

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

610 SCOMM18: HOUSE SPECIAL COMM. ON PERMANENT FUND 1978-80

SCOMM

#18:17

Introduced: 2/22/79
Referred: Special Permanent
Fund Committee and Finance

1 IN THE HOUSE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

2 HOUSE JOINT RESOLUTION NO. 23

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - FIRST SESSION

5 Proposing an amendment to the Con-
6 stitution of the State of Alaska
7 relating to finance.

8 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. Article IX, sec. 15, Constitution of the State of Alaska,
10 is amended to read:

11 Section 15. ALASKA PERMANENT FUND. At least seventy-five
12 [TWENTY-FIVE] per cent of all mineral lease rentals, royalties, royalty
13 sale proceeds, and federal mineral revenue sharing payments, one
14 hundred per cent of all [AND] bonuses received by the State, and one
15 hundred per cent of all revenue received by the State from the sale of
16 land, except land-sale revenue pledged, before or after the effective
17 date of this amendment, to repay bonds, shall be placed in a permanent
18 fund, the principal of which shall be used only for those income-
19 producing investments specifically designated by law as eligible for
20 permanent fund investments. All income from the permanent fund shall
21 be deposited in the general fund unless otherwise provided by law.

22 * Sec. 2. EFFECTIVE DATE. The increase from twenty-five per cent of
23 mineral revenue to seventy-five per cent of certain mineral revenue and the
24 increase to include all bonuses, in sec. 1 of this resolution, become
25 effective on July 1, 1981.
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27
28
29

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

Opinion 1977-21
POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

MEMORANDUM

SUBJECT: Permanent fund

TO:

FROM: Billy G. Berrier, Director
Division of Legal Services

You have requested my comments on the legal implications of the words "permanent" and "income producing" as used in the constitutional amendment authorizing the permanent fund on the legal standards and guides the legislature may wish to establish in legislation.

The relevant provision is Section 15, of Article IX which reads:

"Section 15 ALASKA PERMANENT FUND. At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State of Alaska shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law".

It is clear from the wording of the amendment itself and from the surrounding context that the concept is that a fund be created in which a portion of the mineral revenues of the state would be set aside in order to insure preservation for the future of that portion of the revenue. There can be no legitimate question that the objective is preservation of that portion as capital for the long term use of the state and its people and prevention of uses which are expedient in the short term but which would dissipate the capital of the fund. The paramount consideration must be the probable safety of the capital of the fund to be invested.

The term "permanent" as used three times in the body of the amendment and in the title of the fund would be read in the normal sense of that word since that reading is consistent with the context of the amendment, with the legislative and public discussion of the amendment, and with the understanding that the voters would be presumed to have in approving the amendment.

While the permanent fund is not a trust in the technical legal meaning of the term, the protection of capital required has substantial similarities to the requirements binding upon a trustee. This requirement is commonly referred to as the prudent-man rule. There have been numerous cases on this rule and many commentators have set out reasonable similar statements of the rule. A good statement is found in Scott on Trusts 3rd Ed in Sec. 227 (pages 1805 - 1806) which reads:

"The only general rule which can be laid down as to investments is that the trustee is under a duty to make such investments as a prudent man would make of his own property having primarily in view the preservation of the estate and the amount and regularity of the income to be derived. In various forms this rule has been stated in innumerable cases. It involves three elements, namely care and skill and caution. The trustee must exercise a reasonable degree of care in selecting investments. He must exercise a reasonable degree of skill in making the selection. He must, in addition, exercise the caution which a prudent man would exercise where a primary consideration is the preservation of the funds invested."

This rule would seem to adequately set out the general parameters constitutionally required for permanent fund investments of principal. It would apply at two stages of the process. The legislature would be bound to apply it in exercising the duty to circumscribe and delineate investments required under the limitation in the constitution reading:

"...the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investment. (emphasis added)

The managers of the fund are given no constitutional discretion under this clause. The discretion is lodged exclusively in the legislature; and, if the objectives of the permanent fund are to be attained, investments specifically designated by law as eligible for permanent fund investment must also meet the criteria of having as a primary consideration the preservation of the funds invested.

The legislation, however, would not be expected to detail the permissible investments. It would presumably designate specific investment categories and create a management structure for the fund which would make the specific decisions as to which investments are to be made. Here again, the prudent-man rule would be applicable. In addition to designating specific categories of investment, any legislation should also establish guidelines for the fund management which are consistent with the objective of the fund. The need for this arises because within a class which as a class meets the objectives of preservation of the funds invested, some specific investments would still not be made by a prudent man. Possibly this could be largely avoided by using an ultra restrictive approach to allowable categories of investment but this approach would create or exacerbate other problems.

The primary difficulty with an ultra restrictive approach to allowable investments is that, as a matter of law, the problem of inflation would not be a factor in investment decisions. It can be reasonably assumed that inflation to some degree may be anticipated.

The argument has been made that inflation can realistically be anticipated to occur, that if principal is not increased in an amount to compensate for inflation the real value of the principal will decline even though the nominal value is maintained and that the duty of a prudent investor is to maintain the real value of the principal. Therefore, failure to account for inflation in investment policy violates the prudent-man rule of investment. I have found no authority to support this argument as a legal requirement. Factually, the argument would fall here. The constitutional amendment makes a clear distinction between principal which is permanent and income which is subject to expenditure by the normal appropriation process unless the legislature directs otherwise. At the time the amendment was adopted, inflation had occurred at an extremely high rate in the immediate past so it must be assumed that both the legislature and the public were conscious of inflationary effect. It would therefore, to support this argument, require assuming that investments which would have a capital appreciation, entirely apart from income earned, which is at least equal to inflation are the only permissible investments. This does not seem reasonable.

The argument that inflation must be taken into account does not seem valid here but that does not mean that inflation may not, or even that it should not, be taken into account. There is no reason that legislation establishing the management of the permanent fund and the disposition of fund income should not address this problem directly. I have suggested earlier that the legislation needs to establish standards for investments to avoid having to specify only ultra restrictive investments. The legislation could also require that the possible effects of inflation be a consideration in investment decisions made by the fund managers.

The term "income-producing" as used in the amendment presents serious conceptual difficulties. In context, this could simply be a restatement of the normal duty to make productive investments. In relation to trusts this has been stated:

"It is the duty of a trustee to preserve the trust property and make it productive. It is ordinarily his duty to invest trust funds in such a way as to receive an income without improperly risking the loss of principal." (Scott on Trusts 227 p. 1805)

However, as stated earlier, the permanent fund is not a trust in the technical legal sense. Simply carrying over the trustee's duty could be misleading.

The term "income-producing" is not a term of art and has no fixed legal meaning differing from the conventional meaning of the term. It is possible that a court would hold that the term implies that maximum income consistent with safety of principal must be the exclusive criteria for investment. This would be consistent with trust law but it appears that the amendment contemplates broader considerations as well. It would appear more likely that other considerations, such as the effect particular investments would have on furthering public purposes other than maximization of income, could also be given weight. Some examples of other public purposes are providing jobs, improvement of the Alaskan economy and economic diversification.

It is clear that production of income is a necessary goal of each investment; it is probably that maximization of income consistent with safety of principal must be a major goal, ; but it appears unlikely that a court would hold that this must be the exclusive goal of permanent fund investment policy.

While the investment of the permanent fund differs from investment of state treasury surplus funds in several respects including the specific requirement of income producing investment of permanent fund principal, both have as major goals protection of principal and production of income. It is interesting to note that state treasury surplus fund investment specifies policy goals additional to the primary goals. On this point AS 37.10.075(f) provides:

(f) Investment policy shall be formulated by the commissioner of revenue who shall be advised by a committee appointed by the governor which shall contain representation from the legislature. In formulating investment policy they shall consider maximum income and safety as governed by the prudent-man rule and the benefit to the private and public sectors of the economy in terms of increased housing and commercial credit, stimulated business activity, increased employment, support of the market for state and local bonds, increased public revenue together with the possible inflationary effect of the investment, and (h) and (i) of this section.

The question of what the term means as a matter of law will almost certainly be decided by the courts on a case by case basis. The questions involved are complex and change over time. In reasonably similar instances, the courts have refused to provide a general definition. For example the Alaska court in dealing with the term "capital improvements" as used in the Alaska Constitution said:

"We believe it would be unwise for this court to attempt to provide an abstract definition of "capital improvements." We have concluded that it is beyond human ability to permanently circumscribe with mere words at a given point in time a concept which though limiting in aspect, is otherwise intended to provide a broad, permanent and continuing authority for municipalities to finance present as well as unforeseeable future needs." (Juneau v. Hixon 373 P2d 743 (Alaska 1962))

While it is my opinion the courts will be liberal in sustaining the reasonable expectations of the legislature and the fund managers, they are unlikely to allow investments which cannot reasonably be anticipated to produce maximum current income consistent with safety of principal modified by application of other permissible public policy considerations. It appears certain that investments which cannot reasonably be anticipated to produce direct income would not be allowed.

BGB:jpd

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

POUCH 5 - JUNEAU 99811

March 29, 1979

Fran Ulmer, Director
Division of Policy Development
& Planning
Office of the Governor
Pouch AD
Juneau, AK 99811

Dear Ms. Ulmer:

I am enclosing the projections relative to permanent fund moneys which you requested.

The assumptions include a 25% permanent fund contribution rate through FY 81, and 75% thereafter. The earnings on the permanent fund are assumed to be 7% each year from FY 82 through FY 95. The earnings prior to this period range from 6.5% to 7%.

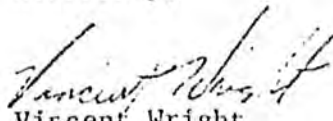
I have enclosed two basic scenarios: one which assumes 50% of the earnings from the permanent fund are deposited into the permanent fund balance, and the other which assumes that 100% of the earnings from the permanent fund are deposited into the general fund balance.

The three cases relative to expenditure growth are a balanced budget, a 10% expenditure growth rate compounded annually, and a balanced budget constrained by a 10% expenditure growth factor.

The pricing, inflation, employment, and other assumptions concerning petroleum and non-petroleum revenues are based on the assumptions utilized in the Department of Revenue's January Revenue Forecast. The particular Forecast I refer to also assumes a 50% probability that the gas line will be built and sustains deliveries of 2.0 Bcf/D as early as 1985.

If you have any questions, feel free to call.

Sincerely,


Vincent Wright
Chief of Research

VW:clm
Enclosures

BALANCED BUDGET APPROACH

FY	TOTAL GF PETROLEUM (GROSS)	TOTAL GF NON-PETRO REVENUE (LESS INTEREST)	TOTAL INTEREST REVENUE	TOTAL GF REVENUE (GROSS)	(LESS) STATE NATIVE CLAIMS PAYMENT	(LESS) PF CONTRIBUTION	TOTAL GF REVENUE (NET)	GF EXPENDITURES	GF BALANCE	PF BALANCE
79	793.8	311.7	42.0	1,147.5	41.6	75.2	1,030.7	1,087.6	522.6	129.9
80	861.8	319.1	45.0	1,225.8	50.8	90.7	1,084.3	1,030.0	576.9	220.6
81	1,072.2	350.5	60.4	1,483.1	68.5	117.8	1,296.8	1,296.8	576.9	338.4
82	1,525.3	399.4	68.1	1,992.8	96.8	488.7	1,407.3	1,407.3	576.9	827.1
83	1,708.9	462.2	98.3	2,269.4	112.8	563.7	1,592.9	1,592.9	576.9	1,390.8
84	1,888.7	526.3	137.7	2,552.7	104.3	640.2	1,808.2	1,808.2	576.9	2,031.0
85	2,050.3	599.4	182.6	2,832.3	-0-	710.1	2,122.2	2,122.2	576.9	2,741.1
86	2,271.5	641.1	232.3	3,145.2	-0-	810.0	2,335.2	2,335.2	576.9	3,551.1
87	2,462.9	686.3	289.0	3,438.2	-0-	890.4	2,547.8	2,547.8	576.9	4,441.5
88	2,647.8	734.3	351.3	3,733.4	-0-	968.1	2,765.3	2,765.3	576.9	5,409.6
89	2,826.8	785.7	419.1	4,031.6	-0-	1,047.3	2,984.3	2,984.3	576.9	6,456.9
90	2,955.1	840.7	492.4	4,288.2	-0-	1,105.8	3,182.4	3,182.4	576.9	7,562.7
91	2,975.2	899.5	569.8	4,444.5	-0-	1,121.1	3,323.4	3,323.4	576.9	8,683.8
92	2,828.9	962.5	648.2	4,439.6	-0-	1,068.9	3,370.7	3,370.7	576.9	9,752.7
93	2,364.1	1,029.9	723.1	4,117.1	-0-	888.9	3,228.5	3,228.5	576.9	10,641.3
94	2,082.7	1,102.0	785.3	3,970.0	-0-	780.9	3,189.1	3,189.1	576.9	11,422.2
95	1,921.9	1,179.1	839.9	3,940.0	-0-	714.0	3,226.9	3,226.9	576.9	12,136.2

Department of Revenue/Research/March 22, 1979

10% EXPENDITURE GROWTH APPROACH

FY	TOTAL GF PETROLEUM (GROSS)	TOTAL GF NON-PETRO REVENUE (LESS INTEREST)	TOTAL INTEREST REVENUE	TOTAL GF REVENUE (GROSS)	(LESS) STATE NATIVE CLAIMS PAYMENT	(LESS) PF CONTRIBUTION	TOTAL GF REVENUE (NET)	GF EXPENDITURES	GF BALANCE	PF BALANCE
79	793.8	311.7	42.0	1,147.5	41.6	75.2	1,030.7	1,087.6	522.6	129.9
80	861.7	319.1	45.0	1,225.8	50.8	90.7	1,084.3	1,030.0	576.9	220.6
81	1,072.2	350.5	60.4	1,483.1	68.5	117.8	1,296.8	1,133.0	740.7	338.4
82	1,525.3	399.4	75.5	2,000.2	96.8	488.7	1,414.7	1,246.3	909.1	827.1
83	1,708.9	462.2	121.5	2,292.6	112.8	563.7	1,616.1	1,370.0	1,154.3	1,390.8
84	1,888.7	526.3	178.2	2,593.2	104.3	640.2	1,848.7	1,508.0	1,495.0	2,031.0
85	2,050.3	599.4	246.8	2,896.5	-0-	710.1	2,186.4	1,658.8	2,022.6	2,741.1
86	2,271.5	641.4	333.5	3,246.4	-0-	810.0	2,436.4	1,824.7	2,634.4	3,551.1
87	2,462.9	686.3	433.0	3,582.2	-0-	890.4	2,691.8	2,007.2	3,318.9	4,441.5
88	2,647.8	734.3	543.2	3,925.3	-0-	968.1	2,957.2	2,207.9	4,068.2	5,409.6
89	2,826.8	785.7	663.4	4,275.9	-0-	1,047.3	3,228.6	2,428.7	4,868.1	6,456.9
90	2,955.1	840.7	792.8	4,588.6	-0-	1,105.8	3,482.8	2,671.6	5,679.3	7,562.7
91	2,975.2	899.5	926.9	4,801.6	-0-	1,121.1	3,608.5	2,938.7	6,421.1	8,683.8
92	2,828.9	962.5	1,057.3	4,848.7	-0-	1,068.9	3,779.8	3,232.6	6,968.3	9,752.7
93	2,364.1	1,029.9	1,170.5	4,564.5	-0-	888.9	3,675.6	3,555.8	7,088.1	10,641.3
94	2,082.7	1,102.0	1,241.1	4,425.8	-0-	780.9	3,644.9	3,911.4	6,821.6	11,422.2
95	1,921.9	1,179.1	1,277.1	4,378.1	-0-	714.0	3,664.1	4,302.6	6,183.1	12,136.2

Department of Revenue/Research/March 22, 1979

BALANCED BUDGET NOT TO EXCEED 10%

FY	TOTAL GF PETROLEUM (GROSS)	TOTAL GF NON-PETRO REVENUE (LESS INTEREST)	TOTAL INTEREST REVENUE	TOTAL GF REVENUE (GROSS)	(LESS) STATE NATIVE CLAIMS PAYMENT	(LESS) PF CONTRIBUTION	TOTAL GF REVENUE (NET)	GF EXPENDITURES	GF BALANCE	PF BALANCE
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83	1,708.9	462.2	121.5	2,292.6	112.8	562.7	1,616.1	1,370.9	1,154.3	1,390.8
84	1,888.7	526.3	178.2	2,593.2	104.3	640.2	1,848.7	1,508.0	1,495.0	2,031.0
85	2,050.3	599.4	246.8	2,896.5	-0-	710.1	2,186.4	1,658.8	2,022.6	2,741.1
86	2,271.5	641.4	333.5	3,246.4	-0-	810.0	2,436.4	1,824.7	2,634.3	3,551.1
87	2,462.9	686.3	433.0	3,582.2	-0-	890.4	2,691.8	2,007.2	3,318.9	4,441.5
88	2,647.8	734.3	534.2	3,925.3	-0-	968.1	2,957.2	2,207.9	4,068.2	5,409.6
89	2,826.8	785.7	663.4	4,275.9	-0-	1,047.3	3,228.6	2,428.7	4,868.1	6,456.9
90	2,955.1	840.7	792.8	4,588.6	-0-	1,105.8	3,482.8	2,671.6	5,679.3	7,562.7
91	2,975.2	889.5	926.9	4,801.6	-0-	1,121.1	3,608.5	2,938.7	6,421.1	8,683.8
92	2,828.9	962.5	1,057.3	4,848.7	-0-	1,068.9	3,779.8	3,232.6	6,968.3	9,752.7
93	2,364.1	1,029.9	1,170.5	4,564.5	-0-	888.9	3,675.6	3,555.8	7,088.1	10,641.3
94	2,082.7	1,102.0	1,241.1	4,425.8	-0-	780.9	3,644.9	3,644.9	7,088.1	11,422.2
95	1,921.9	1,179.1	1,295.7	4,396.7	-0-	714.0	3,682.7	3,682.7	7,088.1	12,136.2

Department of Revenue/Research/March 23, 1979

BALANCED BUDGET APPROACH
(50% of Permanent Fund Earnings Back to Permanent Fund)

FY	TOTAL GF PETROLEUM (GROSS)	TOTAL GF NON-PETRO REVENUE (LESS INTEREST)	TOTAL INTEREST REVENUE	TOTAL GF REVENUE (GROSS)	(LESS) STATE NATIVE CLAIMS PAYMENT	(LESS) PF CONTRIBUTION	TOTAL GF REVENUE (NET)	GF EXPENDITURES	GF BALANCE	PF BALANCE
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82	1,525.3	399.4	42.2	1,966.9	96.8	488.7	1,381.4	1,381.4	576.9	838.9
83	1,708.9	462.2	69.8	2,240.9	112.8	565.7	1,564.4	1,564.4	576.9	1,432.0
84	1,888.7	526.3	90.5	2,505.5	104.3	640.2	1,761.0	1,761.0	576.9	2,122.3
85	2,050.3	599.4	114.7	2,764.4	-0-	710.1	2,054.3	2,054.3	576.9	2,906.7
86	2,271.5	641.1	142.1	3,054.7	-0-	810.0	2,244.7	2,244.7	576.9	3,818.4
87	2,462.7	686.3	174.0	3,323.2	-0-	890.4	2,432.8	2,432.8	576.9	4,842.4
88	2,647.8	734.3	209.9	3,592.0	-0-	968.1	2,623.9	2,623.9	576.9	5,980.0
89	2,826.8	785.7	249.7	3,862.2	-0-	1,047.3	2,814.9	2,814.9	576.9	7,236.6
90	2,955.1	840.7	293.7	4,089.5	-0-	1,105.8	2,983.7	2,983.7	576.9	8,595.7
91	2,975.2	899.5	341.2	4,215.9	-0-	1,121.1	3,094.8	3,094.8	576.9	10,017.6
92	2,828.9	962.5	391.0	4,182.4	-0-	1,068.9	3,113.5	3,113.5	576.9	11,437.1
93	2,364.1	1,029.9	440.7	3,834.7	-0-	888.9	2,946.1	2,946.1	576.9	12,726.3
94	2,082.7	1,102.0	485.8	3,670.5	-0-	780.9	2,889.6	2,889.6	576.9	13,952.6
95	1,921.9	1,179.1	528.7	3,629.7	-0-	714.0	2,915.7	2,915.7	576.9	15,154.9

Department of Revenue/Research/March 27, 1979

10% EXPENDITURE GROWTH APPROACH
(50% of Permanent Fund Earnings Back to Permanent Fund)

FY	TOTAL GF PETROLEUM (GROSS)	TOTAL GF NON-PETRO REVENUE (LESS INTEREST)	TOTAL INTEREST REVENUE	TOTAL GF REVENUE (GROSS)	(LESS) STATE NATIVE CLAIMS PAYMENT	(LESS) PF CONTRIBUTION	TOTAL GF REVENUE (NET)	GF EXPENDITURES	GF BALANCE	PF BALANCE
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81	1,072.2	350.5	60.4	1,483.1	68.5	117.8	1,296.8	1,133.0	740.7	338.4
82	1,525.3	399.4	63.7	1,988.4	96.8	488.7	1,402.9	1,246.3	897.3	838.9
83	1,708.9	462.2	92.2	2,263.3	112.8	563.7	1,586.8	1,370.0	1,114.1	1,432.0
84	1,888.7	526.3	128.1	2,543.1	104.3	640.2	1,798.6	1,508.0	1,404.7	2,122.3
85	2,050.3	599.4	172.6	2,822.3	-0-	710.1	2,112.2	1,658.8	1,858.1	2,906.7
86	2,271.5	641.4	231.8	3,144.7	-0-	810.0	2,334.7	1,824.7	2,368.1	3,818.4
87	2,462.9	686.3	299.4	3,448.6	-0-	890.4	2,558.2	2,007.2	2,919.1	4,842.4
88	2,647.8	734.3	373.8	3,755.9	-0-	968.1	2,787.8	2,207.9	3,499.0	5,980.0
89	2,826.8	785.7	454.2	4,066.7	-0-	1,047.3	3,019.4	2,428.7	4,089.7	7,236.6
90	2,955.1	840.7	539.6	4,335.4	-0-	1,105.8	3,229.6	2,671.6	4,647.7	8,595.7
91	2,975.2	899.5	626.1	4,500.8	-0-	1,121.1	3,379.7	2,938.7	5,088.7	10,017.6
92	2,828.9	962.5	706.8	4,498.2	-0-	1,068.9	3,429.3	3,232.6	5,285.4	11,437.1
93	2,364.1	1,029.9	770.3	4,164.3	-0-	888.9	3,275.4	3,555.8	5,005.0	12,726.3
94	2,082.7	1,102.0	795.8	3,980.5	-0-	780.9	3,199.6	3,911.4	4,293.2	13,952.6
95	1,921.9	1,179.1	788.8	3,889.8	-0-	714.0	3,175.8	4,302.6	3,166.4	15,154.9

Department of Revenue/Research/March 27, 1979

BALANCED BUDGET NOT TO EXCEED 10%
(50% of Permanent Fund Earnings Back to Permanent Fund)

FY	TOTAL GF PETROLEUM (GROSS)	TOTAL GF NON-PETRO REVENUE (LESS INTEREST)	TOTAL INTEREST REVENUE	TOTAL GF REVENUE (GROSS)	(LESS) STATE NATIVE CLAIMS PAYMENT	(LESS) PF CONTRIBUTION	TOTAL GF REVENUE (NET)	GF EXPENDITURES	GF BALANCE	PF BALANCE
79	793.8	311.7	42.0	1,147.5	41.6	75.2	1,030.7	1,087.6	522.6	129.9
80	861.7	319.1	45.0	1,225.8	50.8	90.7	1,084.3	1,030.0	576.9	220.6
81	1,072.2	350.5	60.4	1,483.1	68.5	117.8	1,296.8	1,133.0	740.7	338.4
82	1,525.3	399.4	63.7	1,988.4	96.8	488.7	1,402.9	1,246.3	897.3	838.9
83	1,708.9	462.2	92.2	2,263.3	112.8	563.7	1,586.8	1,370.0	1,114.1	1,432.0
84	1,888.7	526.3	128.1	2,543.1	104.3	640.2	1,798.6	1,508.0	1,404.7	2,122.3
85	2,050.3	599.4	172.6	2,822.3	-0-	710.1	2,112.2	1,658.8	1,858.1	2,906.7
86	2,271.5	641.4	231.8	3,144.7	-0-	810.0	2,334.7	1,824.7	2,368.1	3,818.4
87	2,462.9	686.3	299.4	3,448.6	-0-	890.4	2,558.2	2,007.2	2,919.1	4,842.4
88	2,647.8	734.3	373.8	3,755.9	-0-	968.1	2,787.8	2,207.9	3,499.0	5,980.0
89	2,826.8	785.7	454.2	4,066.7	-0-	1,047.3	3,091.4	2,428.7	4,089.7	7,236.6
90	2,955.1	840.7	539.6	4,335.4	-0-	1,105.8	3,229.6	2,671.6	4,647.7	8,595.7
91	2,975.2	899.5	626.1	4,500.8	-0-	1,121.1	3,279.7	2,938.7	5,088.7	10,017.6
92	2,828.9	962.5	706.8	4,498.2	-0-	1,068.9	3,429.3	3,232.6	5,285.4	11,437.1
93	2,364.1	1,029.9	770.3	4,164.3	-0-	888.9	3,275.4	3,275.4	5,285.4	12,726.3
94	2,082.7	1,102.0	815.2	3,999.9	-0-	780.9	3,219.0	3,219.0	5,285.4	13,952.6
95	1,921.9	1,179.1	858.3	3,959.3	-0-	714.0	3,245.0	3,245.0	5,285.4	15,154.9

Department of Revenue/Research/March 27, 1979

AFTER RECESS

The Senate reconvened at 5:33 p.m.

INTRODUCTION AND REFERENCE OF SENATE RESOLUTIONS

SJR SENATE JOINT RESOLUTION NO. 26 by the Rules Committee by
26 request of the Governor,

Proposing an amendment to the Constitution
of the State of Alaska relating to finance,

was read the first time and referred to the State Affairs
Committee and the Finance Committee.

Governor's transmittal letter follows:

February 13, 1979

The Honorable Clem Tillion
President of the Senate
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. President:

Under authority of art. III, sec. 18 of the Alaska
Constitution, I am transmitting for your consideration a
joint resolution to amend the provisions of article IX,
section 15, of the Alaska Constitution to increase the
amount of money to be deposited in the Alaska Permanent
Fund.

The revenue from our oil and gas resources has been
disappointingly low, and, as a consequence, the amounts
which will go into the permanent fund will not measure up
to our original expectations. At the same time, many
Alaskans, and I am among them, have come to conclude that
our original dedication was too meager in the first
place. The permanent fund cannot possibly be both a nest
egg for our future and a foundation for diversifying our
economy at the present level of dedication.

I propose, therefore, that the dedication from rentals,
royalties, royalty sales, and federal mineral revenue
sharing be increased from 25 percent to 75 percent. I
propose that all bonuses be dedicated in their entirety.
And I propose that land-sale revenue be added to the
dedication and that, with the exceptions discussed below,

all of the latter be dedicated. The land is our capital,
and, as we convert it to money, it should remain capital,
that is, as a part of the permanent fund.

By necessary implication, any land-sale revenue which is
dedicated by federal law for another purpose is excepted
from this dedication. The federal law takes precedence.
The revenue from the University of Alaska's land is a
good example. The proposed amendment also expressly
exempts land-sale revenue pledged now or in the future to
repay bonds. This exemption allows the revenue to be
used as security for a proposed revenue-bond program for
financing our land disposal program. When it is no
longer used as security, it will be deposited into the
fund as well.

With the proposed increases in the permanent fund
dedications, the fund should acquire sufficient money to
permit the additional amounts to be used for development
banking activities as authorized by law. Without the
increases, I do not see how we can, in good faith, use any
of the permanent fund for that purpose.

I urge your favorable consideration.

Sincerely,

Jay S. Hammond
Governor

INTRODUCTION AND REFERENCE OF SENATE BILLS

SENATE BILL NO. 216 by Senators Hackney, Fahrenkamp, Meland,
Rodey, Stimson and Sturgulewski, entitled:

"An Act authorizing state aid to municipi-
palities for the construction and develop-
ment of cultural facilities."

was read the first time and referred to the Community and
Regional Affairs Committee and the Finance Committee.

SENATE BILL NO. 217 by Senator Sackett, entitled:

"An Act providing for an advisory com-
mittee on judicial sentencing practices;
and providing for an effective date."

was read the first time and referred to the Judiciary
Committee and the Finance Committee.

SCOMM

#18:18

Introduced: 3/20/79
Referred: Special Permanent
Fund Committee and Finance

1 IN THE HOUSE

BY THE SPECIAL PERMANENT
FUND COMMITTEE

2 HOUSE BILL NO. 414

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to income of the Alaska permanent
7 fund; and providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 37.13 is amended by adding new sections to read:

10 Sec. 37.13.190. PERMANENT FUND INCOME. Income from investment of
11 the permanent fund becomes part of the permanent fund and shall be
12 deposited in the permanent fund annually. The income may be used to
13 provide for guarantees of indebtedness issued by governmental agencies
14 of the state for power projects.

15 Sec. 37.13.200. GUARANTEES OF INDEBTEDNESS. The Board of Trustees
16 of the Alaska Permanent Fund Corporation is authorized to enter into
17 agreements with any public authority of this state or any municipality
18 or other governmental agency of the state, providing for a guarantee of
19 the payment when due, whether at maturity or by sinking fund redemption
20 but not by acceleration of maturity, of the principal of and interest on
21 bonds, notes or other indebtedness issued to finance projects for con-
22 struction of electric generating and related transmission facilities,
23 this guarantee to be payable solely from the income derived from the
24 Alaska permanent fund established by AS 37.13.010 (other than income
25 derived from the Alaska enterprise development fund established by AS
26 44.55.010). The agreements shall contain such terms, provisions, and
27 covenants in furtherance of the purposes of AS 37.13.190 - 37.13.230 as
28 the board of trustees determines.

29 Sec. 37.13.210. LIMITATION ON INDEBTEDNESS. No bonds, notes or

1 other indebtedness may be guaranteed under AS 37.13.200 unless the board
2 determines that the debt service for any year for all bonds, notes and
3 other indebtedness guaranteed will not exceed the amount of annual
4 income estimated by the board to be derived during that year from the
5 Alaska permanent fund (other than income from the Alaska enterprise
6 development fund). The determination shall be made by resolution of the
7 board before the execution of a guarantee agreement under AS 37.13.200.

8 Sec. 37.13.220. GUARANTEE ENDORSED. A bond, note or other
9 indebtedness guaranteed under AS 37.13.200 shall have on its face an
10 endorsement of the guarantee by the chairman of the board or his
11 designee.

12 Sec. 37.13.230. LEGISLATIVE APPROVAL. No bond, note or other
13 indebtedness may be guaranteed by the board under AS 37.13.200 until the
14 facilities to be financed with the proceeds of the bonds, notes or other
15 indebtedness have been approved by the legislature by concurrent
16 resolution.

17 * Sec. 2. This Act takes effect upon the effective date of a version of
18 House Bill No. 281 establishing the Alaska Permanent Fund Corporation.
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Alaska State Legislature

1976

Source:

SCS CSSS HJR 39(Resources) am S

HOUSE JOINT RESOLUTION NO. 39

Proposing an amendment to the Alaska Constitution, establishing an Alaska Permanent Fund for certain proceeds derived from non-renewable resources.

and the election laws of the state.

* Sec. 4. The amendments proposed by this resolution if adopted by the voters at the next general election shall become effective 90 days after the certification of the election returns by the lieutenant governor.

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. Article IX, sec. 7, Constitution of the State of Alaska, is amended to read:

SECTION 7. DEDICATED FUNDS. The proceeds of any state tax or license shall not be dedicated to any special purpose, except as provided in section 15 of this article or when required by the federal government for state participation in federal programs. This provision shall not prohibit the continuance of any dedication for special purposes existing upon the date of ratification of this section by the people of Alaska.

* Sec. 2. Article IX, Constitution of the State of Alaska, is amended by adding a new section to read:

SECTION 15. ALASKA PERMANENT FUND. At least twenty-five per cent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.

* Sec. 3. The amendments proposed by this resolution shall be placed before the voters at the next general election in conformity with art. XIII, sec. 1, Constitution of the State of Alaska,

SSHJR
39"JOINT CHAIRMANS' REPORT ON
CS SSHJR 39

The Finance and Judiciary Committees of the House have each considered individually SS HJR 39, transmitted to the House by the Governor on January 15, 1976. The House Judiciary Committee, in unanimously adopting and reporting out a Judiciary Committee Substitute, incorporated amendments adopted by both the Finance and Judiciary Committees. CS SSHJR 39 is addressed in this joint report so that the intent of the constitutional amendment proposed by the resolution is clear.

The proposed constitutional amendment, which both committees view as of vital importance to the state, would establish an Alaska Permanent Fund into which 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments, bonuses and all mineral production taxes would automatically be placed.

The committee substitute raises from 15 to 25 the percentage of nonrenewable resource revenue to be dedicated. This change was made after the committees' concurrence with the Governor that the 25 percent level of funding would allow flexibility in future budgeting of state expenditures even if the most conservative case for future state revenue projections proves true. On the other hand, sufficient income would be accumulated in the Alaska Permanent Fund to allow diversification of Alaska's economy and to insure that future generations receive benefits from development of the State's nonrenewable resources.

The word "all" has been added before the words "mineral production taxes" in sec. 11 of the proposed constitutional amendment so that it is clear that all future taxes measured by mineral production or severance are included in this provision of the Constitution. The addition of the word "all" does not include property taxes. Examples of taxes included under sec. 15 include Oil and Gas Property Production Tax, AS 43.55 and the Oil and Gas Regulation and Conservation Tax, AS 43.57. Taxes which are not included are Oil and Gas Exploration, Production and Pipeline Transportation Property Taxes, AS 43.56 and Oil and Gas Reserves Ad Valorem Tax, AS 43.58.

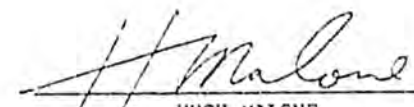
In regard to both mineral leasing and mineral production taxes, the amount to be placed in the Fund would be based upon the gross amount to be received by the state. Accordingly, twenty-five percent of the gross amount of these revenues would be paid into the fund even though a portion of these revenues will be paid into the Alaska Native Fund as required by law.

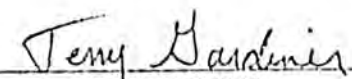
In the event royalties are taken in kind, 25 percent of the proceeds from their sale would be placed in the fund. Also, revenue sharing payments which the state receives from federal mineral leasing would be dedicated.

The principal of the Fund would be used only for investment in income-producing investments which the legislative would establish and change from time to time to meet the needs of the state. The Fund would come into existence and accumulate 25 percent of all nonrenewable source revenues received by the state 90 days after the certification of the 1976 election returns by the lieutenant governor. It is the purpose of the delayed effective date to allow the legislature to provide by law for an investment structure for the Alaska Permanent Fund.

The purpose of the language in the last sentence of the resolution is to give future legislatures the maximum flexibility in using the Fund's earnings -- ranging from adding to Fund principal to paying out a dividend to resident Alaskans.

The fiscal note provides for an interim study and development of alternative investment goals and structures for the Fund to be performed jointly by executive and legislative staff under the direction of the State Investment Advisory Committee.


HUGH MALONE
Chairman House Finance Committee


TERRY GARDINER
Chairman House Judiciary Committee

The State Affairs Committee has had HOUSE JOINT RESOLUTION NO. 41 (Requesting the Secretary of the United States Department of Transportation to transfer Southeast Alaska from the Pacific Standard Time Zone to the Yukon Standard Time Zone) under consideration and a majority of the members of the Committee recommends it be replaced with COMMITTEE SUBSTITUTE FOR HOUSE JOINT RESOLUTION NO. 41 (Requesting the Secretary of the United States Department of Transportation to revise the standard time zones in which Alaska is located) and that it do pass. The report was signed by Mr. McKinnon, Chairman, and concurred in by Parker, Wallis, Fischer and Miller. Not concurring was McKinnon who has no recommendation.

Mr. Malone moved and asked unanimous consent that the Finance Committee referral on HOUSE JOINT RESOLUTION NO. 41 be waived. There being no objection, it was so ordered and the resolution was referred to the Rules Committee for placement on the calendar.

FIRST *Southwest* COMPANY

INVESTMENT BANKERS

MERCANTILE BANK BUILDING

DALLAS, TEXAS 75201

March 19, 1979

(214) 742-6461

The Honorable Terry Gardiner
Speaker
House of Representatives
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Mr. Speaker:

In response to your request, we have summarized below certain options for tax-supported financing of small hydroelectric projects.

In general, public projects are financed through the use of general obligation bonds, revenue bonds, or a combination thereof. General obligation bonds are backed by the "full faith and credit" of the issuer, the revenues used to pay the bonds being derived principally from taxes. Revenue bonds are usually secured solely by the net revenues (after operation and maintenance expenses) of the project being financed. Revenue bonds with a full or partial tax or general obligation pledge are a hybrid which, if used properly, can achieve the advantages of both bond types.

General obligation bonds generally sell at interest rates approximately 1 1/2% lower than revenue bonds of equal credit quality (rating). Nevertheless, the indiscriminate use of general obligation bonds in lieu of revenue bonds to achieve lower interest costs can be detrimental to the credit of the issuer in that the bond credit rating agencies critically examine the issuer's total debt burden payable from general funds. Careful use, however, of a general obligation bond or combination tax and revenue bond to finance a revenue project should not adversely affect the issuer's credit if the project produces net revenues sufficient to pay the debt, thus relieving the general fund of the debt burden.

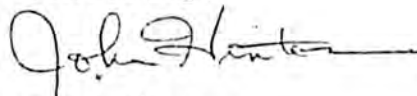
All of the above points out the critical elements for financing small hydroelectric projects with general obligations of the State of Alaska. The concept is financially workable from a State viewpoint if feasible projects are funded and professionally managed. The projects, if feasible, would thus gain the benefit of a much lower interest rate, and the State's general fund would not be burdened with repaying the debt. The difference between the interest rate for the State's bonds and marginal-quality project revenue bonds is in excess of 2%. The differential alone will have a significant feasibility impact on the projects.

The Honorable Terry Gardiner
March 19, 1979
Page Two

One vehicle presently in place that could be used to assist small hydroelectric projects is the Alaska Power Authority Revolving Fund. The Authority would issue, pursuant to a vote of the people, revenue bonds with a full or partial general obligation guarantee of the State. The funds could be deposited in the Revolving Fund for loans to local communities or cooperatives, the loans being secured by the revenues of the project and possibly by a local tax. In addition, interest during the project construction period could be funded from bond proceeds, as well as a reasonably required bond reserve fund equal to a year's debt service to further reduce the possibility of the State having to contribute to the Revolving Fund to pay principal and interest on the Authority bonds.

I hope this memorandum is responsive to your needs. If you have any further questions, please don't hesitate to contact me.

Sincerely,

A handwritten signature in dark ink, appearing to read "John Hinton", with a long horizontal flourish extending to the right.

John Hinton
Assistant Vice President

157
WHITE, WELD & Co.
INCORPORATED

ONE LIBERTY PLAZA
91 LIBERTY STREET, NEW YORK, N. Y. 10006

THEODORE P. SWICK
FIRST VICE PRESIDENT
212/285-2153

CABLE ADDRESS "WHITEWELD"

December 9th, 1977

Mr. Clark Gruening, Chairman
House Permanent Fund Committee

Since the House Special Committee on the Permanent Fund is in the final stages of structuring legislation for consideration by the 1978 legislature, it is time to consider the use of the income of this "Permanent Fund".

The provisions of the Permanent Fund Constitutional Amendment include that "the income from the Permanent Fund shall be deposited in the General Fund unless otherwise provided by law". According to the best estimates of the Department of Revenue, the minimum amount (25%) of the funds received as mineral lease rentals, royalties and other payments will result in an accumulation by 1985 of some \$1.8 billion. The investment income from that amount, at an average 7% rate of return, would produce approximately \$126,000,000 any one year. As the Permanent Fund continues to grow, its increased capital will provide additional annual income in excess of the aforementioned figure, however, for the sake of perspective, the ensuing discussion will be confined to the \$126,000,000 projected income.

If the estimates are correct as to the principal accumulated in the Permanent Fund by 1985 at a 25% rate, the remaining balance accumulated in the General Fund should amount to some \$5.4 billion. The effect of the addition of \$126,000,000 to such an accumulation would increase the 1985 accumulation by approximately 2%. Such an increase is minimal in relation to a General Fund accumulation of the magnitude as anticipated.

Therefore, the income of the Permanent Fund should be dedicated to doing more than just adding a small increment to the General Fund. Even though it may eventually return to the Permanent Fund, it should be channeled into projects with revenue producing capability that provide benefits for the majority of Alaskans, and simultaneously allow for long-term financings at the lowest possible interest rate.

The House Special Committee, during the conduct of public hearings, has received many proposals for the use of Permanent Fund's income. Many of these proposals appear to be meritorious from numerous points of view. However, in turn, many of these same proposals would seem to be better responded to through

the actions of the legislature and addressed through the General Fund as opposed to the Permanent Fund's income.

Essential to the lifestyle of all modern societies is the availability of electric power. Advocates of no growth, modest growth, rapid growth or controlled growth all share a need for power. The availability of power often determines whether desirable economic growth can take place. The cost of such power is of course, an important element. All other things considered, the cost of power influences the future direction in any modern society.

Whether power generation occurs through capital-intensive projects (hydro-electric) or fuel-intensive projects (coal or gas-fired) its financing is generally through issuance of long-term debt. Production costs of hydro are generally stable since the fuel (water) costs are practically non-existent. Production costs of coal or gas-fired facilities are subject to continually escalating costs of the fuel necessary for the electric generation.

Long-term debt sold for the construction of either type of facility, without regard to the operation and maintenance expense of each, must be amortized through the service of debt; principal and interest payments annually until the debt is extinguished. The total cost of the debt service is affected by the rate of interest which investors demand for the long term loan of money.

A 40 year debt instrument in the amount of \$100,000,000, bearing an interest rate of 6½% will require a level debt service (principal and interest) of \$7,069,400 annually to liquidate the debt. If the interest rate is 5½%, the annual debt service requirement is \$6,232,000. This represents a difference of \$837,400 per year and over a 40 year period involves a saving of \$33,496,000.

Since debt service is a major factor in determining the rates users must pay for electric usage, the rate of interest at which a debt instrument is financed is a significant element in the total cost to the consumer. Bonds payable solely from the revenues of the utility are judged by investors on their credit-worthiness. The more credit-worthy, the lower the interest rate, the less credit-worthy, the higher the interest rate.

Alaska possesses many sites which are suitable for hydro-electric generating facilities. However, in some instances, these sites are not located near the population centers which require the power generated. Due to its topography, long-range transmission lines bringing power to the load-centers are often not feasible. In other instances, the best development of such capital-intensive projects may require large-scale projects which in the near-term, produce a surplus of power. Smaller scale generation facilities using coal or gas-fired power production are required in those areas without large load demands or without good potential hydro sites. The fact that the latter use a precious commodity which is non-renewable is not the point. If the power is needed, it must be produced. Nevertheless, if the project can be financed at a lower interest cost, a benefit will accrue to the user through a lower cost of service.

It is suggested that the future power needs of Alaskans can be delivered at a lower cost whether such power is provided through hydro or fossil fuels. The ability to affect the interest rate on whatever long-term project is financed, can accomplish this. The following paragraphs suggests how this can be done without depriving the Permanent Fund of other uses of its income.

The income from the Permanent Fund will be derived from "investment grade" securities and as such represents a highly reliable and secure cash flow. This annual cash flow can be dedicated to assuring that principal and interest requirements on bonds issued to construct revenue producing power projects are met in the event of a revenue short-fall from the revenue producing project. The effect will make it possible for the revenue bonds to receive a high credit rating and high evaluation in the market place which will result in a significantly lower cost of borrowing for the project construction. At the end of a given period, (debt service year or monthly), income from the Permanent Fund dedicated to the revenue bonds debt service requirements not needed is released to the General Fund or for any other purpose directed by law.

The dedication of Permanent Fund income to revenue bond debt service would not be accomplished in the legislation itself, but rather in a "guarantee agreement" between the Permanent Fund and the entity issuing the revenue bonds and the "guarantee agreement" would actually appear on the face of the debt instrument. From the investor and rating agency point of view, if the guarantee is in the legislation it is legally subject to change by succeeding legislatures. If the guarantee is in an agreement as part of the revenue bond issue it is dedicated for as long as the bonds are outstanding.

It must be assumed for the purpose of this guarantee arrangement that the Permanent Fund will receive 25% of the oil and gas income because of the terms of the Constitutional Amendment. Based on that assumption, estimates (by the State) of the size of the Permanent Fund in 1985 will be \$1,800,000,000.

A reasonable assumption of 7% income from investment produces an annual cash flow available for guarantees of \$126,000,000. An annual cash flow of this magnitude, assuming a 6% interest cost on guaranteed bond issues, will support approximately \$1,800,000,000 of bonds.

The various projects to be supported by the guarantee would be financed by revenue bonds of any state agency or any subdivision of government in Alaska for electric generation and transmission. Each bond issue would capitalize interest during construction and fund its own debt service reserve to conform to the demands of the market for such bonds at the time of financing.

The act providing for a guarantee should be broad in form. The covenants relating to, and provisions of, each project will be structured into each bond issue.

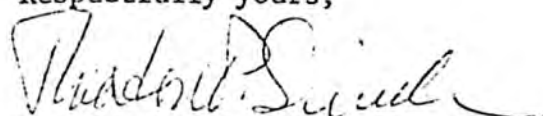
There might be some merit in including in the act certain findings and directives to the Board of the Permanent Fund, but it probably is more appropriate for the Board to outline its own guidelines as it relates to such guarantee on bonds of projects to be financed in its administrative rules and regulations. By this is meant, for example, considerations by the legislature in its deliberations leading to the approval of a project such as economic need, economic feasibility, geographic locations, social benefit, impact on locality, etc.

A draft of a bill has been provided to your committee which would, subject to redraft to conform to custom, constitutional requirements, the Permanent Fund Act and language usage in Alaska, creates the mechanism for such a debt guarantee program. A brief analysis of this draft follows.

- Section 1. Creates the mechanism by authorizing the Board of the Permanent Fund to enter into guarantee agreements. Limits the guarantee to income only. Provides for agreements with any entity of state or local government. Provides guarantee of principal payments, sinking fund payments and interest but prevents use of Permanent Fund income for optional early retirement of guaranteed debt. Limits the guarantee to electric generation and transmission. Leaves the details of guarantee agreements to the Board of Trustees.
- Section 2. In effect limits the amount of debt that can be guaranteed. This adds to the credit-worthiness of the guarantee from the lenders point of view. Depending somewhat on the actual portfolio of investments in the Permanent Fund, it is important to consider whether or not to limit the total of guarantees to something less than 100% of the Fund income. This could be done in the Act, which does not happen in this draft, or it could be a policy matter of the Board of the Fund.
- Section 3. Provides that the guarantee article appear on the debt instrument which clearly establishes that it survives as long as the bonds are outstanding. This definitely is stronger and distinguishes the guarantee from any similarity to the so called "moral-obligation" pledge.
- Section 4. Provides that a guarantee agreement can be entered into on the debt of projects only after approval by the legislature. Part of the thrust of this section is in contemplation of a centrally controlled State-wide power development plan that considers the needs and best interest of all of Alaska.
- Sections 5 & 6 These sections are simply "boiler-plate" provisions.

The draft bill clearly does not contemplate any subsidy of electric costs to energy consumers. However, there is no prohibition that any subsidy to energy users deemed to be appropriate by the State can be accomplished by the legislature through appropriation from the General Fund or other sources which would not interfere with the value of this guarantee program to finance the capital costs of meeting the power needs of Alaska.

Respectfully yours,


Theodore P. Swick

TPS/vmr

STATE
of ALASKA

MEMORANDUM

*Singer*TO: [Frances A. Ulmer, Director
Div. of Policy Development & Planning

DATE: April 11, 1979

FILE NO: J-66-614-79

TELEPHONE NO:

FROM: AVRUM M. GROSS
ATTORNEY GENERALSUBJECT: Use of Permanent
Fund income as debt
guarantee, HB 414

By:

Rodger W. Pegues
Assistant Attorney General *RP*

You have asked us to review HB 414, and to advise whether the legislature may provide for the use of the income from the Permanent Fund to guarantee bonds, notes, and other indebtedness issued to finance public power projects.

While HB 414 will require substantive amendment, the income from the permanent fund probably can be used for this purpose.

The constitutional amendment establishing the permanent fund provides in pertinent part that "[a]ll income from the permanent fund shall be deposited in the general fund unless otherwise provided by law." Alaska Const., art. IX, § 15. */ The concluding clause: "unless otherwise provided by law" was intended to give the legislature maximum flexibility in using the fund. 1976 H. Jour. 684-685. It may be that the record of proceedings before the several committees which considered the amendment and of proceedings on the floor of the legislature would show its purpose in more detail. Its purpose is not discussed in the ballot summary or voter's pamphlet. Both simply advised the electorate that the income would go into the general fund and be available for appropriation unless otherwise provided by law. The title of the joint resolution by which the legislature proposed the amendment makes no reference to the disposition of the Permanent Fund's income. Disposing of it so as to establish still another dedicated fund probably encompasses a whole new and different subject from establishing the

*/ The clause, "unless otherwise provided by law" was added to the proposed constitutional amendment by a House Judiciary Committee Substitute. Compare SSHJR 39, 1/15/76, with CSSS HJR 39, 3/24/76. It was dropped by SCS CSSS HJR 39, 4/7/76 (which would have authorized additional dedications), and restored by SCS CSSS HJR 39 (Res), 5/21/76. It remained in SCS CSSS HJR 39 (Res) am S, 5/21/76, the final version.

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Alaska Permanent Fund. As a general rule, separate subjects must be treated separately in adopting constitutional amendments, and each must be summarized for the voters. Our conclusion is, therefore, that the clause does not exempt the fund's income from the prohibition against dedicated funds.

We turn to the question of whether the clause permits the legislature to provide for the Permanent Fund's income to be pledged as a guarantee for financing public power projects. While we doubt that the clause exempts the fund's income from the prohibition against dedications for a special purpose, we believe that neither repaying debts nor guaranteeing their repayment comes within the constitution's prohibition against dedicated funds and that, therefore, the income can be used as a security to repay or guarantee the repayment of a debt for a given capital improvement. */

The next question is whether an appropriation is required to make payments on the debt as may become necessary.

The relevant provisions of the constitution provide as follows:

No money shall be withdrawn from the treasury except in accordance with appropriations made by law.

Alaska Const., art. IX, § 13. **/

It appears that an appropriation would be necessary either to make the guaranty at the outset or subsequently to make payments. A guaranty is a promise that payment will be made in accordance with its terms. ~~Aside from those~~

*/ This conclusion is based on a reading of the Minutes of the Constitutional Convention and the files of the Convention's Committee on Finance and Taxation. The wording, "proceeds of any tax or license," in article IX, section 7, of the constitution was intended to allow exemptions for pension fund payments, bond proceeds, sinking fund receipts, and the like. 1975 Op. Atty. Gen. No. 9, 6-9.

**/ A related provision, article II, § 13, requires appropriations to be made in bills that are confined to appropriations.

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the promise is unconditional. However, any promise to pay made by the state is necessarily conditioned on the appropriation of the monies to be paid. Id. In order to meet this constitutionally imposed condition, an appropriation is necessary. It can be made at the outset as a conditional appropriation, e.g., "\$x million is appropriated annually to pay the guaranty on the condition that it becomes due." It can be made, as is done for general obligation bonds, as the payments become due, i.e., in the case of a guaranty, an annual, conditional appropriation.

While there is authority that no money can be paid from the treasury even on a judgment, United States v. Commonwealth, 288 S.W.2d 664 (Ky. 1956), the better view is that the provisions of a state constitution requiring an appropriation to be made by law must give way under the combined effect of the federal constitution's contracts and supremacy clauses. */ Cf., Virginia v. West Virginia, 246 U.S. 565 (1918). A guaranty is a contract and cannot be impaired. The legislature's refusal to honor it would constitute its impairment. A court would render judgment for the debtor and levy on the fund's income to enforce the judgment. Therefore, no appropriation would be required in order to enforce payment. Nevertheless, to avoid the necessity for obtaining a judgment, an appropriation should be made.

It appears that the concluding clause of the 1976 amendment authorizes the legislature to make an appropriation from the income on a continuing basis for the purpose of paying or guaranteeing payment of a debt for a public power project, i.e., provide in a single Act for a given sum of monies to be expended annually from the income of the fund. Thus, a conditional appropriation could be made at the time the guaranty is made, and no further appropriations would be required. With respect to a guaranty, our best guess is that a continuing appropriation would probably be upheld. The guaranty would probably include a promise not to repeal the appropriation so long as the guaranteed debt remains outstanding. Any repeal would then be invalidated by a court.

*/ U.S. Const., art. VI, cl. 2; Amend. V, XIV, § 1.

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The next question is whether the guaranty must be made by law and approved by the voters. Because the guaranty would be a contract for a conditional debt which could result in the state's being, in effect, in debt to the creditor, it appears that the approval of the electorate would be required to make the guaranty. Article IX, section 7, of the Alaska Constitution prohibits contracting debt unless it is for a capital improvement and is ratified by the electorate. The court places a great premium on this ratification. Thomas v. Rosen, 522 P.2d 1120 (Alaska 1974). The constitutional exceptions from the requirement of ratification do not expressly apply to a guaranty. Alaska Const., art. IX, § 11. Our best guess is that the requirement, therefore, applies to guaranties and that any proposed guaranty would have to be presented to the voters as a ballot proposition. It would almost certainly, therefore, require as well that, as with a bond issue, the guaranty be authorized by law in the first instance and then submitted to the voters. Enactment of a law is what the language of the 1976 amendment requires on its face.

We do not believe that a one-time-only ratification by the voters of an Act generally authorizing the Permanent Fund's managers to guarantee debts for public power projects would satisfy the constitutional requirement for contracting debt. However, it might aid the court in deciding that those requirements do not apply to a guaranty which is based solely on the Permanent Fund's income. There is a line of cases which hold that debt restrictions similar to those contained in article IX, section 8, of the Alaska Constitution apply solely to debts which the state's full faith and credit is pledged to pay. The likelihood that the rationale of these cases would be applied by the Alaska Supreme Court to a guaranty based solely on the income from the Permanent Fund could possibly be increased by the voter's having ratified the concept. Nothing prevents the legislature from making the statutory authorization for guaranties contingent on voter approval. Accordingly, while we do not believe it will be valid, a general authorization for the Permanent Fund managers to make guaranties could be enacted and then tested in court.

Finally, the constitution provides that the "public credit [cannot] be used except for a public purpose." Alaska Const., art. IX, § 6. We believe that only the most

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irrational of power projects would be barred under this provision. E.g., Wright v. City of Palmer, 468 P.2d 326 (Alaska 1970). We assume that the projects would be public works. Whether the income from the Permanent Fund could be used to guarantee financing for private works is an entirely different question which involves entirely different issues.

RWP/pjg

cc: Jerry Reinwand
Office of the Governor

Ron Lind
Div of Budget & Management

Keith Specking
Office of the Governor

bcc: Tom Singer
Div of Policy Development
& Planning

SCOMM

#18:19

Introduced: 2/9/79
Referred: Finance

BY HAUGEN, ANDERSON, BETTISWORTH,
ELIASON, FREEMAN, FULLER, HAYES,
HURLBERT, MALONE, MOSS, OSTERBACK
AND PHILLIPS

1 IN THE HOUSE

2 HOUSE BILL NO. 162

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE .. FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the Alaska Permanent Fund and the
7 water resources revolving loan fund."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 37.10.065 is amended to read:

10 Sec. 37.10.065. INVESTMENT OF THE ALASKA PERMANENT FUND. (a) The
11 Alaska Permanent Fund consists of 25 per cent of all mineral lease
12 rentals, royalties, royalty sale proceeds, federal mineral revenue
13 sharing payments and bonuses received by the state. The commissioner of
14 revenue shall deposit in the Alaska Permanent Fund 25 per cent of the
15 receipts from these sources at least once each month. The commissioner
16 of revenue shall invest the money in the Alaska Permanent Fund in loans
17 made under the provisions of AS 45.86 and may invest money in excess of
18 current requirements for those loans in income-producing investments of
19 the following types:

20 (1) obligations of, or obligations insured or guaranteed by,
21 the United States or agencies or instrumentalities of the United States;

22 (2) obligations secured by reserves paid in by the United
23 States or agencies or instrumentalities of the United States or obliga-
24 tions of corporations in which the United States is a shareholder or
25 member;

26 (3) certificates of deposits issued by United States domestic
27 banks which are members of the Federal Deposit Insurance Corporation and
28 secured as to the payment of principal and interest in accordance with
29 Alaska law;

1 (4) corporate investment-grade securities;

2 (5) bankers' acceptance drawn on and accepted by United
3 States banks which each have a combined capital and surplus aggregating
4 at least \$100,000,000;

5 (6) repurchase agreements, the securities underlying the
6 agreements being any of the items in (1) - (5) of this subsection;

7 (7) deposits of federally insured savings and loan associa-
8 tions not to exceed 10 per cent of each savings and loan association's
9 deposits exclusive of federal, state, and municipal deposits;

10 (8) fixed-term certificates of debentures of federally in-
11 sured credit unions not to exceed 10 per cent of each credit union's
12 shares.

13 (b) The commissioner of revenue may enter into contracts providing
14 for custody of securities and execution of transactions.

15 [(c) THE COMMISSIONER OF REVENUE SHALL TRANSFER TO WHATEVER AGENCY
16 IS ESTABLISHED FOR THE EXPRESS PURPOSE OF MANAGING AND INVESTING THE
17 ALASKA PERMANENT FUND ALL OR PART OF THE SECURITIES AND MONEY IN THE
18 ALASKA PERMANENT FUND IN ACCORDANCE WITH ALASKA LAW NO LATER THAN TWO
19 WEEKS AFTER RECEIPT OF WRITTEN NOTICE FROM THAT AGENCY.]

20 * Sec. 2. AS 45.86.030 is repealed and re-enacted to read:

21 Sec. 45.86.030. LOAN FUND SOURCE. The principal and income from
22 the Alaska Permanent Fund shall be allocated by the commissioner of
23 revenue to the water resources revolving loan fund to the extent neces-
24 sary for loans under this chapter.

SCOMM

#18.20

Introduced: 2/22/79
Referred: Special Permanent
Fund Committee and Finance

1 IN THE HOUSE

BY THE SPECIAL PERMANENT
FUND COMMITTEE

2 HOUSE BILL NO. 280

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the permanent fund; amending
7 Appellate Rule 45, Alaska Rules of Court Procedure; and
8 providing for an effective date."

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. AS 37.10.065(a) is amended to read:

11 (a) The Alaska Permanent Fund consists of 25 per cent of all
12 mineral lease rentals, royalties, royalty sale proceeds, federal mineral
13 revenue sharing payments and bonuses received by the state. The commis-
14 sioner of revenue shall deposit in the Alaska Permanent Fund 25 per cent
15 of the receipts from these sources at least once each month. The com-
16 missioner of revenue, unless otherwise instructed in accordance with
17 AS 37.10.110, shall invest the money in the Alaska Permanent Fund in
18 income-producing investments of the following types:

19 (1) obligations of, or obligations insured or guaranteed by,
20 the United States or agencies or instrumentalities of the United States;

21 (2) obligations secured by reserves paid in by the United
22 States or agencies or instrumentalities of the United States or obliga-
23 tions of corporations in which the United States is a shareholder or
24 member;

25 (3) certificates of deposit issued by United States domestic
26 banks which are members of the Federal Deposit Insurance Corporation and
27 secured as to the payment of principal and interest in accordance with
28 Alaska law;

29 (4) corporate investment-grade securities;

1 (5) bankers' acceptance drawn on and accepted by United
2 States banks which each have a combined capital and surplus aggregating
3 at least \$100,000,000;

4 (6) repurchase agreements, the securities underlying the
5 agreements being any of the items in (1) - (5) of this subsection;

6 (7) deposits of federally insured savings and loan associa-
7 tions not to exceed 10 per cent of each savings and loan association's
8 deposits exclusive of federal, state, and municipal deposits;

9 (8) fixed term certificates of debentures of federally in-
10 sured credit unions not to exceed 10 per cent of each credit union's
11 shares.

12 * Sec. 2. AS 37.10 is amended by adding new sections to read:

13 ARTICLE 5. PERMANENT FUND INCOME.

14 Sec. 37.10.110. DISTRIBUTION OF INCOME TO RESIDENTS. (a) No
15 later than June 30, 1981, the commissioner of revenue shall issue one
16 share of the Alaska Permanent Fund to each resident of the state, re-
17 gardless of age, who has been a resident continuously since July 1,
18 1980, and who, no later than February 1, 1981, has filed with the com-
19 missioner a statement of residency. The commissioner shall notify the
20 public of the availability of shares under this subsection and the
21 method for qualifying for shares. The notification shall be by publi-
22 cation in at least one newspaper of statewide circulation, by radio and
23 television announcements, and by other means the commissioner determines
24 to be appropriate and reasonable.

25 (b) One share issued under (a) of this section represents the
26 total principal amount of the permanent fund at the time of the annual
27 distribution of income under (c) of this section divided by the number
28 of shares issued.

29 (c) Beginning July 1, 1981, and annually thereafter, the commis-

1 siorer shall distribute the net income from general investments of the
2 permanent fund for the previous fiscal year to the qualified share-
3 holders in accordance with the procedures established by this section.

4 (d) The net income from general investments of the permanent fund
5 shall be distributed to shareholders in proportion to the amounts of
6 their shares which are in general investments. The amount or a part of
7 the amount represented by one share is considered to be in general
8 investments if the shareholder has not elected to direct under AS 37.-
9 10.120(a) the amount or part of the amount represented by the share.

10 (e) A share issued under this section is not transferable by sale,
11 donation, lien, judgment, devise, or any other method. Alienation of a
12 share is void as against public policy. Upon a shareholder's death or
13 the termination of his residency, his share lapses to the state and
14 shall be counted as a full share for the purposes of (b) of this sec-
15 tion. The lapsed share shall be invested for the state by the commis-
16 sioner in accordance with AS 37.10.065(a). Income of the lapsed share
17 shall be allocated to the general fund.

18 (f) Possession of a share imparts no right to ownership or posses-
19 sion of the principal of the permanent fund it represents; possession of
20 a share imparts only those rights specified in AS 37.10.110 - 37.10.150.

21 Sec. 37.10.120. DIRECTED INVESTMENTS. (a) Within 60 days after
22 the determination under (b) of this section of the amount of permanent
23 fund principal available to each shareholder for directed investments, a
24 shareholder may notify the commissioner of his election to direct the
25 investment of the available amount of permanent fund principal or a part
26 of it. The shareholder may direct investments to be made in any of the
27 investments listed by the commissioner in accordance with AS 37.10.150-
28 (b). The notification shall indicate the specific investments to be
29 made and the specific amounts to be invested. Unless the shareholder

1 notifies the commissioner otherwise, the commissioner shall consider any
2 investments directed by the shareholder from the previous determination
3 under (b) of this section as part of the shareholder's directions for
4 the current determination. The commissioner shall distribute net income
5 as it is received from investments made under this subsection to the
6 shareholder directing the investments.

7 (b) The amount of permanent fund principal for which the share-
8 holder may direct investments under this section shall be determined by
9 the commissioner when the principal of the permanent fund reaches
10 \$2 billion and at each \$1 billion increase in principal thereafter. The
11 amount of permanent fund principal available to a shareholder for
12 directed investments is equal to the value of one share, as determined
13 under AS 37.10.110(b), at the time the principal reaches \$2 billion and
14 at the time of each subsequent \$1 billion increase in principal, as
15 appropriate. The commissioner shall give public notice of the amount
16 available for directed investments by publication in at least one news-
17 paper of statewide circulation, by radio and television announcements,
18 and by any other means the commissioner determines to be reasonable and
19 appropriate.

20 (c) Upon receipt of notification provided in accordance with (a)
21 of this section, the commissioner or his designee shall make investments
22 of permanent fund principal in accordance with the notification.

23 (d) If the notification under (c) of this section is defective in
24 that it directs investment of an amount greater than that which is
25 available under (b) of this section to a shareholder, or in that it
26 contains directions which are unclear or which the commissioner or his
27 designee is not able to follow, the commissioner or his designee shall
28 make reasonable efforts to expeditiously inform the shareholder of the
29 defect. If the shareholder fails to revise his directions to cure the

1 defect or fails to notify the commissioner or his designee of the revi-
2 sion within the time period established in (a) of this section, or if
3 there is insufficient time to allow the commissioner or his designee to
4 inform the shareholder of the defect within the time period established
5 in (a) of this section, the shareholder's investment directions are
6 void, and the shareholder shall share in the distribution of income
7 under AS 37.10.110.

8 (e) If the notification under (c) of this section directs invest-
9 ment of an amount less than that which is available under (b) of this
10 section to a shareholder, the commissioner or his designee shall make
11 the investments specified in the notification, and the shareholder shall
12 receive, in addition to net income earned by the directed investments, a
13 proportionate share of the distribution of net income under AS 37.10.110
14 for the amount not invested by his direction.

15 (f) A shareholder may direct the commissioner or his designee to
16 sell an investment directed under (a) of this section at any time. The
17 shareholder may direct the investment of the principal recovered at the
18 sale in another eligible investment under (a) of this section or may
19 allow the principal recovered at the sale to be invested by the commis-
20 sioner in accordance with AS 37.10.065. If the shareholder decides to
21 allow investment by the commissioner in accordance with AS 37.10.065,
22 the shareholder may not direct any investments until the next determi-
23 nation under (a) of this section.

24 (g) The commissioner shall invest, in accordance with AS 37.10.-
25 065, and distribute the net income of, in accordance with AS 37.10.110,
26 any increase in permanent fund principal during periods between deter-
27 minations under (b) of this section.

28 Sec. 37.10.130. DETERMINATION OF RESIDENCY. (a) An individual
29 who applies for a share of the Alaska Permanent Fund must prove his

1 eligibility to the satisfaction of the commissioner. The commissioner
2 may not issue an individual a share or make a payment to an individual
3 until proof of that individual's eligibility sufficient to satisfy a
4 reasonable person has been made to the commissioner.

5 (b) Proof of eligibility may be from school attendance records,
6 state and local tax and licensing records, voter registration records,
7 birth and marriage certificates, selective service records, sworn affi-
8 davits from others having knowledge of an individual's residence, and
9 from other forms of documentary evidence which a reasonable person would
10 rely on in the conduct of his own affairs. An affidavit from an indi-
11 vidual without supporting evidence of eligibility is not satisfactory
12 proof of eligibility.

13 (c) Upon determination of an individual's eligibility for a share,
14 the commissioner shall, by first class mail, notify the individual of
15 that determination. If the individual is determined to be ineligible,
16 he shall be informed by certified mail, of the following:

17 (1) the reason for his ineligibility;

18 (2) that he may file additional proof and file a request for
19 a hearing before the commissioner to present proof of his eligibility;
20 and

21 (3) that the decision becomes final and unappealable 30 days
22 after receipt of the notification unless, within that time, the indivi-
23 dual files additional proof or files a request for a hearing before the
24 commissioner.

25 (d) If an individual does not file additional proof or file a
26 request for a hearing with the commissioner within 30 days after his
27 receipt of the commissioner's notice of the determination, the commis-
28 sioner's decision becomes final as to the period involved and there is
29 no further appeal. The time limit is jurisdictional.

1 (e) If an individual files additional proof or files a request for
2 a hearing with the commissioner within 30 days after he receives the
3 commissioner's notice of the determination and, after the additional
4 evidence has been considered or the hearing held, he is still determined
5 to be ineligible, he may appeal to the superior court within 30 days
6 after he receives notice of the final decision. The time limit is
7 jurisdictional, and no appeal may be brought after it has elapsed. In
8 considering the appeal, the superior court may review solely on the
9 record which was before the commissioner and must apply the reasonable
10 basis test to factual matters and its own judgment on the law. The same
11 standard of review applies if a further appeal is taken to the supreme
12 court.

13 Sec. 37.10.140. CONFIDENTIALITY. An investment made at the direc-
14 tion of a shareholder in accordance with AS 37.10.120(a) is confiden-
15 tial.

16 Sec. 37.10.150. REGULATIONS. The commissioner may adopt regula-
17 tions in accordance with the Administrative Procedure Act (AS 44.62) for
18 the administration and enforcement of AS 37.10.110 - 37.10.150, in-
19 cluding, but not limited to, regulations relating to the allocation of
20 permanent fund receipts to income and to principal.

21 Sec. 37.10.155. ELIGIBLE DIRECTED INVESTMENTS. (a) The commis-
22 sioner shall, by regulation, establish a list of at least 100 specific
23 investments which may be made at the direction of shareholders in accor-
24 dance with AS 37.10.120(a). The commissioner shall include in the list
25 only those investments which, in his opinion, accord with the prudent-
26 man rule.

27 (b) An investment of permanent fund principal made under AS 37.-
28 10.120(a) in an investment which is removed by the commissioner from the
29 list of eligible investments shall be redeemed by the commissioner or

1 his designee at the earliest possible time, and the commissioner or his
2 designee shall notify the shareholder at whose direction the investment
3 was made of the redemption. The shareholder may direct the commissioner
4 to reinvest the amount redeemed in eligible investments in accordance
5 with AS 37.10.120(d).

6 Sec. 37.10.160. DEFINITIONS. For the purposes of AS 37.10.110 -
7 37.10.160,

8 (1) "commissioner" means the commissioner of revenue;

9 (2) "directed investments" means investments of permanent
10 fund principal made by the commissioner of revenue or his designee under
11 the direction of a shareholder in accordance with AS 37.10.120(a);

12 (3) "general investments" means investments of permanent fund
13 principal made by the commissioner of revenue or his designee in accor-
14 dance with AS 37.10.065 but not under the direction of a shareholder in
15 accordance with AS 37.10.120(a);

16 (4) "net income" means total income to the Alaska Permanent
17 Fund reduced by costs directly related to the attainment of income;

18 (5) "prudent-man rule" means the investment policy requiring
19 exercise by the investor of the care, skill, and prudence in making
20 investment decisions which would be exercised by a reasonably prudent
21 person in managing his own property, taking into consideration maximum
22 profit and safety of principal;

23 (6) "resident" means an individual who maintains a permanent
24 place of abode in the state with the intention of making the state his
25 permanent place of residence and who resides in the state continuously
26 except for temporary purposes only and with the intent of returning; no
27 person may be considered to have gained a residence solely by reason of
28 his presence nor may he lose it solely by reason of his absence while in
29 the civil or military service of this state or of the United States or

1 of his absence because of marriage to a person engaged in the civil or
2 military service of this state or the United States; while a student at
3 an institution of learning; while in an institution or asylum at public
4 expense; while confined in public prison; while engaged in the naviga-
5 tion of waters of this state, of the United States, or of the high seas;
6 or while residing upon an Indian or military reservation; a minor takes
7 the residence of his parent or of his legal guardian; a married woman
8 shall establish her own residence and does not presumptively take the
9 residence of her husband;

10 (7) "shareholder" means a person to whom the commissioner of
11 revenue issues a share of the Alaska Permanent Fund under AS 37.10.110.

12 * Sec. 3. In sec. 2 of this Act, the enactment of AS 37.10.130(d) and (e)
13 has the effect of imposing a jurisdictional limitation on the operation of
14 Appellate Rule 45, Alaska Rules of Court Procedure, in that an appeal under
15 the rule (having to do with appeals from administrative decisions to the
16 superior court) must be brought from the commissioner's decisions as to
17 eligibility within 30 days or the court will have no jurisdiction to hear it.
18 This is an exercise of the legislature's authority over the jurisdiction of
19 the courts, but because it also effects an implied, narrow amendment to
20 Appellate Rule 45 by imposing this jurisdictional time limit instead of the
21 procedural time limit of the same duration which will continue to apply to
22 other appeals, this section has also been included.

23 * Sec. 4. This Act takes effect July 1, 1979.
24
25
26
27
28
29

SCOMM

#18:21

Merrill Lynch White Weld Capital Markets Group
Merrill, Lynch Pierce Fenner & Smith, Inc.
1 Liberty Plaza
New York, New York 10006

June 14, 1978

The Speaker of the House, Rep. Hugh Malone
The Chairman of the House Sub-Committee Permanent Fund,
Rep. Clark Gruening

Gentlemen:

I regret I am unable to remain in Juneau for a proposed free conference on the Permanent Fund Bill. Other matters press me in New York and I am forced to return.

As a result of attending numerous hearings over the last several months, both Ted Swick and I have attempted to assist the Committee in drafting a bill for the administration of your Permanent Fund. We have received the distinct impression that the voters look upon this fund as an Alaskan Legacy. With the legacy concept in mind, we believe that House Bill 596 is written in such a way as to assure the professional, independent and non-political administration and investment of the fund according to the highest ethical standards. We believe that doing it any other way will defeat the expressed mandate of the voters.

In our opinion, the income from the Permanent Fund should be treated in such a manner as to bring benefit to all classes of Alaskans and if such purpose cannot be properly addressed in this closing session it would be better to permit it to flow back into the Permanent Fund and be dealt with by subsequent legislative actions. "Soft Loan" programs may have a legitimacy, but to utilize the income of the Fund to support such programs is to shirk the responsibility for the outright subsidy inherent in the "Soft Loan" concept.

We believe that the Senate's capital needs assessment and proposed six year forecast of capital expenditures and the segregating of a percentage of the Oil Royalty income to create a "pay-as-you-go" program is excellent and fiscally responsible. We have no opinion as to what this percentage should be.

Rep. Hugh Malone
Rep. Clark Gruening

-2-

June 14, 1978

The joining together of the above Senate Bill with the House Bill's administration of the Permanent Fund would constitute an excellent piece of legislation of which both Houses could be proud. "Soft Loan" programs do not belong in a legacy, public or private.

We are grateful for having had the opportunity to serve you as financial consultants on this singularly important issue. We will be available for any telephone consultation you may so desire.

Respectfully submitted,

Merrill Lynch White Weld
Capital Markets Group

A handwritten signature in dark ink, appearing to read "Samuel L. Plaia". The signature is fluid and cursive, with the first name "Samuel" and last name "Plaia" being the most prominent parts.

Samuel L. Plaia
Vice-President

March 5, 1980

The Alaska Permanent Fund and Management of Alaska's Wealth

This information is provided by Representative Hugh Malone, chairman of the House Special Committee on the Permanent Fund and a member of the free conference committee on the Permanent Fund.

The Alaska Permanent Fund was established by the voters in 1976 to receive at least 25% of all mineral royalties and bonuses. What this means in real terms is that approximately one out of every eight dollars which the state receives in oil revenues is deposited in the Permanent Fund. The fund currently contains about \$350 million and is earning interest of over 11%. It is being invested by the Department of Revenue under an interim management plan, and the earnings flow into the general fund. The legislature has yet to decide just how the Permanent Fund shall be invested and managed over the long-run. A free conference committee, of three House and three Senate members, is presently meeting in an attempt to reach agreement on Permanent Fund legislation.

Alaska today is in the unique position of having enough money to adequately provide governmental services; to construct needed capital projects; to eliminate the personal income tax, expand loan opportunities, and return a share of the oil wealth to Alaskans as dividends; and to save a portion of the wealth for the future. Although earnings of the Permanent Fund will never completely replace today's oil revenues, they can go a long way towards helping stabilize the Alaskan economy and reducing the need for personal income tax payments in the

future.

Q. What are the basic components of the House Permanent Fund bill (HCS for SB 161)?

A. The House bill focuses on the management of the Permanent Fund and addresses three major concerns-- safety of principal, accountability, and legislative oversight. The fund would be invested as a trust consisting of a wide variety of quality, high-grade investments. These investments have been described as "squeaky conservative." The House also decided that the fund, because of its fundamentally different goals, should not be invested by the same people who manage money for day-to-day use by the state-- the Department of Revenue-- but should be managed by a public corporation distinct from state government. The proposed Permanent Fund Corporation, with its own board of trustees, would be made accountable in several ways. The House bill also expands the powers and duties of the Legislative Budget and Audit Committee to oversee all lending and investment functions of the state, including those of the Permanent Fund Corporation.

Q. How much money would the House bill deposit into the Permanent Fund?

A. The House bill would raise the contribution level to the Permanent Fund from the current 25% to 50% of all bonuses, 25% of royalties from existing leases, and 50% of royalties from new leases. It's important to remember that 50% of bonuses and royalties actually means about 25% of all oil revenues, so that three-quarters of state revenues would still be going to the general fund for general governmental purposes.

Q. What would be the advantages of investing the Permanent Fund according to the House plan?

A. The Permanent Fund, if invested as an "inviolable trust," would be just as secure as possible and would return substantial earnings to Alaskans. Because the investments would be diversified and would not rise and fall with Alaska's economy, the earnings would be stable. In addition, the establishment of a secure trust would be a sign to the national financial community that Alaska is following a responsible fiscal policy. The passage of the House bill would not preclude aiding the state's economy in other ways as well. Loan programs, capital projects, tax repeals or refunds-- all these can be taken care of through the general fund.

Q. Under the House plan, what would happen to the fund's earnings?

A. The earnings would flow into the general fund, just as they do today. Future legislatures would still have the option of redirecting the earnings. Paying them as dividends to today's Alaskans is one idea.

Q. How does the Hohman bill (SB 1) differ from the House bill?

A. Senator Hohman's bill is an extremely long and complex one which deals only peripherally with the Permanent Fund. SB 1 provides for the elimination of existing loan programs and development authorities and the substitution of a new program combining all loan purposes. The loan program would be tied to the Permanent Fund by using the Permanent Fund earnings to guarantee revenue bonds to fund the loans. The Hohman bill also differs from the House bill in that its Permanent Fund investment list is much broader (and less secure), its contribu-

tion rate is set at 100% of bonuses and 25% of royalties, and the fund is managed by the Department of Revenue.

Q. What are the House objections to the Hohman bill?

A. The primary objection is that it is concerned much more with the state's loan programs than with the Permanent Fund, and that a free conference committee on the Permanent Fund is not the place to so drastically restructure the loan programs. SB 1 is extremely complex and, if implemented, would have far-reaching consequences for the state's economy and credit rating. Specific problems with the concept include 1) the earnings of the Permanent Fund are put at risk, 2) consolidation of the loan programs does not solve the existing problem of access to them, 3) the programs would receive automatic funding without legislative review, 4) there is no method of prioritization and the different loan programs could not be judged separately on their merits, and 4) municipalities would be encouraged to issue unrestricted debt.

Q. What does the House offer as an alternative to the loan program portion of SB 1?

A. The House Finance Committee is currently developing a package of loan bills which will address the needs of Alaskans for easily accessible and low-cost loans. Although the details are yet to be worked out, some consolidation will occur and loans will be made available for financing housing and businesses. Emphasis will be placed on ensuring that those people who most needs loans receive them. Interest rates will be reasonable. I feel confident that the House will pass comprehensive and responsible loan legislation within the

next several weeks. I might add that \$35 million a month in state funds is right now available for Alaskan mortgages through HCR 33, sponsored by the House Finance Committee this session.

Q. What does the state's financial picture look like for the next few years?

A. The latest financial projections are very impressive. With the Permanent Fund receiving just 25% of royalties and bonuses and with the earnings being distributed to the public, at the end of 1982 we should have about \$1.2 billion in the Permanent Fund and \$6.7 billion in the general fund. Since, at current growth and inflation rates, \$1.6 billion will be needed to meet the state budget, there will be over \$5 billion extra in the general fund to be appropriated for whatever purposes the legislature desires. While the opportunities for spending money within the state are vast, the legislature also bears an unprecedented responsibility to manage Alaska's new wealth wisely. Setting a portion of it aside in a secure Permanent Fund should be one step in responding to that responsibility.

REMARKS OF GEORGE G. WOLF ON SSSB1
BEFORE THE HOUSE SPECIAL COMMITTEE ON THE PERMANENT FUND
Juneau, Alaska
March 29, 1979

MR. CHAIRMAN; MEMBERS OF THE COMMITTEE:

My name is George Wolf. I am with the firm of Orrick, Herrington, Rowley & Sutcliffe in San Francisco. Our firm specializes in, among other things, municipal bond matters. I myself am a tax lawyer, and I assist our bond department on federal tax questions arising in connection with our bond practice.

I am here today at the invitation of your staff to provide to you an analysis of Sponsor Substitute for Senate Bill No. 1, entitled 'An Act relating to the Alaska loan programs fund, the Alaska permanent fund, and state investment policy and other state revenues; and providing for an effective date', insofar as the Bill raises questions under Section 103 of the federal Internal Revenue Code of 1954, which deals with the exemption from tax for interest on obligations of a state or a political subdivision thereof.

I have been told that the members of the committee are familiar with the provisions of the Bill and how

they would operate if the Bill becomes law. Accordingly, I will dispense with any provision-by-provision or flow-of-funds analysis, and confine my remarks to the general impact of section 103 upon the perceived benefits of the Bill. Details will be addressed only as they become pertinent.

INTRODUCTION

Section 103(a) of the Internal Revenue Code provides that interest on the obligations of a state or any political subdivision thereof is excluded from the gross income of the recipient, and is therefore exempt from federal income tax. A typical example of such so-called tax-exempt obligations would be general obligation bonds issued by a state to finance a public project, such as a courthouse or public roads.

However, the statute also provides two significant limitations on the tax-exempt status of governmental obligations. That is, Section 103(b) denies the tax exemption to "industrial development bonds," and Section 103(c) denies the exemption to "arbitrage bonds." I will discuss the details of these provisions in a moment.

Insofar as Section 103 is concerned, the Bill under consideration essentially does two things. First,

it will consolidate virtually all of the State's loan programs into a single omnibus State loan agency. The Alaska Loan Programs Fund so created will issue revenue bonds to finance a large number of loan programs that are now financed individually by single purpose revenue bonds or by appropriation from the State general fund. Second, the Bill will dedicate the income from the Alaska Permanent Fund as security for the bonds issued by the Loan Programs Fund. (For purposes of clarity, I will refer to the Loan Programs Fund simply as "the Fund;" when I refer to the Permanent Fund, I will say the Permanent Fund.)

Both of these features will have a significant affect on the tax-exempt status of the revenue bonds issued by the Fund. This affect is both obscured and compounded by ambiguities in the Bill as to exactly how these two essential features will be accomplished.

The balance of my prepared remarks will follow the following format. First, the impact of the industrial development bond provisions of the Internal Revenue Code to the revenue bonds issued by the Fund. Second, the impact of the arbitrage bond provisions of the Code on the loans made by the Fund as well as the investment of the Permanent Fund and the Allocated Reserve Account. Third, various miscellaneous considerations. And fourth, as requested, a discussion of the trends in the tax-exempt status of governmental obligations.

INDUSTRIAL DEVELOPMENT BOND ASPECTS

An industrial development bond, to which tax exemption is denied, is one which meets two tests, commonly referred to as the trade or business test and the security interest test, respectively. In the arcane language of the Code, an IDB is any obligation (A) which is issued as part of an issue all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business carried on by any person other than an exempt person (an exempt person being a governmental unit or a "section 501(c)(3)" charity), and (B) the payment of the principal or interest on which (under the terms of the obligation or any underlying arrangement) is, in whole or in major part, secured by any interest in property used or to be used in a trade or business or in payments in respect of such property, or to be derived from payments in respect of property, or borrowed money, used or to be used in a trade or business.

For purposes of the trade or business test, a "major portion" means more than 25%. In other words, if 75% or more of the proceeds of an issue of obligations will be used other than in the trades or businesses of nonexempt persons, the obligations will not be IDBs. Alternatively, if less than 75% of the proceeds are used

for noncommercial purposes, but the security interest test is not met, the bonds will not be IDB's.

The abuse sought to be remedied by the enactment of these IDB provisions in 1968 was the loaning, so to speak, by a state or city of its tax exemption to private business. The prior practice of many governments of issuing tax-exempt bonds to finance large-scale private business expansion has, as a result, been largely curtailed.

There are three exceptions to what would otherwise constitute an IDB. These are for bonds substantially all of the proceeds of which are used to provide so-called exempt facilities, to provide industrial parks, or which qualify as exempt small issues. That is, obligations that would otherwise be IDBs will nonetheless carry tax-exempt interest if substantially all of the proceeds of the bonds are to be used for one of the described purposes, unless held by a user of the facilities financed. "Substantially all" for this purpose means 90% or more of the net bond proceeds.

Exempt facilities are specifically defined in the statute, and include residential real property for family units, sports facilities, convention or trade show facilities, various types of transportation facilities, sewage or solid waste disposal facilities, air or water

pollution control facilities, and certain types of public utility facilities. All of these items are subject to considerable refinement, such as various public use requirements, both in the statute itself and in regulations promulgated by the Secretary of the Treasury.

Briefly stated, the small issue exemption permits the issuance of up to \$1 million in obligations to finance facilities within one locality for one principal user. Under certain conditions, related to what is called the capital expenditure test, up to \$10 million in obligations may be issued without losing the tax exemption. The industrial park exemption appears to be largely self-explanatory.

The Bill indicates that the following types of loans will be made from the Fund: farming, fishing, forestry, renewable and nonrenewable resources development, tourism, general business, small business, child care facilities, exempt facilities, single and multifamily housing, scholarship, municipal and nonprofit corporation, public and private historical preservation, and outdoor recreation development. Of the foregoing, only the following would fail to meet the trade or business test: single family residential housing, municipal and certain nonprofit corporation, scholarship, noncommercial historic preservation, and noncommercial outdoor recreation

development. All of the remaining types of loans would be commercial loans, and as a general proposition would meet the trade or business test, and therefore, assuming that the security interest test would be met, which will be discussed in a moment, single purpose bonds issued for such commercial loans would not carry tax-exempt interest.

It is my understanding that a major purpose of the Bill, and perhaps the single overriding purpose, is to finance the commercial loans enumerated above with tax-exempt bonds by combining the commercial loan programs with the noncommercial loan programs, and thereby utilizing the minor portion of bond proceeds for the commercial loans. The question then is whether that purpose can be accomplished under current federal law and regulations, and the general answer is, yes, it can be, provided that the volume of noncommercial loans is sufficient to support the commercial loan program at a rate of at least three to one, either on an overall basis or on an issue-by-issue basis.

This raises the first significant ambiguity in the Bill and the consequent uncertain application of Section 103(b) to the revenue bonds of the Fund. That is, it is not clear under the Bill whether the Fund will issue general revenue bonds to provide funds for all of the types of loans that can be made by the Fund, or

whether limited purpose bonds will be issued to provide funds for only specified types of loans. In other words, whether there will be a complete pooling of all bond proceeds to be used for all types of loans, or whether there will be a tracing of the proceeds of particular bonds into particular loans.

The distinction is important because, if complete pooling is contemplated, the Fund would likely lose the ability to issue bonds under the exempt activities, industrial park, and small issue exemptions, which require specific tracing of the bond proceeds into the designated expenditures for determining compliance with the substantially all test. The Fund would also lose its ability to issue tax-exempt bonds under the Housing Act (an independent basis for issuing tax-exempt bonds) by complete pooling, because Housing Act bonds also require tracing. Of course, if commercial loans will comprise less than 25% of the pool in any event, these factors are less important. In addition, while there is nothing to suggest that complete pooling is impermissible, that would be something new in the bond world, and a ruling from the Internal Revenue Service may be appropriate, and might be required to make the bonds marketable.

Because of these considerations, limited purpose revenue bonds, the proceeds of which are traceable into specific types of loans, would probably be required. Thus, a bond issue combining, for example, 75% municipal, single family residential, and student loans with 25% commercial loans would qualify for tax-exempt status. Similarly, bonds combining 90% exempt facilities (such as convention facilities and pollution control facilities) with 10% nonexempt commercial, could qualify for tax exemption, although this is somewhat more difficult to achieve because all or most of the 10% leeway for exempt facility loans and small issues is often necessary to account for the nonqualifying expenditures, such as loan proceeds being used to provide working capital, and other items that cannot properly be charged to capital account.

Whether such limited purpose revenue bonds, combining disparate loan activities such as student loans and farming loans, are marketable and at the more favorable interest rates contemplated by the Bill, is, of course, a question for your financial advisors.

I will mention only briefly the security interest test, because in almost all instances where the trade or business test is met the security interest test is also met. This is because, for revenue bonds to be marketable, payments on the loans made with bond proceeds must

secure the bonds. So it is here, where the assets of the Fund, which will consist essentially of its loan portfolio, are pledged as security for its bonds. In one published ruling of the Internal Revenue Service, the security interest test was broken on general obligation bonds issued to provide commercial loans, where the loans were not pledged as security for the bonds, but this Bill does not describe that situation. Here, payments on the commercial loans as well as on the noncommercial loans will be necessary for the payment of the principal of and interest on the bonds, and accordingly, under Treasury regulations, even if there was no specific pledge of the loans as security for the bonds, there would be an "underlying arrangement" which would supply the necessary element to satisfy the security interest test. It is possible that a very large pool of small loans, each of which is individually insignificant as security for the bonds, may fail the security interest test, but that is unlikely.

ARBITRAGE BONDS ASPECTS

Section 103(c) of the Internal Revenue Code provides that an arbitrage bond, which is also denied tax-exempt treatment, is any obligation all or a major portion of the proceeds of which, at the time of issuance,

are reasonably expected to be used directly or indirectly to acquire other obligations which may be reasonably expected to produce a yield over the term of the issue which is materially higher than the yield on the obligations, or to replace funds which are used directly or indirectly to acquire securities or obligations with a materially higher yield.

The basic abuse sought to be outlawed by the arbitrage bond provisions was the exploitation by governmental issuers of the difference between tax exempt and taxable securities. In other words, prior to 1969, a city or a state could issue bonds carrying an interest rate of, say, 6%, which would be two to three percent below market interest because of the tax exemption, invest the proceeds of the bond issue in U.S. government securities bearing 8% interest, and pocket the 2% difference.

As with the IDB provisions, the arbitrage provisions of Section 103 deal essentially with the use of the proceeds of governmental obligations. Unlike the IDB provisions, however, the arbitrage provisions affect every issue of governmental obligations, even those issued for purely public purposes as well as those issued to finance noncommercial loan programs, such as residential housing and veterans programs. For this reason, and because they

deal with the intricate and arcane rules of public finance and flow of funds, the arbitrage rules, currently set forth merely in proposed form as Treasury regulations, are among the most complex provisions to be found in the federal revenue laws, dealing with definitions, yield computations, temporary periods, reserve funds, refunding issues, and so forth.

In the jargon of this area of the law, bonds issued by the governmental unit are called "governmental obligations" and the obligations acquired with the proceeds of such bonds are called "acquired obligations." The loans made by the Fund will constitute acquired obligations for this purpose.

The first question on the application of these rules to the Bill under consideration is which yield spread is applicable. The Bill provides that the interest rate on loans made by the Fund will be equal to the Fund's cost of borrowing plus 1% (which goes into loss reserve account) plus the optional 1/6 of 1% for fire and liability insurance. Thus, the Bill contemplates a basic 1% spread in the yield between the obligations it issues and the obligations it acquires.

Generally, the arbitrage rules permit a yield spread of only 1/8th of one percentage point between the governmental obligations and the acquired obligations.

Under various conditions, the permitted yield spread is reduced to zero or increased to 1/2%. However, if the proceeds of the bonds are used to fund a "governmental program," the permitted yield spread is increased to 1-1/2 percentage points. The question, then, is whether the loan program contemplated in the Bill will constitute a "governmental program" under the arbitrage regulations.

The regulations define a governmental program as one which involves the acquisition of so-called acquired purpose obligations (that is, obligations acquired to carry out the purpose of the program and for which the governmental obligations were issued); at least 90% of all such obligations acquired under the program, by amount of cost outstanding, are evidences of loans to a substantial number of persons representing the general public, loans to exempt persons, or loans to provide housing and related facilities, or any combination of the foregoing; at least 90% of all of the amounts received by the governmental unit with respect to the obligations acquired under the program will be used to pay debt service on the obligations, make additional program loans, or for other purposes germane to the program; plus various detail requirements.

By far the most common governmental programs are those involving residential mortgage loans, student loans, and veterans programs. That does not mean, however,

that other types of programs cannot qualify, so long as the general public test is met. In addition, the regulations are reasonably clear that two or more types of loans can be embodied within one governmental program. Thus, for example, there is nothing in the regulations that would explicitly prohibit a governmental program that amalgamated housing, student, and veterans loans with miscellaneous commercial loans, although, again because of the novelty of the proposed Alaska Loan Programs Fund, a ruling on this point would be strongly advisable.

It is clear, however, that single purpose bond issues, such as for exempt facilities, do not constitute a governmental program, and therefore cannot qualify for the 1-1/2% spread. Bonds issued for such purposes, as well as for industrial parks and to qualify for the small issue exemption, will therefore be limited to the 1/8th% spread.

This obviously again raises against the question of pooling or tracing of bonds proceeds. If complete pooling were contemplated, it is possible that a ruling could be obtained from the Internal Revenue Service that the entire Alaska Loan Programs Fund constitutes one governmental program, so that all of the loans could qualify for the 1-1/2% spread.

On the other hand, it is open to question whether a large number of limited purpose issues can each be said to be funding a governmental program.

Another arbitrage aspect of the pooling versus tracing question is that the arbitrage regulations require the yield on each issue of governmental obligations to be computed separately, and compared with the separate computation of the yield on the obligations acquired with the proceeds of such bonds. Permission from the IRS is necessary for a joint yield computation on two or more issues of bonds. Thus, unless a joint yield ruling is obtained each time a series of bonds is issued, it will be necessary for the Fund to maintain adequate accounts to trace all of its bond proceeds into particular loans. Thus, determination of compliance with the arbitrage rules will require extensive tracing in any event. It should also be noted that most single purpose loan agencies, such as housing agencies, find the accounting requirements necessary to comply with this tracing to be extremely difficult at best. The complexity of such accounting for a multi-purpose agency such as that contemplated by the Bill may approach impossibility.

The next significant arbitrage question raised by the Bill is the matter of bond security. Under the Bill, the average annual income from the Permanent

Fund will be placed in the Allocated Reserve Account. Monies in the Allocated Reserve Account will then be used to fund the capital reserve account (equal to 5% of all bonds outstanding), the loss reserve account (equal to 5% of all loans outstanding), and the fire insurance and liability reserve account (with no specific funding requirements). The debt service reserve account is separately funded (with an amount up to the maximum permissible under Section 103(c)).

As I read the section of the Bill dealing with the Allocated Reserve Account (Section 45.96.120; p. 13), after the funding of the three accounts mentioned above, expenditures may be made from the Allocated Reserve Account in accordance with annual appropriations by the Legislature. If the result of that provision is that the balance of the Allocated Reserve Account is not pledged as security for bonds, such that there is no reasonable assurance that amounts in the Account will be available to pay debt service if necessary, the Allocated Reserve Account does not present an arbitrage problem because the funding levels for the reserve accounts (assuming some level such as 1% is specified for the liability account) are well within the 15% limit that can be invested without restriction.

I have been advised, however, that this section of the Bill, dealing with the Allocated Reserve Account, was intended to pledge the entire Account as security for bonds issued by the Fund, in order to increase the security for the bonds and therefore reduce interest cost. If that is the case, or if the same result is achieved through a subsequent pledge of the monies in the Allocated Reserve Account by the Legislature or through resolutions authorizing the issuance of the bonds (assuming that could lawfully be done), a serious arbitrage problem will result, because the entire Allocated Reserve Account would become what is called an "invested sinking fund." This is because the Treasury currently takes the position that any monies pledged as security for bonds, where the pledge is sufficient to restrict the issuer's discretion with respect to such monies so that there is a reasonable assurance to the bondholders that such monies will be available to pay debt service ~~is~~ necessary, such monies will be treated as bond proceeds, whether or not they are in fact bond proceeds. The result of being classified as an invested sinking fund is that when the amounts held in the Allocated Reserve Account, when aggregated with all other reserve funds (such as the debt service reserve fund), exceed 15% of the original

face amounts of all bonds outstanding, such excess will be subject to investment yield restrictions. Moreover, sinking fund proceeds are not entitled to the 1/8th% yield spread, but are essentially restricted to a zero spread.

Again, whether the significant reduction in interest expense contemplated by the Bill can be achieved if less than the entire Allocated Reserve Account is pledged as security for the Fund's bonds is a question for your financial advisors.

The final significant arbitrage question raised by the Bill is the potential application of the replacement clause of Section 103(c)(2). You will recall that a bond is an arbitrage bond not only if the immediate use of the proceeds is investment in higher yielding obligations, but also if bond proceeds are used to replace other funds of the issuer which in turn had been invested in higher yield obligations. In other words, a city cannot issue bonds to finance its everyday expenditures, while investing its tax receipts.

The only known application of the replacement clause to treat bonds as arbitrage bonds involved a complicated financial maneuver by a city-owned utility whereby the city switched the usual application of funds so that operating revenues were used to pay debt service

and an investment fund was used to pay operating expenses. The Internal Revenue Service held that the investment fund was being used to replace revenues, and the investment fund was therefore subject to arbitrage yield restrictions.

On the other hand, it is generally accepted that a state or local government is not required to fund capital projects out of current revenues to the extent of its ability before it can issue bonds. On the contrary, states with large surpluses continue to issue general obligation and other bonds to fund various projects, including loan programs.

The question, then, is whether the Internal Revenue Service will view the Permanent Fund or the income therefrom as available for making loans under the Alaska Loan Programs Fund, with the result that the proceeds of revenue bonds issued by the Fund will be viewed as replacing amounts in the Permanent Fund or in the Allocated Reserve Account for the purpose of applying arbitrage yield restrictions. While this result is unlikely, again, because of the novelty of the arrangement purposed, a ruling on this point should be considered.

MISCELLANEOUS

The bill provides that the Fund may purchase

bonds issued by nonprofit corporations on behalf of certain municipalities. (Actually there is a technical error in the Bill in this respect, because it refers to bonds issued by municipalities on behalf of nonprofit corporations.) The Bill states that a nonprofit corporation is eligible for a loan under this section if it is exempt from federal income tax under section 501(c)(3) or (4) of the Internal Revenue Code, it is a public corporation or other municipal instrumentality under Alaska statutes, or it is created by statute and performs a state function. It should be pointed out that the requirements for nonprofit corporations to issue tax-exempt bonds are substantially more complicated than reflected in the Bill. (Moreover, only Section 501(c)(3)'s are exempt persons for purposes of determining the IDB status of bonds.) These requirements to date have been developed in public and private rulings issued by the Internal Revenue Service. In addition, in February, 1976, the Treasury Department published detailed proposed regulations on what it refers to as "constituted authorities," which can issue tax-exempt obligations on behalf of a state or local governmental unit. It is questionable whether the final form of these regulations will be substantially similar to that proposed. In short, it would probably be impossible

to draft a statute that adequately reflected all of the current and anticipated requirements of the Treasury Department, and it may be preferable simply to require that the interest on bonds issued by such nonprofit corporations be tax-exempt if held by a person other than a person exempt from federal income tax generally, such as the state.

One of the numerous provisions of the Bill regarding loan eligibility and loan limits is a maximum limit on any single commercial project of \$5 million. To the extent that this figure was selected because that was the maximum permissible loan under the small issue exemption for industrial development bonds, the maximum should be raised to \$10 million, in conformity with a change in the law in 1978.

The Bill also allows for bank participation in the origination and servicing of loans made by the Fund. A currently open question in the IDR area is whether the loan servicing contract with the bank results in the proceeds of a bond issue being used in the trade or business of the bank, even if the most direct use of the funds is to provide, for example, residential housing. For this reason, it is customary for such bank servicing contracts to be terminable at the will of the agency at least annually. This is probably not the kind of detail that should

be placed in a statute, but I bring it to your attention in any event.

At several points in my prior comments I have mentioned the advisability of seeking a ruling from the Internal Revenue Service as to the effect of some of the more novel features of this Bill. In particular, rulings would be advisable on a total pooling of bond proceeds to fund all types of loans, if that is contemplated, whether the fund generally or specific segments of it constitute a governmental program for purposes of the 1-1/2% yield spread, and probably for joint yield computations on all bonds issued for the same general purposes. Requests for IRS rulings, however, have become substantially more complex in the last few months. As part of the Revenue Act of 1978, the Congress added a new provision to the Internal Revenue Code permitting issuers of governmental obligations to seek a declaratory judgment from the United States Tax Court that the interest on prospective obligations will be tax exempt. Because of this new provision, the IRS will no longer issue rulings on one question involving the tax exempt status of bonds. Instead, they now require that the ruling request address every question that can affect the tax-exempt status of the bonds. In other words, in connection with bonds that might be issued by the Fund, the Fund could not seek a ruling limited to, for example,

the question whether the intended use of the bond proceeds will constitute a governmental program, but will have to address every other issue in a ruling request as well.

Moreover, the IRS will accept a ruling request only with respect to an actually prospective issue of obligations, which will require a resolution calling for the issuance of the bonds. Because this is an entirely new procedure, we do not know at this time how strictly the IRS will interpret this requirement. It is possible that they might require the implementation of the entire Alaska Loan Programs Fund before they will even accept a ruling request on the tax-exempt status of the bonds to be issued by the Fund.

TRENDS

Your staff asked me to address not only the application of the current law and regulations to the omnibus loan program and bond security arrangements contemplated by the Bill, but also to make an assessment of what the law might be in five years.

I will say at the outset that there is no serious suggestion at this time to eliminate the tax-exempt status of governmental obligations generally, and it is politically unlikely that that will happen in the foreseeable future. Most of the proposals for a so-

called taxable bond option, whereby the interest on governmental obligations would be subject to federal income tax in the hands of the holders of the obligations and the federal government would provide a subsidy to the issuer to pay the extra interest expense, have provided that the option would be with the issuer and would be with respect to bonds that would otherwise be tax-exempt. One proposal in the last Congress would have given the holder of the obligation the option to include the interest in income, pay the tax thereon, and take a tax credit for the full amount of such interest, but that proposal would have been beneficial, by expanding the market for tax-exempt obligations to moderate income individuals.

The current controversy in the tax-exempt bond market relates to bonds issued to finance single and multi-family housing for other than low and moderate income individuals. The volume of housing bonds has taken a sharp upswing in the last few years, and Treasury and Housing and Urban Development, as well as the politically powerful banking & savings and loan industries, are urging the Congress to restrict the availability of tax-exempt housing bonds. Various alternatives are being proposed, such as limiting the income level of the recipients of governmental assistance, limiting the fair market value

of residences financed with governmental assistance, and geographic targeting of government mortgage assistance. How this controversy will be resolved, and it is likely that some restrictions will be placed on housing bonds within the next one to two years, may have a significant affect on the omnibus loan Fund. For example, if arbitrary income limits are imposed, with bonds financing mortgage loans for persons exceeding certain income limits being treated in a manner similar to the current treatment of industrial development bonds, and if, in addition, a substantial portion of Alaska's residential mortgage loans are to persons exceeding the income limits, a significant portion of the leverage that the Bill contemplates to produce a large minor portion to be used for commercial loans may be eliminated. This may, of course, be mitigated somewhat by cost-of-living adjustments for different geographic areas, which would yield a much higher income limit for Alaska, but it cannot be known at this time how the housing bond controversy will eventually be resolved.

There are no other specific trends in the area of tax-exempt bonds. However, as a wholly new approach to state lending activities, the Alaska Loan Programs Fund may create its own trend. That is, if this Bill is adopted and is successful in raising large amounts of capital for

commercial loans with tax-exempt financing, you will have accomplished exactly what the Congress thought it had prohibited in 1968 with the enactment of the industrial development bond provisions. That may prompt other states to do the same, which may in turn prompt the Treasury to seek legislation from the Congress prohibiting this type of financing vehicle. Whether that would occur in three years, five years, or ten years, if at all, cannot be known.

My final comment in this area is to make reference again to the Tax Court declaratory judgment procedure enacted last year. Under this new procedure, we will for the first time be getting a significant body of case law in this area. Probably the first area to come under challenge will be the Treasury's proposed regulations, expected to be finalized in the immediate future, on arbitrage bonds, especially the invested sinking fund provisions. An opinion widely held within the bond community is that the regulations go far beyond the statute and are invalid. Whether that opinion will be shared by the courts remains to be seen. What is virtually certain, however, is that an increasing number of judicial decisions over the next several years will have an unsettling effect upon the law in this area. In such a

climate, the value of following customary financial practices in the bond industry, established over many years, cannot be estimated.

#1821

MEMORANDUM

To: Representative Hugh Malone
From: Nancy Lord, Aide
Date: May 3, 1979
Subject: CS for SS for SBI ^(Rules) and CS for SJR26

At your request I have prepared the following summary of the contents of the latest version of Senator Hohman's permanent fund bill and his CS for the governor's proposal for a constitutional amendment.

CS for SS for SBI is basically a gluing together of CS for HB281 (the House permanent fund bill), HB99 (the governor's tax credit bill), and SS for SBI, with a few important changes.

I have not attempted here to analyze any of the bill but only to identify the changes from previous drafts of SBI as well as changes in the House and governor's bills which are incorporated into it.

Pages 1 through 12 are identical to CS for HB281 except in three places.

First, the contribution level of the permanent fund is set at 100% of bonuses and 25% of royalties rather than the 50% level for both set forth in the House bill. This conflicts with the accompanying CS for SJR26, however, in that it provides for the dedication to the permanent fund of 25% of all dedicated mineral

revenues (i.e. 25% of 100% of bonuses and 25% of 75% of royalties). Mr. Berrier assures me that this is a drafting error and that the intent of the resolution was for the permanent fund to receive 25% of both bonuses and royalties. Thus, should that correction be made and should the constitutional amendment become law, the permanent fund would receive 25% of bonuses, not 100% as stated in the bill.

Second, the new Hohman bill sunsets the Permanent Fund Corporation in 1982 (page 5, lines 14-17) and turns the management of the fund back to the Department of Revenue.

Third, the language in section k (page 10) differs from 281's language and offers a possibly dangerous loophole concerning allowable permanent fund investments.

Pages 12-13 correspond to HB99 except that the tax credits are not given unless a constitutional amendment dedicating 75% of mineral revenues to various funds and accounts becomes effective.

The allocated reserve account (page 19) now gets one-half of the permanent fund earnings instead of all. This, however, is inconsistent with the resolution, which says that half of the earnings go to tax credits and half to the general fund.

The problem of the spread of responsibilities for the loan program among departments is partially taken care of by assigning the

accounting and collecting duties to the Department of Commerce.

This latest CS excludes veteran and scholarship loans. (That is, those loan programs are not repealed and replaced under the umbrella program.) The loan programs, funds, and authorities now repealed are those for agriculture, commercial fishing, housing, recreation and open space, area development, child care, state development, small business development, AIDA, water resources, alternative power, tourism, business, and historical districts.

A new section 45.96.000 (page 34) says that "public purpose" loans may not be made unless certified by the commissioner of Revenue as good risks.

A section in earlier drafts which prevented municipalities from selling industrial development bonds is now deleted.

A new Sec. 27 (page 50) sets up a comprehensive loan program reserve account to receive 15% of mineral royalties (bonuses aren't mentioned here). That money is then appropriated to the allocated reserve account for the securing of the bonds, and flows from there to various other reserve accounts.

Another new section, Sec. 34 (page 52), sets up for six months a "special account" in the general fund, made up of the general fund surplus in excess of \$100 million. This provides interim loan money for the period between the time the old loan programs