WHO ARE THE BENEFICIARIES?

LAND GRANT PERMANENT FUNDS:		Amount Distributed
Public Schools		\$204,521,642
NM Military Institute		9,262,997
NM School for the Deaf		5,551,212
NM School for the Visually Hdcp		5,536,561
Penitentiary of New Mexico		5,544,740
University of NM		4,335,311
Miners' Hospital in Raton		2,968,811
Public Buildings - Capitol		2,668,767
Water Reservoirs		2,290,133
Charitable, Penal & Reform		1,631,291
NM State University		1,098,719
Rio Grande Improvements		937,683
NM State Hospital		688,110
NM Inst of Mining & Tech		504,553
Eastern NM University		298,722
Western NM University		83,701
NM Highlands University		82,825
Northern NM State School		56,259
UNM Saline Lands		21,305
NM Boys' School		18,251
TOTAL:		\$248,101,593
<b>THE SEVERANCE TAX PERMANENT FUND</b>		
State's General Fund (Budget)		\$131,291,316
TOTAL BOTH FUNDS		\$379,392,908

# VALUE OF A 1926 DOLLAR

THE EFFECTS OF INFLATION: 1926 - 1996



— CUMULATIVE VALUE OF A DOLLAR

## CONSTITUTIONAL AMENDMENT #1 WHAT IT MEANS TO YOU!

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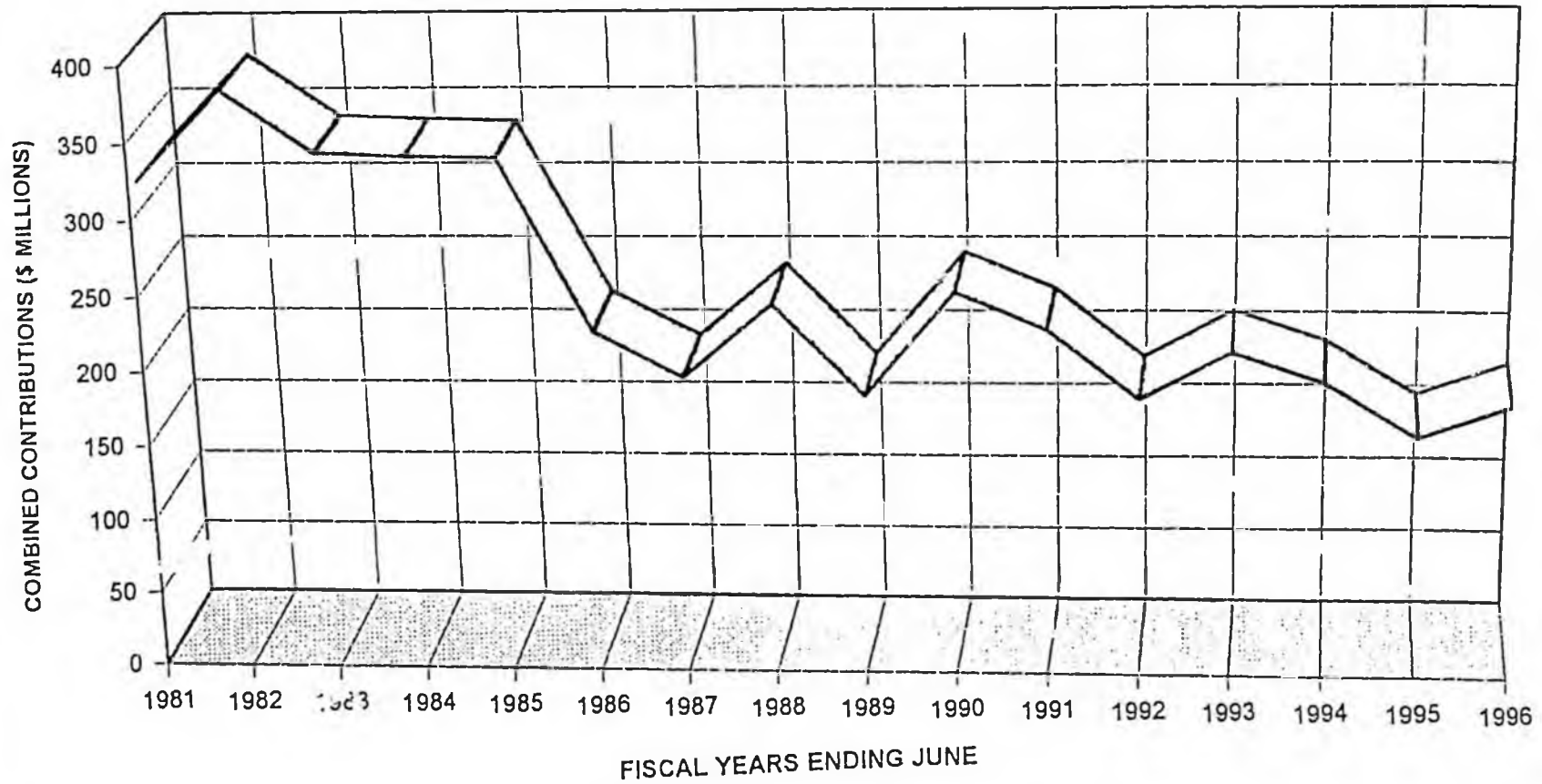
Perhaps Theodore Roosevelt said it best:

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**"The nation behaves well if it treats the natural resources as assets which it must turn over to the next generation increased, and not impaired, in value."**

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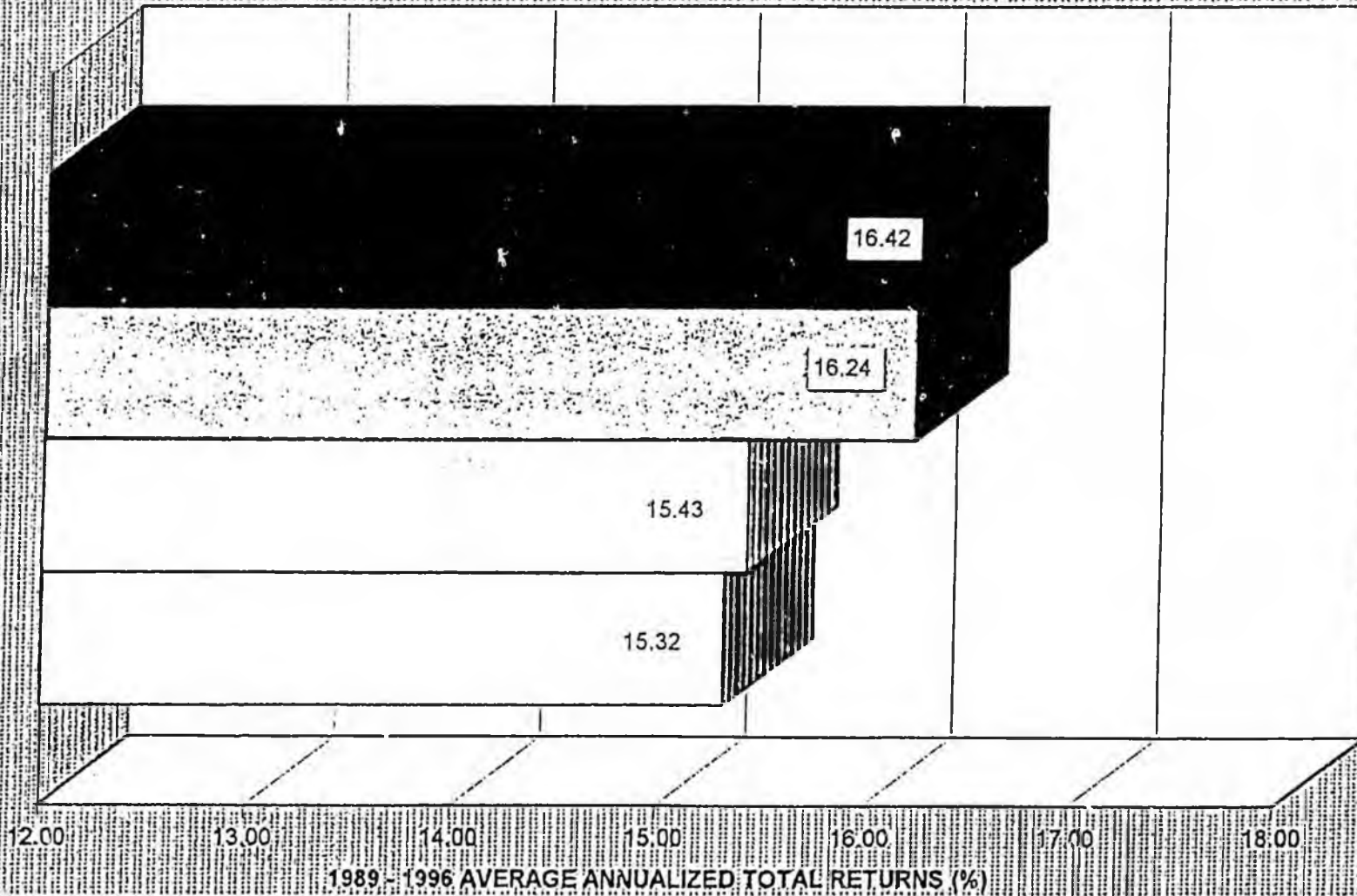
# TOTAL CONTRIBUTIONS COMBINED FUNDS



□ COMBINED CONTRIBUTIONS

# 8 YEARS' ANNUAL TOTAL RETURNS - LGPF & STPF STOCKS

COMPARED TO THE S&P-500 INDEX AND THE CALLAN TOTAL EQUITY DATABASE

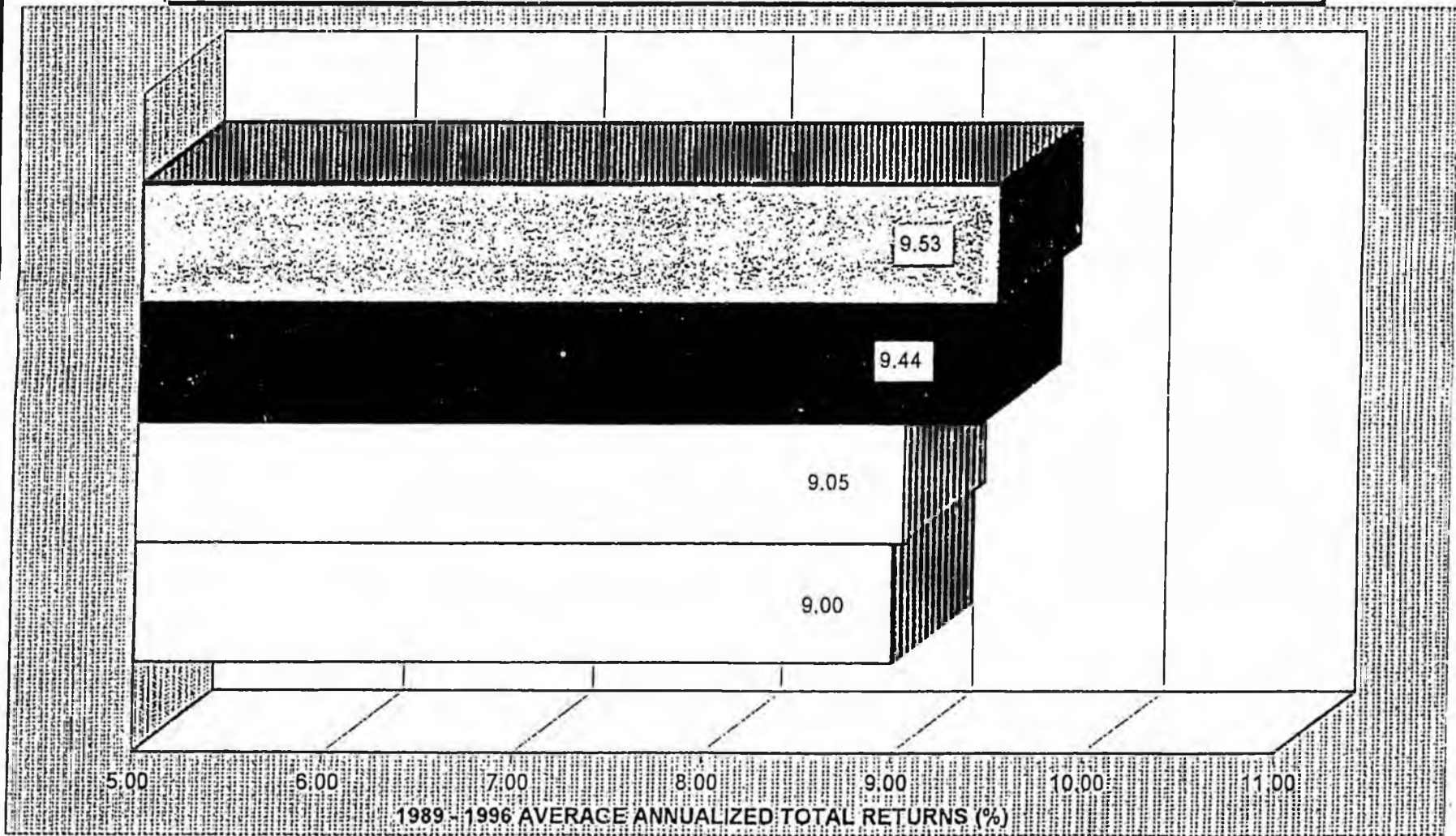


12.00 13.00 14.00 15.00 16.00 17.00 18.00  
1989-1996 AVERAGE ANNUALIZED TOTAL RETURNS (%)

□ S&P-500 INDEX    □ CALLAN TOTAL EQUITY DATABASE    □ STPF STOCKS    ■ LGPF STOCKS

# 8 YEARS' ANNUAL TOTAL RETURNS - LGPF & STPF BONDS

COMPARED TO THE AGGREGATE INDEX AND THE CALLAN TOTAL FIXED-INCOME DATABASE



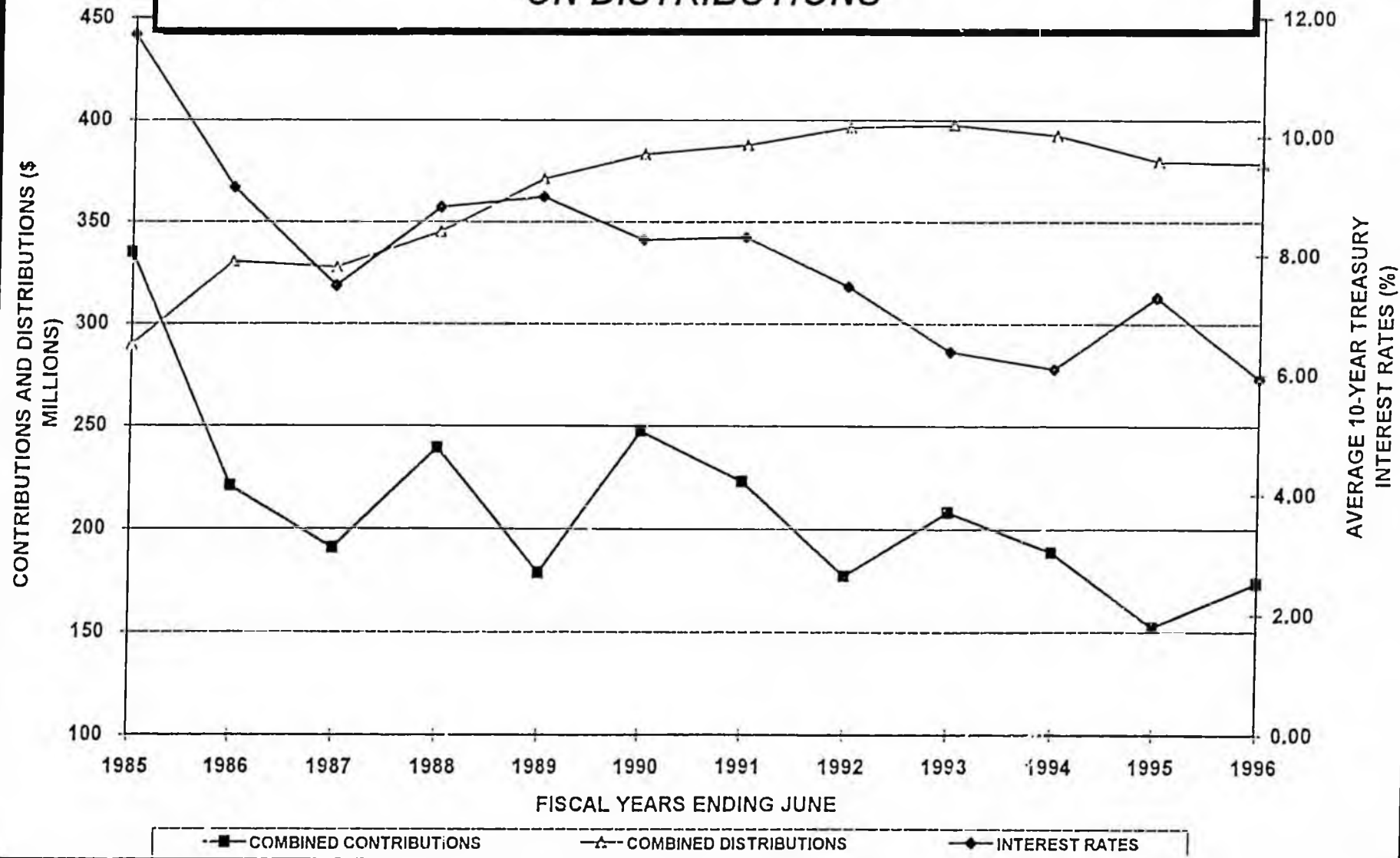
□ AGGREGATE INDEX      □ TOTAL FIXED-INCOME DATABASE      ■ LGPF BONDS      □ STPF BONDS

## *NEW MEXICO STATE INVESTMENT COUNCIL*

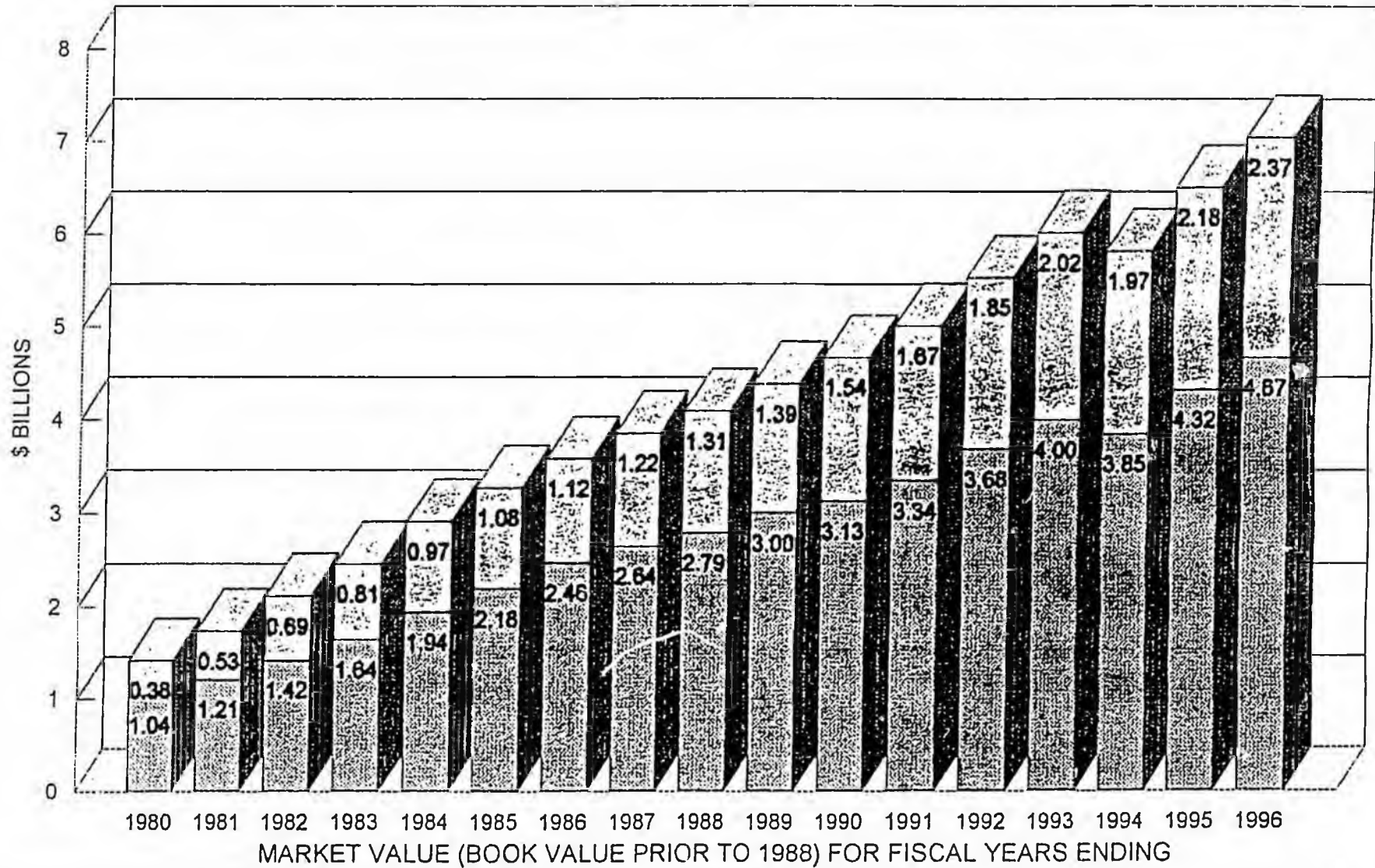
### OBJECTIVES FOR THE PERMANENT FUNDS

- TO PRESERVE THE FUNDS FOR FUTURE GENERATIONS BY GROWING THE FUNDS AT A RATE AT LEAST EQUAL TO THE RATE OF INFLATION;
- TO DISTRIBUTE THE REAL (INFLATION ADJUSTED) RETURN TO NEW MEXICO CITIZENS;
- TO MAXIMIZE TOTAL RETURNS WITHIN ACCEPTABLE LEVELS OF RISK IN ORDER TO INCREASE THE BENEFITS FOR BOTH CURRENT AND FUTURE NEW MEXICANS.

## THE EFFECTS OF CONTRIBUTIONS AND INTEREST RATES ON DISTRIBUTIONS



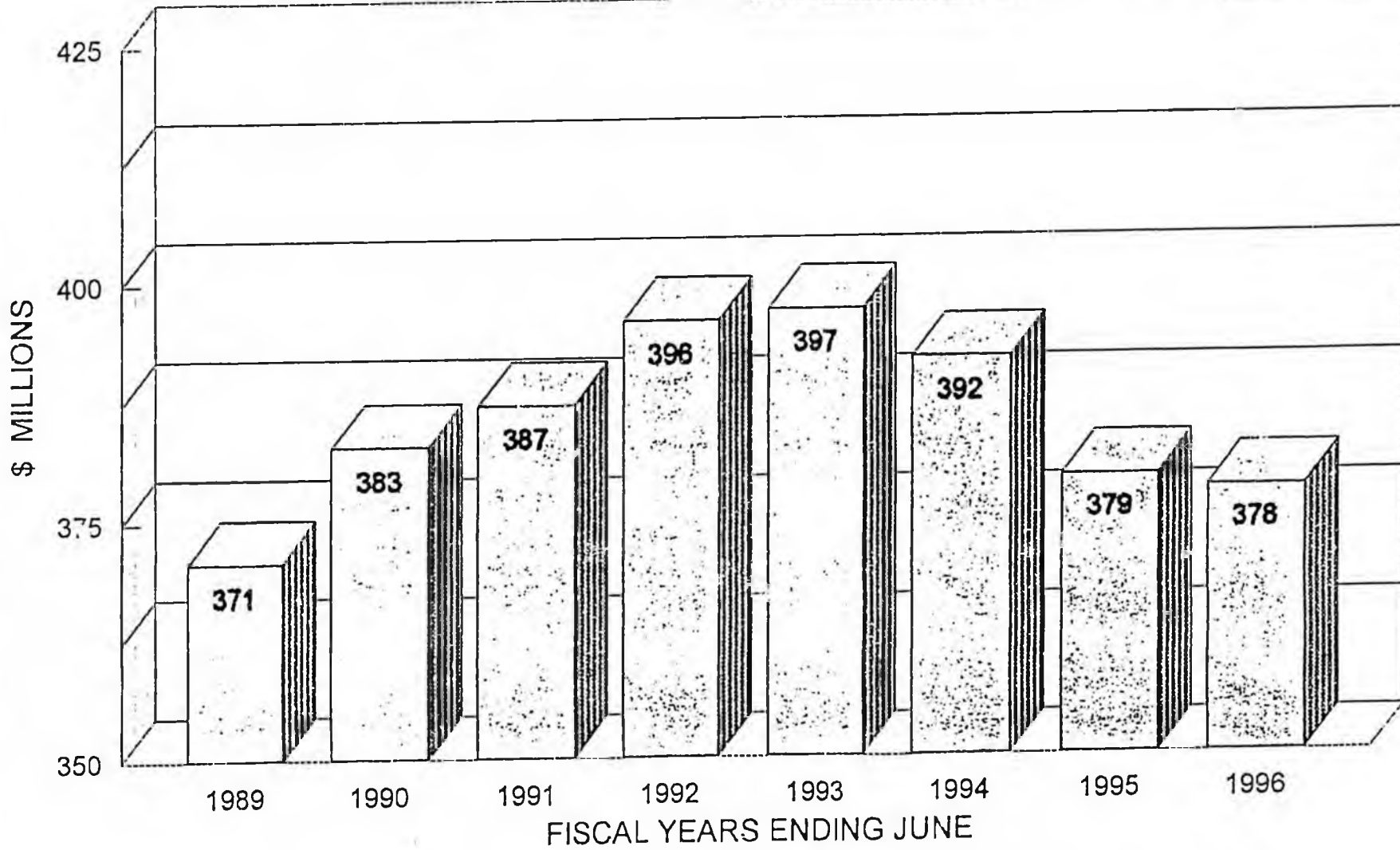
# GROWTH IN TOTAL ASSETS COMBINED FUNDS



□ LAND GRANT PERMANENT FUND

□ SEVERANCE TAX PERMANENT FUND

# TOTAL DISTRIBUTIONS COMBINED FUNDS



□ LGPF AND STPF COMBINED DISTRIBUTIONS

**ON THE BALLOT IN NOVEMBER, 1996:**

**A JOINT RESOLUTION PROPOSING AMENDMENTS TO  
ARTICLE 8, SECTION 10 AND ARTICLE 12, SECTIONS 2,  
4 AND 7 OF THE CONSTITUTION OF NEW MEXICO:**

**TO PROTECT THE STATE'S PERMANENT FUNDS  
AGAINST INFLATION BY LIMITING DISTRIBUTIONS  
TO A PERCENT OF EACH FUND'S MARKET VALUE AND  
BY MODIFYING CERTAIN INVESTMENT RESTRICTIONS  
TO ALLOW OPTIMAL DIVERSIFICATION OF INVESTMENTS.**

*NEW MEXICO STATE INVESTMENT COUNCIL*

CHANGES TO THE DISTRIBUTIONS POLICY

- CHANGE THE PAYOUT TO A FIXED-PERCENTAGE OF THE FUND;
  - USE A 5-YEAR AVERAGE MARKET VALUE TO SMOOTH OUT MARKET VALUE FLUCTUATIONS;
- ADOPT A TRANSITION PERIOD TO EASE THE CHANGEOVER TO THE NEW DISTRIBUTIONS METHOD.

\$10,000

# MAJOR ASSET CLASS COMPOUND TOTAL RETURNS

Stocks, Bonds, Bills, and Inflation - 1926 thru 1996

\$1,000

356.24 (1996)

\$100

40.76 (1996)

\$10

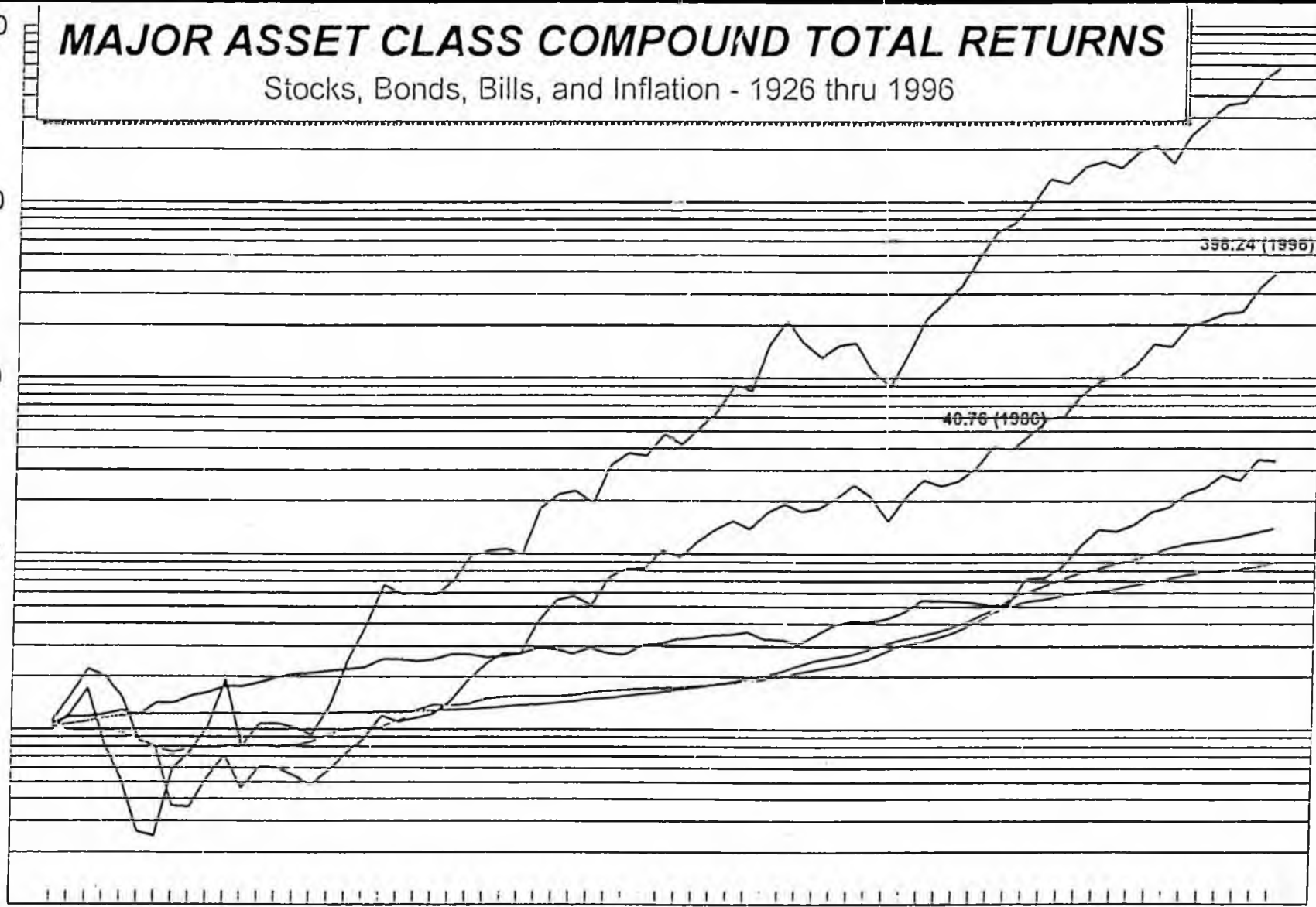
\$1

\$0

26 28 30 32 34 36 38 40 42 44 46 48 50 52 54 56 58 60 62 64 66 68 70 72 74 76 78 80 82 84 86 88 90 92 94 96

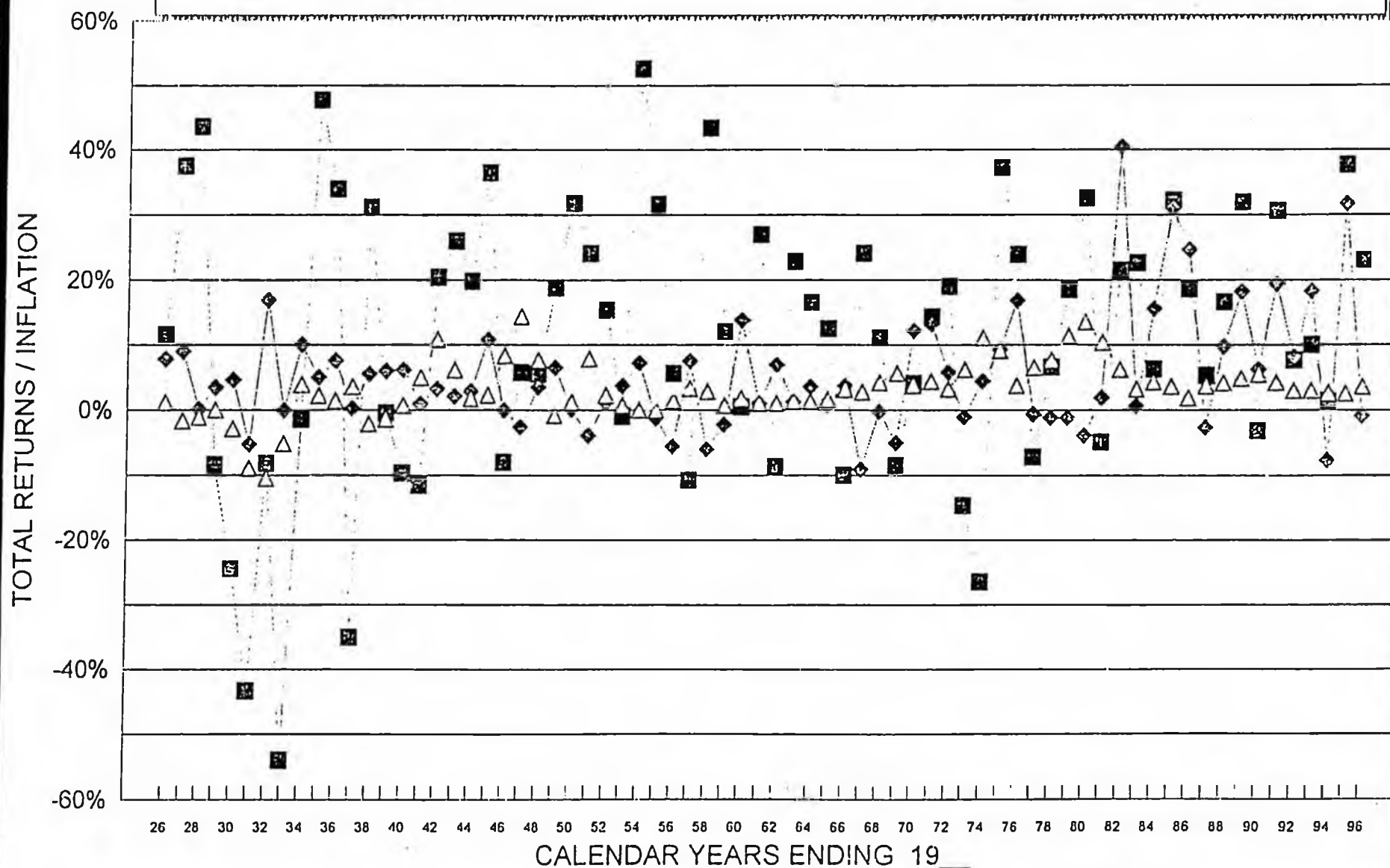
CALENDAR YEARS ENDING 19\_\_

- |                  |                          |                  |
|------------------|--------------------------|------------------|
| - SMALL STOCKS   | - LARGE STOCKS (S&P 500) | - LT GOV'T BONDS |
| - 90-DAY T-BILLS | - CPI                    |                  |



# EQUITY / BOND TOTAL RETURNS VERSUS THE CPI

RELATIVE VOLATILITY AND CORRELATIONS CHART: 1926 - 1996



■ EQUITY TOTAL RETURNS    ◆ LT GOVT. TOTAL RETURNS    △ CONSUMER PRICE INDEX

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## WHAT ARE THE STATE'S PERMANENT TRUST FUNDS?

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New Mexico has two large permanent trust funds, the \$2.3 billion Severance Tax Permanent Fund and the \$4.7 billion Land Grant Permanent Fund. Together, these Funds total over \$7 billion and are the savings accounts or "nest-eggs" for future generations of New Mexicans. The Funds will help future taxpayers when the state's natural resources are depleted.

The Severance Tax Permanent Fund is a separate savings account derived from a portion of taxes paid on oil, gas, coal and other resources when they are severed from the earth within New Mexico. The Fund distributes all interest and dividend income each year to the state's operating budget, sixty-four percent of which was spent on public schools, higher education and special education in the fiscal year ending 6/30/96.

The Land Grant Permanent Fund is the state's savings account for royalties on oil, gas and other natural resources extracted from the 13.4 million acres given to New Mexico by the federal government at statehood. The interest and dividends earned on the Fund's investments have provided a primary funding source for twenty public institutions, most of which are public schools, universities, and hospitals.

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## WHAT BENEFITS DOES NEW MEXICO RECEIVE FROM THE PERMANENT FUNDS?

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In fiscal year 1996, \$378 million, or 13%, of the state's budget was derived from distributions of income from the two Funds. During the last eight years, nearly \$3.1 billion of the state's revenue has come from this source. Without this income, state income taxes would have been about \$600 higher per year for each taxpayer.

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## WHAT DOES PASSAGE OF THE AMENDMENT DO?

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If approved by the voters, the Amendment will allow the State's Permanent Funds (New Mexico's nest-eggs or savings accounts for the future) to be managed similar to other major educational endowment funds in the U.S., using long-term investment goals.

The Amendment has been approved by the Governor's Permanent Fund Advisory Committee, the Constitution Revision Commission, the Legislature, the State Investment Council, the beneficiaries of the Fund (public schools, higher education and other public institutions) and independent financial experts.

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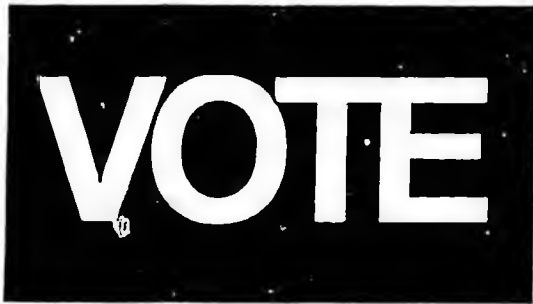
## WHO ARE THE BENEFICIARIES OF THE LAND GRANT PERMANENT FUND?

Public Schools  
New Mexico Military Institute  
New Mexico School for the Deaf  
New Mexico School  
for the Visually Handicapped  
Penitentiary of New Mexico  
University of New Mexico  
Miners' Hospital of New Mexico  
Capitol Buildings Repair Fund  
Water Reservoirs  
Charitable, Penal & Reform  
New Mexico State University  
Rio Grande Improvements  
New Mexico State Hospital  
New Mexico Institute  
of Mining & Technology  
Eastern New Mexico University  
Western New Mexico University  
New Mexico Highlands University  
Northern New Mexico State School  
UNM Saline Lands  
New Mexico Boys' School

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## WHO IS THE BENEFICIARY OF THE SEVERANCE TAX PERMANENT FUND?

The state's annual operating budget, of which 64% is appropriated to public schools, higher education and special education.



On the Ballot November 5, 1996:

## CONSTITUTIONAL AMENDMENT # 1

TO AMEND ARTICLE 8  
SECTION 10 AND ARTICLE 12, SECTIONS  
2, 4 AND 7 OF THE NEW MEXICO  
CONSTITUTION

TO PROTECT THE STATE'S  
PERMANENT TRUST FUNDS AGAINST  
INFLATION

BY LIMITING DISTRIBUTIONS  
TO A PERCENTAGE OF EACH FUND'S  
MARKET VALUE

AND BY MODIFYING CERTAIN  
INVESTMENT RESTRICTIONS TO ALLOW  
OPTIMAL DIVERSIFICATION OF  
INVESTMENTS.

For additional information about the  
proposed constitutional amendment, contact  
the State Investment Council  
(505) 827-6226

A VOTE  
"FOR"  
THE AMENDMENT:

A VOTE  
"AGAINST"  
THE AMENDMENT:

<p>Is intended to protect the Funds from inflation by limiting annual distributions to 4.7% of the average market value of the Funds for the preceding five years.</p>	<p>All income, including the inflation component of interest, is paid out each year which may expose future distributions to potential reductions in their purchasing power.</p>
<p>Is intended to provide greater stability in the amount of income paid to public schools and other beneficiaries.</p>	<p>Distributions of income will continue to be determined primarily by interest rates. If interest rates continue to fluctuate widely, distributions may vary accordingly.</p>
<p>Allows the trustees to further diversify investments for the purposes of protecting the safety of the Funds and to try to maximize the total rate of return.</p>	<p>The historical practice of investing the Funds to maximize current income, rather than trying to maximize both current income as well as future income, will continue.</p>
<p>Allows the Funds to be invested for growth as well as preservation of principal similar to the majority of other educational endowment funds in the U.S.</p>	<p>The Funds are mainly managed to preserve the principal, rather than for growth, which may, over time, diminish the real, inflation-adjusted, value of the principal of the Funds.</p>
<p>Allows up to 65% of the Land Grant Permanent Fund to be invested in stocks. The Legislature, by a vote of 3/4 of its members, may authorize not more than 15% to be invested in international securities.</p>	<p>Limits Land Grant Permanent Fund investments in both corporate stocks and bonds combined to 50% or less, and prohibits any investments in international stocks.</p>
<p>Allows the Permanent Fund to purchase higher-growth stocks that have not paid dividends or are listed on NASDAQ, such as Intel and Microsoft.</p>	<p>Limits Land Grant Permanent Fund stocks to those listed on a national exchange and to those that have paid dividends for ten consecutive years.</p>

## ***NEW MEXICO STATE INVESTMENT COUNCIL***

### **CONCLUSIONS AND LESSONS LEARNED**

- **Study the issues thoroughly, and involve both respected citizens and professional consulting advice in the process.**
- **Recommend solutions that are in line with average endowment fund practices.**
- **The solutions must offer advantages for all affected parties.**
- **Obtain support from the leadership of all affected parties.**
- **One influential disaffected party can defeat the initiative.**
- **Don't pay too much attention to the nay-sayers - there will be some.**
- **Publicize the problems and solutions using all available media.**

*New Investment Trends:  
The Callan Perspective*

Alaska Permanent Fund Corporation

February 12, 1997



Michael J. O'Leary, Jr., CFA  
Executive Vice President

## *Asset Allocation*

### Pension & Investments (1/20/97):

- Corporate DC Plan equity exposure
  - 48% in 1992
  - 63% in 1996
- Corporate DB                      63% equity
- Public DB                            54% equity
- Taft Hartley DB                    45% equity

# *Now Is Always The Hardest Time To Invest*

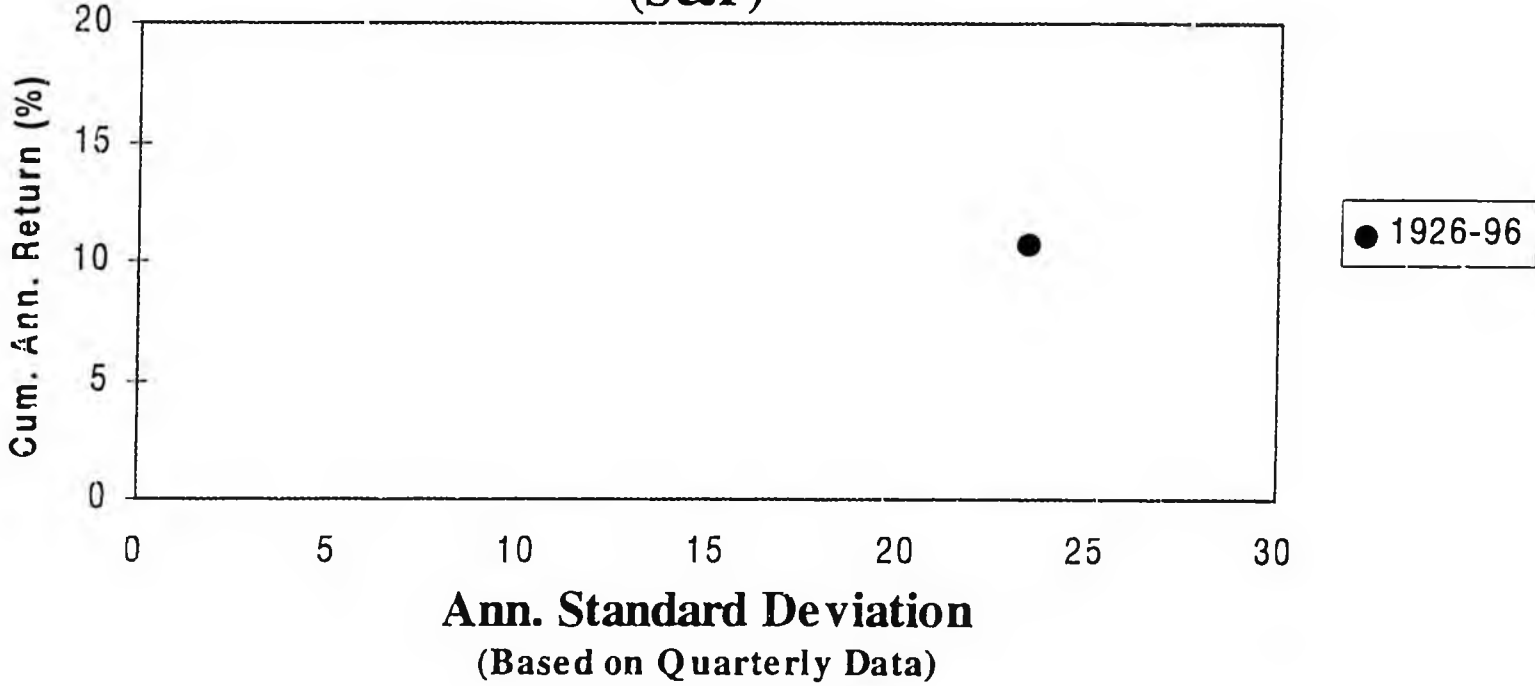
- Historic perspective
- Callan's 5-year projections
- Implications

# *Callan's Asset Allocation Process*

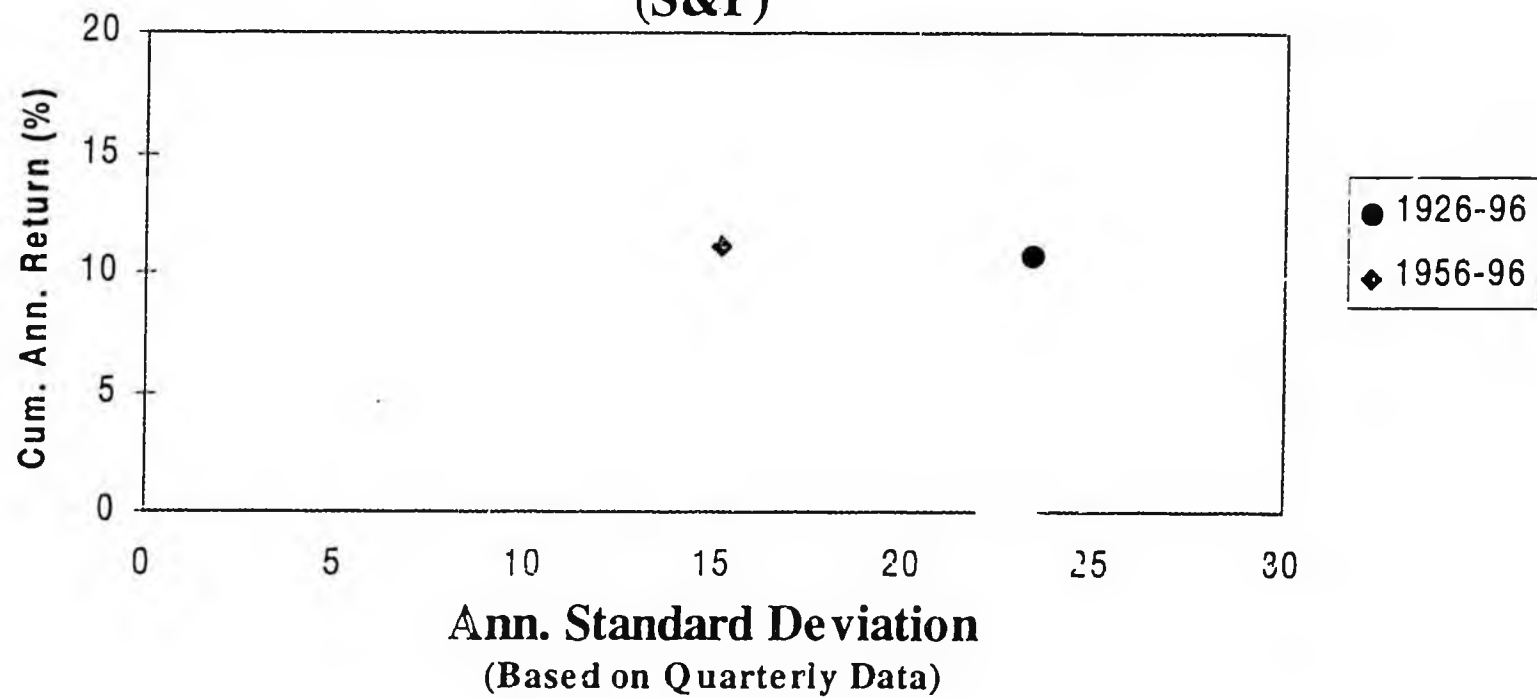
## 3 Key Inputs:

- 5-year mean
- Annual standard deviation
- Correlation estimates

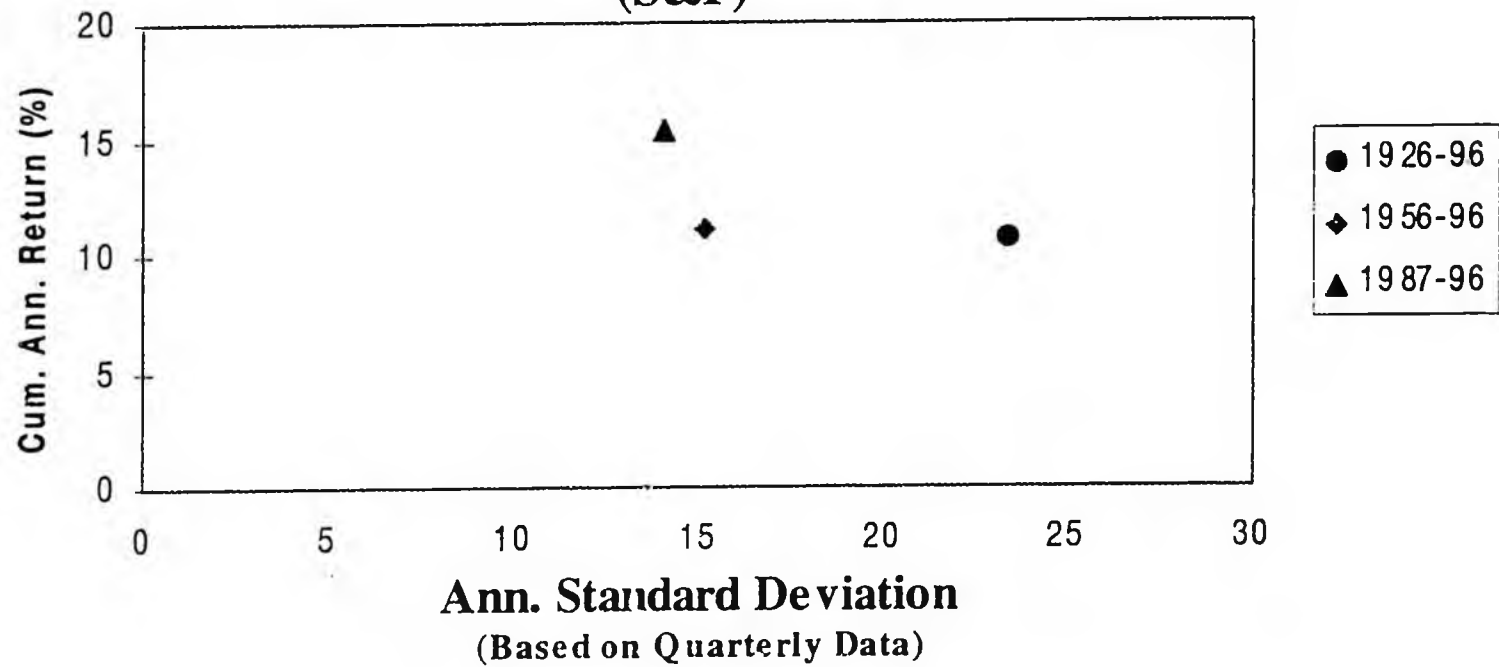
**Risk/Reward  
Domestic Stocks  
(S&P)**



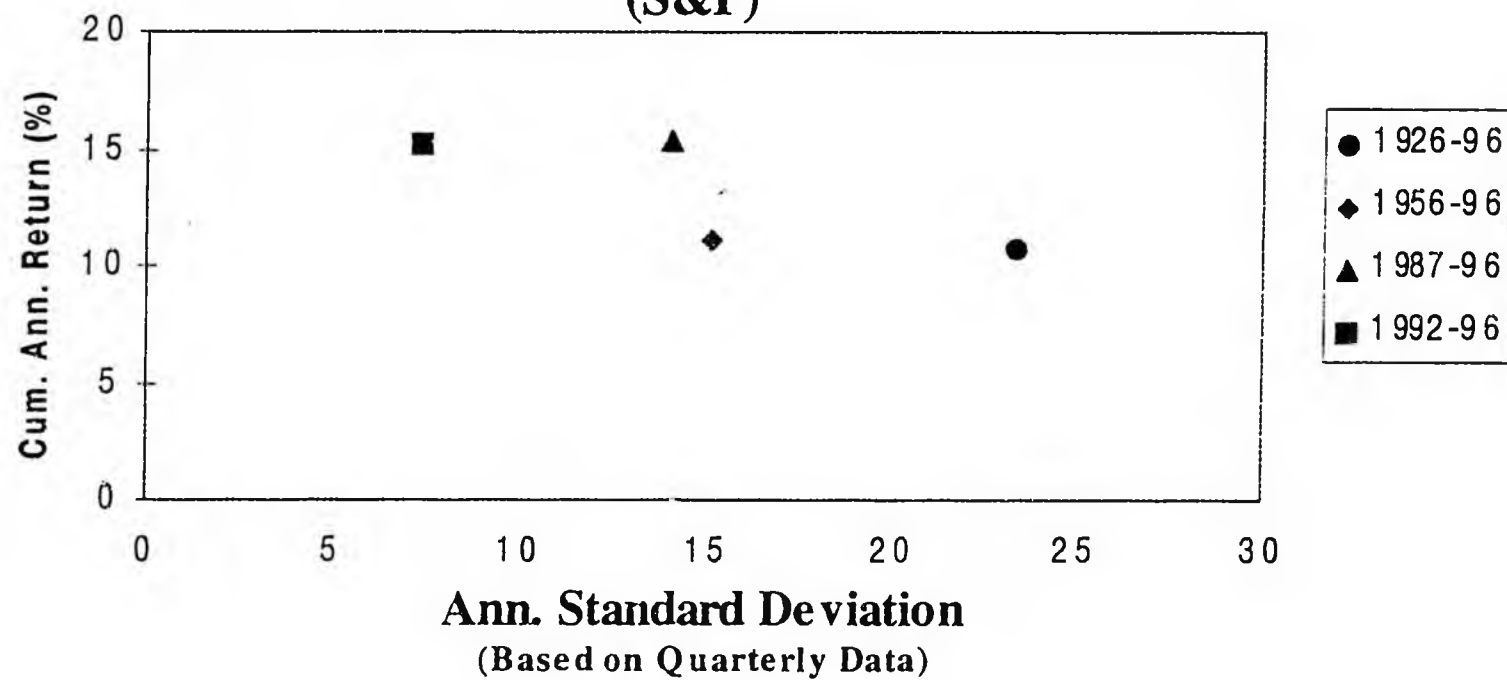
# Risk/Reward Domestic Stocks (S&P)



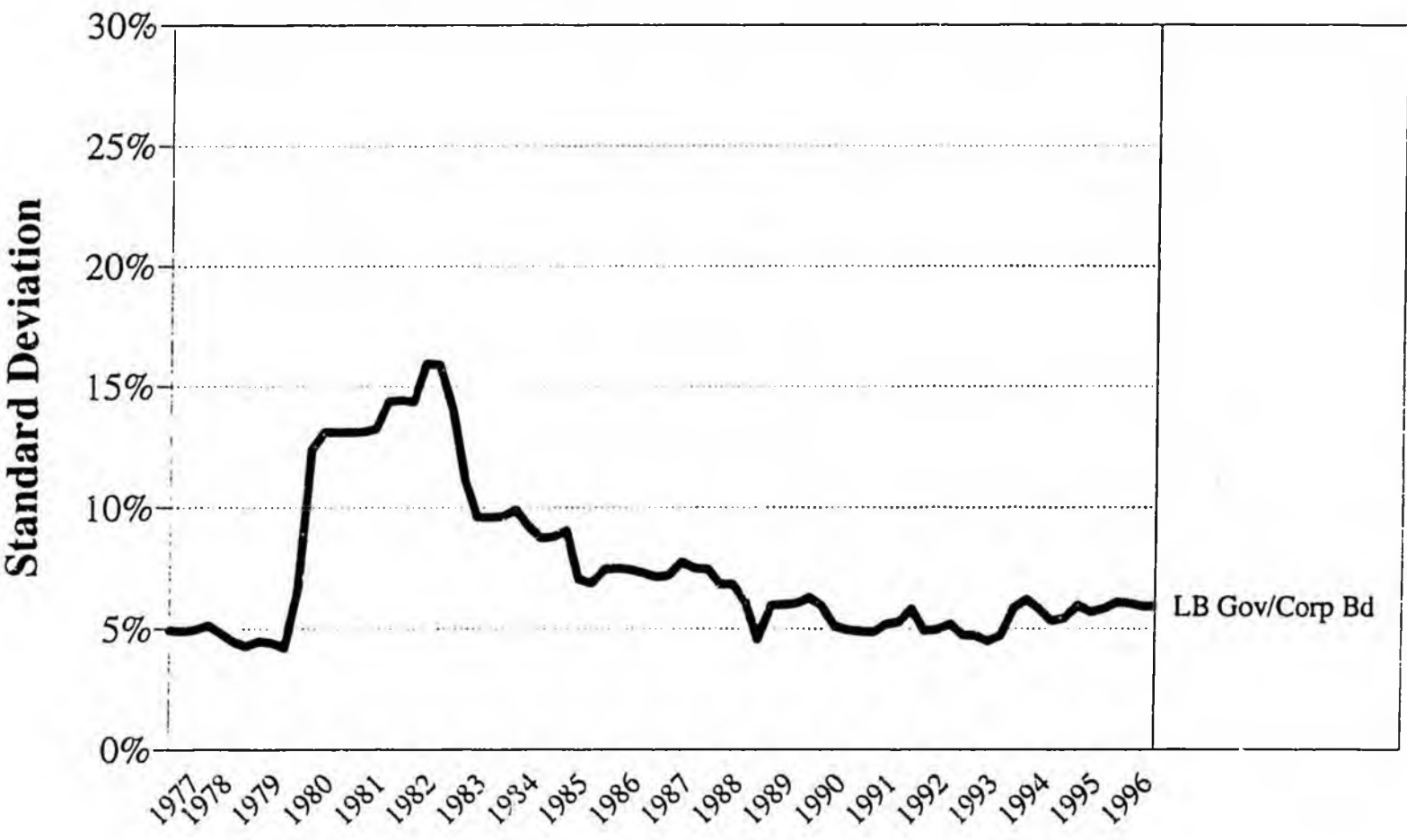
## Risk/Reward Domestic Stocks (S&P)



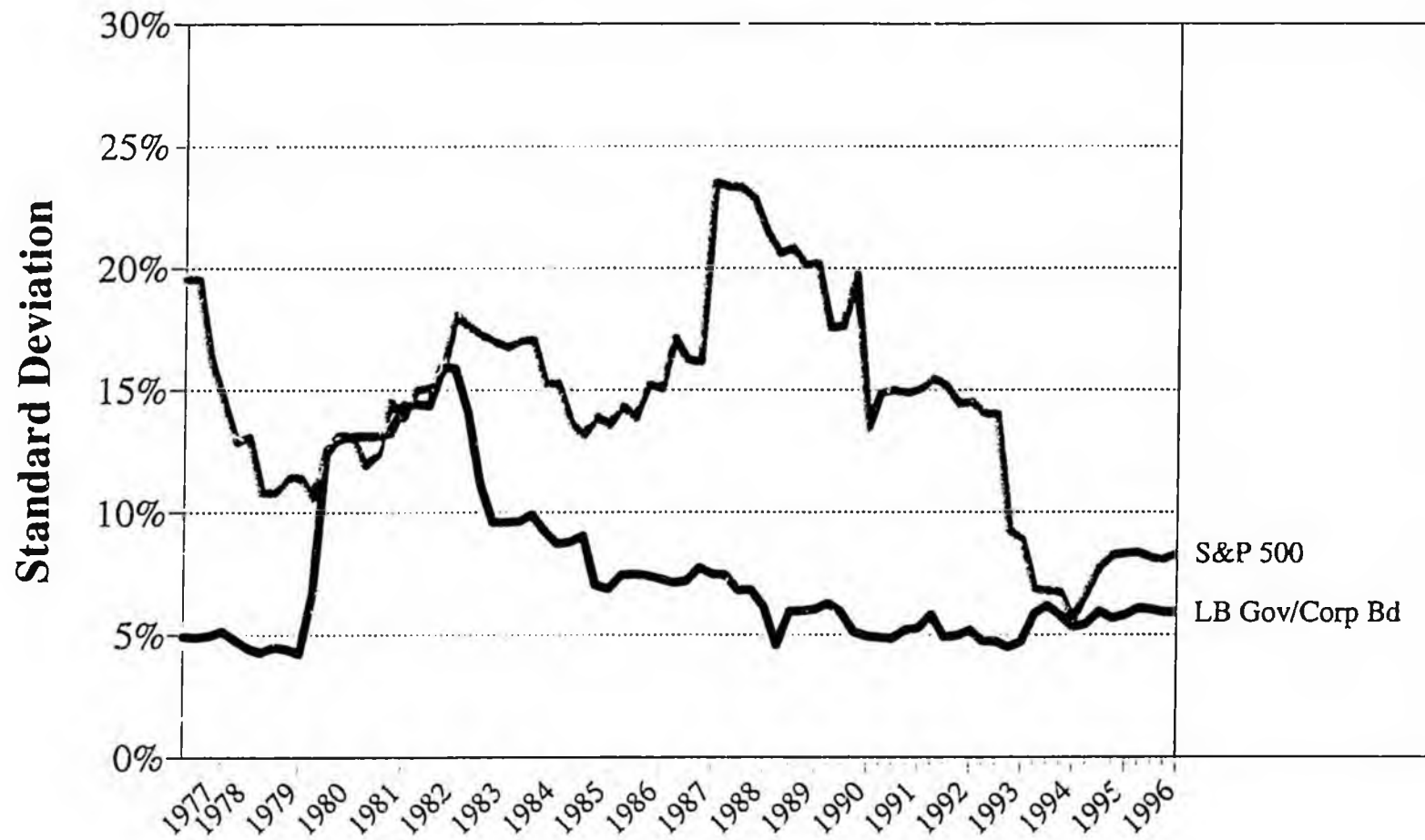
# Risk/Reward Domestic Stocks (S&P)



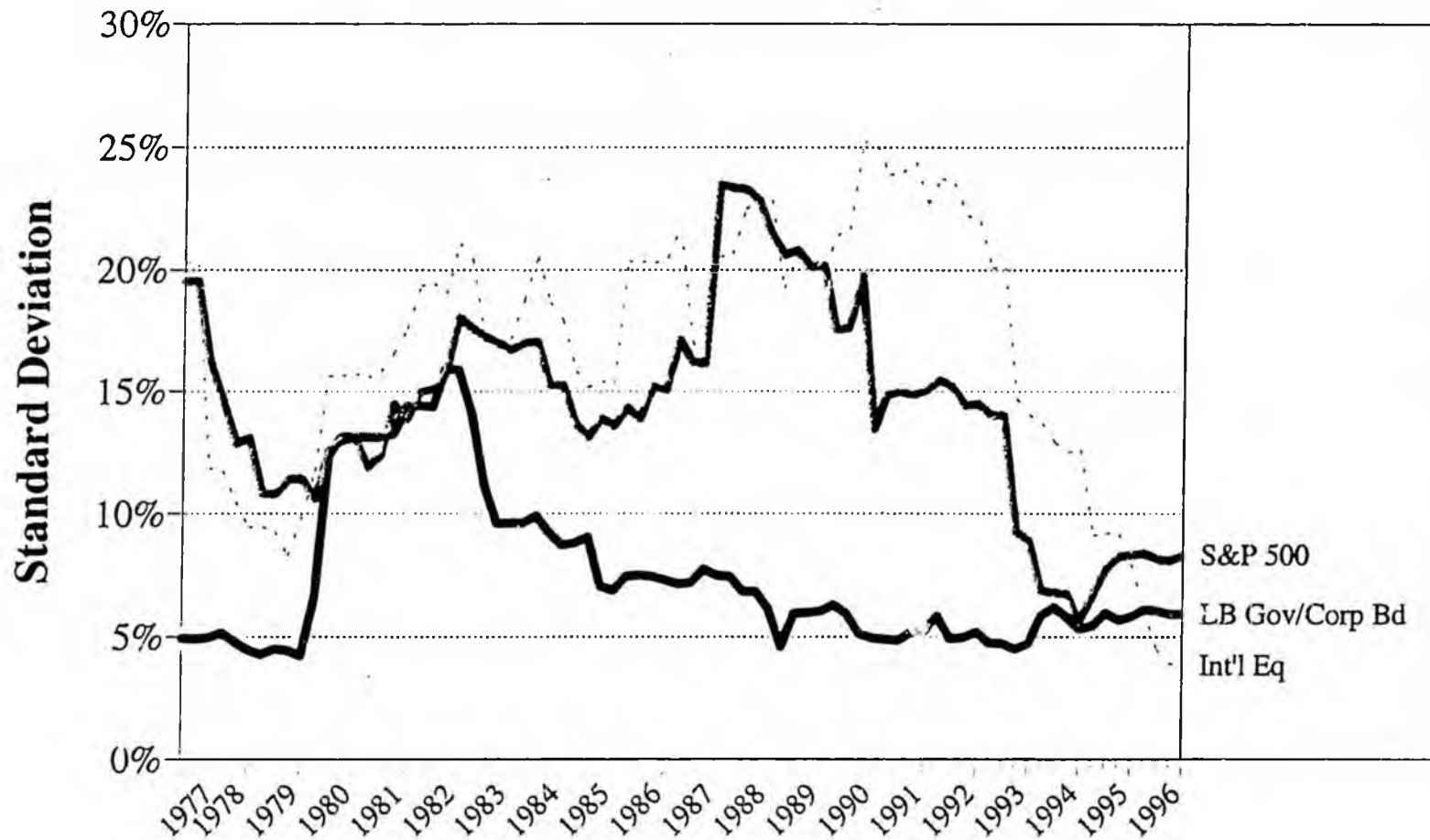
# Annualized Standard Deviation Using Rolling Periods of 12 Quarters



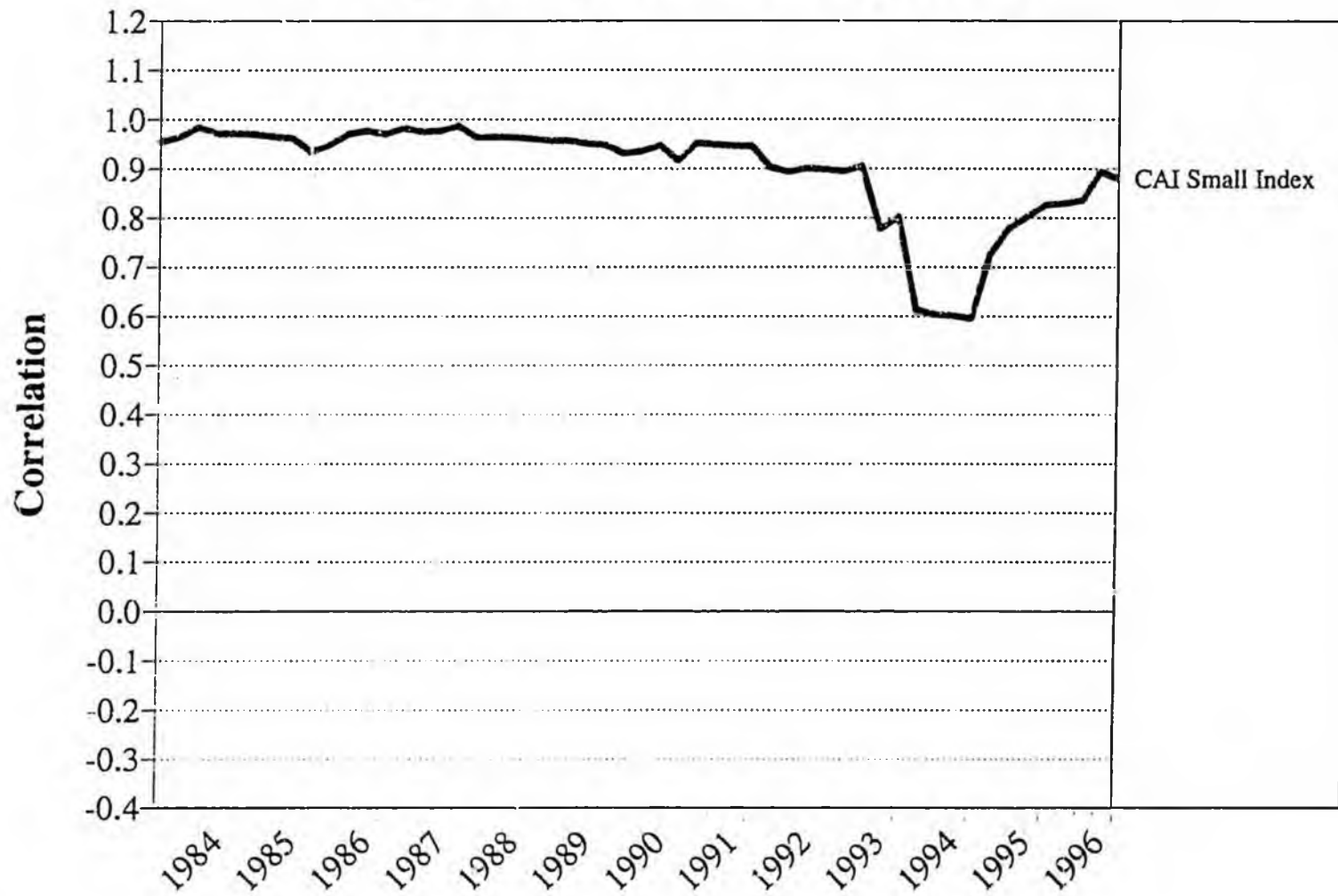
## Annualized Standard Deviation Using Rolling Periods of 12 Quarters



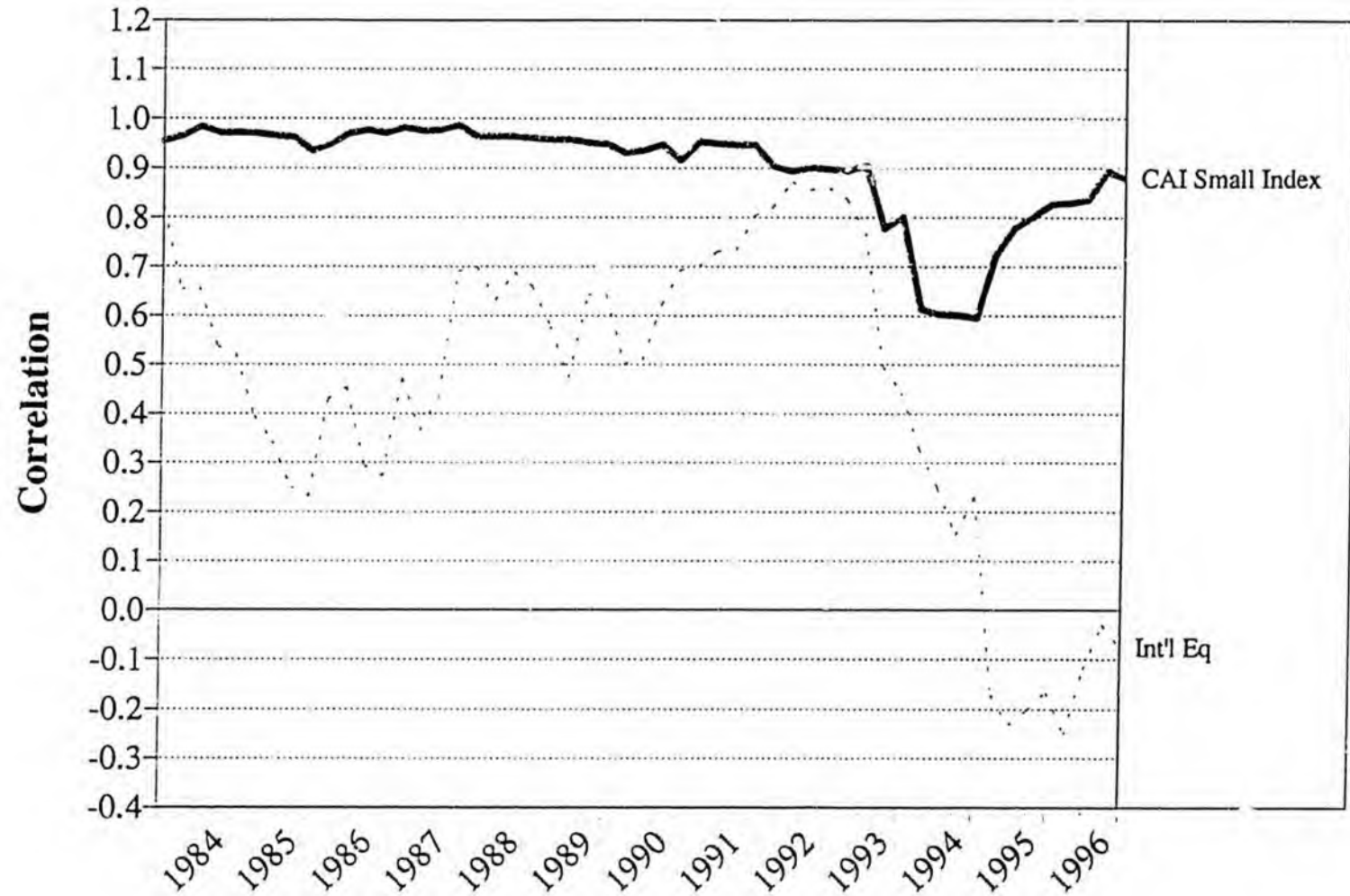
## Annualized Standard Deviation Using Rolling Periods of 12 Quarters



### Correlation Relative to S&P 500 Using Rolling Periods of 12 Quarters

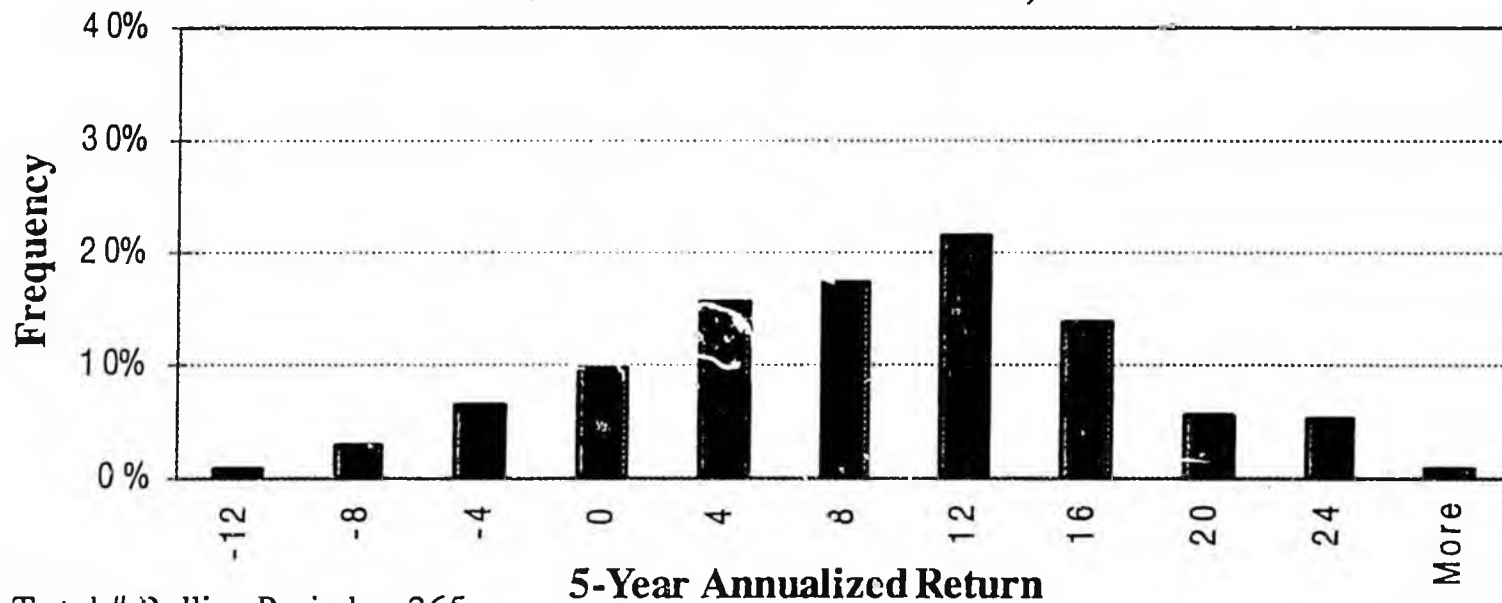


### Correlation Relative to S&P 500 Using Rolling Periods of 12 Quarters



# Domestic Stocks 5-Year Real Return Histogram 1930-1996

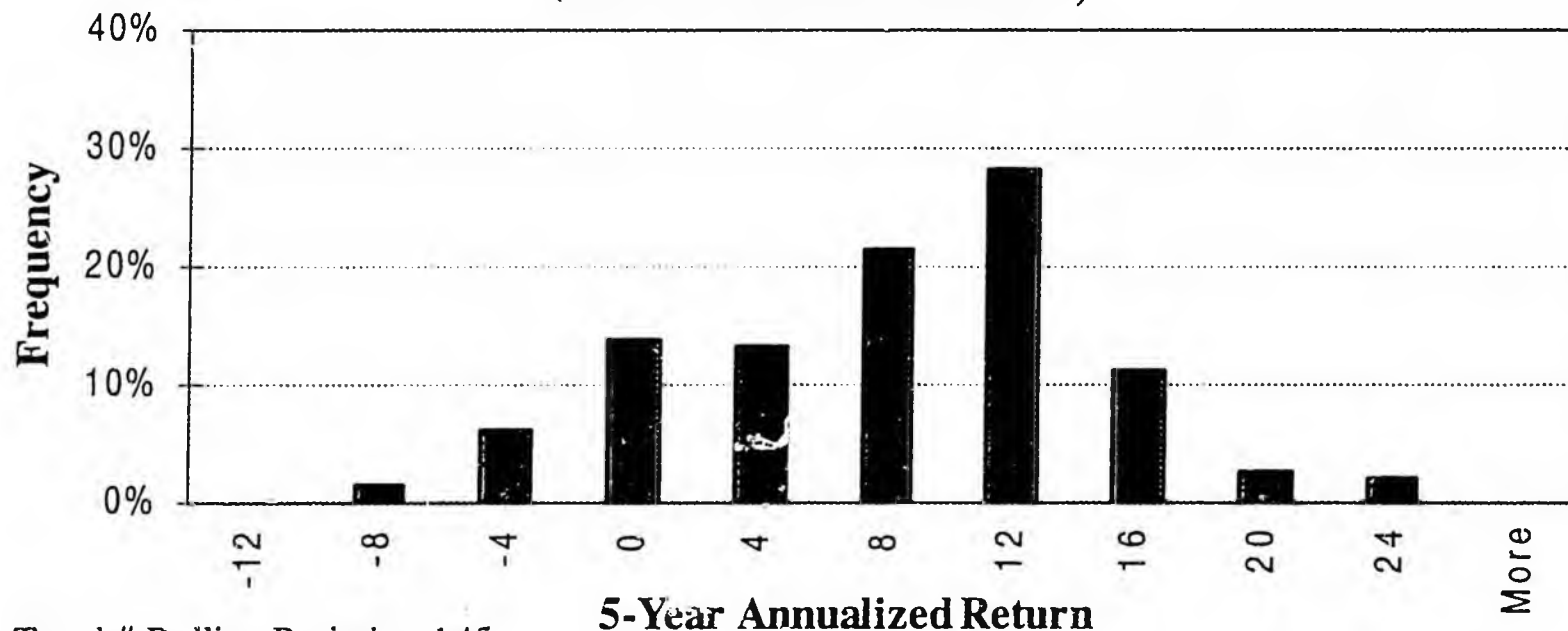
(1st 5-Yr Period: 1/26 to 12/30)



Total # Rolling Periods = 265  
(Based on quarterly data)

# Domestic Stocks 5-Year Real Return Histogram 1960-1996

(1st 5-Yr Period: 1/56 to 12/60)

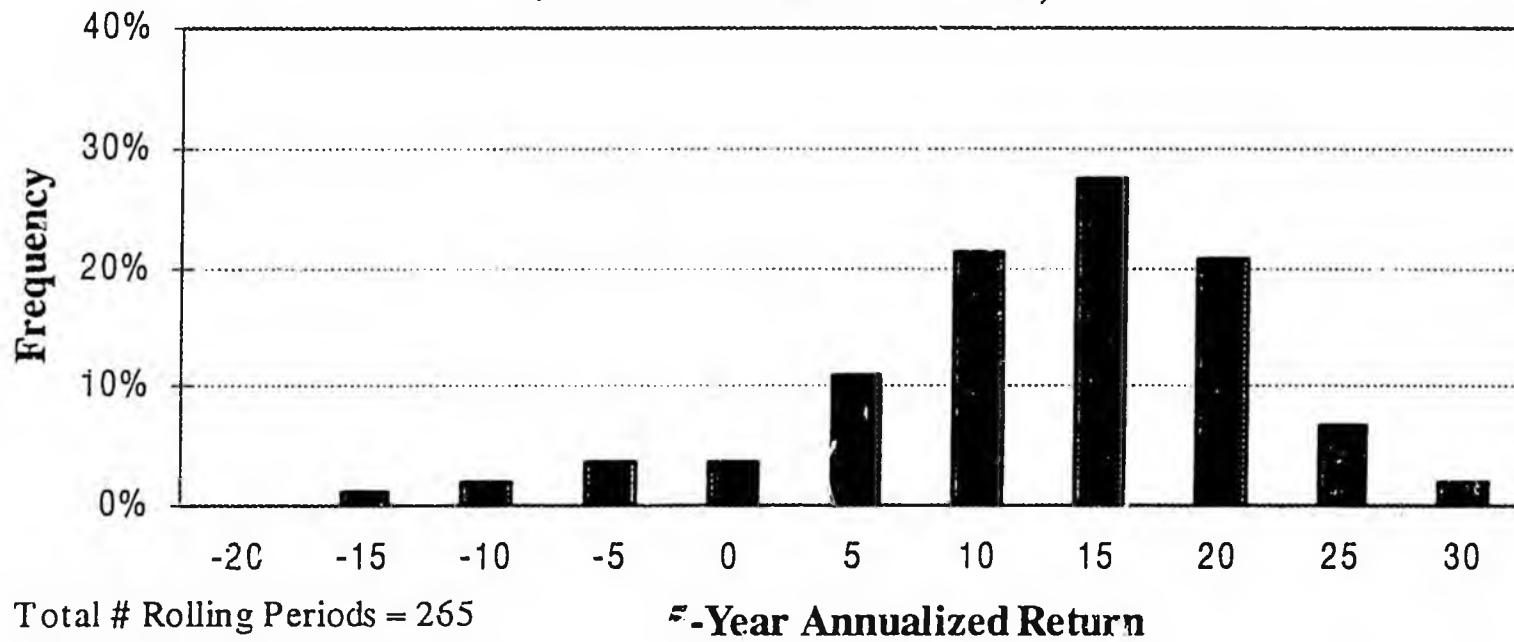


Total # Rolling Periods = 145  
(Based on quarterly data)



**Domestic Stocks**  
**5-Year Nominal Return Histogram**  
**1930-1996**

(1st 5-Yr Period: 1/26 to 12/30)

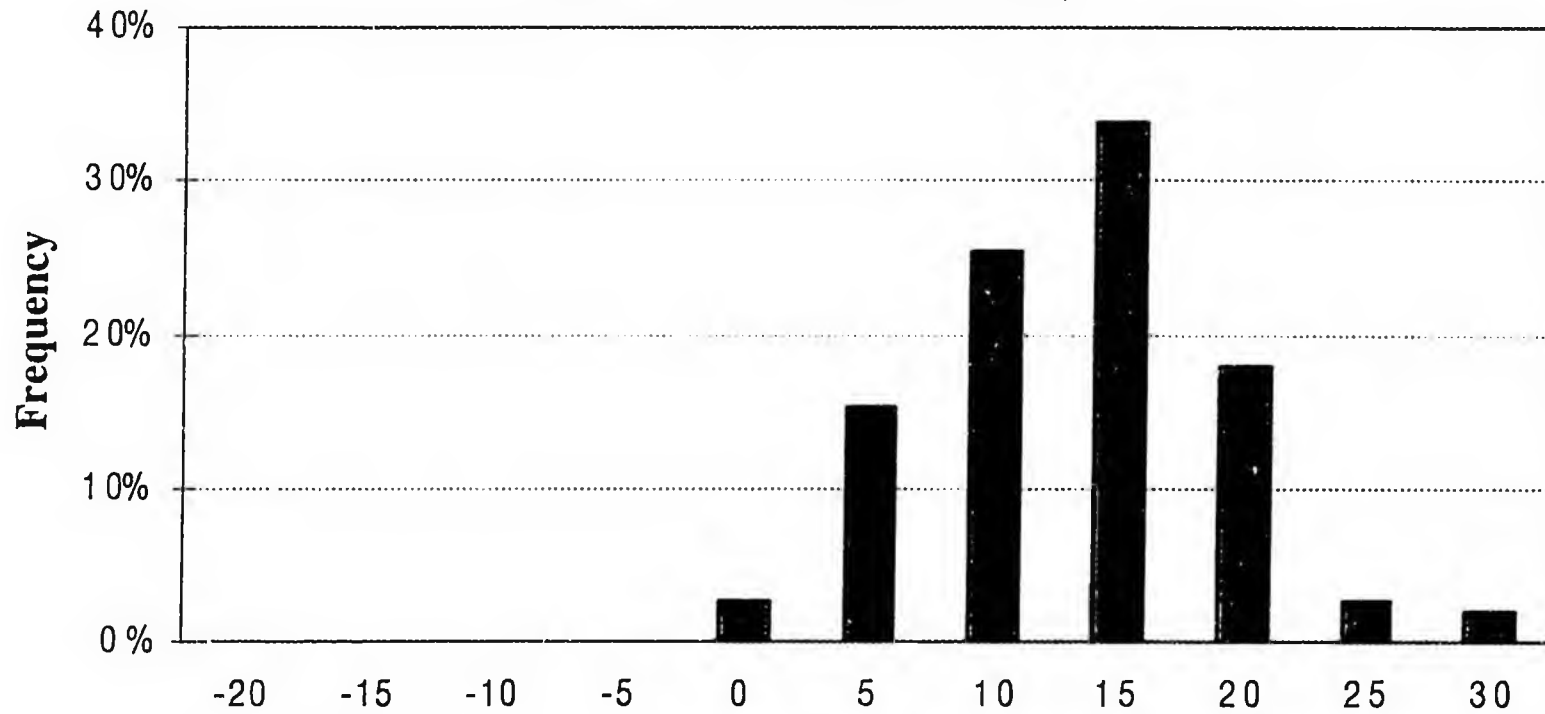


Total # Rolling Periods = 265  
(Based on quarterly data)



**Domestic Stocks**  
**5-Year Nominal Return Histogram**  
**1960-1996**

(1st 5-Yr Period: 1/56 to 12/60)



Total # Rolling Periods = 145  
(Based on quarterly data)

**5-Year Annualized Return**

