APFC ALASKA PERMANENT FUND CORPORATION
801 W 10TH SUITE 302 | JUNEAU, AK 99801
907.796.1500 | apfc.org

Memo

To: Senator Bert Stedman, Co-Chair
Senator Natasha von Imhof, Co-Chair
Senate Finance Committee, Alaska State Senate

From: Craig Richards, Chair - Board of Trustees
Angela Rodell, CEO
Alaska Permanent Fund Corporation

Date: February 19, 2019

Re: Follow Up to Questions posed in SFIN January 25th

Senator Olson asked Chair Richards -

1. *What effect the Governor's plan will have on future POMV draws and the ERA.*

The Governor's plan has multiple components. They are addressed in turn.

• *Pay the statutory dividend going forward*: In FY2017-2019 less than the full dividend as provided in AS 37.13.140-.145(b) was distributed as a dividend. Paying the full statutory dividend in future years will not impact either the POMV or the ERA because the consequence will not be to total cash outflows to the Permanent Fund, but instead to reduce how much of Permanent Fund withdrawals are available to the General Fund to support governmental operations under S.B. 26.

• *Inflation proof the Principal of the Permanent Fund going forward:* AS 37.13.145(c) provides an amount will be transferred from the ERA to the Principal each year sufficient to offset the effect of inflation on the Principal. In FY2016-2018 the legislature did not provide an appropriation to "inflation proof." The FY2019 appropriation is included in the enacted budget. As of December 31, 2018, the APFC projects inflation proofing will be approximately $1 billion for each of the next 5 fiscal years (see the attached December 31, 2018 APFC Fund Financial History & Projections worksheet for year-by-year projections). The APFC projects that transfer, along with the POMV transfer provided in S.B. 26, will result in the ERA having a relatively steady balance of $16 billion over the next five fiscal years. Inflation proofing is an internal transfer between the ERA and Principal of the Fund, meaning it has no net impact on either the value of the Fund as a whole or the POMV.

• *Payback of underfunded dividends:* The Department of Revenue predicts the Governor's plan to payback underfunded FY2017-FY2019 dividends, as provided in S.B. 23 & S.B 24, would result in transfers out of the ERA for retroactive dividends of $565 million in FY2020, $683 million in FY2021, and $705 million in FY2022. The net effect to the ERA of those appropriations would be to reduce the ERA by $1.95 billion plus the effect of diminished earnings potential that is currently forecasted to be 6.5% annually. The APFC projects that those appropriations out of the ERA would result in the POMV payment under S.B. 26 being reduced from $$3.254 billion in FY2023 to $3.235 billion, or $19 million. Future POMV payment reductions are projected to be that amount plus foregone earnings on those funds. For example, the POMV transfer from the Fund (for dividends and to the General Fund) is projected to be $3.432 billion in FY2025 without repayment of those dividends, and $3.369 if repayment is made.

• *Payback of underfunded inflation proofing:* The net underfunded inflation proofing for FY2016-2018 was $1.479 billion. Making that transfer in FY2020 would reduce the ERA by a like amount, which results in the projected ERA balance going from approximately $16 billion in FY2020 to $14.5 billion for the next five fiscal years (not taking into account payment of underfunded dividends).

2. *What view does the Board of Trustees and the staff of the APFC have on those draws?*

For over 30 years APFC fund transfers were managed according to the "rules-based framework" provided by law. Collapse of State revenues associated with a drop-in oil prices resulted, for the first time, in a breakdown of rules-based transfers including ad hoc reduction of transfers for dividends (FY2017-2019) and inflation proofing (FY2016-2018).

In response, the Board of Trustees of the APFC has unequivocally stated its view that all transfers into and out of the Fund, as well as those between the ERA and Principal, should occur as provided by the constitutional and statutory framework provided in Alaska law (Resolution Nos. 18-01 and 18-04). The Board has explained that adherence to the legally provided rules-based framework under Alaska law is consistent with best practices for sovereign wealth funds, greatly reduces the chance that draws over time are unsustainable (both in terms of preserving intergenerational wealth and maintaining ERA durability), and is necessary to maximize long-term investment returns. Consequently, the Board and staff of the APFC do not support ad hoc fund transfers.

That means the APFC supports following, on a go forward basis, the constitutional and statutory rules provided under Alaska law for payment of dividends and inflation proofing. The Board of Trustees has taken a strong position that inflation proofing should occur (Resolution Nos. 17-01, 18-01, and 18-04). The APFC has no position on what dividends should be, so long as they are paid according to the statutory formula in effect at the year of transfer (Resolution Nos. 18-01 and 18-04) as part of the overall rules-based distribution from the ERA.

In FY2019, via adoption of S.B. 26 and reinstating inflation proofing, great strides were made towards a recommitment to adherence to a legal framework for fund transfers. Continuing that adherence across the constitutional and statutory rules is critical. How to address fund transfers in those recent years in which the rules were not followed is also important. At a minimum the rules should be followed going forward; a rational approach to retroactively following the rules – including for dividend payments and inflation proofing – is also consistent with the Board of Trustee's position that fund transfers should not be ad hoc but instead rules based.