

ALASKA LEGISLATURE COMMITTEE FILES 1995-1996 8672

9029 SENATE STATE AFFAIRS

FISCAL NOTE

STATE OF ALASKA
1995 LEGISLATIVE SESSION

BILL NO. SB 37

Revision Date: _____
Title: Repeal PFD Hold-Harmless
Sponsor: Sen. Phillips
Requestor: Senate State Affairs

Dept. Affected Health and Social Services
BRU: Medical Assistance
Component: Medicaid Facility
COMPONENT SERIAL NO. 230

Expenditures/Revenues:

(Thousands of Dollars)

OPERATING	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01
PERSONAL SERVICES	00	00	00	00	00	00
TRAVEL	00	00	00	00	00	00
CONTRACTUAL	00	00	00	00	00	00
SUPPLIES	00	00	00	00	00	00
EQUIPMENT	00	00	00	00	00	00
LAND & STRUCTURES	00	00	00	00	00	00
GRANTS, CLAIMS	488.4	527.5	569.7	615.2	664.5	717.6
MISCELLANECUS	00	00	00	00	00	00
TOTAL OPERATING	488.4	527.5	569.7	615.2	664.5	717.6
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGES IN REVENUES	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts	244.2	293.8	284.8	307.9	332.3	358.9
1003 GF Match	244.2	293.7	284.8	307.6	332.2	358.9
1004 GF	00	00	00	00	00	00
1005 GF/Program Receipts	00	00	00	00	00	00
1006 GF/MHTIA	00	00	00	00	00	00
Other (Interagency Receipt)	00	00	00	00	00	00
TOTAL	488.4	527.5	569.7	615.2	664.5	717.6

Estimate of current year (FY95) impact: 0.0

POSITIONS:

FULL-TIME	01	01	01	0	01	01
PART-TIME	01	01	01	0	01	0
TEMPORARY	01	01	01	0	01	01

ANALYSIS (attach a separate page in necessary)

Senate Bill 37 repeals the Permanent Fund Dividend Hold Harmless (PFD-MH) program. The PFD-MH program replaces the Medicaid benefits of individuals who are denied benefits because federal law or regulation requires that their PFD payment be treated as income or a resource (asset) in determining their eligibility for medical assistance benefits. The legislature established the program in 1981 to assure that low-income Alaskans could receive their PFD on an equal basis with all other Alaskans, without the loss of eligibility for needs-based medical assistance.

Prepared by: Jon Sherwood MAA IV
Division: Medical Assistance
Approved by: Karen Petcoe
Commissioner: Department of Health and Social Services
Agency: Department of Health and Social Services

Phone: 465-2355
Date: 11/20/95
Date:

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ANALYSIS (cont.)

The PFD-MH program allows Medicaid recipients to receive and retain PFD money for up to four months and still receive Medicaid services.

If the PFD-MH program is eliminated, most Medicaid recipients will continue to remain eligible in the month they receive the check. They could become ineligible for Medicaid if they chose to retain their PFD check and it puts them over the Medicaid resource limit in the following month.

Many individuals, however, will elect to spend their PFD check in the month of receipt to prevent that money from being considered a resource; these individuals will retain Medicaid eligibility. In absence of PFD-MH funds, the regular Medicaid funding will be necessary to cover these individuals, both in Medicaid Facilities and Non-Facilities. We anticipate that those individuals who receive Medicaid services in an amount equal to or greater than the amount of a permanent fund dividend are the individuals who will dispose of their PFD check and remain Medicaid eligible. Currently, 80% of annual Medicaid expenditures are for recipients who receive on average \$887 or more in Medicaid benefits each month. We anticipate the regular Medicaid budget will see a commensurate increase equal to 80% of the amount currently budgeted for the PFD-MH program (1.1 million). See companion facts note for Medicaid Non-Facility to show related increase.

The Medicaid expenditures shown reflect what would be a 1% growth (inflation and client growth) in future years in the cost of benefits.

MEDICAID FACILITY CALCULATION

Current FY 93 PFD-MH funding	\$1,100,000
% of PFD-MH costs shifted to Medicaid	10%
Medicaid (type of those retaining Medicaid)	\$990,000
Less Medicaid Non-Facility share of cost (28%)	\$1,171,800
Medicaid Facility expenditures from Medicaid	\$248,800

FISCAL NOTE

STATE OF ALASKA
1995 LEGISLATIVE SESSION

BILL NO. SB 37

Revision Date: _____
Title: Repeal PFD Hold-Harmless
Sponsor: Sen. Phillips
Requestor: Senate State Affairs

Dept. Affected: Health and Social Services
BRU: Medical Assistance
Component: Permanent Fund Hold-Harmless
COMPONENT SERIAL NO. 966

Expenditures/Revenues:

(Thousands of Dollars)

OPERATING	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01
PERSONAL SERVICES	00	00	00	00	00	00
TRAVEL	00	00	00	00	00	00
CONTRACTUAL	00	00	00	00	00	00
SUPPLIES	00	00	00	00	00	00
EQUIPMENT	00	00	00	00	00	00
LAND & STRUCTURES	00	00	00	00	00	00
GRANTS CLAIMS	(1,100.0)	(1,210.0)	(1,331.0)	(1,464.1)	(1,610.5)	(1,771.6)
MISCELLANEOUS	00	00	00	00	00	00
TOTAL OPERATING	(1,100.0)	(1,210.0)	(1,331.0)	(1,464.1)	(1,610.5)	(1,771.6)
CAPITAL EXPENDITURES	00	00	00	00	00	00
CHANGES IN REVENUES	00	00	00	00	00	00

FUND SOURCE

(Thousands of Dollars)

	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01
*002 Federal Receipts	00	00	00	00	00	00
*003 GF Match	00	00	00	00	00	00
*004 GF	00	00	00	00	00	00
*005 GF Program Receipts	00	00	00	00	00	00
1006 GF MMTA	00	00	00	00	00	00
Other (Interagency Receipt)	(1,100.0)	(1,210.0)	(1,331.0)	(1,464.1)	(1,610.5)	(1,771.6)
TOTAL	(1,100.0)	(1,210.0)	(1,331.0)	(1,464.1)	(1,610.5)	(1,771.6)

Estimate of current year (FY98) impact: 00

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS

(Attach a separate page in necessary)

Senate Bill 37 repeals the Permanent Fund Dividend Hold Harmless (PFD-HH) program. The PFD-HH program replicates the Medicaid benefits of individuals who are denied benefits because federal law or regulation requires that their PFD payment be treated as income or a resource (asset) in determining their eligibility for medical assistance benefits. The legislature established the program in 1981 to assure that low-income Alaskans could receive their PFD on an equal basis with all other Alaskans, without the loss of eligibility for needs-based medical assistance.

Prepared by: Jon Sherwood, MAA IV
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Approved by: Karen Perdue
Commissioner: Department of Health and Social Services
Agency: Department of Health and Social Services

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Date:

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ANALYSIS (cont.):

The PFD-HH program allows Medicaid recipients to receive and retain PFD money for up to four months and still receive Medicaid services.

If the PFD-HH program is eliminated, most Medicaid recipients will continue to remain eligible in the month they receive the check. They could become ineligible for Medicaid if they chose to retain their PFD check and it puts them over the Medicaid resource limit in the following month.

Many individuals, however, will elect to spend their PFD check in the month of receipt to prevent that money from being considered a resource. These individuals will retain Medicaid eligibility. In absence of PFD-HH funds, the regular Medicaid funding will be necessary to cover these individuals, both in Medicaid Facilities and Nonfacilities. We anticipate that those individuals who receive Medicaid services in an amount equal to or greater than the amount of a permanent fund dividend are the individuals who will dispose of their PFD check and remain Medicaid eligible. Currently, 60% of annual Medicaid expenditures are for recipients who receive on average \$967 or more in Medicaid benefits each month. We anticipate the regular Medicaid budget will see a commensurate increase equal to 60% of the amount currently budgeted for the PFD-HH program (1.1 million). See companion fiscal notes for Medicaid Facility and Medicaid Non-facility to show this increase.

This fiscal note shows the elimination of the FY 95 budget request of 1.1 million. The reduction in expenditures shown reflects what would be an 10% growth (inflation and client growth) in future years in the cost of PFD-HH benefits to replace Medicaid funds.

Department of Health and Social Services
Division of Public Assistance
February 1, 1995

PERMANENT FUND DIVIDEND SPENDING PATTERNS OF PUBLIC ASSISTANCE RECIPIENTS

The Division of Public Assistance requires all AFDC, Food Stamp, Medicaid, and Adult Public Assistance recipients to complete special report forms which explain in some detail how they have spent their dividend payments. These forms are used by Eligibility Workers to verify when dividends are received and whether recipients have used any of their dividend money to purchase a resource that could affect eligibility.

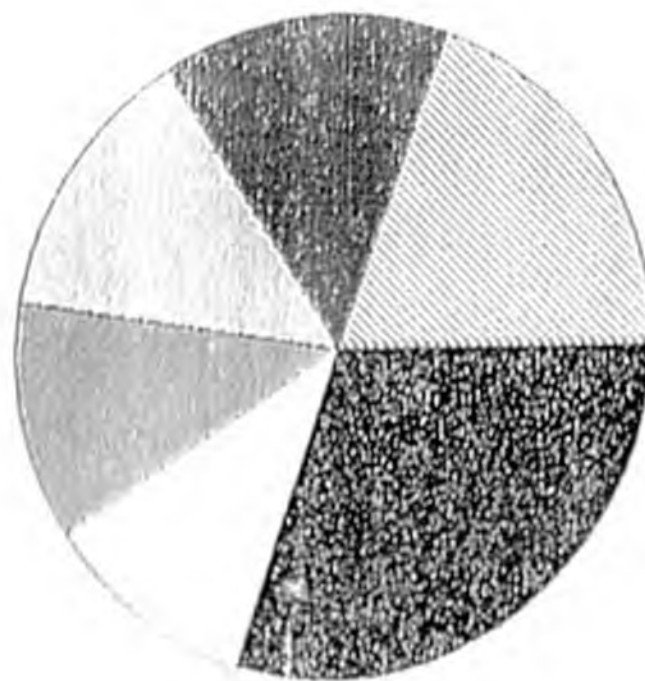
DPA analyzed more than 5,000 of these forms to determine how public assistance recipients spent their 1989 dividend payments. The study results provide the most accurate picture available of how welfare recipients spend their dividends. These results are summarized in the attachments. The pattern that emerges is one of expenditures on basic expenses, with little utilization for luxury items.

About 60 percent of reporters spent some part of their dividend money on clothing and about 58 percent reported spending dividend money on food. Roughly 44 percent bought household items, and nearly 40 percent paid past due bills. About 39 percent reported that they had saved at least part of their dividend money. Experience with the public assistance caseload shows that most savings are short-term, rarely extending beyond the month after dividend receipt.

STATEWIDE GRAND TOTAL

HOW SPENT	AMOUNT SPENT	PERCENT SPENT	NUMBER FAMILIES	PERCENT FAMILIES
FOOD	1,944,268.00	19.2	2,968	52.1
SAVED	1,463,100.00	14.6	1,962	38.8
CLOTHING	1,335,085.00	13.3	3,082	60.4
HOUSEHOLD	1,174,702.00	11.7	2,253	44.1
PD PAST BILLS	1,082,555.00	10.8	2,021	39.6
GIFT	417,962.30	4.2	753	14.7
AUTO	371,535.90	3.7	414	8.1
SNOW MACHINE	349,949.50	3.5	190	3.7
OTHER	348,500.80	3.5	725	14.2
HOME RENT	314,718.10	3.1	483	9.5
TRAVEL	245,249.70	2.5	332	6.5
PAID LOAN	135,378.40	1.3	455	9.0
GARNISHED	128,893.30	1.3	207	4.1
PD UTILITIES	108,353.70	1.1	328	6.4
GAVE AWAY	106,573.80	1.1	240	4.7
FIX VEHICLE	100,551.30	1.0	262	5.2
MEDICAL	84,751.11	0.8	162	3.2
MOTORCYCLE	68,904.05	0.7	38	0.7
BOAT	62,678.36	0.6	44	0.9
PAID TAXES	40,320.23	0.4	112	2.2
CHILD SUPPORT	29,467.75	0.3	46	0.9
LAND	17,735.39	0.2	26	0.5
CAMPER	10,377.30	0.1	16	0.3
TOTAL FAMILIES	5,107			
AMT DIV. SPENT	10,011,350.00			
AMT DIV. REC'D	10,132,300.00			
TOTAL PEOPLE			17,505	

PFD Statewide Total Amount Spent By Type



Legend

- Food
- Savings
- Clothing
- Household
- Past Bills
- All Other



ALASKA STATE LEGISLATURE

SENATOR RANDY PHILLIPS
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January 19, 1995

MEMORANDUM

TO: Senator Bert Sharp
Chairman, Senate State Affairs Committee

FROM: Senator Randy Phillips *R.P.*

RE: SB 37, "An Act relating to treatment of permanent fund dividends for purposes of determining eligibility for certain benefits"

The above referenced bill has been referred to the Senate State Affairs Committee.

Please consider this as my formal request that SB 37 be scheduled before your committee for a hearing.

If you have any questions or comments do not hesitate to call me at ext. 4949. Your cooperation is appreciated.

9-LS0449C
Cook
1/26/95

CS FOR SENATE BILL NO. 37()
IN THE LEGISLATURE OF THE STATE OF ALASKA
NINETEENTH LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsors: SENATORS PHILLIPS, Taylor

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to treatment of permanent fund dividends for purposes of
2 determining eligibility for certain benefits; and providing for an effective date."

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

4 • Section 1. AS 43.23.025(a) is amended to read:

5 (a) By October 1 of each year, the commissioner shall determine the value of
6 each permanent fund dividend for that year by

7 (1) determining the total amount available for dividend payments, which
8 equals

9 (A) the amount of income of the Alaska permanent fund
10 transferred to the dividend fund under AS 37.13.145(b) during the current year;

11 (B) plus the unexpended and unobligated balances of prior fiscal
12 year appropriations that lapse into the dividend fund under AS 43.23.045(d);

13 (C) less the amount necessary to pay dividends from the dividend
14 fund in the current year under AS 43.23.055(3) and (7);

1 (D) less the amount necessary to pay dividends from the dividend
2 fund due to eligible applicants who, as determined by the department, filed for a
3 previous year's dividend by the filing deadline but who were not included in a
4 previous year's dividend computation;

5 (E) less appropriations from the dividend fund during the current
6 year, including amounts to pay costs of administering the dividend program
7 [AND THE HOLD HARMLESS PROVISIONS OF AS 43.23.075];

8 (2) determining the number of individuals eligible to receive a dividend
9 payment for the current year; and

10 (3) dividing the amount determined under (1) of this section by the
11 amount determined under (2) of this section.

12 * Sec. 2. AS 43.23.028(a) is amended to read:

13 (a) By October 1 of each year, the commissioner shall give public notice of the
14 value of each permanent fund dividend for that year. The notice and the stub attached to
15 each individual dividend check must disclose the amount

16 (1) of each dividend attributable to income earned by the permanent fund
17 from deposits to that fund required under art. IX, sec. 15, Constitution of the State of
18 Alaska;

19 (2) of each dividend attributable to income earned by the permanent fund
20 from appropriations to that fund and from amounts added to that fund to offset the effects
21 of inflation; and

22 (3) by which each dividend has been reduced due to each appropriation
23 from the dividend fund, including amounts to pay the costs of administering the dividend
24 program [AND THE HOLD HARMLESS PROVISIONS OF AS 43.23.075].

25 * Sec. 3. AS 43.23.075(b) and 43.23.075(c) are repealed.

26 * Sec. 4. This Act takes effect July 1, 1995.



ALASKA STATE LEGISLATURE

SENATOR RANDY PHILLIPS

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SPONSOR STATEMENT

SB 37, "An Act relating to treatment of permanent fund dividends for purposes of determining eligibility for certain benefits"

The purpose of this legislation is to end the hold harmless provision of the permanent fund dividend program. This provision allows welfare recipients to receive their permanent fund dividend without experiencing any reductions to their public assistance benefits.

The FY '96 funding request for this hold harmless program is \$22.316 million. Last year, that resulted in a reduction of \$41.45 to each permanent fund dividend check issued. By the year 2000 it is projected that the deduction will be \$48.31. This amounts to a tax on each Alaskan's dividend check, and is the only tax taken directly from the check.

With the elimination of the hold harmless provision, permanent fund dividends received by welfare recipients would be treated as income, just as are the dividend checks received by any other Alaskan.



ALASKA STATE LEGISLATURE

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Sectional Analysis

SB 37

Section 1.

Deletes the reference to the hold harmless provisions of AS 43.23.075 from AS 43.23.025(a), the statute directing the method of computation of the Permanent Fund Dividend.

Section 2.

Deletes the reference to the hold harmless provisions of AS 43.23.075 from AS 43.23.028(a), the statute requiring that deductions from Permanent Fund Dividends be listed in a public notice and on each Permanent Fund Dividend check stub.

Section 3.

Repeals AS 43.23.075(b), which provides for up to four months of state-funded medical assistance equivalent to medicaid which could be lost as a result of receiving the Permanent Fund Dividend.

Section 4.

Provides for an effective date of July 1, 1995.



ALASKA STATE LEGISLATURE

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Fact Sheet

SB 37

The FY '96 funding request for Permanent Fund Dividend Hold Harmless is \$22.316 million.

Added to past appropriations for hold harmless the total is \$126.07 million.

Prior to FY 1986 hold harmless costs were appropriated from the general fund. Budget decision changed source of funds to PFD.

The amount deducted from each of approximately 535,000 checks for 1994 was \$41.45.

Based on a projected 573,300 1996 PFD recipients, each would see \$38.93 deducted from their check to fund hold harmless.

Current law provides:

If welfare benefits, either cash or medical assistance, are lost due to the receipt of a PFD, the state will fund an equivalent amount of assistance for up to four months.

Affected population

39,639	AFDC recipients
11,373	Food Stamp recipients
2,000	Medicaid recipients
7,932	Adult Public Assistance recipients
5,630	Supplemental Security Income recipients

This represents a total of approximately 47,500 people; most receive a combination of AFDC, food stamps and Medicaid, or Adult Public Assistance and Medicaid, or Adult Public Assistance, Supplemental Security Income and Medicaid.

It is anticipated that most Medicaid recipients could continue to receive Medicaid benefits if they spend their dividend check in the month they receive it.

Legislative Research Agency

Alaska State Legislature



130 Seward Street, Suite 218
Juneau, Alaska 99801-2196

Phone: (907) 465-3991
Fax: (907) 463-3351

January 26, 1995

MEMORANDUM

TO: Senator Randy Phillips

FROM: Linda Brooks ⁷⁶
Legislative Analyst

RE: Projection of Permanent Fund Dividend "Hold Harmless" Amounts
Research Request 95 076

You requested an update of research memorandum 93 156 that projected permanent fund dividend "hold harmless" forecasts from the year 1994 to 2000. In this memorandum we update the data to provide a forecast from 1996 to 2002.

In the earlier projection, we calculated that the deduction from each permanent fund dividend would increase from \$35.18 in 1994 to \$48.31 in 2000, an increase for the period of 37.3 percent. Our new projection for the seven year period of 1996 to 2002 shows a slower increase. We expect the amount deducted from each check to rise from \$38.93 in 1996 to \$45.23 in 2002, resulting in an increase for the new seven year period of 16.2 percent.

The slower increase can be attributed in part to Department of Health and Social Services' (DHSS) lower assumed program growth rate. In the earlier projection, program growth was expected to be 8 percent: a 5 percent increase in caseload and a 3 percent increase in benefits. In the new projection, program growth is expected to be 5 percent, which is a 5 percent increase in caseload and no increase in benefits. Benefit increases used to be tied automatically to changes in the cost-of-living, but House Bill 67 in 1993 suspended the automatic increases. Benefit increases must now be approved by the Legislature. The department also expects its administrative costs to increase by only 3 percent annually as compared to 5 percent annually in the earlier projection.

Please do not hesitate to contact this agency if you would like additional information.

Attachment

Permanent Fund Dividend "Hold Harmless" Calculator for Fiscal Years 1996 THROUGH 2002

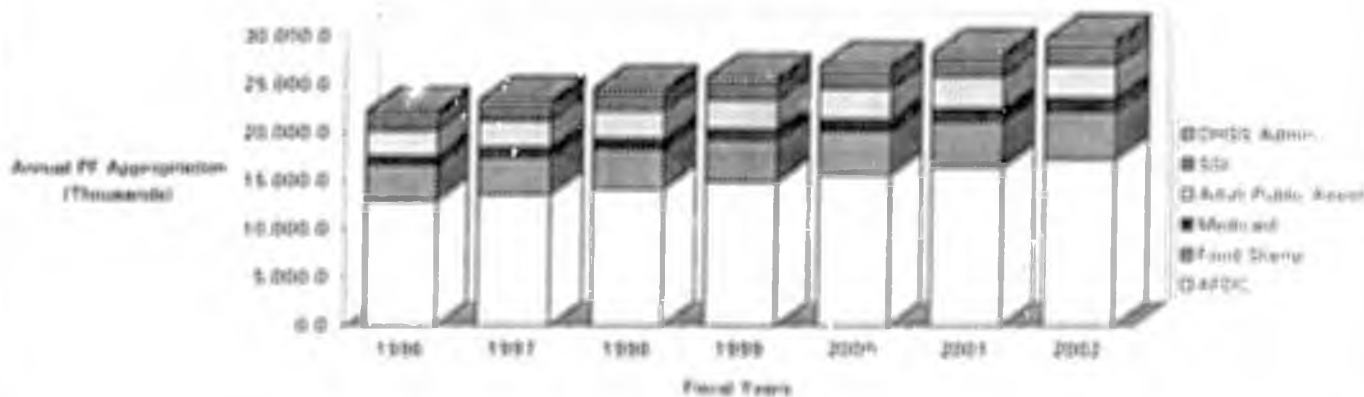
Data			Assumed ^a		Forecast ^b							Totals over 7 yrs 1996-2002	
	Costs	Persons Impacted	FY 96 ^a Request	Program Growth R ^b	Budget data in thousands of dollars								
					1996	1997	1998	1999	2000	2001	2002		
Program													
A/D/C	12,987	29,679	12,875.5	5.00%	12,875.5	13,519.2	14,195.2	14,905.0	15,650.3	16,432.8	17,254.6	104,822.4	
Food Stamp	11,272	26,288	3,688.1	5.00%	3,688.1	3,872.5	4,066.1	4,269.4	4,482.9	4,707.1	4,942.8	30,028.5	
Medicaid	na	2,000	1,100.0	5.00%	1,100.0	1,155.0	1,212.8	1,273.4	1,337.1	1,403.9	1,474.1	8,958.2	
Adult Public Assist	7,922	7,922	2,562.1	5.00%	2,562.1	2,690.2	2,824.7	2,966.0	3,114.2	3,270.0	3,433.5	20,860.8	
SSI	6,620	6,620	1,617.7	5.00%	1,617.7	1,698.8	1,782.5	1,872.7	1,968.2	2,064.6	2,167.9	13,121.3	
DMSS Admin			472.7	2.00%	472.7	484.9	501.5	518.5	537.0	556.0	576.4	3,622.0	
Total Permanent Fund Cost			22,316.1		22,316.1	23,422.5	24,583.2	25,863.0	27,082.0	28,426.3	29,826.8	181,471.2	
Forecast number of PF dividend recipients **					572.2	587.7	601.2	615.6	630.0	645.2	659.7		
Indicated deduction from each PF Dividend Check					0.3093	0.3285	0.3483	0.3692	0.3919	0.4165	0.4433	2.7228	

Notes

^a Program growth rate assumptions and FY 96 request amounts provided by the Department of Health and Social Services (DHSS).

^b Dividend recipient forecast is 90 percent of Department of Health & Social Services' population forecast through year 2002. This is the same forecast used by the Permanent Fund Corporation in their model.

Forecast Cost of PFD Hold Harmless Program



Legislative Research Agency

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Alaska State Legislature

January 31, 1995

MEMORANDUM

TO : Senator Randy Phillips

FROM : Linda Brooks -
Legislative Analyst

RE: Clarification on the Permanent Fund Dividend "Hold Harmless" Amounts
Research Request 95 076 (Supplemental Information)

You asked why Legislative Research Agency memorandum 9) 156 projected a deduction of \$3) 18 from each 1994 Permanent Fund Dividend check. The 1994 checks actually had a deduction of \$4) 45. The spreadsheets attached to memorandum 9) 156 and the update of that memorandum, 9) 076, show the deductions for each fiscal year. Therefore, the projected \$3) 18 deduction for fiscal year 1994 (FY 94), was for dividends paid out in calendar year 1993.

The projected deduction for the "hold harmless" program from each dividend check for calendar year 1993 (FY 94) was \$3) 18, the actual deduction \$4) 45. The difference of \$1) 27 is due to the fact that the actual number of dividend recipients was lower than projected. The number of dividend recipients was projected to be 547,200 persons but the actual figure was closer to 528,200 persons. Although fewer recipients mean higher overall dividend checks it also means a higher deduction is taken from each check for the "hold harmless" program.

For FY 95 (calendar year 1994) we projected a reduction from each dividend of \$1) 12. The actual dividend reduction for fiscal year 1995 was \$1) 45, a difference of \$4) 33. Again, part of the discrepancy is due to the number of dividend recipients being lower than anticipated. The forecast anticipated 559,800 dividend recipients but the actual figure was closer to 535,600 persons. However, other variables account for the wider difference in the fiscal year 1995 (calendar year 1994) amount.

House Bill 67 affected the amount of money that the Department of Health and Social Services (DHSS) needed to budget for the "Hold Harmless" program. The department expected greater

Fiscal years run from July 1 through June 30, which is why the dividend payments made on October 1993 is listed under FY 94 (July 1, 1993 - June 30, 1994).

Senator Phillips
January 31, 1995
Page 2

cuts in recipient payments than actually occurred with the result that a supplemental budget appropriation of \$241,400 was needed for FY 94. Since dividend checks for FY 94 had already been distributed (in October 1993), this supplemental appropriation actually affected the amounts deducted from dividend checks distributed for FY 95. In addition to the FY 94 shortfall, all projected budget amounts also had to be adjusted for subsequent years. The total DH&SS budgeted amount for the "hold harmless" program in fiscal year 1995 rose from \$20,778,200 to \$21,955,000. This increase in the budget coupled with the lower than forecasted number of dividend recipients resulted in the \$433 deviation of the actual dividend reduction from the forecasted amount for fiscal year 1995.

Finally, the difficulty of comparing forecasted numbers to actual numbers is further compounded by the change in the permanent fund dividend application periods. The old dividend application deadline was in the summer, but it was changed two years ago to a spring deadline. The change was made to help screen seasonal residents from permanent residents. Although the application deadline has changed, the method of forecasting the number of dividend recipients may not have been adjusted.

Attached is a revised version of the spreadsheet we sent you with the original memorandum 95-076. We added a line to emphasize the difference between calendar and fiscal years for clarification and also list FY 94 and FY 95 data from request 93-156 to assist in the explanation of this memorandum.

I hope this has helped to clarify the issue. If you have any questions, please call.

Attachment

Permanent Fund Dividend "Hold Harmless" Calculation for Fiscal Years 1996 THROUGH 2002

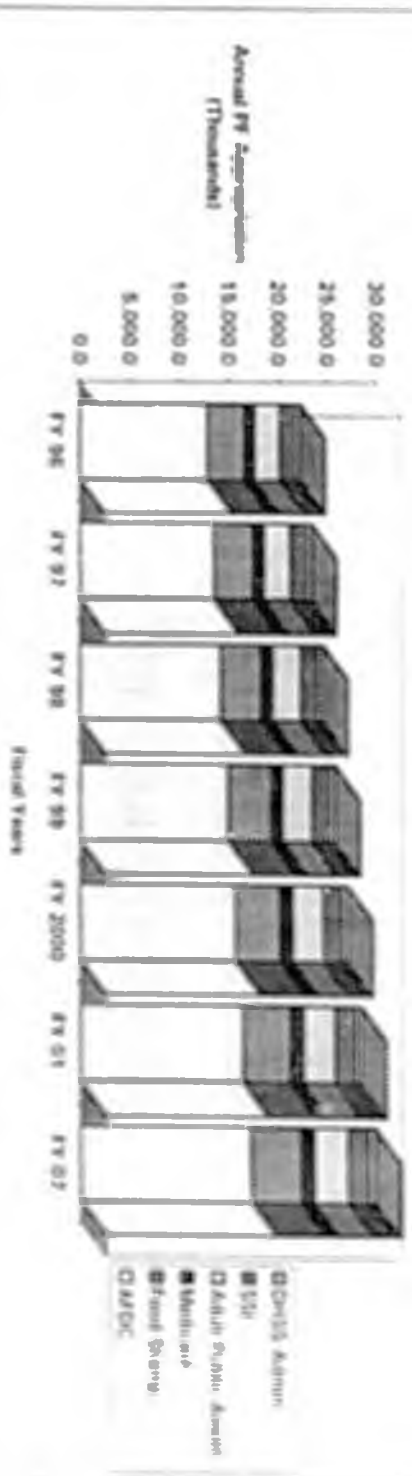
Data	Program	Costs	Budgeted	FY 90*	Program	FISCAL YEAR											Total	FY 94	FY 95
						FY 90*	FY 96	FY 97	FY 98	FY 99	FY 2000	FY 01	FY 02	FY 03	FY 04	FY 05			
	AFDC	12,987	29,839	12,875.5	0.00%	12,975.5	13,519.3	14,195.2	14,905.0	15,650.3	16,432.2	17,254.4	18,127.4	19,050.5	19,924.7	20,849.9	21,826.2	22,853.5	
	Food Stamp	11,272	26,384	3,688.1	5.00%	3,688.1	3,812.5	4,068.1	4,369.4	4,719.4	5,121.1	5,585.9	6,116.8	6,720.0	7,399.7	8,150.0	8,978.8	9,893.2	
	Medicaid	na	na	1,100.0	5.00%	1,100.0	1,155.0	1,212.8	1,274.7	1,341.9	1,414.8	1,493.8	1,579.4	1,672.2	1,773.0	1,882.5	2,000.5	2,127.8	
	Adult Public Assist	7,922	7,922	2,502.1	5.00%	2,502.1	2,600.2	2,728.7	2,890.0	3,086.2	3,318.2	3,590.0	3,904.8	4,266.8	4,681.9	5,156.8	5,697.5	6,310.0	
	SSI	5,830	5,830	1,812.7	5.00%	1,812.7	1,890.6	1,973.5	2,062.5	2,158.7	2,263.2	2,376.4	2,498.6	2,630.8	2,773.9	2,928.9	3,097.0	3,279.2	
	Disability Admin	5,830	5,830	872.7	2.00%	872.7	889.9	901.5	915.5	932.0	950.0	969.4	990.3	1,012.7	1,036.8	1,063.5	1,092.8	1,124.8	
	Total Permanent Fund Cost			22,316.1		22,316.1	23,422.5	24,583.8	25,803.0	27,082.0	28,426.3	29,836.7	31,319.2	32,878.2	34,519.9	36,250.2	38,073.2		

Forecast number of dividend recipients: **
 Actual Number of Recipients for FY 94 and FY 95
 Deduction from each Dividend Check by FISCAL YEAR
 (calendar year is indicated in parentheses)
 Actual Deduction from FY Dividend for FY 94 and FY 95

Fiscal Year	Forecast	Actual	Deduction
FY 94	522.2	522.2	0.0
FY 95	507.1	529.85	22.75
FY 96	601.2	600.89	0.31
FY 97	615.8	641.92	26.12
FY 98	630.0	679.91	49.91
FY 99	645.2	700.01	54.81
FY 00	659.2	720.02	60.82
FY 01	673.2	740.03	66.83
FY 02	687.2	760.04	72.84
FY 03	701.2	780.05	78.85
FY 04	715.2	800.06	84.86
FY 05	729.2	820.07	90.87

Notes:
 * Program growth rate assumptions and FY 95 request amounts provided by the Department of Health and Social Services
 ** Dividend received forecast is 90 percent of Department of Labor's Mid-Care Population Forecast derived from year
 *** FY 94 and FY 95 data are taken from the table contained in LMA memorandum 93-156. The data were calculated using the assumptions made in the table regarding program and recipient
 written. It is presented here to clarify the assumptions contained in this memorandum (93-0761)

Forecast Cost of PFD Hold Harmless Program



ALASKA DEPARTMENT OF REVENUE
PERMANENT FUND DIVIDEND DIVISION

SB 37 ANALYSIS

As of January 25, 1995

Section 3 of this bill repeals AS 43 23 075(b) and (c), the sections of the Alaska Statutes that require the state to hold public and medical assistance recipients harmless from the effects that receipt of a Permanent Fund Dividend (PFD) would have on their federal benefits. However, AS 43 23 075(a) and AS 43 23 085 still require the Department of Health & Social Services and other state and municipal agencies to *not* consider a PFD as income or resources for benefit program purposes unless required to do so by federal law or regulation. In addition, Sections 1 and 2 of this bill remove references to the hold harmless program cost reductions from the dividend calculation formula and the disclosure requirements.

The amended language does not preclude the legislature from appropriating dividend fund monies for state hold harmless costs. However, the legislation implies that any such future program costs will not be taken from the dividend fund. As a result, the deduction from each Alaskan's dividend would be eliminated. See the attached table entitled **Hold Harmless Program Deductions From 1985-1994 Dividends**, as of September 29, 1994.

Attachment:

**ALASKA DEPARTMENT OF REVENUE
PERMANENT FUND DIVIDEND DIVISION
HOLD HARMLESS PROGRAM DEDUCTIONS FROM 1985-1994 DIVIDENDS
As of September 29, 1994**

The legislature first funded the Hold Harmless program from the Dividend Fund in FY86. Prior to that time, the program was funded by the General Fund. The following table reflects the amounts appropriated and the corresponding reduction to each eligible applicant's dividend that resulted from the use of Dividend Fund monies for this program.

<u>Fiscal Year</u>	<u>Dividend Fund Hold Harmless Appropriations</u>	<u>Dividend Year</u>	<u>Reductions To Each Dividend</u>	<u>Reductions Reported</u>
1986	\$3,644,300	1985	\$6.94 (a)	
1987	4,211,700	1986	7.75 (a)	
1988	8,581,200	1987	16.05	\$16.05
1989	9,850,700	1988	18.61	18.61
1990	11,305,100	1989	22.72	22.72
1991	12,217,300	1990	24.12 (b)	24.12
1992	14,704,500	1991	28.63	28.63
1992	1,494,700	1992	2.89 (c)	
1993	18,540,900	1992	35.85	38.74
1994	19,252,100	1993	36.45	36.45
1994	244,400	1994	0.46 (d)	
1995	21,955,000	1994	40.99	41.45
Total	\$126,001,900		\$241.46	\$226.77

(a) These amounts were not reported on the 1985 or 1986 dividend check stubs. The Department first reported the effect of the appropriation on the dividend amount on the 1987 dividend check stub. In 1988 the legislature passed AS 43.23.026 requiring the reporting of all deductions from dividends.

(b) In FY81 there was a General Fund supplemental of \$1,092,200 to the Hold Harmless program bringing the total FY81 Hold Harmless program appropriation to \$12,209,500. Since the supplemental appropriation was from the General Fund it did not reduce the amount of the 1991 dividend.

(c) The FY82 supplemental appropriation brought the total FY82 Hold Harmless program appropriation to \$14,199,200. Since the supplemental appropriation was made after the calculation of the 1991 dividend its effect was to reduce the 1992 dividend. The total 1992 dividend reduction as reported on the check stub was \$28.74.

(d) The FY84 supplemental appropriation brought the total FY84 Hold Harmless program appropriation to \$19,252,500. Since the supplemental appropriation was made after the calculation of the 1993 dividend its effect was to reduce the 1994 dividend. The total 1994 dividend reduction as reported on the check stub was \$41.45.

SB

40

TONY KNOWLES, GOVERNOR

DEPARTMENT OF REVENUE

STATE OFFICE BUILDING
P.O. BOX 110410
JUNEAU, ALASKA 99811-0410

February 1, 1995

The Honorable Bert Sharp
Alaska State Legislature
State Capitol Rm. 514
Juneau, AK 99801-1182

Dear Senator Sharp:

Per your request for amplification of this Department's SB40 fiscal note which addressed Alaska Housing Finance Corporation's "transfers to...the General Fund...\$595,171,000.00" the following is submitted:

Debt Repayment	FY86	\$12,141,000.00
	FY87	\$16,127,000.00
	FY94	\$ 1,573,000.00
Assets Purchased from the State	FY 87	\$ 70,000,000.00
	FY92	\$179,892,000.00
	FY94	\$ 1,114,000.00
Dividends	FY91	\$ 17,171,000.00
	FY92	\$ 19,412,000.00
	FY93	\$ 40,715,000.00
	FY94	\$ 16,983,000.00
	FY95	\$ 20,043,000.00
Transfers	FY95	\$200,000,000.00

If I can provide any further assistance please call me at 465-2310

Sincerely,



R.E. Baranko

Director
Administrative Services Division

95-007

Alaska Housing Finance Corporation
Comments Concerning senate Bill No. 40
January 30, 1995

Alaska Housing Finance Corporation interprets Senate Bill 40 to be an appropriation contingent on the State's receipt of funds "anticipated to be transferred at the direction of the board." The effect of the bill, then is to (i) announce the Legislature's anticipation that the Corporation will transfer the amounts indicated, (ii) allow for the entry of the amounts on to the State accounting system, and (iii) designate where the funds, if received, are to be deposited.

The Corporation appreciates the sensitivity expressed in the language of the bill to the issue of control by the Corporation over the financial resources securing the pledge to holders of AHFC debt securities. While a public instrumentality whose mission and authority is governed by the Administration and Legislature, the separate legal status of AHFC, which is clearly stated in the enabling legislation and has been represented to each purchaser of its debt obligations, must be honored.

The value of the Corporation to the State of Alaska extends well beyond calculations of equity and net unrestricted assets. The Alaska Housing Finance Corporation is financially sound and well managed, factors which were critical to its achieving investment-grade ratings from three internationally recognized agencies. Because of these ratings, the Corporation is able to multiply its resources many times over by (i) accessing the lowest-cost capital market available for its mortgage lending programs, and (ii) administering, and funding the required match for, available Federal programs. This leveraging has tremendous economic benefit to Alaska.

In considering any plan for transferring AHFC resources to the State, of paramount concern should be (i) protecting the Corporation's ability to access capital markets, (ii) an understanding of how the perception of AHFC in the capital markets affects the borrowing capacities and costs of other Alaskan entities, (iii) honoring the rights and expectations of holders of AHFC debt obligations, and (iv) maintenance of essential programs of benefit to residents throughout Alaska. The Corporation has successfully met these objectives in the past in connection with transfers to the State general fund which, at the end of this fiscal year, will aggregate \$595,171,000.

Any transfer plan must recognize that bondholders and other financial partners have relied on all assets of AHFC being available to meet commitments. The removal of assets must occur only when it can be clearly demonstrated that in so doing, those obligations will still be met.

There are several key factors that needs to be incorporated in any plan to transfer resources from AHFC to the State. These include:

1. The need for the determination and authorization for any transfer to be done at the AHFC Board level.
2. The requirement that the financial integrity of the Corporation be maintained.
3. The maintenance of financial resources sufficient to assure that financial and program commitments can be met.
4. The transfer does not violate the terms of any outstanding agreements and is not likely to ultimately cause any terms to be violated.
5. The transfer will not result in the reduction, withdrawal or suspension of a rating on any of the Corporation's outstanding debt obligations.

The AHFC Board of Directors has been recently reconstituted. While much has been done with regard to the strategic planning process discussed last year, it is reasonable to expect that the Board will need some time to review the work accomplished, current resource and program status, and overall statewide housing needs prior to taking a position concerning any program of funds transfer to the State. If the Board adopts the above criteria for transfers, it will need time to apply the criteria to these facts.

sb40pos.a1f

FISCAL NOTE

STATE OF ALASKA
1995 LEGISLATIVE SESSION

BILL NO. SB 40

Revision Date: _____ Dept. Affected: _____ Revenue: _____
 Title: Appropriation: AHFC to General Fund BRU: Alaska Housing Finance Corporation
 Component: AHFC-Operations

Sponsor: Sen. Sharp
 Requester: _____ COMPONENT SERIAL NO. 110

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

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

CHANGE IN REVENUES ()	(200,000.0)	(135,000.0)				
-------------------------------	--------------------	--------------------	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

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

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

See attachment

Prepared by: Bob Barano
 Division: Administrative Services Division
 Approved by: [Signature]
 Commissioner: Deborah Vogt
 Agency: Revenue

Phone: 465-2312
 Date: 1/30/95
 Date: 1/31/95

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SENATE COMMITTEE REPORT
First Committee of Referees

DATE: 1/20/95

FURTHER: Finance

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

DATE TURNED INTO OFFICE: _____

State Affairs Committee considered SB 40

Requesting appropriations from the Alaska Housing Finance Corporation revolving fund to the general fund; efd.

Committee recommends:

to be replaced with _____ CS _____ ()

to adopt previous _____ CS _____ ()

to attach amendment(s)

to adopt Letter of Intent by _____ Committee

to further referral to the _____ Committee

Senate Bill:

same title

new title

House Bill:

technical change

new: SCR# _____

AGREING WITH RECOMMENDATIONS:

	DP	DNP	NR	AM
<i>Richard C. Pelt</i>	✓			
<i>David Ashley</i>			✓	
CHAIR: <i>Bob Sharp</i>	✓			

NEW FISCAL NOTE(S):

Department	Date	Zero	Fiscal

PREVIOUS FISCAL NOTE(S):*

Department	Date	Zero	Fiscal



Alaska State Legislature

SENATE

Official Business

State Capitol
Juneau, AK 99801-1182

SPONSOR STATEMENT

SB - 40

Senator Bert Sharp

The State of Alaska is facing a major funding shortfall in FY 1996 and beyond. Our primary tool in handling this budget shortfall has been and will continue to be spending reductions. I also feel it is time to use some of our "savings accounts" to cushion the blow on our state's economy. The State's general fund has contributed \$1,073,515,000 to capitalize AHFC, a majority of those funds appropriated 1980-84.

In writing the FY 95 operating and capital budget the Governor and Legislature felt it was prudent to begin receiving a dividend from Alaska Housing Finance Corporation (AHFC). The Division of Legislative Audit conducted an audit (#04-4486-94) to prepare a Financial Analysis of AHFC to determine the amount of cash and investments that would be available in FY 94 and FY 95 and beyond.

The audit analysis of AHFC's financial statements and cash flow projections demonstrated that there is approximately \$535 million of available unrestricted cash that could be withdrawn from AHFC. The FY 95 budget included a dividend from AHFC of the first \$200 million.

FY 94	\$200 million
FY 95	\$214 million
FY 96	\$121 million
Total Available	\$535 million

Based on this audit analysis I have introduced Senate Bill 40 to assist the Governor and Legislature in solving some of Alaska's revenue problems.

UPDATE on FY 95 AHFC Dividend: The current year appropriation of \$200 million is on track with a \$50 million deposit quarterly. There has been no negative impact on AHFC's bond rating as a result of this dividend program.

**ALASKA HOUSING
FINANCE
CORPORATION**

FINANCIAL ANALYSIS

March 15, 1994

Control Number
04-4486-94

Prepared by:

The Division of Legislative Audit

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit



P. O. Box 113300
Juneau, AK 99811-3300
(907) 465-3830
FAX (907) 465-2347

March 15, 1994

Members of the Legislative Budget
and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached analysis is submitted for your review.

ALASKA HOUSING FINANCE CORPORATION

FINANCIAL ANALYSIS
March 15, 1994

Control Number
04-4486-94

The accompanying analysis was prepared in response to a Committee request to review the assets of the Alaska Housing Finance Corporation and the restrictions on those assets. Because of the short time frame we established to complete this analysis, this report is necessarily brief and the information in it is summarized at a high level. We are prepared to work with the Legislative Budget and Audit Committee and the Senate and House Finance Committees to provide any additional analysis or detail deemed necessary as the legislature continues its review of the unrestricted assets of the Corporation.

The fieldwork procedures utilized in the course of developing the findings and discussion presented in this analysis are discussed in the Objectives, Scope, and Methodology section.

We would like to acknowledge the cooperation and professionalism of the Corporation's staff during our intensive review.

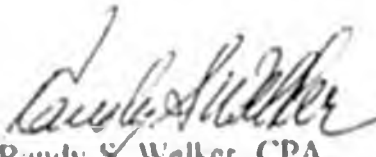

Randy S. Welker, CPA
Legislative Auditor

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OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Based on a request from the Legislative Budget and Audit Committee, we performed a financial analysis of the Alaska Housing Finance Corporation (AHFC). The purpose of the analysis was to determine the amount of cash and investments that would be available in FY 94 and FY 95 beyond that required by debt covenants and AHFC operations.

Scope and Methodology

This financial analysis focused in two main areas, first on the individual bond funds and secondly on the general account.

1. Analysis of Bond Funds

Separate bond funds are maintained by AHFC to account for each bond issue or series of issues. This system of segregated funds is mandated by the bond indentures to directly associate the bonds with the related collateral and to provide for bond payment.

We reviewed all of the outstanding indentures and determined the normal redemption schedule, early redemption provisions, call and in-substance defeasance options, interest rates, restrictions on AHFC's general account, and loan recycling provisions. We also reviewed each fund's recent prepayment history in conjunction with prevailing mortgage interest rates. Based upon all of the above and the December 31, 1993 balance sheet of each fund, we estimate that seventeen¹ bond funds will likely close out in the remainder of FY 94 or in FY 95. The volume of mortgage loan prepayments is critical to this type of bond retirement analysis; we took a conservative approach to this determination. AHFC independently performed a similar analysis and identified the same seventeen bond funds for probable retirement in this time period.

AHFC scheduled an estimate of the amount of net assets² that would be released by each fund's retirement. This schedule included the seventeen bond funds expected to close in FY 94 and FY 95 and the other seven funds that did close in December 1993. We reviewed their estimates and adjusted them upward by \$62 million. Most of the adjustment was because AHFC did not include deposits in suspense. Our final projection is included in the cash flow analysis discussed below.

¹ In addition to these seventeen bond funds, seven bond funds were closed in December 1993. The remaining net assets in those bond funds were transferred to the general account.

² The net assets that are released upon the retirement of each bond fund represents the cumulative effect of the overcollateralization, i.e., the total dollars of mortgage loans pledged to a given bonded debt which exceed that debt.

2. Analysis of the General Account

AHFC prepared a cash flow analysis of the general account for FY 94 and FY 95. This analysis forecasts on the sources and uses of financial resources for AHFC's unrestricted current assets and liabilities.

We reviewed the estimates on the cash flow to determine if they were consistent with prior financial and statistical trend information. Major assumptions used in the cash flow were the estimated rate of prepayments on current mortgage loans and the expected demand for new mortgage loans.

The cash flow analysis was used to assess the impact of increased dividend payments to the State. The assessment included both analyzing the impact of how much could be withdrawn and the timing of any withdrawal.

RESULTS OF FINANCIAL ANALYSIS

Our analysis of AIFC's financial statements and cash flow projections demonstrated that there is approximately \$535 million of available unrestricted cash that could be withdrawn from AIFC. The schedule below shows which fiscal year the funds would become available.

Funds available by Fiscal Year	(in thousands)
Fiscal Year 1994	\$200,000
Fiscal Year 1995	213,871
Fiscal Year 1996	<u>121,129</u>
Total Available for Fiscal Year 1994-1996	<u>\$535,000</u>

Areas impacted by the withdrawal of corporate assets

Programs administered by AIFC will be impacted in two primary ways by the withdrawal of corporate assets. First, AIFC's ability to meet all program demands may be limited. Secondly, if there is a drop in the bond rating, any corresponding increase in interest rate would increase the cost of borrowing money to the users of AIFC programs.

There will be a relationship between the amount of money withdrawn from AIFC and the impact on programs. The greater the amount of assets withdrawn from AIFC, the greater the program impact will be.

Impact on existing AIFC programs

With certain exceptions, AIFC's accounting and therefore availability of unrestricted assets is not program specific. Various AIFC loan programs and loan features are frequently combined into a single bond fund. Generally, mortgage loans are grouped more by the taxable or tax-exempt nature of the program, rather than by individual program. This makes determining the impact of a withdrawal of corporate assets on a specific program very difficult.

Using AIFC's estimates of program demand, there should be sufficient working capital in the general account after a scheduled withdrawal of \$535 million to meet expected demand. However, a substantial increase in the anticipated demand for AIFC's programs, will require AIFC's Board of Directors to establish funding priority for some of the new programs such as Loans to Sponsors of the Energy Efficiency Interest Rate Reduction program. Only in an extreme case would the residential mortgage programs be hindered.

The one program that we can specifically identify that will be impacted is the Senior Housing Bond Program. In 1990 the legislature appropriated \$10 million of corporate receipts to the Senior Housing bond account. This appropriation was intended to provide extra collateral for up to \$40 million in bonds. The extra collateral would be used to provide credit enhancements to improve the financial viability of the projects. These funds are currently not restricted because no bonds have been issued requiring a pledge of these assets. Therefore the balance in this fund has been included in our list of unrestricted cash; however, the withdrawal of these funds could preclude any new bond issues to fund this type of project.

Repercussions on the cost of existing AHFC programs

A substantial withdrawal of corporate assets will likely have a negative impact on the corporation's bond rating. A drop in the bond rating will result in AHFC paying a higher interest rate on their bonds. The higher bond interest costs will be passed on by AHFC to the borrowers through higher interest rates on mortgage loans.

A higher mortgage loan interest rate will limit the financial attractiveness of AHFC programs. Since there is alternative financing for many borrowers in AHFC's taxable program, there may be a natural migration of those borrowers to alternative financing options. New borrowers in AHFC programs without any other financing options, are more likely to experience the financial impact of a drop in AHFC's credit rating through increased mortgage loan interest rates.

According to a recent credit report¹

Alaska Housing Finance Corp's (AHFC) rating is based on its strong capital base, which is available to absorb a significant level of loan losses, as well as the quality and liquidity of its assets. AHFC has achieved liquidity by maintaining a substantial percentage of its assets in high-quality, short-term investments. However, the rating also reflects the corporation's exposure to the volatile nature of the state's oil-dependent economy.

Much of the credit rating on AHFC's bonds is supported by the overall financial condition of the corporation and the extra collateral pledged to individual bond issues. Withdrawal of corporate assets will limit the additional collateral that can be provided², the more assets withdrawn the greater limitation on capital available for additional collateral.

¹ Quote taken from Standard and Poor's Creditweek, February 28, 1994

² Regardless of whether the loans are considered normal or special risk, the substance of overcollateralization is that it is an insured subsidy. While AHFC's direct subsidy program for some of programs has been phased out, this type of subsidy continues.

The degree to which bond ratings will be affected is not known

We do not know the degree to which bond ratings will be affected by a withdrawal of corporate assets. It is safe to assume the more assets that are withdrawn from AHFC the larger the drop in the bond rating. As discussed above, a drop in the bond rating will have a ripple effect on costs paid by the borrower.

Each rating agency classifies bond ratings into investment grade and speculative grade, depending on the credit risk associated with the security. Most institutional investors have guidelines that require their investments be at least investment grade bonds. The State's own investment policies require that only investment grade bonds be purchased. As a result, a rating's drop below the investment grade threshold would impact not only the costs of the debt but also the marketability of that debt.

It is speculation, at best, for us to estimate the impact on AHFC's credit rating if \$335 million is withdrawn. However, if that amount is withdrawn, no restrictions will be breached, no covenants will be broken. Additionally, AHFC will be left with sufficient working capital for continued operations. Given the combination of these factors, we believe that while the credit rating will be affected, it should not drop below investment grade for AHFC debt issuances.

ANALYSIS OF TOTAL CASH AND INVESTMENTS

The following table is an analysis of the total cash and investments reported in AHFC's December 31, 1993 financial statements. Cash and investments are reported in over 75 individual funds, the table below sorts the total cash and investment balance of these funds into five general categories.

	(In Thousands)
Cash and investments that can be partially or fully withdrawn	\$667,988
Cash and investments held in bond funds and restricted by bond covenants	370,391
Cash and investments used to recycle ¹ loans	855,416
Cash and investments held in insurance fund, partially or fully restricted by other bond funds	14,551
Cash and investments held in other programs ²	<u>106,187</u>
Total cash and investments reported in the December 31, 1993 financial statements	<u>\$2,014,533</u>

The amounts above are not easily reconciled to the \$535 million identified in this report as available to be withdrawn. The difficulty with looking at cash is that significant amounts of it have been borrowed. The balance of cash and investments in a fund is a good indicator of liquidity, but not the best indicator of "excess" funds. Rather an analysis of fund equity, particularly contributed capital is the better indicator of assets in excess of outstanding liabilities.

Using the general account as an example, there is almost \$475 million in unrestricted cash and investments, but there is also over \$310 million in short term notes that will have to be paid with that cash.

As discussed in the Source of Funds Available section of this report, a substantial portion of the \$535 million which will be available over the next few years is currently held in various bond funds as mortgage loans.

¹ Recycling is basically selling mortgage loans held in the general account to an existing bond fund that has available cash, rather than issuing new debt. The availability of cash in bond funds results primarily from the prepayment of mortgage loans.

² The largest single component of this category is the Housing Assistance Loan Fund with \$65.9 million. The remaining balance is primarily a combination of Energy and Public Housing Programs.

**SCHEDULE OF FUNDS AVAILABLE BY SOURCE
AND FISCAL YEAR**

<u>Funds Available in Fiscal Year</u>	(In Thousands)	<u>Source of Funds by Type</u>
<u>Funds Available in Fiscal Year 1994</u>		
- bond funds closing in December 1993	\$81,784	Type 1
- bond funds closing in June 1994	10,377	Type 1
- overall reduction in the general account	<u>107,839</u>	Type 2
Total Available in Fiscal Year 1994	200,000	
<u>Funds Available in Fiscal Year 1995</u>		
- bond funds closing in June 1994	12,269	Type 1
- bond funds closing in December 1994	48,744	Type 1
- bond funds closing in June 1995	51,766	Type 1
- reduction in other funds	36,800	Type 3
- elimination of the Capital Budget	44,885	Type 4
- closure of the FNMA Note fund	<u>19,407</u>	Type 5
Total Available in Fiscal Year 1995	213,871	
<u>Funds Available in Fiscal Year 1996</u>		
- bond funds closing in June 1995	<u>121,129</u>	Type 1
Total Available in Fiscal Years 1994-1996	<u>553,000</u>	

SOURCE OF FUNDS AVAILABLE

Type I - Closing of bond funds

A substantial portion of the unrestricted net assets available for withdrawal is from bond funds that have been or will likely be closed in FY 94 and FY 95. These bond funds are closing primarily as a result of accelerated prepayment of the bonds due to the significant amount of refinancing activity.

Net assets of cash, investments, and mortgage loans are transferred to the general account (AHFC's operating account) when a bond fund closes. The cash and investment portions being transferred are available for immediate withdrawal. However, the recycling of mortgage loans into other bond funds usually takes about two months. When the loans are recycled into a bond fund, the general account receives in exchange an equivalent amount of cash which then can be withdrawn.

The schedule below shows: (1) the amount of cash and investments or mortgage loans that are expected to be transferred to the general account when the bond funds are closed, and (2) which fiscal year the assets transferred will be available for withdrawal. As illustrated in the schedule below, the amount of mortgage loans transferred to the general account in bond funds closing in June are generally not available for appropriation until the following fiscal year.

Date the Bond Funds Close	Type of Assets Released	Amount (in Thousands)	Available*
December 1993	Cash/Investments	\$20,414	FY 94
	Mortgage Loans	61,370	FY 94
June 1994	Cash/Investments	10,377	FY 94
	Mortgage Loans	12,269	FY 95
December 1994	Cash/Investments	13,226	FY 95
	Mortgage Loans	35,518	FY 95
June 1994	Cash/Investments	51,766	FY 95
	Mortgage Loans	121,129	FY 96

Because of the decline in interest rates over the last year and the related increase in refinancing activity, AHFC's general account has a higher than average balance in mortgage

* Fund will not be available on the first day of each fiscal year. A schedule of payments would have to be worked out with AHFC.

loans. These excess loans are expected to be moved to bond funds in FY 95 either through recycling^a or the issuance of new debt.

Type 2 - Reduction in the general account

The general account is AHFC's unrestricted operating account. Our cash flow analysis shows that there is more cash and investments in the general account than is required to continue financial operations. We estimate that there could be an overall reduction in the general account of approximately \$108 million.

Type 3 - Reduction of other funds

Additional cash and investments totalling \$36.8 million could be moved into the general account from other funds. Once in the general account, these funds would be available for withdrawal.

1. \$6 million from a reduction in the State Insurance Mortgage Fund Currently the reserves in this fund exceed both the statutory requirement and AHFC's annually projected reserve requirement. The reduction in this fund brings the reserve balance down to the AHFC calculated estimate, which is higher than the statutory requirement.
2. \$9.8 million from closure of the Home Maintenance Equity account This fund was originally established by AHFC to provide extra financial support for bond funds in the Home Mortgage Bond fund group. All the funds in this group are expected to be closed by June 1995. Therefore, the net assets in this fund will no longer be needed and can be transferred to the general account.
3. \$9 million from a reduction in the Home Ownership Fund In 1980 the legislature established this fund to provide a subsidy for low or moderate income borrowers. The subsidy reduces the monthly mortgage payment of the borrowers to 28 percent of their income or a 6 percent interest rate on the loan, whichever is less. Due to the current low mortgage interest rates, the demand for this program is minimal.

Our analysis shows that the income produced on an annual basis from assets held in this fund substantially exceeds the annual demand for these funds. A reduction in this fund of \$9 million should not impair the fund's ability to meet the current estimated demand.

^a The Analysis of Total Cash and Investments on page 7 of this report, identifies that over \$890 million will be used for recycling loans, primarily tax-exempt bond issues are used.

4. \$12 million from a reduction of the Senior Housing Bond Fund In 1990 the legislature appropriated \$10 million of AHFC corporate receipts to the Senior Housing Bond account. Although a bond issue has been authorized under the Senior Housing program, the financing package did not require the pledge of these funds as part of the bond package. As a result, currently there are no restrictions on these funds and therefore, we have included them as available cash.

Type 4 - Elimination of the capital budget

Approximately \$45 million is from the elimination of AHFC's capital budget request. It is not our intent to recommend that AHFC's capital budget not be approved, rather that their projects compete with other general fund projects for funding.

As further discussed in the Questions and Answers section of this presentation, the removal of significant funds from AHFC will significantly impair the corporation's ability to fund their capital budget requests with corporate receipts.

Type 5 - Closure of the FNMA Note Fund

The FNMA⁷ Note fund was established to provide extra security to outstanding FNMA notes. AHFC signed an agreement to hold this security until May 1995. Ironically all the FNMA notes have been paid off, however, the agreement is still enforceable. The amount held in the FNMA Note fund is \$30 million. At the expiration of the agreement these assets will be transferred into the general account. While a portion of the cash will be required for FY 95 financing activities, an estimated \$19 million will be available for withdrawal.

⁷ Federal National Mortgage Association (Fannie Mae) is a federally chartered association that buys home mortgages.

QUESTIONS AND ANSWERS

This sections attempts to answer some questions that may need to be considered when determining the timing and extent to which the corporation's assets will be withdrawn.

1. What impact will this have on AHFC's bond ratings?

We expect that the overall credit rating of AHFC will be negatively impacted by a substantial withdrawal of corporation assets. The more difficult assessment is to what degree the corporation's or an individual bond issue's credit rating will be affected.

In 1991 Alaska Housing Finance Corporation became the first housing agency to receive a credit rating based solely on its general obligation pledge. Criteria used when rating the general obligation of the corporation includes the legislative mandate, agency management, financial operations and the overall economy of the State. For Alaska the two main economic factors are the State's dependence on the oil industry and that bond issues and mortgages extend beyond the Prudhoe Bay oil curve.

While each individual rating agency uses its own symbols to signify the credit risk associated with a security, all agencies classify bond ratings into investment grade and speculative grade. Using Standard & Poor's symbols the top four ratings (AAA, AA, A, and BBB) are investment grade and anything else is considered speculative. Plus and minus signs are used with a rating symbol to indicate the relative position of a credit within the rating category.

Bond credit ratings are an evaluative process

Bond ratings provide a guide to investors in determining the credit risk associated with a particular security issue. The ratings represent a credit rating agency's assessment of the bond issuer's ability to meet the obligations of a specific debt issue or class of debt in a timely manner. In general, the higher a credit rating a bond issue receives, the lower the borrowing costs in terms of interest rate.

Credit ratings can be assigned both to individual bond issues and to the general obligation of the housing finance agency. General criteria used when rating an individual housing bond issue includes identifying the portfolio, determining an expected actual loss, and availability of mortgage insurance. In addition to looking at the particulars on the issue, the rating company looks at the financial strength of the corporation. The management team is scrutinized to see how well they are managing operations and if they have the ability to correct problems should they occur.

Currently, AHFC has an A+ credit rating on the general obligation of the corporation from Standard & Poor's. AHFC has a mid-level placement in the investment grade group. Maintaining investment grade status is important to AHFC because many financial institutions are only allowed to buy investment grade securities. If AHFC's rating was to drop below investment grade, not only would the interest rate increase for a particular issue but the marketability of the bonds would be severely impacted.

The withdrawal of \$535 million from AHFC is likely to have a negative impact on the corporation's credit rating. We can expect the general obligation rating of the corporation to go down. Also, AHFC will not have the excess funds available to buy credit enhancement to improve the credit rating on individual bond issues.

It is speculation, at best, for us to estimate the impact on AHFC's credit rating if \$535 million is withdrawn. However, if that amount is withdrawn, no restrictions will be breached, no covenants will be broken. Additionally, AHFC will be left with sufficient working capital for continued operations. Given the combination of these factors, we believe that while the credit rating will be affected, it should not drop below investment grade for AHFC debt issuances.

We believe that the packaging of the withdrawal as an extraordinary dividend by AHFC and the legislature may lessen the impact. State housing finance agencies serve the public and, therefore, are answerable to the state legislature. The public nature of state housing finance agencies makes the autonomy of their management and security of general account balances an important credit consideration to rating agencies. The willingness and cooperation of AHFC's Board of Directors in determining the amount and timing of significant and extraordinary dividend payments to the State may ease some of the anticipated concerns of the credit rating agencies.

2. *How does AHFC's bond rating compare to those of housing finance authorities in other states?*

For several reasons, AHFC's bond ratings cannot be compared to those of other states. The non-comparability is due to two primary reasons. First, AHFC has a rating on general obligations of the corporation, while most states' housing finance authorities that we surveyed do not.¹⁰

Secondly, an attempt to compare individual issuances of debt (either revenue bonds or mortgage obligations) was also not successful. We found that Alaska has a wider variety of types of programs and a much larger volume of bond issues than the other states surveyed. Also, compounding the comparison difficulty are the variances in the type of collateral, credit enhancement, and market condition at the time of issuance. Each of these factors will significantly influence the credit rating on a specific issue.

3. *How does this impair AHFC's low to moderate income or specialty programs?*

With certain exceptions, AHFC's accounting and therefore availability of unrestricted assets is not program specific. Various AHFC loan programs and loan features are frequently

¹⁰ We understand that two or three states are in the process of obtaining a rating on the general obligation of their state's housing finance authorities.

combined into a single bond fund. Generally, mortgage loans are grouped more by the taxable or tax-exempt nature of the program, rather than an individual program. This makes determining the impact of a withdrawal of corporate assets on a specific program very difficult.

Using AHFC's estimated program demands, there should be sufficient working capital in the general account to meet expected demand. However, a substantial increase in the anticipated demand for AHFC's programs, will require AHFC's Board of Directors to establish funding priority for some of the new programs. Only in an extreme case would the residential mortgage programs be hindered.

The one program that we can specifically identify that will be impacted is the Senior Housing Bond Program. In Chapter 206, SLA 1990 the legislature appropriated \$10 million of corporate receipts to the Senior Housing bond account. This appropriation was intended to provide extra collateral for up to \$30 million in bonds. The extra collateral would be used to provide credit enhancements to improve the financial viability of the projects. These funds are currently not restricted because no bonds have been issued requiring a pledge of these assets. Therefore the balance in this fund has been included in our list of unrestricted cash, however the withdrawal of those funds could preclude any new bond issues to fund this type of project.

Given the changing national financial environment, AHFC's Board of Directors will have to re-evaluate their overall mission and individual programs. The new programs and commitments by FNMA related to the goal of home ownership by families with low and moderate income may have a substantial impact on the niche that AHFC now fills in the housing needs of the State of Alaska.

FNMA to invest \$1 trillion over seven years

FNMA has recently announced that they intend to spend \$1 trillion in the next seven years so 10 million families with low and moderate incomes can buy homes.

The investment will provide mortgage money for families with modest incomes, minority families, new immigrants, city dwellers and people with special housing needs. FNMA hopes to promote home ownership by finding ways to lower down payments, reduce closing costs and make it easier for rejected applicants to get mortgages.

Some specific programs are:

- development of at least 10 new financing tools to meet the needs of the elderly, renovators, minorities, rural families and people with acquired immune deficiency syndrome and other disabilities.
- a \$50 billion commitment to multifamily finance to create more affordable rental housing for those who cannot buy.
- a commitment of \$30 million during the next year to support nonprofit housing.

Source: Anchorage Daily News, March 16, 1994

4. *How will AHFC's ability to absorb potential losses be affected if there is a significant downturn in the housing market?*

Two reports on AHFC were issued in 1989 and early 1990 on AHFC. First, *A Special Report on the Department of Revenue Alaska Housing Finance Corporation* was issued by Legislative Audit in April 1989. Secondly, Ernst & Young issued a report in January 1990 for the Legislative Housing Finance Task Force titled *Evaluation of Policy Options Concerning the Future of the Alaska Housing Finance Corporation*.

A common objective of these reports was the evaluation of a return on the State's \$1 billion investment in AHFC without impairing AHFC's financial conditions. Both reports concluded because of the dismal real estate market conditions existing at that time, that the withdrawal of corporate assets could have a serious impact on the financial health of the corporation.

Our current evaluation concludes that \$535 million is available to be withdrawn from the corporation's unrestricted assets. The availability of this cash is largely due to a combination of low mortgage interest rates and a relatively stable housing market. Current conditions are greatly improved over those in 1989-1990.

The withdrawal of \$535 million would seriously impair AHFC's ability to sustain another significant housing market decline. As a public policy, should AHFC maintain reserves necessary to meet a worst case scenario in the housing market?

5. *What is the impact on mortgage loan originators (e.g., banks, savings and loans)?*

Mortgage loan originators would not be significantly affected by a withdrawal of corporate assets. The secondary market would absorb new loans to accommodate an active home sales volume and loan originators would continue to sell loans to other participants in the secondary market.

Mortgage loan originators take the loan applications, conduct credit and employment checks, obtain mortgage insurance, request title searches, etc. Upon completion of this documentation, the loan is made by the loan originator and the loan is normally then sold to a secondary market. AHFC was the leader in Alaska's secondary market for new loan origination in the 1980s. However, since that time interest rates have been declining¹¹ causing new loans to be sold elsewhere, consequently AHFC is currently focusing on refinancing strategies to lower the cost of capital to borrowers as well as to the corporation. Loan originators have successfully engaged the other secondary market participants and are currently doing little business with AHFC except for refinancing previous AHFC loans.

¹¹ AHFC issues bonds in large blocks. If interest rates rise, there is a great demand for these "cheap" loans. However, if interest rates decline, as they have in the early 1990s, these blocks of available funds are not marketable. Given the length of time needed by AHFC for the bonding process and steadily declining interest rates, these funds have not been competitive with the "current" rates offered by other secondary market purchasers.

Given the current heavy reliance on other secondary market participants, a withdrawal of AHFC corporate assets at this time would cause little disruption in the market.

6. *Can AHFC continue to fund their operating and capital budget request from corporate receipts?*

According to the cash flow analyses, AHFC will be able to continue to fund their operating budget. There are two primary sources of continuing income into the general account. First would be from interest from investments or mortgage loans held temporarily in the general account. The second source of continuing income would be from long-term assets, such as mobile home loans and real estate owned held in the general account.

A substantial reduction in the corporation's unrestricted assets will preclude the corporation from being able to fund its annual capital budget. The merger of AHFC with the former Alaska State Housing Authority has substantially increased the corporation's capital budget requirement. Projects in the FY 95 AHFC capital budget which total \$44.9 million are primarily related to the renovation of existing public housing.

7. *When will additional excess assets in funds restricted by bond covenants be freed?*

The cash and investment analysis on page 7 identifies over \$370 million in cash and investment held in bond funds that are restricted by bond covenants. Those funds have a myriad of covenants, maturity dates, and redemption options. The earliest that any of those funds will be available is January 15, 1997.

SB

51



RECEIVED FEB 28 1995

Alaska Permanent Fund Corporation

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

(907) 465-2047

MEMORANDUM

DATE: February 27, 1995

TO: Senator Steve Rieger

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

SUBJECT: Trustees' Position on SB 51

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

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

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

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

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



Alaska Permanent Fund Corporation


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

907) 465-2047

MEMORANDUM

DATE: February 13, 1995

TO: Senator Bert Sharp, Chairman
Senate State Affairs Committee

FROM: Jim Kelly 
Research & Liaison Officer

SUBJECT: Position Paper on Senate Bill 51

The Board of Trustees has not yet had the opportunity to discuss the merits of Senate Bill 51 and therefore has not yet taken a position on the bill. The Trustees are meeting in Juneau on February 24, and hopefully will be able to forward their formal position shortly after that date.

In the meantime, it is safe to say that, historically, the Board has always supported any proposed changes to existing law which would enhance their ability to protect the Permanent Fund from the effects of inflation. Certainly that portion of SB 51 which makes inflation-proofing the highest priority use of Fund income is such a proposed change.

There is another portion of the bill which would change the dividend formula by basing it on "real" income rather than "net" income. That proposal falls outside the scope of what historically has been viewed by the Board of Trustees as their area of responsibility.

Enclosed please find a number of financial projections which the Corporation has prepared at the request of Senators Reiger and Halford. I would be pleased to discuss any of them with you at your convenience.

cc: Senator Steve Reiger
Senator Rick Halford
All Members, Board of Trustees
Martin Pihl, Executive Director

FISCAL NOTE

STATE OF ALASKA
1995 LEGISLATIVE SESSION

BILL NO. SB 51

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

Expenditures/Revenues

(Thousands of Dollars)

OPERATING EXPENDITURES	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

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

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

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/AMTIA						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

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

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

No fiscal impact.

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

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SENATE COMMITTEE REF
First Committee of Referral

DATE: 1/25/95

FURTHER: Finance

Date of 5-Day Notice: 2-9-95
 (in accordance with Uniform Rule 23)

DATE TURNED INTO OFFICE: _____

State Affairs Committee considered **SENATE BILL NO. 51**

"An Act relating to income of the permanent fund; and providing for an effective date."

and recommends:

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

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

SIGNING: <u>(X)</u> PASS	DP	OTHER RECOMMENDATIONS	NR	DNP	AM
		<i>Loren A. Lewis</i>	✓		
		<i>David J. Jolley</i>	✓		
		<i>[Signature]</i>	✓		
		<i>[Signature]</i>	✓		
CHAIR:		<i>Best [Signature]</i>	✓		

NEW FISCAL NOTE(S):

Department	Doc	Zero	Fiscal
REVENUE	P113	✓	

PREVIOUS FISCAL NOTE(S):*

Department	Doc	Zero	Fiscal

APPROPRIATION - no fiscal note

*include fiscal notes accompanying Governor's bill

Alaska State Senate

SENATOR STEVE RIEGER
District 1

Senior Finance Committee
Chair, Senate Transportation Committee

Legislative Budget and Audit Committee
Administrative Regulation Review Committee
Legislative Council



During Session
State Capitol, Room 310
Juneau, Alaska 99801
(907) 465-3979

710 West 4th Avenue, Suite 320
Anchorage, Alaska 99501
(907) 258-9100

SENATE BILL 51

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

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

CONCEPT OF REAL EARNINGS:

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

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

APPROPRIATENESS FOR THE PERMANENT FUND:

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

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

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

EFFECT ON PERMANENT FUND EARNINGS RESERVE:

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

EFFECT ON DIVIDENDS:

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

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

OTHER CHANGES:

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

SUMMARY:

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

PERMANENT FUND PROJECTIONS:

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

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

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



Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (in millions)

as of January 31, 1995

GROWTH OF FUND PRINCIPAL

FY	FY Begin Balance	Appropriations	Dedicated State Revenues*	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
78	3		54		54	
79	54		34		139	
80	139		144		483	
81	483	300	195		1,769	
82	1,769	300	300		2,969	
83	2,969	400	421	231	4,021	
84	4,021	300	366	151	4,838	
85	4,838	300	368	235	5,741	
86	5,741		323	216	6,281	
87	6,281	264 **	170	148	7,864	
88	7,864		418	303	8,585	
89	8,585		228	360	9,173	
90	9,173		257	454	9,894	
91	9,894		335	559	10,888	
92	10,888		338	477	11,703	
93	11,703	5 ***	315	362	12,385	
94	12,385	5 ***	310	372	12,973	
95	12,973	5	212	344	13,534	
96	13,534	5	198	515	14,253	
97	14,253		194	542	14,996	
98	14,996		185	570	15,757	
99	15,757	3	169	598	16,532	
00	16,532	5	160	1,002	17,699	
01	17,699	5	145	1,071	18,921	
02	18,921	7	130	1,143	20,201	
03	20,201	7	117	1,219	21,545	
04	21,545	3	105	1,299	22,958	
05	22,958	3	74	1,383	24,444	
06	24,444	10	87	1,472	26,012	
07	26,012	11	81	1,566	27,669	
08	27,669	12	78	1,665	29,421	
09	29,421	13	70	1,770	31,273	
10	31,273	14	67	1,880	33,234	

Cumulative Totals Projected For FY 1995 - 2010: **2,023** **18,037**

USE OF FUND INCOME

Net Income	Distributions			General Fund	Reserves		FY
	Dividends	Per Capita Dividends	Inflation-Proofing		Add (Delete)	FY End Balance	
2				1			78
3				7			79
32	12			2			80
150	28			28	59	59	81
268	71	\$1,000.00		71	185	244	82
471	108	\$386.15	231	110	110	354	83
530	175	\$331.29	151		203	557	84
658	217	\$404.00	235		206	763	85
1,021	303	\$556.26	216		501	1,264	86
1,069	391	\$708.19	148		529	529	87
789	424	\$826.93	303		62	591	88
968	460	\$873.16	360	4	44	635	89
916	487	\$952.63	454	4	(30)	605	90
1,030	489	\$931.34	559	4	(24)	581	91
1,036	488	\$931.34	477	5	64	645	92
1,226	532	\$949.46	362	5	320	965	93
1,088	556	\$983.90	372	11	151	1,117	94
950	558	\$942.00	344	14	28	1,146	95
1,252	580	\$956.00	515		151	1,297	96
1,325	608	\$979.00	542		169	1,466	97
1,402	627	\$988.00	570		199	1,664	98
1,483	666	\$1,027.00	598		211	1,876	99
1,746	750	\$1,134.00	1,002		(11)	1,865	00
1,855	812	\$1,202.00	1,071		(34)	1,831	01
1,966	879	\$1,275.00	1,143		(62)	1,769	02
2,081	949	\$1,351.00	1,219		(94)	1,674	03
2,199	1,023	\$1,428.00	1,299		(132)	1,542	04
2,319	1,082	\$1,482.00	1,383		(155)	1,388	05
2,445	1,143	\$1,537.00	1,472		(180)	1,208	06
2,576	1,206	\$1,593.00	1,566		(206)	1,002	07
2,713	1,271	\$1,650.00	1,665		(234)	768	08
2,857	1,339	\$1,708.00	1,770		(264)	504	09
3,007	1,410	\$1,770.00	1,880		(297)	207	10
32,176	14,901	\$21,022	18,037	14			

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 85:	3.4%	2.5%	3.8%
FY 86 - 89: ****	3.1%	3.75%	4.36%
FY 2000 - 10:	3.00%	3.00%	3.00%

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

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

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

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

STATUS QUO WITH PER CAPITA DIVIDENDS

1R



Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (in millions)

as of January 31, 1995

GROWTH OF FUND PRINCIPAL

FY	FY Begin Balance	Appropriations	Dedicated State Revenues*	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
91			34		34	
92	34		34		109	
93	109		34		183	
94	183	300	385		1,769	
95	1,769	300	400		2,569	
96	2,569	300	421	231	4,021	
97	4,021	300	366	151	4,838	
98	4,838	300	368	225	5,741	
99	5,741		223	216	6,281	
00	6,281	1,254	170	148	7,364	
01	7,364		418	203	8,585	
02	8,585		228	260	9,173	
03	9,173		257	454	9,894	
04	9,894		435	559	10,888	
05	9,894		435	559	10,888	
06	11,700		315	362	12,385	
07	12,385		210	272	12,977	
95*	12,973	5	212	244	13,534	
96	13,534		204	497	13,738	
97	13,738	5	184	479	13,931	
98	13,931	5	174	485	14,110	
99	14,110	7	160	492	14,268	
00	14,268	5	158	486	14,411	
01	14,411	5	123	769	14,534	
02	14,534	5	105	778	14,639	
03	14,639	5	89	781	14,729	
04	14,729	5	76	783	14,808	
05	14,808	5	54	790	14,877	
06	14,877	5	54	794	14,931	
07	14,931	5	47	797	14,983	
08	14,983	5	41	800	15,030	
09	15,030	5	37	802	15,072	
10	15,072	5	32	805	15,110	

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

USE OF FUND INCOME

Net Income	Distributions			Reserves	
	Dividends	Per Capita Dividends	Inflation-Proofing	General Fund	Add FY End
2				1	
3				7	
12	2			2	
150	29			29	59
268	71	\$1,200.00		71	135
471	109	\$286.15	231	110	244
530	175	\$331.29	151		354
558	217	\$404.00	235		557
1,021	303	\$556.25	216		763
1,369	391	\$708.19	148		1,254
1,739	424	\$826.93	303		1,517
1,668	460	\$873.16	260	4	1,517
310	487	\$952.63	454	4	1,517
1,030	489	\$931.24	559	4	1,517
1,030	489	\$915.34	559	4	1,517
1,226	532	\$749.46	362	5	1,517
1,098	556	\$883.90	372	11	1,517
950	558	\$942.00	344	14	1,146
1,206	559	\$921.00	497		1,250
1,231	564	\$910.00	479		1,362
1,256	561	\$885.00	485		1,490
1,280	575	\$886.00	492		1,619
1,422	510	\$923.00	486		1,519
1,425	524	\$923.00	769		1,406
1,425	537	\$924.00	778		1,282
1,423	549	\$924.00	791		1,144
1,418	560	\$921.00	786		395
1,411	558	\$902.00	790		344
1,403	556	\$882.00	794		693
1,395	553	\$863.00	797		543
1,386	549	\$843.00	800		292
1,377	545	\$823.00	802		243
1,267	541	\$805.00	805		94

21,374 **9,899** **\$14,277** **10,683** **14**

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 95:	4.9%	2.51%	2.68%
FY 96-99:***	8.11%	2.75%	4.26%
FY 00-2010:	7.00%	5.00%	3.00%

* Department of Revenue Fall 1994 Low-Cost Revenue Forecast.
 ** Earnings reserve appropriated to Fund principal by the Legislature July 1, 1987.
 *** Transferred to principal from earnings reserve account per AS 37.12.145(d).
 **** Based on capital market assumptions adopted by the Trustees in March 1994.

STATUS QUO IN REAL 1995 DOLLARS

Constant Real dollars

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



Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (in millions)

as of January 31, 1995

GROWTH OF FUND PRINCIPAL

FY	FY Begin Balance	Appropriations	Dedicated State Revenues*	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
78	3		34		34	
79	54		34		139	
80	139		344		483	
81	483	300	365		1,769	
82	1,769	300	400		2,969	
83	2,969	400	421	231	4,021	
84	4,021	300	366	151	4,838	
85	4,838	300	368	225	5,741	
86	5,741		323	216	6,281	
87	6,281	1,264 **	170	148	7,964	
88	7,964		118	203	8,585	
89	8,585		228	360	9,173	
90	9,173		297	454	9,994	
91	9,994		435	559	10,968	
92	10,968		338	477	11,703	
93	11,703	5 ***	315	362	12,385	
94	12,385	3 ***	210	372	12,973	
95	12,973	5	212	344	13,534	
96	13,534	5	198	515	14,252	
97	14,252	7	194	542	14,995	
98	14,995	7	175	569	15,756	
99	15,756	8	169	597	16,530	
00	16,530	6	160	1,001	17,598	
01	17,598	6	145	1,071	18,919	
02	18,919	7	130	1,143	20,200	
03	20,200	7	117	1,219	21,544	
04	21,544	8	105	1,299	22,956	
05	22,956	9	94	1,383	24,442	
06	24,442	10	87	1,472	26,010	
07	26,010	11	81	1,566	27,667	
08	27,667	12	76	1,665	29,419	
09	29,419	13	70	1,769	31,271	
10	31,271	14	67	1,880	33,231	
Cumulative Totals Projected:						
For FY 1995 - 2010:		2,023	18,034			

USE OF FUND INCOME

Net Income	Inflation-Proofing	Distributions		General Fund	Reserves		FY
		Dividends	Per Capita Dividends		Add (Delete)	FY End Balance	
3							78
32		12					79
150		29			59	59	80
368		71	\$1,000.00		185	244	81
471	231	108	\$386.15	110	110	354	82
530	151	175	\$331.29		203	557	83
658	225	217	\$404.00		206	763	84
1,021	216	303	\$558.26		501	1,264 **	85
1,069	148	391	\$708.19		529	529	86
789	203	424	\$826.93		52	591	87
368	360	460	\$873.16		44	535	88
916	454	487	\$952.63		(20)	505	89
1,020	559	489	\$931.34		(24)	581	90
1,036	477	488	\$915.84		54	645	91
1,225	362	532	\$949.46		320	965	92
1,098	372	556	\$983.90	11	151	1,117	93
950	344	521	\$877.00	14	65	1,182	94
1,255	515	490	\$800.00		244	1,426	95
1,326	542	462	\$731.00		326	1,752	96
1,425	569	424	\$650.00		426	2,178	97
1,526	597	441	\$661.00		480	2,558	98
1,820	1,001	427	\$622.00		385	3,043	99
1,968	1,071	443	\$630.00		446	3,489	00
2,123	1,143	461	\$643.00		511	4,000	01
2,291	1,219	483	\$659.00		582	4,582	02
2,473	1,299	508	\$680.00		558	5,240	03
2,668	1,383	556	\$720.00		720	5,960	04
2,876	1,472	608	\$790.00		786	6,746	05
3,098	1,566	665	\$852.00		857	7,603	06
3,335	1,665	727	\$917.00		933	8,535	07
3,589	1,769	793	\$987.00		1,014	9,549	08
3,859	1,880	864	\$1,062.00		1,101	10,650	09
36,589	18,034	8,873	\$12,293	14			

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 88:	8.65%	2.61%	3.88%
FY 96 - 99: ***	8.11%	3.75%	4.36%
FY 2000 - 10:	9.00%	4.00%	3.00%

* Department of Revenue Fall 1994 Low-Case Revenue Forecast

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

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

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



ER

Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (in millions)

as of January 31, 1995

GROWTH OF FUND PRINCIPAL

FY	FY Begin Balance	Appropriations	Dedicated State Revenues*	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
78			34		34	
79	34		34		109	
80	109		34		183	
81	183	300	385		1,769	
82	1,769	300	400		2,369	
83	2,369	400	421	231	4,021	
84	4,021	300	368	151	4,838	
85	4,838	300	268	225	5,741	
86	5,741		223	216	6,281	
87	6,281	1,254	170	148	7,364	
88	7,364		418	303	8,585	
89	8,585		228	360	9,173	
90	9,173		257	454	9,894	
91	9,894		435	559	10,888	
92	9,894		435	559	10,888	
93	11,703	5 ***	315	362	12,385	
94	12,385	5 ***	210	372	12,973	
95	12,973	5	212	344	13,534	
96	13,545	5	204	496	13,737	
97	13,241	5	184	478	13,931	
98	13,427	5	174	485	14,109	
99	13,599	5	160	491	14,267	
00	13,459	5	138	486	14,410	
01	13,594	5	123	769	14,533	
02	13,710	5	105	775	14,638	
03	13,809	5	89	781	14,728	
04	13,994	5	76	786	14,905	
05	13,967	5	64	750	14,871	
06	14,000	5	54	754	14,930	
07	14,085	5	47	797	14,982	
08	14,134	5	41	800	15,029	
09	14,178	5	37	802	15,070	
10	14,217	5	32	804	15,109	

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

USE OF FUND INCOME

Net Income	Distributions			Reserves		FY End Balance
	Dividends	Per Capita Dividends	Inflation-Proofing	General Fund	Add Deletal	
2						73
3						77
12	12					90
150	28				59	91
268	71	\$1,000.00			135	92
471	108	\$386.15	231	110	110	93
530	175	\$331.29	151		223	94
558	217	\$404.00	235		206	95
1,021	303	\$556.26	216		501	96
1,069	391	\$708.19	148		529	97
789	424	\$326.93	303		52	98
368	460	\$873.16	360	4	44	99
916	487	\$952.53	454	4	(20)	90
1,030	489	\$931.24	559	4	(24)	91
1,030	489	\$915.84	559	4	(24)	92
1,228	532	\$949.46	362	5	220	93
1,098	556	\$983.90	372	11	151	94
950	521	\$877.00	344	14	65	95
1,209	472	\$771.00	496		225	96
1,241	429	\$679.00	478		303	97
1,277	380	\$582.00	485		281	98
1,317	381	\$570.00	451		414	99
1,482	348	\$508.00	486		314	00
1,510	340	\$484.00	769		343	01
1,538	334	\$466.00	775		370	02
1,566	330	\$451.00	781		398	03
1,595	327	\$439.00	786		424	04
1,523	318	\$445.00	750		438	05
1,551	349	\$453.00	754		451	06
1,578	360	\$461.00	797		464	07
1,704	371	\$468.00	800		478	08
1,729	382	\$476.00	802		489	09
1,755	393	\$483.00	804		501	10

23,825 6,057 \$8,611 10,681 14

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 95:	4.49%	2.51%	1.98%
FY 96 - 99: ***	3.11%	1.75%	1.36%
FY 00 - 2010:	3.00%	1.00%	2.00%

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

\$B \$1 IN REAL 1995 DOLLARS

Constant/Real dollars

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



2A

Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (in millions)

as of January 31, 1995

GROWTH OF FUND PRINCIPAL

FY	FY Begin Balance	Appropriations	Dedicated State Revenues*	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
78	0		54		54	
79	54		34		109	
80	109		344		483	
81	483	900	285		1,769	
82	1,769	300	400		2,969	
83	2,969	400	421	231	4,021	
84	4,021	300	366	151	4,838	
85	4,838	200	368	225	5,741	
86	5,741		223	216	5,281	
87	5,281	1,254 **	170	148	7,854	
88	7,854		418	303	8,585	
89	8,585		228	260	9,173	
90	9,173		257	454	9,894	
91	9,894		435	559	10,888	
92	10,888		238	477	11,703	
93	11,703	5 ***	315	362	12,385	
94	12,385	5 ***	210	372	12,973	
95	12,973	5	212	344	13,534	
96	13,534	8	198	824	14,561	
97	14,561	7	194	885	15,648	
98	15,648	7	185	950	16,790	
99	16,790	9	169	1,018	17,985	
00	17,985	9	160	1,089	19,243	
01	19,243	10	145	1,163	20,560	
02	20,560	11	130	1,241	21,943	
03	21,943	12	117	1,324	23,396	
04	23,396	13	105	1,410	24,925	
05	24,925	15	94	1,501	26,535	
06	26,535	18	87	1,597	28,236	
07	28,236	18	81	1,699	30,033	
08	30,033	20	76	1,807	31,936	
09	31,936	22	70	1,920	33,947	
10	33,947	24	57	2,041	36,079	

USE OF FUND INCOME

FY	Net Income	Distributions			Reserves		FY
		Inflation-Proofing	Per Capita Dividends	General Fund	Add (Delete)	FY End Balance	
78	2					1	78
79	3					7	79
80	32		12			12	80
81	150		28			28	81
82	368		71 \$1,000.00			71	82
83	471	231	108 \$386.15			110	83
84	530	151	175 \$331.29			203	84
85	558	225	217 \$404.00			208	85
86	1,021	216	303 \$556.26			501	86
87	1,069	148	391 \$708.19			529	87
88	789	303	424 \$826.93			52	88
89	968	360	460 \$873.18			44	89
90	918	454	487 \$952.63			(30)	90
91	1,000	559	489 \$931.34			(24)	91
92	1,006	477	488 \$915.84			54	92
93	1,226	362	532 \$949.46			320	93
94	1,098	372	556 \$983.90			151	94
95	950	344	521 \$877.00			14	95
96	1,614	824	495 \$808.00			289	96
97	1,757	885	475 \$753.00			350	97
98	1,917	950	448 \$690.00			512	98
99	2,097	1,018	480 \$725.00			591	99
00	2,291	1,089	506 \$748.00			587	00
01	2,502	1,163	563 \$816.00			766	01
02	2,728	1,241	526 \$893.00			849	02
03	2,971	1,324	597 \$978.00			939	03
04	3,231	1,410	773 \$1,065.00			1,034	04
05	3,510	1,501	856 \$1,160.00			1,137	05
06	3,809	1,597	946 \$1,262.00			1,249	06
07	4,130	1,699	1,044 \$1,371.00			1,369	07
08	4,475	1,807	1,149 \$1,486.00			1,499	08
09	4,845	1,920	1,263 \$1,608.00			1,640	09
10	5,243	2,041	1,388 \$1,740.00			1,793	10

Cumulative Totals Projected:

For FY 1995 - 2010: 2,023 20,813

48,088 20,813 12,228 516,878 14

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 95:	5.45%	2.61%	2.88%
FY 96 - 99: ***	10.31%	6.00%	4.31%
FY 2000 - 10: ****	10.31%	6.00%	4.31%

* Department of Revenue Fall 1994 Low-Case Revenue Forecast

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

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

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

SENATE BILL NO. 51, BUT ASSUMES 10.31% FUTURE RATE OF RETURN AND 6% RATE OF INFLATION.



24/R

Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (in millions)

as of January 31, 1995

GROWTH OF FUND PRINCIPAL

FY	FY Begin Balance	Appropriations	Dedicated State Revenues*	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
78			34		34	
79	34		34		139	
80	139		344		483	
81	483	300	385		1,769	
82	1,769	300	400		2,969	
83	2,969	400	421	231	4,021	
84	4,021	300	366	151	4,838	
85	4,838	300	268	235	5,741	
86	5,741		223	216	6,281	
87	6,281	1,254	170	148	7,364	
88	7,364		418	303	8,585	
89	8,585		228	260	9,173	
90	9,173		257	254	9,894	
91	9,894		435	359	10,888	
92	9,894		435	359	10,888	
93	11,703	5	315	262	12,385	
94	12,385	3	210	372	12,973	
95	12,973	5	212	344	13,534	
96	12,768	3	300	277	13,737	
97	12,959	3	176	233	13,926	
98	13,128	3	163	243	14,097	
99	13,299	3	147	232	14,246	
00	13,439	3	126	250	14,379	
01	13,563	3	113	267	14,494	
02	13,674	3	96	274	14,593	
03	13,767	3	82	279	14,679	
04	13,848	3	73	283	14,753	
05	13,918	3	59	287	14,817	
06	13,978	3	50	291	14,874	
07	14,032	3	43	294	14,926	
08	14,081	3	38	297	14,973	
09	14,125	10	34	299	15,015	
10	14,165	10	29	301	15,054	

Cumulative Totals Projected:
For FY 1995 - 2010: 1,636 11,983

USE OF FUND INCOME

FY	Net Income	Distributions			Reserves		FY End Balance	FY
		Dividends	Per Capita Dividends	Inflation-Proofing	General Fund	Add (Deduct)		
78	2							78
79	3							79
80	12							80
81	29					59	59	81
82	71	\$1,000.00				185	244	82
83	108	\$386.15	21	110		110	354	83
84	175	\$331.29	151			303	557	84
85	217	\$404.00	225			306	763	85
86	303	\$556.26	216			501	1,264	86
87	331	\$708.19	148			529	529	87
88	424	\$826.33	203			22	591	88
89	460	\$873.16	260			44	535	89
90	487	\$952.53	254			(30)	505	90
91	489	\$931.34	359			(24)	581	91
92	489	\$915.84	359			(24)	581	92
93	532	\$949.46	362			220	965	93
94	556	\$983.90	372			151	1,117	94
95	521	\$877.00	344			65	1,182	95
96	467	\$782.00	277			273	1,388	96
97	422	\$670.00	233			347	1,657	97
98	376	\$579.00	243			430	1,993	98
99	381	\$574.00	232			468	2,348	99
00	378	\$559.00	250			513	2,729	00
01	397	\$575.00	257			540	3,114	01
02	417	\$594.00	274			565	3,503	02
03	437	\$612.00	279			589	3,893	03
04	458	\$630.00	283			512	4,285	04
05	478	\$648.00	287			635	4,678	05
06	499	\$665.00	291			658	5,071	06
07	519	\$681.00	294			680	5,464	07
08	539	\$697.00	297			703	5,858	08
09	559	\$711.00	299			726	6,252	09
10	578	\$726.00	301			748	6,646	10

28,820 7,424 \$10,560 11,983 14

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 95:	4.9%	2.51%	1.88%
FY 96-99:****	10.31%	4.00%	4.31%
FY 00-2010:	10.31%	4.00%	4.31%

* Department of Revenue Fall 1994 Low-Cost Revenue Forecast

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

*** Transferred to principal from earnings reserve account per AS 07.13.145(d)

**** Based on capital market assumptions adopted by the Trustees in March 1994 SENATE BILL NO. 51, BUT ASSUMES 10.31% FUTURE RATE OF RETURN AND 6% RATE OF INFLATION; IN REAL 1995 \$.

Constant Real Dollars

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



2B

Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (in millions)

as of January 31, 1995

GROWTH OF FUND PRINCIPAL

FY	FY Begin Balance	Appropriations	Dedicated State Revenues*	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
78	0		34		34	
79	34		34		109	
80	109		344		483	
81	483	300	385		1,769	
82	1,769	300	400		2,969	
83	2,969	400	421	231	4,021	
84	4,021	300	366	151	4,838	
85	4,838	200	368	225	5,741	
86	5,741		323	216	6,281	
87	6,281	1,264 **	170	148	7,864	
88	7,864		418	303	8,585	
89	8,585		228	360	9,173	
90	9,173		257	454	9,884	
91	9,884		235	559	10,688	
92	10,688		238	477	11,703	
93	11,703	5 ***	315	362	12,385	
94	12,385	6 ***	210	372	12,973	
95	12,973	5	212	344	13,534	
96	13,534	9	198	349	14,290	
97	14,290	10	194	379	15,073	
98	15,073	11	185	510	15,879	
99	15,879	12	159	642	16,702	
00	16,702	13	160	575	17,550	
01	17,550	15	145	708	18,417	
02	18,417	16	130	742	19,305	
03	19,305	18	117	777	20,217	
04	20,217	20	105	813	21,155	
05	21,155	27	94	850	22,121	
06	22,121	24	97	888	23,120	
07	23,120	25	91	928	24,155	
08	24,155	29	78	969	25,229	
09	25,229	22	70	1,012	26,342	
10	26,342	25	57	1,056	27,501	

Cumulative Totals Projected
for FY 1995 - 2010: 2,023 12,143

USE OF FUND INCOME

Net Income	Inflation-Proofing	Distributions		General Fund	Reserves		FY
		Per Capita Dividends	Dividends		Add (Delete)	FY End Balance	
2				1			78
3				7			79
12		12		12			80
150		28		23	59	59	81
268		71	\$1,000.00	71	185	244	82
471	231	108	\$366.15	110	110	354	83
530	151	175	\$231.29		203	557	84
558	225	217	\$404.00		206	763	85
1,321	216	303	\$556.26		501	1,254 ***	86
1,369	148	391	\$708.19		529	529	87
789	303	424	\$826.93		52	591	88
368	260	460	\$873.16	4	44	535	89
216	454	487	\$952.63	4	(30)	605	90
1,320	559	489	\$931.24	4	(24)	581	91
1,326	477	488	\$915.84	5	54	545	92
1,226	362	532	\$949.46	5	320	965	93
1,098	372	556	\$983.90	11	151	1,117	94
950	344	521	\$877.00	14	65	1,182	95
1,814	549	524	\$859.00		532	1,714	96
1,754	579	515	\$856.00		529	2,243	97
1,907	610	543	\$848.00		743	3,086	98
2,075	642	513	\$940.00		309	3,895	99
2,253	575	578	\$1,020.00		887	4,782	00
2,441	708	747	\$1,102.00		971	5,753	01
2,540	742	822	\$1,190.00		1,060	6,813	02
2,852	777	903	\$1,282.00		1,155	7,968	03
3,077	813	989	\$1,378.00		1,256	9,224	04
3,315	850	1,081	\$1,479.00		1,363	10,587	05
3,569	888	1,178	\$1,586.00		1,479	12,066	06
3,839	928	1,283	\$1,698.00		1,502	13,668	07
4,128	969	1,395	\$1,816.00		1,734	15,401	08
4,432	1,012	1,514	\$1,939.00		1,975	17,276	09
4,758	1,056	1,641	\$2,072.00		2,025	19,301	10

45,603 12,143 14,967 \$20,942 14

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 85:	8.49%	2.51%	3.88%
FY 86 - 89: ***	10.31%	4.00%	6.31%
FY 2000 - 10:	10.31%	4.00%	6.31%

* Department of Revenue Fall 1994 Low-Cost Revenue Forecast.
 ** Earnings reserve appropriated to Fund principal by the Legislature July 1, 1987.
 *** Transferred to principal from earnings reserve account per AS 37.13.145(d).
 **** Based on capital market assumptions adopted by the Trustees in March 1994.
SENATE BILL NO. 51, BUT ASSUMES 10.31% FUTURE RATE OF RETURN AND 4% RATE OF INFLATION.



EB/R

Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (in millions)

as of January 31, 1995

GROWTH OF FUND PRINCIPAL

FY	Begin Balance	Appropriations	Dedicated State Revenues*	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
78			34		34	
79	34		34		109	
80	109		244		433	
81	433	200	285		1,769	
82	1,769	300	400		2,569	
83	2,569	400	421	231	4,021	
84	4,021	300	366	151	4,838	
85	4,838	300	368	225	5,741	
86	5,741		323	216	6,281	
87	6,281	1,264 **	170	148	7,864	
88	7,864		418	203	8,585	
89	8,585		229	260	9,173	
90	9,173		257	254	9,694	
91	9,694		435	359	10,888	
92	9,694		435	359	10,888	
93	11,703	5 ***	315	362	12,385	
94	12,385	5 ***	310	372	12,973	
95	12,973	5	212	344	13,534	
96	13,013	9	203	328	13,740	
97	13,211	9	183	308	13,936	
98	13,400	10	173	315	14,117	
99	13,574	10	158	322	14,277	
00	13,728	11	109	328	14,425	
01	13,870	11	127	333	14,555	
02	13,995	12	110	338	14,670	
03	14,106	12	95	342	14,773	
04	14,204	14	33	346	14,863	
05	14,292	15	71	349	14,944	
06	14,369	15	61	352	15,018	
07	14,441	16	54	355	15,087	
08	14,507	17	49	357	15,152	
09	14,569	18	44	360	15,212	
10	14,627	20	39	362	15,270	

Cumulative Totals Projected:
for FY 1995 - 2010: 1,799 8,438

USE OF FUND INCOME

FY	Net Income	Distributions			Reserves		FY End Balance	FY
		Dividends	Per Capita Dividends	Inflation-Proofing	General Fund	Add (Delete)		
78								78
79	3							79
80	22	12			12			80
81	150	28			28	59	59	81
82	268	71	\$1,000.00		71	185	244	82
83	471	108	\$386.15	231	110	110	354	83
84	530	175	\$231.29	151		203	557	84
85	558	217	\$404.00	235		206	763	85
86	1,021	303	\$556.26	216		501	1,264 **	86
87	1,069	391	\$708.19	148		529	529	87
88	789	424	\$828.93	303		52	591	88
89	568	460	\$873.16	360	4	44	635	89
90	316	487	\$952.63	454	4	(30)	605	90
91	1,030	489	\$931.34	559	4	(24)	581	91
92	1,030	489	\$915.84	559	4	(24)	581	92
93	1,226	532	\$949.46	362	3	320	965	93
94	1,098	556	\$983.90	372	11	151	1,117	94
95	950	521	\$877.00	344	14	65	1,182	95
96	1,552	503	\$826.00	528		512	1,648	96
97	1,522	495	\$791.00	508		582	2,167	97
98	1,596	483	\$754.00	515		561	2,744	98
99	1,774	524	\$804.00	522		691	3,330	99
00	1,551	557	\$838.00	528		729	3,930	00
01	1,329	591	\$871.00	533		768	4,547	01
02	2,006	525	\$904.00	538		806	5,178	02
03	2,084	660	\$937.00	542		844	5,822	03
04	2,162	595	\$968.00	546		882	5,481	04
05	2,240	730	\$999.00	549		921	7,152	05
06	2,318	765	\$1,030.00	552		960	7,838	06
07	2,398	801	\$1,061.00	555		1,000	8,537	07
08	2,478	838	\$1,091.00	557		1,011	9,250	08
09	2,560	874	\$1,120.00	560		1,083	9,976	09
10	2,542	911	\$1,151.00	562		1,125	10,717	10

32,261 10,573 \$15,022 8,438 14

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 95:	9.49%	2.51%	3.88%
FY 96-99: ***	10.31%	4.00%	3.31%
FY 00-2010:	10.31%	4.00%	3.31%

Constant/Real dollar

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

* Department of Revenue Fall 1994 Low-Case Revenue Forecast.
 ** Earnings reserve appropriated to Fund principal by the Legislature July 1, 1987.
 *** Transferred to principal from earnings reserve account per AS 37.13.145(d).
 **** Based on capital market assumptions adopted by the Trustees in March 1994.
 SENATE BILL NO. 51, BUT ASSUMES 10.31% FUTURE RATE OF RETURN AND 4% RATE OF INFLATION; IN REAL 1995 \$S.

ALASKA

POPULATION PROJECTIONS

1990 - 2010

State of Alaska

Walter J. Hickel, Governor

Department of Labor

Nancy Bear Usera, Commissioner

Administrative Services Division

David Teal, Director

Research and Analysis

Chuck Caldwell, Chief

Prepared by Demographics Unit

Gregory Williams, State Demographer

Bob Elliott, Economist

Kristen Tromble, Statistical Technician

Publications Unit

J. Penelope Goforth, Editor

Jim Fowler, Graphic Artist

Jo Ruby, Typesetter

November 1991

Second Printing March 1992

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

Part A. Middle Series

Calendar Year	July 1 Population	Population change July 1 to July 1						
		Net Change	Natural Increase	Births	Deaths	Net Migration	In	Out
1990	553,600	—	—	—	—	—	—	—
1991	574,000	20,400	9,654	11,826	2,172	10,746	57,654	46,908
1992	593,100	19,100	10,017	12,283	2,266	9,083	57,720	48,637
1993	607,500	14,400	10,320	12,676	2,356	4,080	54,733	50,653
1994	622,300	14,800	10,506	12,942	2,436	4,294	56,174	51,880
1995	637,300	15,000	10,690	13,204	2,514	4,310	57,451	53,141
1996	652,500	15,200	10,849	13,437	2,588	4,351	58,769	54,418
1997	668,000	15,500	11,004	13,678	2,674	4,496	60,207	55,711
1998	683,900	15,900	11,194	13,949	2,755	4,706	61,737	57,031
1999	700,000	16,100	11,398	14,241	2,843	4,702	63,088	58,386
2000	716,500	16,500	11,608	14,545	2,937	4,892	64,650	59,758
2001	732,800	16,300	11,853	14,878	3,025	4,447	65,613	61,166
2002	749,000	16,200	12,092	15,217	3,125	4,108	66,664	62,555
2003	764,900	15,900	12,333	15,551	3,218	3,567	67,505	63,938
2004	780,700	15,800	12,572	15,878	3,306	3,228	68,522	65,294
2005	796,200	15,500	12,775	16,182	3,407	2,725	69,365	66,640
2006	811,400	15,200	12,968	16,477	3,509	2,222	70,193	67,961
2007	826,200	14,800	13,169	16,770	3,601	1,631	70,887	69,256
2008	840,700	14,500	13,331	17,034	3,703	1,169	71,685	70,516
2009	854,700	14,000	13,476	17,268	3,792	524	72,274	71,750
2010	868,300	13,600	13,593	17,474	3,881	7	72,947	72,940

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

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

ADM 113/95



FRAN OURNER / Daily News photo

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By BOB ORTEGA
The Wall Street Journal

Please see Page C-3
WAL-MART

...single application to save from more than 25 days at present.

Boosting speed is basic to corporate re-engineering, the trendy technique of using technology to reorganize operations. A survey by International Data Corp. of Framingham, Mass., found that of 200 big companies that were re-engineering, 28 percent said shortening cycle times of various processes was their primary goal; 23 percent viewed reducing costs as No. 1.

"You can only cut costs so far," says Paul Johnston, who ran the survey. "Cycle time helps differentiate you."

International Business Machines Corp. now takes an order for a personal computer over the phone and builds and ships the PC within 24 hours. Gillette Co. is accelerating the pace at which new products are unveiled globally to a two-year cycle from three years; it also says it is introducing 20 new products this year, up from 17 last year and fewer than eight a year in the 1980s.

Please see Page C-7 FASTER, FASTER



TIM BRADNER

Real dollars now means real dividends later

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

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

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

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

Please see Page C-2 BRADNER

GOVERNOR TONY KNOWLES
LIEUTENANT GOVERNOR FRAN ULMER

Executive Summary

KNOWLES/ULMER

POLICY

TRANSITION

TEAMS'

REPORT

JANUARY 1995

Fiscal Policy

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

RECOMMENDATIONS

- Continue to articulate a "vision" of the state's financial future—the administration's views on the appropriate role of government and the values and criteria that should guide our public policy decisions—and recognize the threat the fiscal gap poses to ourselves and our children
 - Make a commitment to develop a plan to bring annually recurring revenues into balance with state spending
 - Integrate the cabinet into the plan and process, i.e., the commissioners should all be speaking in concert and actively involved in the plan's development
 - Convey the message that sound fiscal management equals good government and good government means good politics
 - The team emphatically endorses the Knowles/Ulmer campaign pledge to cap total state spending (except for education funding) at the FY 95 level
 - Continue with an unwavering policy of budget sustainability and develop an annual report card to inform the public about the success of the administration's actions to protect Alaska's fiscal future
- Give average citizens a direct voice in shaping the future and invite the public to help develop a shared vision for Alaska and the role of government in their lives
 - Develop a strategy for inviting public input into fiscal decisions and collect baseline information on public attitudes regarding the fiscal gap
 - Implement a strategy for educating the public on Alaska's fiscal situation and our choices for the future. Effective forums might include newspaper inserts, town meetings, market research, industry groups, social service groups and local government bodies
 - Ask the legislature to participate in every step of the outreach process
 - Make government more open to the public through better use of communication systems, including electronic media (video conference, internet, Alaska Online, etc.)
 - As part of a long-term strategy, the administration should budget for public participation in reexamining the respective roles of state and local governments, setting goals and benchmarks for Alaska, and deciding the role of the Permanent Fund in the state's fiscal future
- Create an annually updated five-year fiscal plan
 - Work with and inform the legislature in a timely manner of any changes the administration wishes to make in the FY 96 budget, and announce that a fiscal plan will be in place by the time the FY 97 budget is proposed
 - Develop a five-year plan and a comprehensive reporting framework that encompasses all aspects of state spending and revenues, including "off-budget items" such as Permanent Fund earnings, Permanent Fund dividends, cash reserves, public corporations, etc. Include deferred maintenance and the operating and maintenance costs of capital projects in the plan

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



Alaska Permanent Fund Corporation

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

(907) 465-2047

January 13, 1994

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

Dear Senator Phillips:

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

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

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

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

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

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

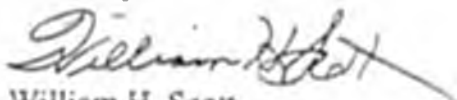
January 13, 1994
Senator Randy Phillips
Page 3

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

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

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

Sincerely,



William H. Scott
Executive Director



ASSET ALLOCATION STUDY
FOR
THE ALASKA PERMANENT FUND

Prepared by Ibbotson Associates, Inc.
January, 1994





Summary of Recommendations

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

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

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

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

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

I. Analyzing an Investment Portfolio

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

Defining Asset Classes

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

U.S. Equity Assets

Large Capitalization
Mid/Small Capitalization

Non-U.S. Equity Assets

Canada
Europe
Pacific
Emerging Markets

Other Assets

Real Estate

Non-U.S. Fixed Income Assets

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

Non-U.S. Fixed Income Assets

Non-U.S. Government Bonds

Cash

U.S. Treasury Bills



Forecasting Return

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


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

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

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

Forecasting Risk

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



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

Forecasting Return Correlation

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

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

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

Determining the Fund's Current Allocation

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



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

Determining the Fund's Three-Year Target Allocation

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



Current and Three-Year Target Portfolios

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



II. Asset Allocation Recommendations

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

Allocation with Risk of the Current Portfolio

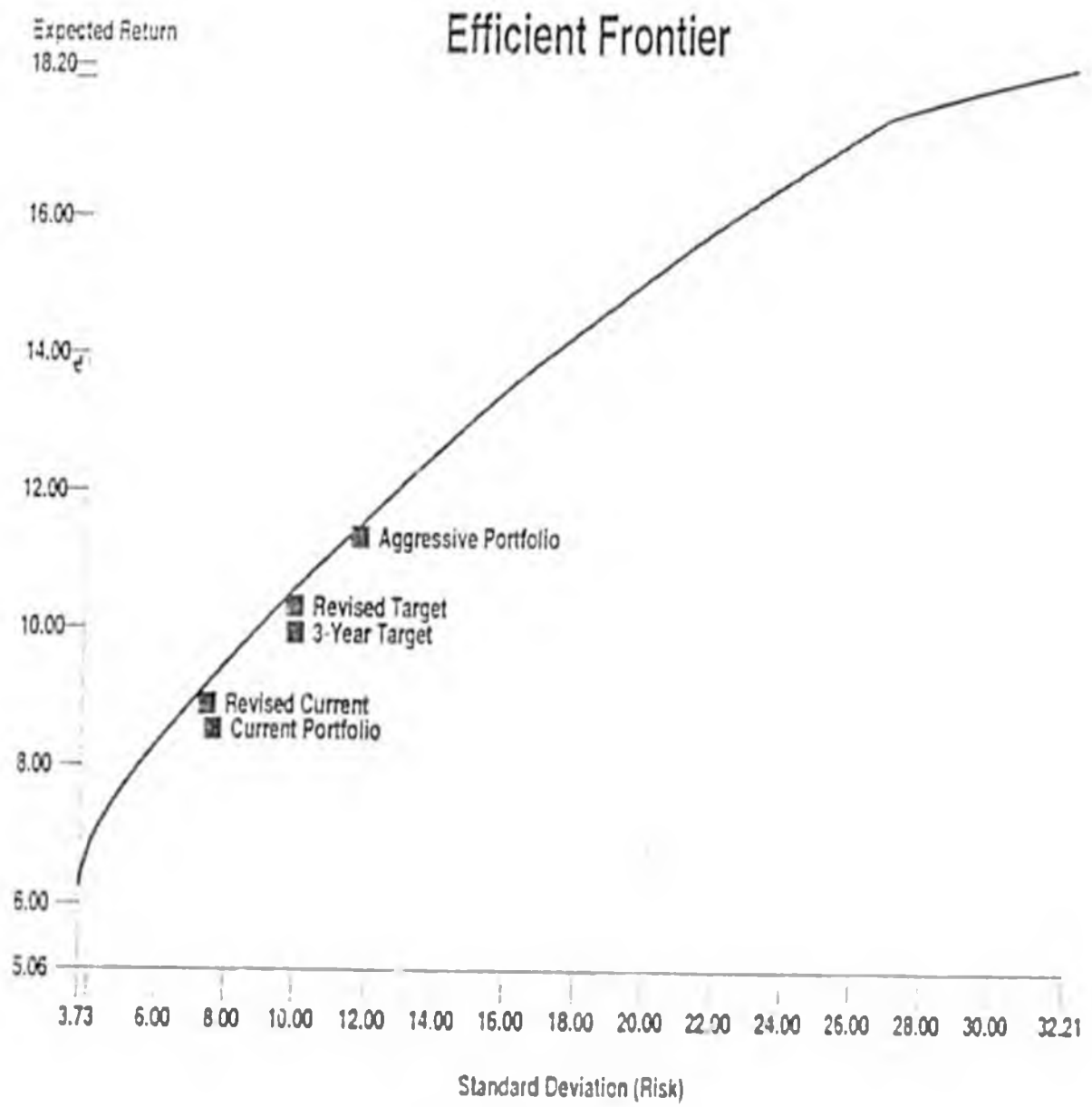
As shown in the graph on page 7, the Fund's current portfolio does not provide the maximum amount of expected return for the amount of risk taken. For example, the portfolio labeled "revised current" provides a higher expected return and slightly less risk than the current portfolio. (The graph is titled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

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

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

Allocation with Risk of the Target Portfolio

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



**Current and Recommended
Portfolio Allocations**

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

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

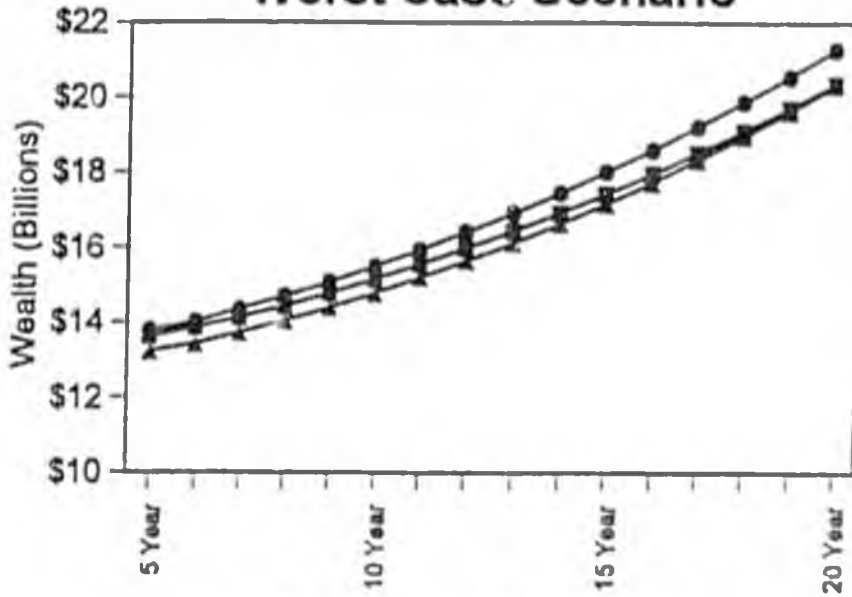
Allocation of a More Aggressive Portfolio

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

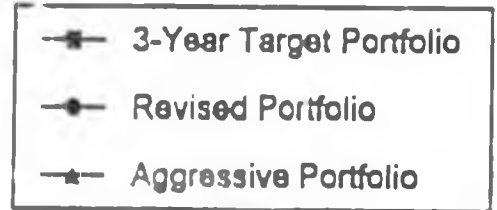
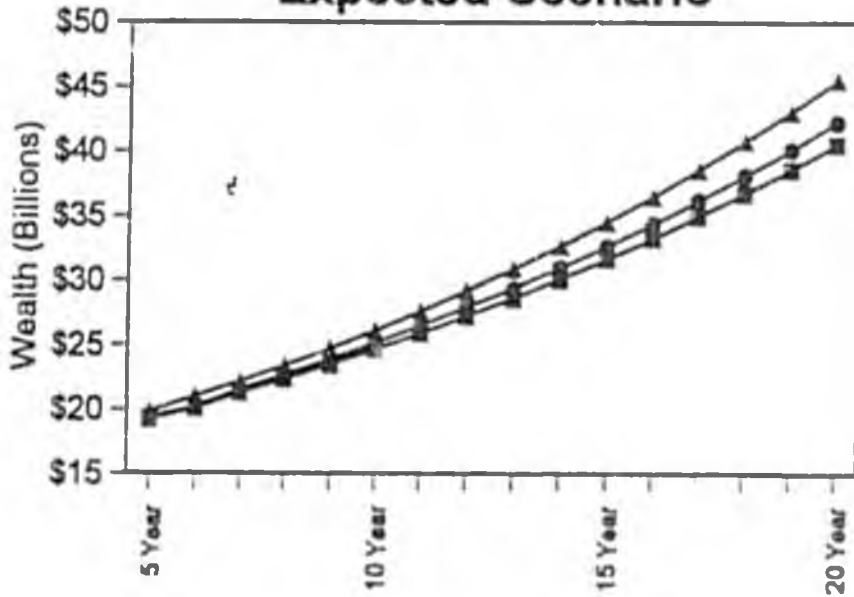
In recent years, the Fund has enjoyed relatively high returns, particularly on its fixed income investments. These high returns were due, in part, to rather unique market conditions, such as a dramatic decline in U.S. interest rates. These market conditions, however, are not expected to continue in the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

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

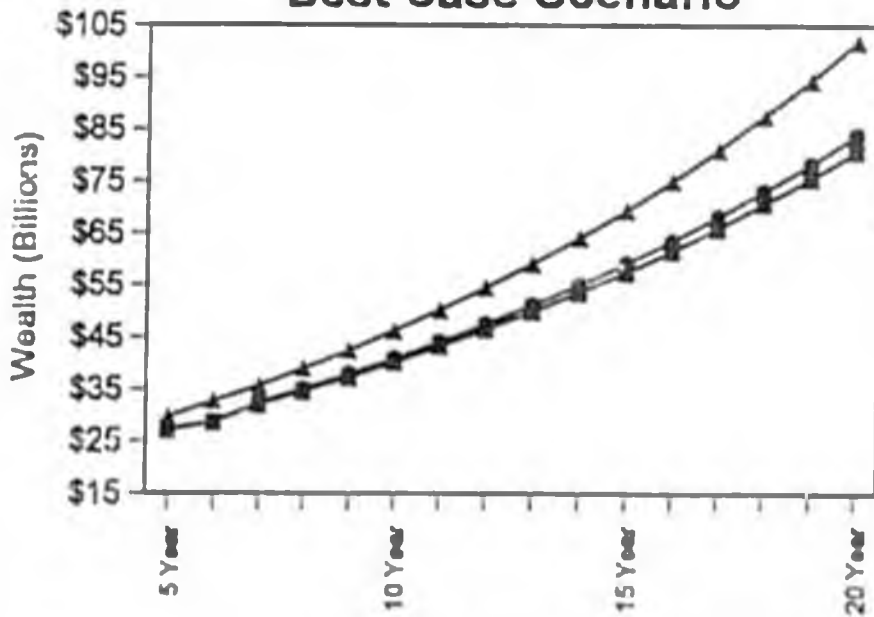
Worst Case Scenario



Expected Scenario



Best Case Scenario





Testing Our Recommended Portfolios

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

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

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



III. Implementation Issues

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

Equity Assets

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

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

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

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

Fixed Income Assets

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

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

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