APPENDIX AA

Opinions of Counsel and Other Materials Pertinent to the Public School Trust Fund

THE ALASKA PUBLIC SCHOOL FUND: A PERMANENT FUND FOR EDUCATION

Paper Presented to the
American Education Finance Association

Annual Conference, Orlando, Florida

March 1984

E. Dean Coon
Associate Professor of Education
College of Human and Rural Development
University of Alaska-Fairbanks
Fairbanks, Alaska 99701
(907) 474-7144

List of Tables

Table No.		Page No.
1:	Alaska Public School Permanent Fund Balances 1918-1958	4
2:	Alaska Public School Permanent Fund Balances, including Cash and Investments, Fiscal Years '58 - '78	5
3:	Alaska Public School Permanent Fund Investment Balances and Interest Earned, Selected Fiscal Years	6
4:	Alaska Public School Permanent Fund, Condensed Statement of Investments, Fiscal Year '63	7
5:	Status of School Lands, August 1977	13
6:	Alaska Public School Fund Receipts, FY '79 - '83	14
7:	Alaska Public School Fund Balances, Fiscal Years '79 - '83 .	15
8:	Investment Earnings and Rate of Return, Alaska Public School Fund, Fiscal Years '79 - '83	15
9:	Public School Permanent Fund Earnings, Selected States, Fiscal Year '79	20
10:	State Aid and Shared Revenue to District Schools in Alaska, Fiscal Years '77 - '83	21
11:	Estimates of State Land Management Receipts, Fiscal Years '83 - '92	23
12:	Estimated Investment Earnings, Public School Fund, Fiscal Years '84 through '92	25
13:	Rate of Return on Investment, Alaska Public School Fund, Alaska Permanent Fund, Fiscal Years '79 - '83	26

List of Figures

		Page No.
Figure 1.	Public School Permanent Fund Model: Territorial Period	4
Figure 2.	Public School Permanent Fund Model: Early Statehood Period	6
Figure 3.	Public School Fund Model: Contemporary Period	17
Figure 4.	Alaska State Aid and Shared Revenue to District Schools	22
Figure 5.	Alaska Public School Fund Balances	24

THE ALASKA PUBLIC SCHOOL FUND: A PERMANENT FUND FOR EDUCATION

Introduction

The purpose of this paper is to examine the development of Alaska's Public School Fund, its current status, and its potential as a major revenue source for elementary and secondary education. The Fund, which was created following the 1915 federal school lands grant to Alaska, will be examined in the 1916-58 territorial period, the 1959-78 early statehood period, and in the 1979-83 contemporary period. This examination will include the treatment and status of school lands which, until July 1, 1978, provided the primary revenue source for the Fund. Legislative changes in the status of school lands and the Fund which took effect at the beginning of the contemporary period will be reviewed. The case for the Public School Fund becoming a permanent fund for education will be developed. The final section of the paper will present a summary and recommendations. An appendix contains supporting data tables. Unless otherwise cited, all references to Fund receipts, balances and investments are from Treasurers' Reports, Territory of Alaska, or Annual Financial Reports, State of Alaska.

The Territorial Period: 1915-1958

The Public School Fund, initially called the Public School Permanent Fund, was created to comply with an Act of Congress of March 4, 1915 which reserved sections 16 and 36 in each surveyed township in Alaska from sale or settlement, and directed that income from these reserved lands be put into a Permanent Fund in the Territorial Treasury. The Act further specified that the investment income of the Permanent Fund be used only for the benefit of the public schools. The Act, which also reserved certain lands in the Tanana Valley for support of a Territorial agricultural college and school of mines, states, in part:

> . . . when the public lands are surveyed . . . sections numbered sixteen and thirty-six in each township . . . (are) . . . reserved from sale or settlement for the support of common schools in the Territory of Alaska . . . (and) . . . the entire proceeds or income derived by the United States from such sections . . . and the minerals therein . . . are hereby appropriated and set apart as separate and permanent funds in the Territorial treasury, to be invested and the income from which shall be expended only for the exclusive use and benefit of the public schools of Alaska . . . . [1]

There are 36 sections in a township. Each section contains 640 acres. Thus, 1,280 acres of land in each surveyed township was designated for the support of the public schools.

While this Act was unique to Alaska, similar enactment by Congress in prior years provided land to the states for the support of the common schools. According to Johns and Morphet:

> The policy of setting aside the sixteenth section of each township for the public schools was followed for states admitted between 1802 and 1848. When the Oregon Territory was established in 1848, Congress set aside two sections of each township for the public schools. This policy was continued until 1896, when Utah was granted four sections in every township. Similar grants were made to other western states admitted after that year.[2]

The Public School Permanent Fund was opened and showed receipts of $153.04 for the two-year period ending December 31, 1918, comprised of the following:

For 1917-
October 12, from C. R. Arundell, Chief of Field Division, General Land Office, Juneau, in settlement for timber trespass by W. A. Simmovick of Chena (wood cut from Section 16, Fairbanks Land District). $18.50

October 25, from Frank A. Boyle, Receiver of U. S. Land Office, Juneau, in settlement for timber cut by Eska Creek Coal Co., from Section 16, Matanuska Coal Lands, under permit . 43.29

December 22, from Frank A. Boyle, Receiver of U. S. Land Office, Juneau, in settlement for timber cut by Eska Coal Co., from Section 15, Seward Meridian 11.25

For 1918-

Aug. 20, from Commissioner of General Land Office, Washington, D. C., settlement for timber trespass by certain persons on Section 36, T. 2 N., R. 1 W. (16 cords of wood @$5.00) 80.00

$153.40

Receipts during the next few years were for timber trespass, wood sales, and coal royalties. The first land leases were negotiated in 1920 with the first lease receipt entry in 1920 showing "From Secretary of Alaska--one year's rental account lease of school lands by C. A. Spring, Anchorage, $7.75."

The first investment of the Public School Permanent Fund was made January 10, 1923, when a $500 U. S. Treasury Bond paying four and one-half percent interest was purchased through the B. M. Behrends Bank of Juneau. This bond, due to mature in 1947, was the only investment of the Fund until 1952.

Investment interest on this bond was credited to the Public School Current Fund, which showed receipts as follows: "Interest received on $500.00 U. S. Treasury 4 1/2 % Bond (Investment of Public School Permanent Fund) . . . $422.50." The Public School Current Fund was credited with various tax receipts and money from the General Fund and made disbursements for support of the Territorial schools.

An additional source of revenue for the Public School Permanent Fund was stipulated in House Bill 54, enacted by the Territorial Legislature in 1931. This legislation provided that real or personal property of any Territorial school or school district which is permanently closed may be sold (or transferred to another school) and the monies received be credited to the Permanent School Fund.[3]

Table 1 shows the balances of the Fund at ten-year intervals. Appendix A shows the balances of the Fund at the end of each biennial period from 1918 through June 30, 1958 (when Alaska changed to a July 1 - June 30 Fiscal Year).

Table 1
Alaska Public School Permanent Fund Balances
1918 - 1958

Period Ending	Balance
Dec. 31, 1918	$ 153.04
Dec. 31, 1928	691.75
Dec. 31, 1938	5,045.48
Dec. 31, 1948	13,997.73
June 30, 1958	161,700.03

With increases in the principal of the Fund amounting to only about $3,850 per year, it would appear that the Fund balances would consistently be minimal. But events and circumstances of 1958 were to change this.

The Alaska Statehood Act, enacted July 7, 1958, stipulated that:

> Grants previously made to the Territory of Alaska are hereby confirmed and transferred to the State of Alaska upon its admission. Effective upon the admission of the State of Alaska into the Union, section 1 of the Act of March 4, 1915 (38 Stat. 1274; 48 U. S.C., sec. 353), as amended . . . (is) repealed and all lands therein reserved under the provisions of Section 1 as of the date of this Act, shall upon admission of said state into the Union be granted to such state <u>for the purposes for which they were reserved</u> (emphasis added).[4]

While the Statehood Act maintained the purpose of the 1915 legislation, it left Alaska relatively free to manage the lands. For example, the prohibition against the sale of school lands might no longer apply. However, the acreage of the grant was limited, since only those sections 16 and 36 in <u>surveyed</u> townships would be transferred to the state. State sources vary in the number of acres involved, but the first annual report of the Alaska Division of Lands, issued in 1961, estimated the total acreage of school lands to be 106,000 when statehood was achieved.[5]

As the 1915-1958 Territorial Period ended, Alaska had cash and investments in its Public School Permanent Fund totaling $161,700 and some 106,000 acres of school lands as a revenue source for the Fund. Fund investment income was being used for the support of the public schools. The school land grant program, displayed in a schematic in Fig. 1, was operating as stipulated by the 1915 Act.

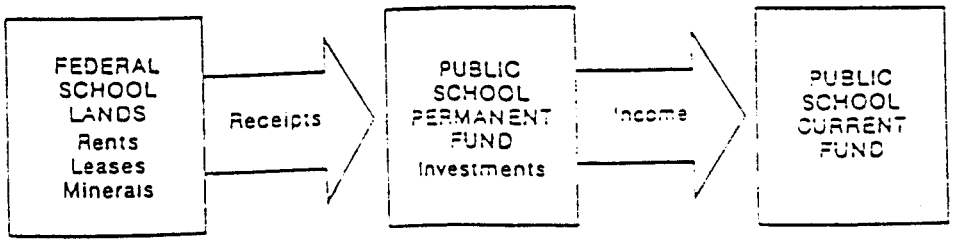

Fig. 1. Public School Permanent Fund Model: Territorial Period

The Early Statehood Period: 1959-1978

On January 5, 1959, Alaska became a state, and the federal school lands became state school lands. Legislation adopted in the first year of statehood provided that management of state lands, including school lands, would be under the control of the director of the newly created Division of Lands in the Department of Natural Resources. This legislation, known as the Alaska Land Act, further provided for the selection, acquisition, management, and disposal of Alaska lands and resources.[6]

The first sale of school land, resulting in receipt of $1,000 to the Fund, occurred in 1959. Income to the Fund for the fiscal year ending June 30, 1959 totaled $95,303.79, and also included receipts from leases, rentals, and sale of timber and minerals. Investments were in U. S. Treasury Notes.

The Public School Permanent Fund balance sheet in the first Annual Report of the State contained the following:

> Legal Reference: Act of Congress, March 4, 1915
> Purpose: To receive income or proceeds from sections 16 and 36 of each township within the State. These monies to be invested and the interest earned to be used for the use of the Public Schools of the State.

Similar references appeared on Fund balance sheets in the Annual Reports in subsequent years.

A 1964 Opinion of the Attorney General (No. 7) directed the continuation by Alaska of the original purpose of the school land grants:

> The grants by the federal government of school . . . lands were confirmed and transferred to the State of Alaska upon its admission to the Union under this subsection, with the express proviso that they be used for the purposes for which they were reserved.[7]

The growth of the Public School Permanent Fund from a beginning balance of $161,700.03 on July 1, 1958 to $8,531,939 on June 30, 1978 is shown in five-year intervals in Table 2. Balances for each year of the twenty-year period are shown in Appendix B.

Table 2
Alaska Public School Permanent Fund Balances
including Cash and Investments
Fiscal Years '58 - '78

Period Ending	Balance
June 30, 1958	$ 161,700.03
June 30, 1963	834,534.66
June 30, 1968	2,003,275.36
June 30, 1973	3,906,247.00
June 30, 1978	8,531,939.00

The annual increase in the principal of the Fund averaged $418,512 during this period. The increase is directly attributable to rapid increases in royalty and rental income, a larger number of leases, and sale of land.

As the principal of the Fund grew, so did the amount invested, and the amount of interest earnings credited to the State's General Fund. Table 3 shows the investment portion of the Fund balance and the amount of interest credited to the State's General Fund in four selected fiscal years during the Early Statehood Period.

Table 3
Alaska Public School Permanent Fund
Investment Balances and Interest Earned
Selected Fiscal Years

Fiscal Year	Investment Balance	Interest Earned
'63	757,416.57	NA
'68	1,960,311.57	74,683.22
'73	3,903,193.00	213,938.55
'78	8,391,085.00	560,489.97

Cash and investment balances of the Fund, as well as interest earned for each fiscal year from 1958 through 1978, are shown in Appendix C.

A Statement of Investments of the Public School Permanent Fund did not always appear in every Annual Report of the State. Table 4, which follows, presents selected information from one such Statement of Investments.

During the Early Statehood Period, the Fund Balance Sheets appearing in the State's Annual Reports typically contained the following text:

> NOTE: Interest received on Investments in the amount of (amount) for the Fiscal Year Ended, posted directly to the General Fund and used exclusively for School purposes. LEGAL REFERENCES: Act of Congress, March 4, 1915 and Chapter 55, SLA 1931.

Once the interest was credited to the State's General Fund its identity was lost, since it was co-mingled with all other revenues in the General Fund. Fig. 2 below is a schematic of the Fund during the Early Statehood Period.

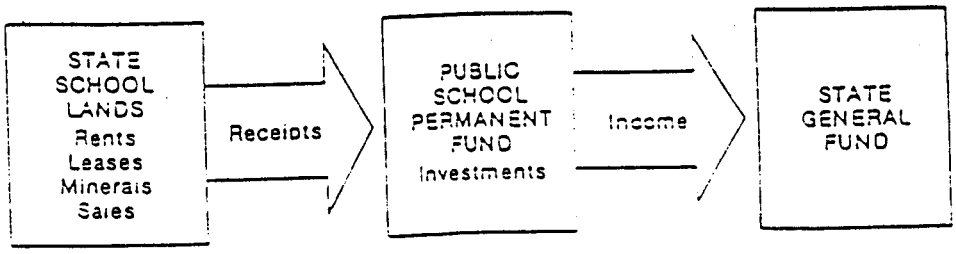

Fig. 2. Public School Permanent Fund Model: Early Statehood Period

Table 4
Alaska Public School Permanent Fund
Condensed Statement of Investments
Fiscal Year '63

Description	Date Acquired/ Maturity	Interest Rate	Book Value
U.S. Treasury Notes Chase Manhattan, N.Y.	7/14/61 8/15/64	3 3/4%	$ 75,000
U.S. Treasury Bonds National Bank of Commerce, Seattle	2/20/62 5/15/66	3 3/4	89,518
U.S. Treasury Bonds NBC, Seattle	11/14/61 9/15/72-67	2 1/2 2 1/2	61,009
U.S. Treasury Bonds NBC, Seattle	3/15/62 8/15/71	4	230,606
U.S. Treasury Bonds Seattle First National Bank	6/15/51 12/15/72-67	2 1/2	20,000
U.S. Treasury Bonds Wells Fargo, SF, Calif.	6/23/60 5/14/64	3 3/4	81,910
U.S. Treasury Bonds NBC, Seattle	3/14/63 11/15/71	3 7/8	199,313
Total Permanent School Fund:			$757,416

Note: Par value of these securities totaled $782,000.

The Public School Permanent Fund drew special attention when Legislative Budget and Audit reviewed the Fund financial statements for 1973-74. Major findings and recommendations of this review, issued on April 22, 1975 were that:

1. the financial position of the Fund was not presented fairly in conformity with generally accepted accounting principles

2. lease income from certain school lands was recorded in the General Fund, causing Permanent Fund assets and Fund balance to be understated by $897,599, income understated by $190,338, and expenditures understated by $36,769

3. lease payments should reflect current market lease values, lease rentals should be readjusted at five-year intervals to reflect current reappraisals, and state agencies should pay for use of school land

4. interest rates on land sale contracts should be reviewed to reflect market conditions

5. State Board of Education approval should be obtained before sale, lease, exchange, or other disposal of school lands.[8]

The Merrill Field School Section lease, although not identified in the audit report, was the one whose lease income was improperly recorded in the General Fund. This lease was for residential development on a 170-acre tract known as Penland Park in Anchorage and, according to the Alaska Division of Lands Annual Report for 1971, " . . . produced an income to the State of Alaska's Public School Permanent Fund of $122,000 in annual rental . . . ."[9] But, as the audit report revealed, the money was not credited to the Permanent Fund.

Penland Park came in for more attention in 1976 when it was determined that this lease, as well as another large one, the Teamster Lease, also in Anchorage, had been illegally executed. Primarily because of efforts of the Alaska Public Interest Research Council, settlements approaching two million dollars were made by the lessees in favor of the Public School Permanent Fund.[10]

Alaska was not unique in having problems in the management of school lands. Several public school finance and school administration authorities have noted the mismanagement of school lands and funds. To cite just three, DeYoung in 1942 stated, "Although some of the funds were poorly managed, these gifts of the federal government to education have been extremely significant,"[11] Burrup in 1974 said, "a few states managed their lands and funds wisely while others were guilty of gross mismanagement,"[12] and Johns and Morphet in 1975 wrote, "partly because of poor management of these lands this (that land income might pay all school costs) was a vain hope and would have been even if—the public lands had been well managed . . . ."[13]

Largely as a result of the audit report and the improper leases in Anchorage, the law was changed and the State Board of Education was named trustee for school lands. The Board was further authorized to retain private counsel or other professional assistance when necessary to fulfill its duties as trustee.[14] This meant that <u>every</u> school land transaction needed State Board of Education approval before contracts could be issued or leases initiated or renewed. This same statute continued the apparent prohibition of sale of school land to anyone except a borough or city, stating, in part, "disposal of school lands, other than by lease . . . or by exchange . . . shall be made only for sites for school facilities or for public park and public recreation purposes."

The management of state lands, including school lands, was examined in FY'76 by the audit division of the Budget and Audit Committee of the Legislature. The Committee's review of the land management programs administered by the Division of Lands of the Department of Natural Resources disclosed procedural errors in handling termination of leases and contracts. The findings and recommendations of this audit stated, in part:

> The Division of Lands should develop and implement procedures for the termination of leases and contracts in default upon the expiration of the specified default period . . . violations of lease terms subject the lessee/purchaser to appropriate legal action, including forfeiture. By not taking prompt termination steps, the land involved is not available for re-lease or resale, and revenue to the State is lost . . . the Division should discontinue the second default notice(which) is not required . . . .[15]

Events and issues of this period would eventually lead to a major change in the status and management of school lands and to a major change in sources and amounts of revenue for the Public School Permanent Fund. These issues included the following:

1. There was increasing public and legislative pressure to make more state land available for sale to the public

2. Laws and regulations prevented wider use of school lands; sale of land was especially restrictive

3. The State Board of Education was spending much time and effort in overseeing the school lands program, a role that many questioned

4. Jurisdictional and management problems existed, not only with respect to school lands, but with Mental Health Grant Lands and University Grant Lands.

Independent efforts within the concerned State agencies to resolve these issues were underway in the 1976-78 period. Eventually, this became an interagency effort, and an ad hoc advisory panel began studying the problem. One of the reports received by this panel in 1977 was a synopsis of applicable statutes, which concluded, in part:

> . . . there is general case-law support for the position that the administration of school . . . trust lands is a trust responsibility, and is governed to a degree by the language and conditions of the original statutory grant of lands. The extent to which such original grant still controls details of the methods and terms under which such lands may be leased or sold . . . is a subject upon which there are no clear guidelines in Alaska at the present time.[16]

Out of this interagency effort came specific recommendations for legislative change. These recommendations resulted in Senate Bill 159 adopted in 1978.

This legislation made sweeping changes in the status and management of school lands as well as in the Public School Permanent Fund. The first change redesignated school land as general grant land:

> Sec. 2. REDESIGNATION AND DISPOSAL OF SCHOOL LAND.
> (a) Land granted to the state in sections 16 and 36 in each township surveyed before January 3, 1959 under the Act of March 4, 1915, 48 U.S.C. 353, and patented to or approved for patent to the state on July 1, 1978 and land designated as school land which was received in exchange for land granted under that federal land grant and land granted to the state as lieu or indemnity is redesignated as general grant land and shall be managed consistent with applicable provisions of law (emphasis added). [17]

This meant that the identity of the land as school land would be lost, as it would be merged with other general grant lands of the state. It also eliminated the State Board of Education from any jurisdiction over lands, clearly charging the Department of Natural Resources with full authority to manage the lands.

The redesignation of school land was included in the Temporary and Special Acts in 1978 and is not in current state laws. Other portions of SB 159 became part of Title 37 (Public Finance), Alaska Statutes, and are presented below as enacted.

The second major change involved the creation of a new fund, the Public School Fund, which would consist of the balance of the Public School Permanent Fund and sums to be transferred from a new source.

ARTICLE 3. PUBLIC SCHOOL FUND.

> Sec. 37.14.110. PUBLIC SCHOOL FUND ESTABLISHED. (a) There is established as a separate fund the public school fund.
> (b) The principal of the fund established in (a) of this section consists of (1) the balance of the public school permanent fund on July 1, 1978; and (2) sums transferred under sec. 150 of this chapter.
> (c) The income of the fund created in (a) of this section consists of the interest and dividends earned from investments of the principal of that fund under sec. 170 of this chapter.

The third major change was to create a Public School Fund Advisory Board with representation from the Department of Revenue and the Department of Education.

Sec. 37.14.120 PUBLIC SCHOOL FUND ADVISORY BOARD CREATED.
(a) There is created in the Department of Revenue the Public School Fund Advisory Board composed of the commissioner of the Department of Education, three members elected by the Board of Education from among its membership, and the commissioner of the Department of Revenue.
(b) The board created in (a) of this section shall elect a chairman from the membership of the board. Members serve without compensation but are entitled to per diem and travel expenses authorized by law for other boards.

Sec. 37.14.130 POWERS AND DUTIES OF BOARD. The board created in sec. 120 of this chapter has the following powers and duties:
(1) to hold regular meetings and special meetings considered necessary;
(2) to have prepared an annual accounting of the principal and income of the fund established in sec. 110 of this chapter; and
(3) to prepare long-range investment plans for the fund established in sec. 110 of this chapter.

The fourth major change was a redesignation of the use of the principal in the Fund, with specific directions regarding investment policy. Most importantly this section of the new law retained the proviso that Fund income be used only for public education programs.

Sec. 37.14.140. FUND UTILIZATION. The principal of the fund established in sec. 110 of this chapter shall be retained in the fund for investment as specified in sec. 170 of this chapter. The income of the fund may not be appropriated for a purpose other than for the support of public education programs.

The fifth, and perhaps most sweeping change, designated a new (or redefined) source of revenue for the Public School Fund. The revenue source was to be a portion of total receipts derived from management of state land--all state land.

Sec. 37.14.150. CONTRIBUTIONS. During each fiscal year the commissioner of the Department of Revenue shall transfer to the fund created in sec. 110 of this chapter a sum equal to one-half of one percent of the total receipts derived from the management of state land, including amounts paid to the state as proceeds of sale or annual rent of surface rights, mineral lease rentals, royalties, royalty sale proceeds, and federal mineral revenue-sharing payments or bonuses (emphasis added).

The effect of this would have the most impact upon the growth of the Fund. No longer would Fund income be only from school lands, comprising some 106,000

acres, but the specified percentage of receipts from management of all state lands, some 105 million acres.

The fifth major change specified that the principal of the Fund was to be invested with the approval of the advisory board and in the same manner as that specified for surplus pension funds:

> Sec. 37.14.170. INVESTMENTS. (a) The commissioner of revenue, with the approval of each advisory board created in secs. 20, 70, and 120 of this chapter, may invest the principal of the funds created in secs. 10, 60, and 110 of this chapter in the same manner as specified for the investment of surplus pension funds under AS 39.35.110.

Subsequent portions of this section defines the powers and duties of the Commissioner of Revenue in serving as treasurer of the Fund.

The statute regarding investment of surplus pension funds lists seventeen kinds of acceptable investments, and gives some specific directions, presented below in part:

> (the Fund) . . . may be invested at competitive national market rates . . . (and) . . . in making investments the commissioner of revenue shall exercise the judgment and care under the circumstances then prevailing which an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it not in regard to speculation but in regard to the permanent disposition of funds, considering the probable safety of capital as well as probable income . . . .[16]

It is worth noting that the 1978 legislation also redesignated as general grant land some 1,000,000 acres of Mental Health Grant Lands and some 100,000 acres of University of Alaska Grant Lands. Similar, but not identical, stipulations were made regarding designated funds and the percent of state land management revenues to be credited or appropriated to these other funds.

So, as the Early Statehood Period came to a close, Alaska had created a completely new method of managing the school lands and maintaining the Public School Permanent Fund. While the school lands would "disappear" into the general land holdings of the state, without any legal challenge, a new, and apparently potentially greater source of revenue was to be directed to the Fund, which would be renamed simply the Public School Fund (not to be confused with the School Fund, another designated state fund used to account for Cigarette Tax Funds).

The Contemporary Period: Fiscal Years '79 - '83

The legislative changes in the status of the school lands, in the source of revenue for the Public School Fund, and in management of the Fund were to take effect in July 1978. Most changes were immediately implemented; some were not. Consequently, it is important at this point to examine each facet of the scheme, following the major sections of the new laws.

School Land

Somewhat in excess of 103,000 acres of school land were redesignated as general grant land. This was the balance of more than 105,354 acres that had been patented to the state; 2,328 acres had been sold. The status of patented school land at the time of transfer, according to the Alaska Department of Natural Resources, is shown in Table 5 below.[20]

Table 5
Status of School Lands
August 1977

Meridian in which located	Number of Acres			
	Patented	Sold	Leased	Balance
1. Seward	53,761	930	3,997	52,834
2. Fairbanks	41,451	1,399	1,139	40,052
3. Copper River	10,140	-0-	48	10,140
Totals	105,354	2,329	5,184	103,026

Additional acres of school land will be patented to the State. This is because at the time of statehood all eligible land had not been applied for, and all land applied for had not been patented to the State. Accounts of the potential additional acres vary. A Department of Natural Resources Report for 1977 stated that 109,211 acres of school land had been applied for (this includes the acres already patented);[20] other reports give the figure as 100,000.[21]

In a Department of Natural Resources document issued in 1982 on general grant lands, the school land is grouped with such other land entitlements as Cook Inlet Land Exchange (500,000 acres), Community Grant (400,000), Mental Health (1 million), National Forest Community Grant (400,000), and General Selection (102.6 million acres). These lands, plus the school lands, total 105 million acres, and are the state lands which are the source of receipts for the Public School Fund.[22]

The Alaska Department of Natural Resources is the state agency responsible for management of state lands. This Department's Division of Lands has its headquarters in Anchorage with branch operations in Juneau, Anchorage, and Fairbanks.

State Land Receipts

Receipts credited to the Public School Fund from the management of state lands in Fiscal Year '79 totaled $1,308,259, more than twice the amount earned in the prior year under the old plan. For each of the three succeeding

years, receipts credited to the Fund exceeded $7,000,000 per year, and in Fiscal Year '83 totaled $9,450,241. Table 6 below shows Public School Fund Receipts, as reported in State of Alaska Annual Reports, consisting of one-half of one percent of all receipts received from the management of state land for this five-year period. The total receipts from management of state lands in Fiscal Year '83 was $1,890,048,200.[23]

Table 6
Alaska Public School Fund Receipts
FY '79 - '83

Fiscal Year	Receipts Received
'79	$1,308,259
'80	7,141,900
'81	7,441,245
'82	7,205,764
'83	9,450,241

While a large share of the increased receipts is due to sharing in a larger base of land, the bulk of the increase, beginning in Fiscal Year '80, is from oil production royalties. No severance taxes are included.

There are fifteen categories established for land management receipts. The categories, along with the code number for each, are as follows:

304 Oil gas lease royalties
305 Mineral royalties
306 Mineral rentals
525 Coal rental lease
527 Coal royalties
528 Sale state gravel
530 Offshore prospecting rent
532 Land lease rental
533 Mineral lease rent
534 Sale of state land
535 Sale of state timber
537 Bonus mineral lease
538 Tideland leases
539 Royalty gas property
747 Royalty oil production

One-half of one percent of the total receipts received for each category is credited to the Public School Permanent (sic) Fund, fund number 715, account 6200, in the Department of Natural Resources.[24] Initial accounting for these receipts is in the Department of Revenue Division of Lands accounting section in Anchorage. (It is of interest that the Alaska Permanent Fund receives a percentage of receipts from ten of the fund categories noted above; the ones it does not receive receipts from are (1) Sale state gravel, (2) Land lease rental, (3) Sale of state land, (4) Sale of state timber, and (5) Tideland leases.)

Public School Fund

The principal of the Fund increased dramatically each year due to increased receipts received from the management of state lands. Growth of principal averaged $6,509,482 per year for each of the five years beginning with Fiscal Year '79. The balances of the Fund in this contemporary period are shown below in Table 7.

Table 7
Alaska Public School Fund Balances
Fiscal Years '79 - '83

Year	Balance
'79	$ 9,840,198
'80	16,982,098
'81	24,423,343
'82	31,629,107
'83	41,079,348

The Fund itself is managed by the Treasury Division of the Department of Revenue. This Division is responsible for all Fund accounting and for making investments using the principal of the Fund. The actual money in this Fund is combined with other Agency and Trust funds managed by this Division but is accounted for separately.

The principal of the Fund can only increase, not decrease, since the law does not permit expenditures to be made from it. The only permitted use of the principal is for investments.

Fund Investments

As the principal of the Public School Fund grew, so did the amounts of dividends and interest earned from investments. These earnings are not put into the Fund but are transferred to the State's General Fund. Earnings of the Public School Fund (including the Merrill Field Trust which is a part of the Fund), as reported by the Department of Revenue, are shown below in Table 8, along with an estimated rate of return.[25]

Table 8
Investment Earnings and Rate of Return
Alaska Public School Fund
Fiscal Years '79 - '83

Fiscal Years	Investment Earnings	Rate of Return
'79	694,574	7.55%
'80	629,247	9.30%
'81	1,752,124	10.46%
'82	3,152,772	13.11%
'83	3,908,606	11.68%

Investment earnings are the amounts transferred to the State's General Fund, as reported by the Alaska Department of Revenue. The Rate of Return is an average rate; investment securities are listed in Appendix D.

Fund earnings come from investments in short- and long-term government securities and, beginning in 1981, certificates of deposit issued by various banks. In the June 30, 1983 listing, the size of security purchases ranges from a low of $250,000 to a high of $14,400,000, both for U.S. Treasury notes.[26] Interest rates vary from a low of 7.1 percent on Federal National Mortgage Association investments to a high of 14.625 percent on the previously mentioned large block of U.S. Treasury Notes. Maturity dates range from July 6, 1983 for Bank of America Certificates of Deposit, to July 12, 2012 for Washington Metropolitan Transit Bonds.

Par value of the securities on hand June 30, 1983 was $40,720,000; book value was $40,206,053.91. Investments are held in the following:

Bank of America (CA) Certificates of Deposit
Manufacturers Hanover Trust (NY) Certificate of Deposit
Bankers Trust (NY) Certificates of Deposit
Federal Land Bank Notes
U.S. Treasury Notes
Tennessee Valley Authority Bonds
Federal National Mortgage Association
General Services Administration
Washington Metropolitan Transit Bonds

U.S. Treasury Notes account for $15,550,000 of the investment, and the next largest amount is $5,500,000 in Certificates of Deposit issued by Bankers Trust. The complete list of securities being held or which have matured during the past five fiscal years is in Appendix D.

All securities are kept at Seattle First National Bank (SEAFIRST) which acts as safekeeping agent for the Alaska Department of Revenue. Interest and dividend payments are transmitted from SEAFIRST to the Department of Revenue which then credits the State's General Fund with these revenues. Funds recovered on matured securities are reinvested based upon instructions to the safekeeping agent from the Treasury Division of the Department of Revenue.

Advisory Board

Although stipulated in the 1978 legislation, the Public School Fund Advisory Board was not created and did not meet during the five years ending June 30, 1983.[27] Thus it did none of the things it was directed to do.

Figure 3 which follows shows the operation of the Public School Fund during the five-year Contemporary Period beginning July 1, 1978.

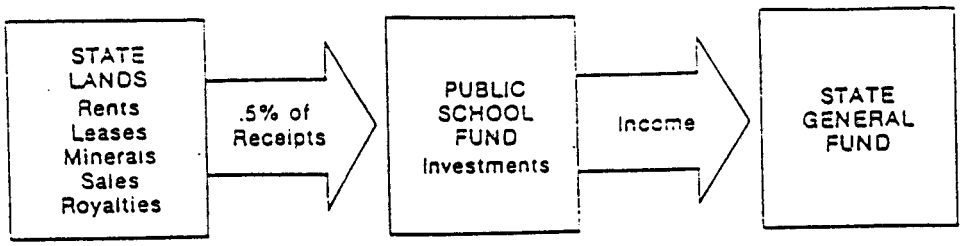

Fig. 3. Public School Fund Model: Contemporary Period

New Land Grant

A major event of the period occurred in 1980 when Congress granted Alaska an additional 75,000 acres of school land. This grant, stipulated in Public Law 96-487, the Alaska National Interest Lands Conservation Act (ANILCA) provided for a school lands settlement which stated, in part:

> In full and final settlement of any and all claims by the State of Alaska arising under the Act of March 4, 1915 (38 Stat. 1214), as confirmed and transferred in section 6 (k) of the Alaska Statehood Act, the State is hereby granted seventy-five thousand acres which it shall be entitled to select until January 4, 1994, from vacant, unappropriated, and unreserved public lands. In exercising the selection rights granted herein, the State shall be deemed to have relinquished all claims to any right, title, or interest to any school lands which failed to vest under the above statutes at the time Alaska became a State . . . . Lands selected and conveyed to the State under this subsection shall be subject to the provisions of subsections (j) and (k) of the Alaska Statehood Act.[28]

The purpose of this legislation was to provide additional land in consideration of school lands not transferred earlier to the Territory because the designated sections (under the Act of March 4, 1915) were withdrawn, reserved, or otherwise appropriated. That additional school land might be granted to the state was known prior to 1978 as provisions for ANILCA were being developed.[29]

Mental Health Lands and University Lands

The status of Mental Health Lands, involving more than 1,000,000 acres, and University lands, over 110,000 acres, must be mentioned here because the 1978 legislation also redesignated them as general grant lands, and established separate trust funds and specified advisory boards for each. A 1979 report prepared for the House Finance Committee had this to say, in part, about the 1978 law:

> . . . the law has been less than a total success. The University of Alaska, given the option of turning down the trust fund and keeping the land, did so. So the University retains its 110,000 acres and no trust fund for the University was set up. A mental health account was finally created in 1979 (account 716), but . . . there is no money in it . . . (the law required sums equivalent to one and one-half percent of land management revenues to be appropriated to this fund) and . . . the legislature has not appropriated any money to the fund . . . (and) . . . there have been no meetings of the advisory board . . . to determine investments and use of the mental health money.[30]

As of June 30, 1983, the Mental Health Fund still had a zero balance and the matter was in litigation.[31] Subsequent legislative action was taken regarding the University lands; the lands were not classified as general grant lands and the trust fund for land receipts was established.

As the five-year contemporary period drew to a close on June 30, 1983, Alaska's new Public School Fund showed a balance of more than $41,000,000, earnings in the last fiscal year had exceeded $3,000,000, and the prospect that additional acres of school land would be granted to Alaska was a reality.

A Permanent Fund for Education

The Alaska Permanent Fund is the prime example of the State's commitment to put aside some current revenues in a manner that will provide growing interest and dividend income in future years. A Constitutional Amendment in 1976 established the Fund and 25 percent of the State's oil, gas, and mineral income is credited to it each year. Additional revenues may be appropriated to the Fund, and investment earnings of the Fund itself can be put into the Fund. Like the Public School Fund, the principal of the Alaska Permanent Fund cannot be used for any purpose other than to produce earnings which can be spent for public services.

A recommendation to double the revenues put into the Alaska Permanent Fund was made by the Alaska Growth Policy Council in its 1981 Report to the Governor, which gave as its rationale the following:

> Despite a large surplus of oil revenue enjoyed by the state today, a matter of unavoidable public concern remains the ability of government to sustain current levels of service to the public when Prudhoe Bay revenues are in decline. Thus the primary objective of policies governing surplus wealth management should be to provide an income stream capable of supporting minimum levels of service indefinitely.[32]

Proposals to save for future use more of Alaska's current revenues, primarily from oil royalties, are still common. In a recent editorial, the Anchorage Daily News observed that State policymakers are discussing this possibility, and went on to explain one way of doing it:

> The mechanism is simple: investing heavily out of current revenues in the Alaska Permanent Fund--that is, 'front-loading' it. The aim is equally simple: to put the money away now to build an endowment that later will sustain basic services and keep taxes down rather than spending it now on things that later cannot be used or maintained.[33]

The need for public school support funds in the future has led to numerous suggestions that there be an endowment fund for education. In surveys conducted in 1982 as part of the Alaska school finance study, it was reported that:

> "(educators) . . . are concerned, however, that since state aid provides such a high proportion of all support, mechanisms need to be created to assure the availability of funds in the future. A permanent education fund has been suggested as one approach to accomplish that end."[34]

Another recent suggestion to consider saving funds now for education costs later was made in the fall of 1982 by Governor Sheffield's Transition Task Force which stated:

> Several proponents of an educational endowment have noted that even under modest growth forecasts, public education costs will exceed one billion dollars before the end of the decade. These proponents have argued that because almost all of these revenues are directly linked to finite oil revenues, prudence argues that the state embark on a long-term savings and investment investment program, similar to what existed in Alaska Alaska during territorial days under the federal public education trust lands program.[35]

The merit of an endowment for elementary and secondary education, in this case for school construction, was suggested in a recent survey of small school superintendents by a respondent who stated:

> I'd like to see a permanent fund or endowment set up which would produce a predictable amount of money, for example, $40 million per year for school construction. That money would be administered by the Commissioner of Education in some priority order similar to the criteria the Department is currently using. I'd like to see the end of pet projects and pork barreling. If an endowment fund is the answer, then I would support it.[36]

According to a recent U.S. Office of Education report, several other states have fairly substantial amounts of earnings from their permanent school funds.[37] Some of these states are listed in Table 9, along with the amount of permanent fund earnings used to support the public schools.

Table 9
Public School Permanent Fund Earnings
Selected States
Fiscal Year '79

State	Earnings
Arizona	$10,642,402
Colorado	25,000,000
Idaho	8,000,000
Minnesota	15,000,000
New Mexico	63,400,000
Oklahoma	6,000,000
Oregon	5,000,000
South Dakota	6,462,643
Utah	6,900,000
Wyoming	12,277,349

The U.S. Office of Education report indicated that the South Dakota earnings provided 15.85 percent of state aid that year, while earnings in Wyoming provided 18 percent of state support for the schools that year. Oregon put its earnings into its Common School Fund before distributing it to the schools on a student Average Daily Membership basis. In Wyoming, the earnings were distributed at $105 per census child. All of the states cited above accounted for permanent fund earnings separately, either by maintaining a separate

account or by putting them into a foundation account; none apparently credited the interest to the State's General Fund.

At least one Alaska community, the City and Borough of Sitka, established its own Permanent Fund using some $10,000,000 in revenues built up over the past few years. In the Charter Amendment approved on October 4, 1983, the permanent fund was to be maintained separately, and

> The principal of the fund shall be invested in such types of income-producing investments as are hereafter specifically designated by ordinance. All income from the permanent fund shall be deposited in the General Fund.[38]

As indicated earlier, state revenues from oil, gas, and mineral income are predicted to decline in the near future. These revenues have been providing about 80 percent of the State's General Fund, which is the primary source of support for the public schools. If the General Fund is diminished in size, fewer dollars will be available for sustaining public services, including elementary and secondary education.

Meanwhile, state support of public schools has been increasing at the rate of 20 percent per year for the past seven years, reaching a total of $535,453,000 in Fiscal Year '83. Note that this is not the total cost of operating the public schools, just the share that the state has been providing. The amount of this state aid, which includes the foundation program, transportation, debt retirement assistance, construction and insurance assistance, non-resident tuition, teachers' retirement contributions, special education out-of-state, juveniles in detention, and contract schools, is shown below in Table 10.

Table 10
State Aid and Shared Revenue
to District Schools in Alaska
Fiscal Years '77 - '83

Fiscal Year	State Support
'77	$165,190,000
'78	180,776,000
'79	207,557,000
'80	223,588,000
'81	356,815,000
'82	433,676,000
'83	535,453,000

If this revenue source continues to increase at the rate of 20 percent annually, a total of $1,110,316,000 would be required in Fiscal Year '87. If this source increased only 10 percent annually, the billion dollar requirement wouldn't be reached until Fiscal Year '90. See Figure 4 for current and projected state support of public schools based upon increases of 7.5 percent, 10 percent, and 20 percent. The projections used in Figure 4 are shown in Appendix E. As Figure 4 shows, the amounts of state support are large and

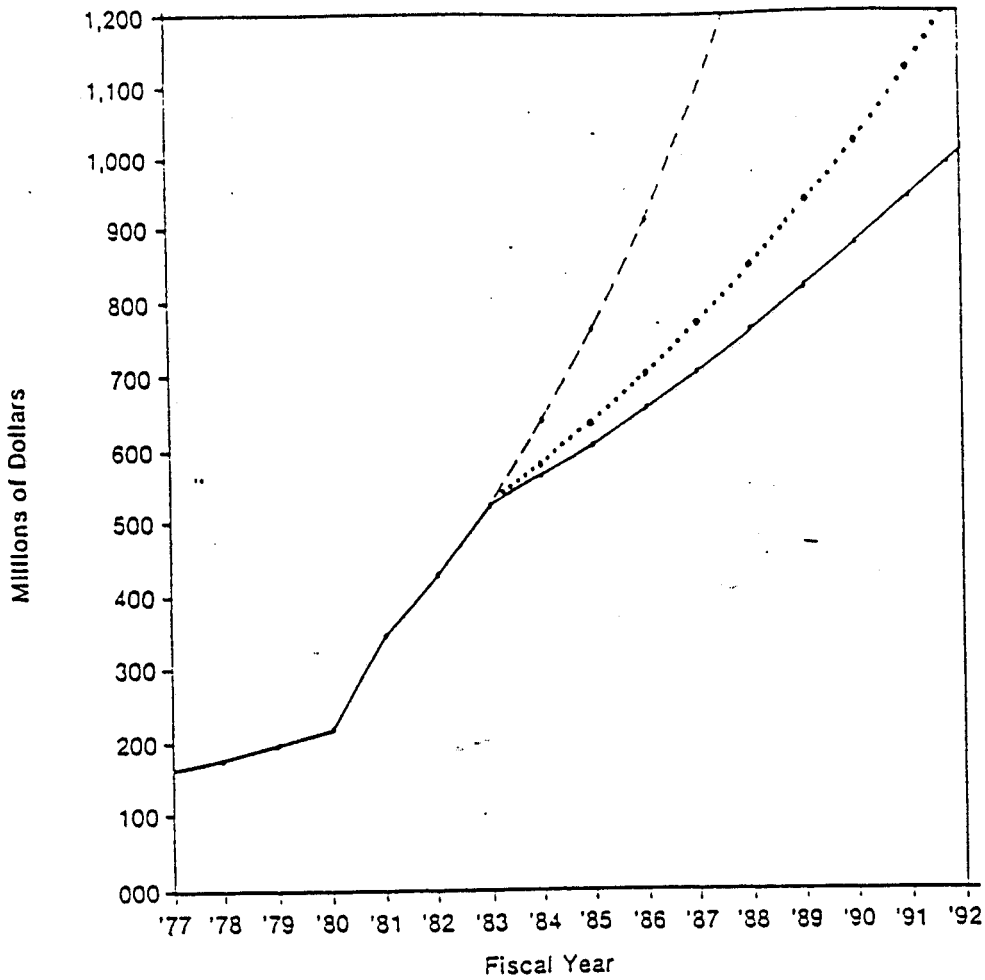

Fig. 4. Alaska State Aid and Shared Revenue to District Schools

Actual ——— Projected

20% annually — — — —
10% annually ·····
7½% annually ———

growing, and attention should be given now as to where the revenues are to come from for this support.

The prospect of an alternate source of revenue for state support of public schools should be welcomed by legislators, school board members, educators, and others. Such an alternate source of revenue could reduce the proportion of state aid appropriated to school districts from the General Fund. It could slow the increase in local revenues needed from property taxes for the city and borough school districts. Such a new revenue source might even be a replacement for local property taxes in the cities and boroughs. If distributed to all school districts on a student average daily membership basis it could give the state-supported Regional Educational Attendance Area districts a substitute for local tax revenues to which they have no access.

The Public School Fund could be an alternative, and perhaps major source of revenue, for state aid to schools if the percent of land management receipts going into the Fund would be increased. Fund investment earnings for the next few years could be returned to further increase the principal of the Fund. Close attention could be paid to the management of the investments in order to increase the rate of return. The recent federal grant of additional school lands could be carefully managed to produce additional revenues to the Fund; the identity of this land could be maintained and it could be withheld from the pool of state general grant land. These are only a few of the possibilities that would enable the Public School Fund to become a substantive endowment fund for public elementary and secondary education in Alaska.

Increasing the percent of land management receipts credited to the Fund would offer the best method for the Fund to become an endowment resource of some magnitude. Examining the potential of this method requires (1) projections of land management receipts, and (2) application of various options which divert larger amounts of these receipts into the Fund.

Projections of land management receipts for Fiscal Years '84 - '86 are based on Alaska Department of Revenue figures; estimates were made for succeeding years. Annual receipts were decreased a little over two percent starting in Fiscal Year '87. This reduction recognizes a predicted decline in mineral leases and revenues from oil and gas royalties but anticipates a modest increase in receipts from land leases, rentals, and sales. The overall intent was to present a conservative estimate of land management receipts. Projections of land management receipts are shown in Table 11.

Table 11
Estimates of State Land Management Receipts
Fiscal Years '83-'92

Fiscal Year	Estimates of Receipts
'83 (actual)	$1,882,605,800
'84	1,394,000,000
'85	1,450,000,000
'86	1,594,400,000
'87	1,570,000,000
'88	1,540,000,000
'89	1,500,000,000
'90	1,460,000,000
'91	1,420,000,000
'92	1,380,000,000

Options of varying amounts of land management receipts to credit to the Fund follow:

1. credit one-half of one percent of all land management receipts to the Fund (the current statutory rate)

2. credit five percent of land management receipts to the Fund, or

3. credit ten percent of land management receipts to the Fund.

If receipts continue at the rate of one-half of one percent (Option 1), the estimated Fund balance in Fiscal Year '92 would be $107,621,000. If the rate were increased to five percent (Option 2), the estimated Fund balance in Fiscal Year '92 would be $643,769,000. If the rate were set at ten percent (Option 3), the estimated Fund balance would reach $1,101,489 in Fiscal Year '91 and $1,239,489,000 in Fiscal Year '92. Figure 5 displays the estimated Fund balances using these three options. Estimated Fund balances for each option through Fiscal year '92 are shown in Appendix F.

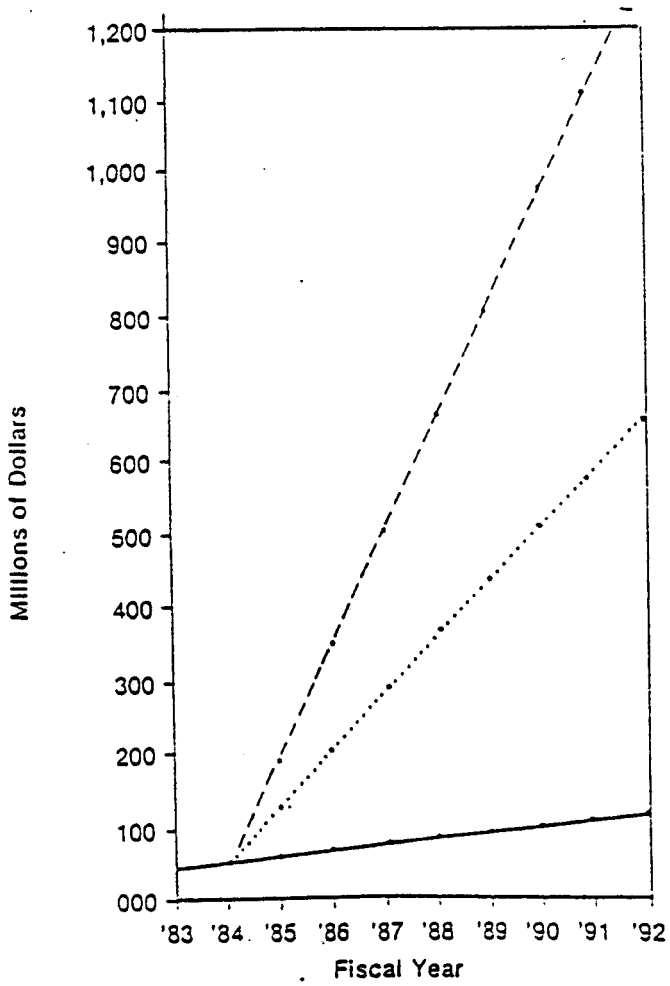

Fig. 5. Alaska Public School Fund Balances

Estimates Based on

10.0% of land management receipts — — — —

5.0% of land management receipts .....

.5% of land management receipts ————

A proportionate increase in investment earnings, and in funds available for the support of public schools, would occur if an increased percent of land management receipts were to be credited to the Fund. Increased Fund earnings could then provide a needed and alternate revenue source for support of the schools. Estimated investment earnings of the Fund, computed at 10 percent on the average balance of the Fund each year for each of the three options described earlier, are presented in Table 12.

Table 12
Estimated Investment Earnings
Public School Fund
Fiscal Year '84 through '92

	Investment Earnings Millions of Dollars		
Fiscal Year	Option 1	Option 2	Option 3
'84	4.5		
'85	5.2	8.4	12.1
'86	5.9	16.0	27.3
'87	6.7	23.9	43.1
'88	7.5	31.7	58.6
'89	8.3	39.3	73.8
'90	9.0	46.7	88.6
'91	9.7	53.9	103.0
'92	10.4	60.9	117.0

Clearly the major way to increase the earnings of the Fund is to increase the principal so there is more money to invest. Besides options two and three noted above (or a variation of them), the principal could be increased more rapidly by depositing the investment earnings into the Fund for a time, say 5 to 10 years. Following this period, even larger amounts of investment earnings would be available for the support of the schools.

Fund investment practices also affect the amount of investment revenues available each year. The average rate of return on Public School Fund investments for the five-year period just ended, presented earlier in Table 8, is compared in Table 13 with the rate of return on investments in the Alaska Permanent Fund.[39] The Alaska Permanent Fund has outperformed the Public School Fund, due in part to a number of long-term Public School Fund investments with interest rates that are low by today's market standards, but which were the prevailing rates at the time the securities were purchased.

Table 13
Rate of Return on Investment
Alaska Public School Fund,
Alaska Permanent Fund
Fiscal Years '79 - '83

Fiscal Year	Rate of Return: Public School Fund	Rate of Return: Permanent Fund
'79	7.55	8.24%
'80	9.30	11.29%
'81	10.46	16.00%
'82	13.11	15.10%
'83	11.68	12.76%

The existence of the Alaska Permanent Fund is evidence that the people of Alaska want to invest current excess revenues now in a manner that will provide substantive state revenues later when oil, gas, and mineral royalty income is expected to decline. Putting more than the obligated 25 percent of oil, gas, and mineral royalty income into the Alaska Permanent Fund does occur and may continue.

Recommendations have been made to have an endowment fund for elementary and secondary education. It would serve the same purpose for education as the Alaska Permanent Fund does for other state programs. However, Alaska already has an endowment fund for education: The Public School Fund. This Fund, which had a balance of over $41 million June 30, 1983, could become a potent resource for public school support if the amount of money put into the principal of the Fund were increased substantially.

If deposits into the Fund were increased from one-half of one percent of State of Alaska land management receipts, to ten percent of these receipts, the Fund balance would exceed $1 billion dollars in 1991 and could be providing investment revenues in excess of $100 million dollars annually for the support of elementary and secondary education. Clearly this would provide a welcome alternate revenue source and would demonstrate Alaska's commitment to school support in the future when current major state revenue sources are expected to be much less than today.

Summary and Recommendations

Summary

The purpose of this paper was to examine the development and status of Alaska's Public School Fund and its potential as a major source of revenue for elementary and secondary education. The Fund, created following the 1915 federal school lands grant to Alaska, was examined in three periods: the 1916-58 Territorial Period, the 1959-78 Early Statehood Period, and the 1979-83 Contemporary Period. The treatment and status of school lands, which until mid-1978 was the major source of revenue for the Fund, was examined, as were the legislative changes made in the status of the Fund and the land that year. A recent federal grant of additional school lands was noted. Finally, the case for an endowment fund for public education was presented, and a method whereby the Public School Fund might become such a fund--a Permanent Fund for Education--was described.

Recommendations

The evidence and options presented in the paper support six recommendations for action. These recommendations follow:

1. Increase the amount of land management receipts deposited in the Public School Fund.

Increasing the amount of land management receipts deposited in the Public School Fund will cause the principal to increase. A larger principal will permit more funds to be invested and, subsequently, there will be larger amounts of investment earnings to use for public school support.

An amendment to the current statute changing ". . . one-half of one percent . . . " to " . . . ten percent . . ." of land management receipts, for example, is all that would be required. Of course, the percent could even be larger, which would result in the Fund growing more rapidly. The potential of the Fund as a major source of revenue for the support of Alaska's public schools will be realized only if this major change is made.

Consideration should also be given to setting a specific amount which must be in the Fund before investment income is distributed; during this period investment income would be put back into the Fund to increase the principal. Specifying a "goal amount" for the principal, for example, would enable the Fund to generate investment income of sufficient magnitude to make a real impact on the school support program when investment income distribution is resumed.

Another consideration would be to "inflation-proof" the Fund by depositing amounts sufficient to keep the value of the Fund constant in real dollars.

2. Manage the Fund to achieve the maximum rate of return on investments.

The Public School Fund Advisory Board is charged to prepare (1) an annual accounting of the principal and income of the Fund, and (2) long-range

investment plans for the Fund. It is also directed to approve the investments of the principal of the fund. Although this Board was authorized in 1978, it did none of these things, as it was not organized until November, 1983, when it met for the first time.[40]

(Information about the Fund is available from the Department of Revenue, but not in published form that one might expect from the statutory directive. Fund balances are published, but this summary information provides little insight into the financial activity for the year. There is no long-range investment plan for the Fund.)

The Public School Fund Advisory Board should carry out all its statutory duties, subsuming under its charges to prepare a long-range investment plan and to approve investments such aspects as: (1) the amount and use of interest earned on the cash balances of the Fund, (2) the arrangement with SEAFIRST, the agent bank, especially with regard to disposition of interest earned on cash on hand after a security matures or is sold and before the principal is reinvested, (3) the nature of Fund management by the Department of Revenue, especially the decision process in the purchase and sale of securities, and (4) the rate of return on the investments. Everything possible should be done to keep the rate of return high on Fund investments.

3. Credit investment income of the Fund to a designated public school support account.

Crediting the Fund's investment earnings to a designated public school support account, such as the public school foundation account or an account established to distribute funds in lieu of local tax revenues, will show clearly that the use of these funds is for the benefit of the schools, since all school districts would receive disbursements from these accounts. This procedure would show full compliance with the statutes.

The practice since Alaska became a state has been to post the Fund's investment earnings directly to the State's General Fund. The contention is that since the amount of earnings placed in the General Fund is less than the General Fund appropriation for support of schools then the intent of the law is being met. Even during the Territorial Period, income from the Public School Permanent Fund was credited to the Public School Current Fund from which disbursements were made for support of the schools. This may seem like a minor point, but as earnings from the Public School Fund increase, it will be important to recognize these earnings as a revenue source apart from General Fund appropriations for school support.

4. Conduct frequent outside audits of the Fund.

According to all available information, the Fund has not had an outside audit since Fiscal Year '74. The audits should be conducted as is the practice now, by the audit division of the Legislative Budget and Audit Committee. Audit division reviews should be conducted for Fiscal Years '78, '79, and '83 or '84.

The examination of Fiscal Year '78 is important as that was the last year for Fund receipts to come solely from school lands. Fiscal Year '79

should be examined since this was the first year of operation when the Fund was credited with a percentage of receipts from the management of all state general grant lands. Future outside audits should be conducted, on a minimum, every five years.

5. Select and manage the 75,000 acres of school land granted additionally in 1980 in a manner that will provide maximum income to the Fund.

While the location of the first school lands was predetermined, i.e., sections 16 and 36 of surveyed townships, no such stipulation governs the new grant; land may be selected from vacant, unappropriated, and unreserved lands. Thus, the new federal grant of land offers Alaska the opportunity to select land which will generate high amounts of lease, mineral, or rental income.

Having this land separate from the pool of state general grant land, but still managed by the State Department of Natural Resources, would be a way to meet the intent of the original federal and statehood legislation while recognizing current management practices. Above all, the land should not be put into the pool of general grant land, as was the case with the previous school lands, without a serious study of the consequences. For one thing, the value of this new land must be considered, for at an estimated $7,500 per acre, the 75,000 acres could be worth $562,600,000. Another consideration would be to prohibit sales of any land if greater overall return to the Fund would result. Or some of the land might be used for school sites, or traded for school sites, especially in the Unorganized Borough where there have been problems with gaining title to some Regional Educational Attendance Area school sites and former Bureau of Indian Affairs school sites.[41]

6. Conduct further definitive studies to enable Alaska to capitalize on the Fund and the new grant of school lands.

Several areas of study and development which could be pursued include:

1. a review of options for increasing the principal of the Fund
2. a long-range plan for obtaining maximum income on the principal of the Fund
3. a comprehensive analysis of the Fund management for Fiscal Years '79 through '83
4. a review of school land and permanent fund management practices in other states
5. a plan for selection and management of the new grant of school land
6. a plan for utilization of Fund investment revenues.

Notes

1. Act of March 4, 1915, Chapter 181 (38 Stat. 1215)

2. Johns, Roe L., and Morphet, Edgar L. The Economics and Financing of Education, A Systems Approach. Third Edition. Englewood Cliffs, New Jersey: Prentice Hall, Inc., 1975, p. 370.

3. Territorial Legislature, Session Laws, 1933, p. 105; Territory of Alaska, Session Laws, 1931, p. 105; Territory of Alaska, Session Laws, 1929-1930, p. 10.

4. Alaska Statehood Act, Public Law 85-508 (85th Congress, H.R. 7999, July 7, 1958) Sec. 6 (k).

5. State of Alaska. Alaska Division of Lands Annual Report, 1961. Anchorage: Department of Natural Resources, p. 3.

6. State of Alaska. Laws of Alaska, 1959, Chapter 169; State of Alaska, Annual Report, 1958-59, pp. 131-132.

7. Alaska Statutes, Alaska Statehood Act, p. 6.; State of Alaska, Annual Report, 1975-76, p. 161.

8. State of Alaska, A Review of the Public School Permanent Fund, June 30, 1974. Juneau: Division of Legislative Audit, April 22, 1975.

9. State of Alaska, Division of Lands Annual Report, 1971. Juneau: Division of Natural Resources, p. 5.

10. Mike C. T. Smith, Assistant Commissioner, Department of Natural Resources in letter to Senator Kay Poland, February 23, 1977.

11. DeYoung, Chris A. Introduction to American Public Education. New York: McGraw-Hill Book Company, Inc., 1942, p. 14.

12. Burrup, Percy E. Financing Education in a Climate of Change. Boston: Allyn and Bacon, Inc., 1974, p. 204.

13. Johns, Roe L., and Morphet, Edgar L. Ibid.

14. Alaska Statutes 35.05.030 (e), 1976

15. State of Alaska Memorandum. Brief Synopsis of School, University, and Mental Health Trust Land Statutes, from Thomas E. Meacham, Assistant Attorney General, to members of the Ad Hoc Land Advisory Panel, February 8, 1977.

16. State of Alaska. A Review of Land Management Programs Administered by the Division of Lands, Department of Natural Resources. Juneau: Audit Division, Budget and Audit Committee of the Legislature, August 16, 1977, p. 5.

17. State of Alaska. Temporary and Special Acts, Chapter 182 (1978).

18. Alaska Statutes, 39.35.110.

19. State of Alaska Abstract of State Trust Land (handwritten). Anchorage: Division of Lands, State Department of Natural Resources, August 1977.

20. Alaska Department of Natural Resources, 1976 Annual Report, p. 21.

21. State of Alaska, Alaska Land Status, December 1982. (Obtained from local Lands Office, n. d., one page.)

22. Ibid.

23. State of Alaska, Unrestricted Current Year Receipt Balances (Computer Print-out AACM2240-R01 for period 07/01/82 through 06/30/83).

24. Ibid.

25. Alaska Department of Revenue sources, including December 15, 1983 letter to the author from Milt Barker, Deputy Commissioner, lists of trust fund securities, and journal worksheets.

26. Ibid.

27. Personal conversations with employees of the Alaska Department of Revenue and the Alaska Department of Education in May 1983 and in November 1983.

28. Public Law 96-487, Section 906 (b).

29. State of Alaska Memorandum dated January 3, 1978 from Thomas E. Meacham, Assistant Attorney General of Alaska to Michael C. T. Smith, Deputy Commissioner, Alaska Department of Natural Resources.

30. Research Company of Alaska. Alaska Land: Ownership and Disposal. Prepared under contract with the Division of Legislative Finance, for the House Finance Committee, October 1, 1979.

31. Conversation between the author and Steve Cowper, November 18, 1983.

32. Alaska Growth Policy Council, 1981 Report to the Governor, pp. 3-4.

33. "Front-load the fund?" Anchorage Daily News, editorial, 8 January, 1984, page e-2.

34. McGuire, C. Kent, and Augenblick, John. Evaluating School Finance in Alaska: Vol. 1, Summaries of Background Papers. Denver, Colorado: Education Commission of the States. March 1983. Page 22.

35. State of Alaska. Transition Task Force's Report (for Human Services), Department of Education section, p. 3, n.d., (memo of transmission from Task Force chair Irene Sackett, dated November 23, 1982).

36. Educational Symposium, (Anchorage, December, 1983), Small School Superintendents' Finance Questionnaire Summary, n.d., n.p.

37. U.S. Office of Education, Public School Finance Programs, 1978-79. Washington, D.C.: Government Printing Office, 1980.

38. Ordinance No. 83-560, City and Borough of Sitka, Alaska, August 19, 1983.

39. Alaska Permanent Fund, 1983 Annual Report and Financial Statements, p. 14-15.

40. State Board of Education Agenda, Nov. 28-29, 1983 Board Meeting in Anchorage.

APPENDIX A

Fund Balances
Alaska Public School Permanent Fund
1918-1958

Period ending	Cash	Investments	Total
1918 (Dec. 31)	153.04		153.04
1920	158.04		158.04
1922	529.20		529.20
1924	119.25	500.00	619.25
1926	159.25	500.00	659.25
1928	191.75	500.00	691.75
1930	235.25	500.00	735.25
1932	2,503.25	500.00	3,003.25
1934	2,599.25	500.00	3,099.25
1936	3,985.50	NA	NA
1938	5,045.48	NA	NA
1940	5,631.48	NA	NA
1942	7,393.98	NA	NA
1944	8,740.48	NA	NA
1946	10,122.98	NA	NA
1948	13,997.73	NA	13,997.73
1950	18,749.50	NA	18,749.50
1952	6,534.67	20,000.00	26,534.00
1954	NA	NA	35,892.43
1956	NA	NA	43,820.93
1958	68,566.23	93,133.80	161,700.03

APPENDIX B

Fund Balances and Investment Income
Alaska Public School Fund
Fiscal Years '59-'78

Fiscal Year	Fund Balance Cash	Fund Balance Investments	Fund Balance Total	Investment Income
'59	163,970.02	93,133.80	257,003.82	NA
'60	31,985.38	232,389.18	264,389.14	NA
'61	38,761.36	405,650.36	444,411.56	NA
'62	56,543.27	558,389.29	614,932.56	NA
'63	77,117.89	757,416.57	834,534.66	NA
'64	24,036.80	1,019,244.10	1,043,281.00	35,488.07
'65	21,966.77	1,265,171.89	1,287,138.66	40,246.78
'66	18,609.36	1,553,510.69	1,572,120.06	53,057.64
'67	59,283.88	1,761,206.57	1,820,490.45	65,731.65
'68	42,963.79	1,960,311.57	2,003,275.36	74,683.22
'69	125,208.45	2,375,263.34	2,500,471.79	85,953.92
'70	83,599.00	2,648,128.00	2,731,727.00	134,099.46
'71	71,191.00	2,946,841.00	3,018,032.00	141,052.38
'72	14,925.00	3,395,928.00	3,410,853.00	216,663.71
'73	3,053.00	3,903,193.00	3,906,247.00	213,938.55
'74	37,574.00	4,922,818.00	4,960,393.00	316,729.00
'75			5,385,291.00	
			791,559.00[1]	
	862,094.00	5,314,756.00	6,176,850.00	370,210.42
'76			5,930,337.00	
			1,005,754.00[1]	
	192,772.00	6,743,318.00	6,936,091.00	426,662.50
'77			6,610,652.00	
			1,189,575.00[1]	
	209,045.00	7,591,182.00	7,800,227.00	487,938.02
'78			7,155,716.00	
			1,376,222.00[1]	
	140,854.00	8,391,085.00	8,531,939.00	560,489.97

1. Merrill Field Trust Fund Balance.

APPENDIX C

Fund Balances and Investment Income
Alaska Public School Fund
Fiscal Years '79 - '83

Period		Fund Balance Cash	Fund Balance Investments	Fund Balance Total	Investment Income 4
FY '79	Public School Trust			8,154,590.00	
	Merrill Field Trust			1,685,608.00	
	Combined Balances	1,459,113.00	8,381,085.00	9,840,198.00	694,574.00
FY '80	Public School Trust			15,265,600.00	
	Merrill Field Trust			1,716,498.00	
	Combined Balances	991,013.00	15,991,085.00	16,982,098.00	629,247.00
FY '81	Public School Trust			21,811,265.00	
	Merrill Field Trust			2,612,078.00[1]	
	Combined Balances	2,447,289.00	21,976,054.00	24,423,343.00	1,752,124.00
FY '82	Public School Trust			29,805,642.00	
	Merrill Field Trust			1,823,465.00[2]	
	Combined Balances	1,254,147.00	30,374,960.00	31,629,107.00	3,152,772.00
FY '83	Public School Trust			39,255,883.00	
	Merrill Field Trust			1,823,465.00[3]	
	Combined Balances	873,294.00	40,206,054.00	41,079,348.00	3,908,606.00

Notes:

1. $895,580.00 was transferred from the Public School Trust to the Merrill Field Trust.
2. $788,613.00 was transferred to the General Fund from the Merrill Field Trust.
3. Unchanged from prior year figure.
4. Investment Income is amount credited to the State General Fund.

APPENDIX D

Public School Fund Investments: Fiscal Years '79-'83

Fund Investments: Fiscal Year '79

Purchase Date	Security	Par Value	Interest	Maturity Date
10/23/73	Federal Land Bank Bonds	$ 750,000	7.3 %	10/20/83
09/25/74	Tenn. Valley Authority Bonds	2,050,000	7.35	05/01/97
10/27/72	Federal National Mortgage Cap. Deb.	2,500,000	7.40	10/01/97
03/06/74	Federal National Mortgage Assoc.	300,000	7.10	12/10/97
12/21/72	General Services Administration	590,000	7.15	12/15/02
11/10/72	Washington Metro Transit Bonds	800,000	7.30	07/01/12
01/13/77	U.S. Treasury Notes	300,000	6.125	02/15/82
05/16/77	U.S. Treasury Notes	300,000	7.25	02/15/84
08/16/76	U.S. Treasury Bonds	250,000	8.00	08/15/86
05/23/78	U.S. Treasury Bonds	805,000	8.25	05/15/88

Fund Investments: Fiscal Year '80

Purchase Date	Security	Par Value	Interest	Maturity Date
10/23/73	Federal Land Bank Bonds	$ 750,000	7.3 %	10/20/83
09/25/74	Tenn. Valley Authority Bonds	2,050,000	7.35	05/01/97
10/27/72	Federal National Mortgage Cap. Deb.	2,500,000	7.40	10/01/97
03/06/74	Federal National Mortgage Assoc.	300,000	7.10	12/10/97
12/21/72	General Services Administration	590,000	7.15	12/15/02
11/10/72	Washington Metro Transit Bonds	800,000	7.30	07/01/12
01/13/77	U.S. Treasury Notes	300,000	6.125	02/15/82
05/16/77	U.S. Treasury Notes	300,000	7.25	02/15/84
08/16/76	U.S. Treasury Bonds	250,000	8.00	08/15/86
05/23/78	U.S. Treasury Bonds	805,000	8.25	05/15/88
*02/20/80	Wells Fargo Bank Cert. of Deposit	6,300,000	14.80	08/20/80
*05/07/80	Federal National Mortgage Assoc.	1,280,000	10.00	04/10/81

Note: An asterisk preceding the purchase date indicates a purchase in that Fiscal Year; an asterisk following the maturity date indicates a maturing investment in that Fiscal Year.

Funds Investments: Fiscal Year '81

Purchase Date	Security	Par Value	Interest	Maturity Date
10/23/73	Federal Land Bank Bonds	$ 750,000	7.3 %	10/20/83
09/25/74	Tenn. Valley Authority Bonds	2,050,000	7.35	05/01/97
10/27/72	Federal National Mortgage Cap. Deb.	2,500,000	7.40	10/01/97
03/06/74	Federal National Mortgage Assoc.	300,000	7.10	12/10/97
12/21/72	General Services Administration	590,000	7.15	12/15/02
11/10/72	Washington Metro Transit Bonds	800,000	7.30	07/01/12
01/13/77	U.S. Treasury Notes	300,000	6.125	02/15/82
05/16/77	U.S. Treasury Notes	300,000	7.25	02/15/84
08/16/76	U.S. Treasury Bonds	250,000	8.00	08/15/86
05/23/78	U.S. Treasury Bonds	805,000	8.25	05/15/88
02/20/80	Wells Fargo Bank Cert. of Deposit	6,300,000	14.80	08/20/80*
05/07/80	Federal National Mortgage Assoc.	1,280,000	10.00	04/10/81*
*08/05/80	U.S. Treasury Notes	1,350,000	8.875	06/30/84
*08/20/80	Bank of America C.D.	6,300,000	10.50	02/18/81*
*10/03/80	U.S. Treasury Notes	1,100,000	11.875	09/30/82
*12/03/80	U.S. Treasury Notes	1,000,000	13.875	11/30/82
*02/19/81	Bank of America C.D.	7,900,000	16.375	08/19/81
*04/08/81	Bank of America C.D.	1,000,000	14.625	10/07/81
*04/10/81	Bank of America C.D.	1,300,000	14.875	10/07/81

Fund Investments: Fiscal Year '82

Purchase Date	Security	Par Value	Interest	Maturity Date
10/23/73	Federal Land Bank Bonds	$ 750,000	7.3 %	10/20/83
09/25/74	Tenn. Valley Authority Bonds	2,050,000	7.35	05/01/97
10/27/72	Federal National Mortgage Cap. Deb.	2,500,000	7.40	10/01/97
03/06/74	Federal National Mortgage Assoc.	300,000	7.10	12/10/97
12/21/72	General Services Administration	590,000	7.15	12/15/02
11/10/72	Washington Metro Transit Bonds	800,000	7.30	07/01/12
01/13/77	U.S. Treasury Notes	300,000	6.125	02/15/82*
05/16/77	U.S. Treasury Notes	300,000	7.25	02/15/84
08/16/76	U.S. Treasury Bonds	250,000	8.00	08/15/86
05/23/78	U.S. Treasury Bonds	805,000	8.25	05/15/88
08/05/80	U.S. Treasury Notes	1,350,000	8.875	06/30/84
08/20/80	Bank of America Cert. of Deposit	6,300,000	10.50	02/18/81*
10/03/80	U.S. Treasury Notes	1,100,000	11.875	09/30/82
12/03/80	U.S. Treasury Notes	1,000,000	13.875	11/30/82
02/19/81	Bank of America Cert. of Deposit	7,900,000	16.375	08/19/81*
04/08/81	Bank of America Cert. of Deposit	1,000,000	14.625	10/07/81*
04/10/81	Bank of America Cert. of Deposit	1,300,000	14.875	10/07/81*
*08/20/81	Bank of America C.D.	11,600,000	18.10	02/16/82*
*10/07/81	First Interstate Bank	3,100,000	16.00	04/15/82*
*02/16/82	U.S. Treasury Notes	14,193,000	14.625	02/15/85
*04/05/82	Bank of America C.D.	4,700,000	14.50	10/01/82

Fund Investments: Fiscal Year '83

Purchase Date	Security	Par Value	Interest	Maturity Date
10/23/73	Federal Land Bank Bonds	$ 750,000	7.3 %	10/20/83
09/25/74	Tenn. Valley Authority Bonds	2,050,000	7.35	05/01/97
10/27/72	Federal National Mortgage Cap. Deb.	2,500,000	7.40	10/01/97
03/06/74	Federal National Mortgage Assoc.	300,000	7.10	12/10/97
12/21/72	General Services Administration	590,000	7.15	12/15/02
11/10/72	Washington Metro Transit Bonds	800,000	7.30	07/01/12
05/16/77	U.S. Treasury Notes	300,000	7.25	02/15/84
08/16/76	U.S. Treasury Bonds	250,000	8.00	08/15/86
05/23/78	U.S. Treasury Bonds	805,000	8.25	05/15/88
08/05/80	U.S. Treasury Notes	1,350,000	8.875	06/30/84
10/03/80	U.S. Treasury Notes	1,100,000	11.875	09/30/82*
12/03/80	U.S. Treasury Notes	1,000,000	13.875	11/30/82*
02/16/82	U.S. Treasury Notes	14,193,000	14.625	02/15/85
04/05/82	Bank of America C.D.	4,700,000	14.50	10/01/82*
*09/30/82	Bank of America C.D.	4,550,000	10.67	03/29/83*
*10/01/82	Ranier National Bank	4,700,000	9.80	10/04/82*
*10/04/82	Bank of America C.D.	4,700,000	10.55	04/04/83*
*11/03/82	Manufacturers Hanover Trust	1,000,000	8.85	01/31/83*
*11/30/82	Bank of America C.D.	650,000	8.90	03/19/83*
*12/07/82	Bankers Trust	1,000,000	8.75	06/06/83*
*01/07/83	Bank of America C.D.	650,000	8.375	07/06/83
*02/01/83	Manufacturers Hanover Trust	1,000,000	8.75	08/01/83
*02/04/83	Bank of America C.D.	625,000	8.875	08/01/83
*03/11/83	Bank of America C.D.	650,000	8.40	07/06/83
*03/29/83	Bankers Trust	5,500,000	9.125	09/26/83
*04/04/83	Manufacturers Hanover Trust	5,200,000	9.05	10/20/83
*06/06/83	Bank of America C.D.	3,000,000	9.05	11/07/83

APPENDIX E

Estimates of State Aid and Shared Revenue to District Schools
Fiscal Years '84-'92

Fiscal Year	7.5% Increase	10.0% Increase	20.0% Increase
'84	$ 577,612,100	588,998,500	642,543,800
'85	618,783,000	647,898,000	771,052,500
'86	665,191,800	712,688,100	925,263,000
'87	715,081,200	783,957,000	1,110,315,600
'88	768,712,200	862,352,600	1,332,378,800
'89	826,365,700	948,587,900	1,612,178,300
'90	888,343,100	1,043,446,700	1,934,614,000
'91	954,968,800	1,147,791,400	2,321,537,000
'92	1,026,591,500	1,262,570,500	2,785,844,100

Note: This revenue source increased an average of 20% annually from FY '77 through FY '83.

APPENDIX F

Estimates of Public School Fund Balances
Using Three Land Management Receipt Options
Fiscal Years '83 - '92

Fiscal Year	Fund Balances Percent of Land Management Receipts .5%	5.0%	10.0%
'83	$ 41,079,000	-	-
'84	48,049,000	-	-
'85	55,299,000	120,549,000	193,049,000
'86	63,271,000	200,269,000	352,489,000
'87	71,121,000	278,769,000	509,489,000
'88	78,821,000	355,769,000	663,489,000
'89	86,321,000	430,769,000	813,489,000
'90	93,621,000	503,769,000	959,489,000
'91	100,721,000	574,769,000	1,101,489,000
'92	107,621,000	643,769,000	1,239,489,000

Note: Fiscal Year '83 is actual; the 5% and 10% options begin in FY '85 presuming a change in the law could first occur in FY '84.

MEMORANDUM State of Alaska

TO: Honorable Mary A. Nordale
Commissioner
Department of Revenue

DATE: August 13, 1985

FILE NO: 366-403-85

TELEPHONE NO: 465-3600

FROM: Harold M. Brown
Attorney General

By: G. Thomas Koester
Assistant Attorney General
Department of Law

SUBJECT: Public school fund: trust status, dedication of revenues, income disposal

You requested our advice on three issues: (1) the trust status of the public school fund (AS 37.14.110); (2) the dedication of revenues to the public school fund; and (3) the disposition of the income of the fund.

The short answers to your three questions are: (1) a trust obligation does exist with respect to the public school fund; (2) the dedication of revenues to the public school fund probably is permissible, but only until the principal in the fund equals the fair market value of the school lands; and (3) the income should be retained in the fund until appropriations for school purposes are enacted into law.

1. The trust status of the public school fund. To fully understand the law applicable to the public school fund, a brief historical review is necessary. Under the Act of March 4, 1915, 48 U.S.C. 353, sections 16 and 36 of each township were granted to the Territory of Alaska for the support of public schools. Under section 6(k) of the Alaska Statehood Act, this grant to the territory was confirmed and transferred to the State of Alaska upon its admission to the Union.

There is no question that these school lands were received by the territory and the state as a true public land trust. Wessells v. State, Dept. of Highways, 562 P.2d 1042, 1051 n.34 (Alaska 1977). The school land grant was similar in all respects to school trust land grants to other western public land states, and the functional equivalent of the university land trust addressed by the Alaska Supreme Court in State v. University of Alaska, 624 P.2d 807 (Alaska 1981). 1/

1/ Earlier opinions and memoranda by this office, including those you refer to in your request for advice, have tended to equate the legal principles applicable to school lands, university lands and mental health lands granted to the territory

(Footnote Continued)

In University of Alaska, the Alaska Supreme Court held that the law of private trusts was applicable to the university land grant to the territory and the state. Accordingly, when the legislature placed university lands in a state park, the court held that the university land trust must be compensated for the fair market value of the lands removed from the trust and placed in the park. 624 P.2d at 816.

The United States Supreme Court reached the same conclusion with respect to school lands granted to Arizona in its Act of Admission. Lassen v. Arizona, 385 U.S. 458 (1967). The basic theory underlying these cases is that the lands or their equivalent monetary value must be administered as a trust for the exclusive benefit of the university (in the university land grant) or public schools (in the school land grant).

One problem with administering the lands exclusively for the benefit of the university or public schools is that it is not particularly good land management. The preferable way to administer lands is to determine their highest and best use, and administer them accordingly. The problem is that the highest and best use of certain lands may not result in the receipt of any income or proceeds. Where lands which are dedicated to the support of the university or public schools are used for purposes which do not produce revenue, the failure to compensate the trust for the fair market value of the lands may constitute a breach of the trust under which the lands were received. It consistently has been held that the proper remedy for such a breach is to compensate the trust for the fair market value of the lands. See, e.g., Lassen, 385 U.S. at 469-470; University of Alaska, 624 P.2d at 816.

With respect to school lands in Alaska, the 1978 Legislature did two things. First, in sec. 2, ch. 182, SLA 1978, it redesignated all school lands as general grant lands. Under the

---

(Footnote Continued)
and the state under the Alaska Mental Health Enabling Act of 1956, P.L. 84-830, 70 Stat. 709. There are significant differences between the true public land trusts governing university lands and school lands and the broader public trust doctrine governing mental health lands. The legal principles applicable to mental health lands currently are at issue in State v. Weiss, Alaska Supreme Court Nos. S-653 and S-678. The remainder of this memorandum will address only the functionally-equivalent university and school land grants.

decision in the University of Alaska case, this had the effect of removing all the lands from the public trust. Second, in sec. 4, ch. 182, SLA 1978, the legislature created the public school fund, AS 37.14.110, and provided that the commissioner of the Department of Revenue was to transfer to the fund a sum equal to one-half of one percent of the total receipts derived from the management of state land as well as federal mineral revenue-sharing payments or bonuses. See AS 37.14.150. This appears to be the legislatively-created mechanism to compensate the trust for the value of the lands removed.

The clear import of these two actions was to substitute the public school fund for the lands which formed the corpus of the school lands trust. Under well-established principles of trust law, the same fundamental trust obligations which existed with respect to the school lands trust now apply to the public school fund. Among the trust principles now applicable to the public school fund are the fiduciary duty of due care to preserve the corpus of the trust, the duty not to commingle the funds in the public school fund with other state funds (i.e., separate accounts must be maintained), and, of course, the requirement that the fund be administered for the exclusive benefit and support of public schools.

Summarizing, it is our opinion that a trust obligation clearly exists with respect to the public school fund.

2. The dedication of revenues to the public school fund. Under AS 37.14.150, the commissioner of the Department of Revenue is to transfer one-half of one percent of state land revenues, as well as federal mineral revenue-sharing payments, to the public school fund. This has been construed by your department as authorizing the transfer without appropriation by the legislature. 2/ This is a clear example of a dedicated fund. Dedicated funds are unconstitutional under article IX, section 7, of the Alaska Constitution unless "required by the federal government for state participation in federal programs" or in the event the "dedication for special purposes exist[ed] upon the date of ratification of this section by the people of Alaska."

2/ Compare AS 37.14.050, also enacted as part of sec. 4, ch. 182, SLA 1978, which makes similar transfers to the mental health fund "subject to legislative appropriation of sufficient funds."

Here, the legislature has removed the lands from a federally-created trust and substituted a monetary fund. We believe the exceptions to the prohibition on dedicated funds contained in article IX, section 7, of the Alaska Constitution -- i.e., for dedicated funds "required by the federal government" or "existing upon the date of ratification of this section by the people of Alaska" -- authorize the dedication of revenues to the public school fund, since the dedication of revenues is an alternate form to the pre-statehood federal dedication of lands. However, the dedication is authorized only to the extent it is necessary to fully compensate the trust for the fair market value of the lands removed. Any continued dedication of funds over and above the fair market value of the lands removed would be an impermissible dedication because it would go beyond the requirements of federal law and would exceed the dedication existing at the time the constitution was ratified (i.e., the dedication of the lands).

Accordingly, the proper approach is to assess the fair market value of the lands as of 1978. That amount could then be paid over time by the automatic deposit of revenue as provided in AS 37.14.150. 3/ At the time the debt is completely retired, the automatic deposit under AS 37.14.150 should cease. Additional deposits beyond that point would conflict with the dedicated fund prohibition in that they no longer would be required by federal law as compensation for the pre-existing dedication of lands.

In short, the dedication is permissible until the amount deposited in the public school fund equals the fair market value of the lands.

3. Disposition of income from the fund. Under trust law, the income from the principal of the trust must be accounted

---

3/ Under Lassen, 385 U.S. at 469 n.21, "deferred payment arrangements" would seem to be permissible. However, general principles regarding trust management -- e.g., the duty to preserve the trust property (see Restatement (Second) of Trusts, § 176 (1959)) and the duty to make the trust property productive (see Restatement (Second) of Trusts § 181 (1959)) -- would seem to require that the public school fund also receive an amount equal to what the unpaid balance would have earned, probably calculated at the same rate at which the general fund earns income (since otherwise the general fund would benefit from earnings properly attributable to the public school fund).

for separately from other revenues. Restatement (Second) of Trusts § 172 (duty to keep and render accounts) and § 179 (duty to keep trust property separate) (1959). The best procedure to follow would be to retain the income in the public school fund until appropriations for school purposes are enacted into law which specifically identify public school fund income as the fund source for the appropriation. The reason for this is that the income in the fund continues to earn additional income through compounding. If the income is automatically deposited in the general fund, the benefit of that compounded income is not devoted to school purposes, arguably a breach of the trust obligation. See Restatement (Second) of Trusts § 182 (duty to pay income to the beneficiary (1959).

You note that current general fund appropriations for school purposes greatly exceed the income generated by the public school fund. However, in the University of Alaska case, the Alaska Supreme Court held that this was not sufficient to discharge the trust obligation.

Moreover, if the public school fund at some point reaches a level that its income exceeds appropriations for public school purposes, the trust nature of the dedicated fund would preclude the expenditure of surplus monies for other purposes. The surplus income would have to be retained in the public school fund to satisfy the trust obligation. While this may not be good policy, it is an obligation of trust law. 4/

4. Conclusion. For the foregoing reasons, the short answers to your questions are (1) a trust obligation does exist with respect to the public school fund; (2) the dedication of revenues to the public school fund is constitutional until the

---

4/ Problems arising from such dedication in other states, notably Texas, led directly to the prohibition on dedicated funds in the Alaska Constitution. See 4 Proceedings of the Alaska Constitutional Convention 2364 (Jan. 17, 1956). That same experience was noted during deliberations on the Alaska Mental Health Enabling Act, see Care of Alaskan Mentally Ill: Hearings on H.R. 6376, H.R. 6334, H.R. 610, H.R. 5092, H.R. 3991 and H.R. 5093 before the Subcommittee on Territorial and Insular Affairs of the House Committee on Interior and Insular Affairs, 84th Cong., 1st Sess. 352 (1955) (statement by Rep. Rogers), and the mental health land grant eventually was enacted without a dedication requirement to avoid that particular problem.

amount in the fund equals the fair market value of school lands; and (3) the income from the fund should be retained in the fund until appropriations for school purposes are enacted into law which specifically identify public school fund income as the fund source for the appropriations.

We hope this answers your questions. If we can be of further assistance, please contact us at your convenience.

GTK:dlm

cc: Honorable Esther C. Wunnicke
Commissioner
Department of Natural Resources

Honorable Harold Raynolds, Jr.
Commissioner
Department of Education

To: Bruce M. Botelho, Attorney General
Wilson L. Condon, Commissioner of Revenue

From: G. Thomas Koester

Date: November 27, 1995

Re: Public School Trust Fund (AS 37.14.110)

You asked several questions relating to the public school trust fund, AS 37.14.110. The questions you asked and the short answers are:

1. Does the state have enough information at this time to stop paying the one-half of one percent of state land revenues to the public school trust fund as required by AS 37.14.150? No.

2. If not, what does it still need to know? The state needs to know two things: (1) the fair market value of the school trust land at the time the land was redesignated as general grant land in 1978; and (2) whether the state's payments to the public school trust fund exceed that amount.

3. Should the payments of one-half of one percent of state land revenues to the public school trust fund be considered as including both a contribution to the principal of the fund and a payment of interest on the unpaid balance until the full fair market value has been paid? No. All of the money paid was deposited to the principal of the public school trust fund to be retained in perpetuity and invested to generate income. Interest on the unpaid balance of the fair market value of the school trust land redesignated as general grant land in 1978 would be considered income to the trust available for expenditure for public education. Any state liability to the trust for interest would be subject to a set-off for state expenditures on public education. To the extent state expenditures on public education since 1978 do not equal the amount the trust would have earned on the unpaid balance, the state owes a debt to the trust which, when paid, should be considered income available for appropriation by the legislature for public education in the future.

4. If too much money has been paid to the public school trust fund to compensate the school land trust for the 1978 redesignation of school trust land as general grant land, can the overpayment be recovered and returned to the general fund? Yes.

5. Is the current method of calculating income available for expenditure from the public school trust fund's investments in domestic equity pools, under which increases in share values attributable to dividends are treated as income and increases (or decreases) attributable to capital gains (or losses) are credited (or debited) to principal, consistent with the state's public school trust obligation and the statutes governing administration of the fund? Yes. While perhaps not the

only permissible method of calculating the fund's income available for expenditure for public education, it is certainly a permissible method.

6. What options does the state have for dealing with public school trust fund earnings that exceed projected earnings and, as a consequence, have not been appropriated for school purposes by the legislature? Public school trust fund earnings available for expenditure do not lose that status even though they were not appropriated by the legislature for expenditure in the year in which they were received. They accordingly remain available for expenditure as a matter of trust law, needing only to be appropriated by the legislature for school purposes in a subsequent year.

I. Factual background.

The school land trust began with a reservation of federal land "for the support of common schools" while Alaska was still a Territory. As relevant here, section 1 of the Act of March 4, 1915, 38 Stat. 1214, 43 U.S.C. 353, did four things: (1) it reserved from disposal sections 16 and 36 in the Territory of Alaska; (2) it authorized the Territorial legislature to "provide for leasing" -- but not selling -- the reserved land; (3) it provided that all income and proceeds from the land were "appropriated and set apart as separate and permanent funds in the Territorial treasury, to be invested;" and (4) it required that all of the investment income "be expended only for the exclusive use and benefit of the public schools of Alaska."

Several aspects of the 1915 Act are worth noting. First, it did not actually create a land trust. Instead, the land was simply reserved for, and the revenues from the land statutorily dedicated to, school purposes. Neither the reservation of the land nor the dedication of the revenues was made irrevocable, and both could be (and at statehood were) changed by a subsequent Congress. Second, only leasing of the land was authorized; sale was not. Third, unlike a trust where revenues are allocated either to principal which must be preserved or income which may be expended for trust purposes, all income from the land was dedicated to a permanent fund and invested with only the investment earnings available for expenditure.

A public school permanent fund was created in the territorial treasury to which $153.04 had been deposited by December 31, 1918.[1] The first investment was a $500.00 U.S. Savings Bond paying 4 1/2 percent interest purchased on January 10, 1923. On June 30, 1958, shortly before the Alaska Statehood Act was enacted on July 7, 1958, there was $161,700.03 in the public school permanent fund.

The school land trust was created when Alaska became a state in 1959. The public school

---

[1] The information in this paragraph is taken from E.D. Coon, "The Alaska Public School Fund: A Permanent Fund for Education" (1984) (hereafter "The Alaska Public School Fund"), a paper presented to the American Education Finance Association.

permanent fund was transferred to the new state under section 5 of the Alaska Statehood Act, P.L. 8-508, 72 Stat. 339, 340, which provided that the new state would succeed to the Territory's title to real and personal property. Section 6(k) of the Alaska Statehood Act, 72 Stat. at 343, repealed section 1 of the Act of March 4, 1915, and provided for the conveyance to the new state of the reserved land "for the purposes for which they were reserved" under the 1915 Act -- i.e., "for the support of common schools."

In *Wessells v. State, Dept. of Highways*, 562 P.2d 1042, 1051 n. 34 (Alaska 1977) (citations omitted; emphasis added), the Alaska Supreme Court summarized how this created the school land trust:

> Two sections in each township of Alaska were reserved for the support of schools by Congressional act. The Alaska Statehood Act provided that those lands were granted to the State of Alaska "for the purposes for which they were reserved." The people of Alaska consented to the terms and conditions of the federal act by art. XII, sec. 13 of the Constitution of the State of Alaska. <u>The grant and its acceptance created a trust.</u>

The Alaska Land Act, AS 38.05, enacted by the First Alaska Legislature in 1959, provided for management and disposal of school trust land (as well as other state land), including for the first time authorizing the sale of that land.[2] With only minor exceptions that subsequently were

---

[2] It might be argued that sale of the land was beyond the new state's power in light of the provision in the Alaska Statehood Act that the lands were granted to Alaska "for the purposes for which they were reserved." That argument assumes that the purpose for which they were reserved was to generate income for deposit to a permanent fund and that sale was not authorized. Section 6(j) on its face defeats that argument, as it expressly refers to sale of the land reserved for educational purposes: ". . . and no part of the proceeds arising from the sale or disposal of any lands granted herein for educational purposes shall be used for the support of any sectarian or denominational school, college, or university." Construing the repeal of section 1 of the Act of March 4, 1915, as permitting sale, moreover, would be consistent with congressional treatment of other school land grants. Without exception, school land grants to other states have included the power of sale. There is no indication that Congress intended a different result for Alaska. A challenge to the sale provision at this late date, moreover, would probably be barred under the doctrine of laches. Finally, as set out below, courts consistently have held that states can take school trust land for their own use by compensating the school land trust for the fair market value of the land taken. In light of the 1978 legislation redesignating school trust land as general grant land, also discussed below, any challenge to the 1959 legislation authorizing disposal and sale of school trust land would now be moot. It accordingly is extremely unlikely that a court would hold that the state was precluded from disposing of school land simply because sale of the land was not authorized in section 1 of the Act of March 4, 1915, a section repealed in the Alaska Statehood Act. The better interpretation is that the repeal of that section and the

questioned, all revenues from school land continued to be deposited in the public school permanent fund.[3]

The Alaska Legislature made major changes to the school land trust in ch. 182, SLA 1978.[4] First, sec. 2 of that act redesignated all school trust land as general grant land, thereby removing the land from the trust. Second, sec. 4 of that act enacted a comprehensive statutory scheme for the trust, codified at AS 37.14.110-37.14.170. The public school trust fund was statutorily established in AS 37.14.110,[5] to consist of (1) the balance of what had been the public school permanent fund as of July 1, 1978 (the effective date of the relevant sections of ch. 182), and (2) additional payments to the new fund under AS 37.14.150 of one-half of one percent of all state land revenues (including federal mineral revenue sharing payments) to compensate the trust for the land removed from it.

A number of 1988 amendments established the current administrative requirements for the fund. Under AS 37.14.160, the commissioner of revenue is the treasurer of the fund and must,

> (1) in carrying out investment duties under this section, exercise the same powers and duties established for the Alaska State Pension Investment Board in AS 14.25.180(c);
>
> (2) deposit the principal and income from investments in separate principal and income accounts for the fund;
>
> (3) invest and maintain accounting records that distinguish between the principal and income of the fund; and

---

conveyance of the land to the new state included the same powers of administration given to other states as trustees of school trust land, including the power of disposal and sale, subject only to the requirement that the trust be compensated for the fair market value of the land. That is what the 1959 state legislation provided.

[3] "The Alaska Public School Fund," *n. 1 supra*, at 6-8.

[4] *Id.* at 8-9.

[5] The 1978 law established the public school fund as a separate fund; that fund was characterized as an "endowment trust" fund and the word "trust" was added to its name in sec. 21 of ch. 141, SLA 1988.

(4) provide reports to the board established under AS 37.14.120[6] on the condition and investment performance of the fund.

AS 37.14.170 provides that the commissioner is the "fiduciary" of the fund and establishes additional investment guidelines. AS 37.14.110(c) provides:

(c) The commissioner of revenue shall determine the net income of the fund in accordance with investment accounting principles and in a manner that preserves the distinction between principal and income and that excludes capital gains or losses realized on principal. The principal of the fund and the capital gains or losses realized on principal shall be perpetually retained in the fund for investment purposes.

II. Analysis

Before turning to your specific questions, it may be helpful to address several more basic legal questions raised by the facts surrounding the conversion of the school land trust to a monetary trust. Many cases hold that, while states can take public trust lands for non-trust purposes, the trust must be compensated for the full fair market value of the lands under principles similar to those governing private trusts.[7]

---

[6] The Public School Fund Advisory Board was created in AS 37.14.120 as part of the 1978 legislation. As a result of the 1988 amendments, its primary responsibility now is to "have prepared an annual accounting of the principal and interest of the fund. AS 37.14.130(2).

[7] *See, e.g.*, *Lassen v. Arizona ex rel. Arizona Highway Dept.*, 385 U.S. 458, 465-70 (1967); *State v. Weiss*, 706 P.2d 681, 683 (Alaska 1985); *State v. University of Alaska*, 624 P.2d 807, 813-14 (Alaska 1981). Courts increasingly are recognizing, however, that public trust obligations must be accommodated with other public interests. *See, e.g.*, *National Parks and Conservation Association v. Board of State Lands*, 869 P.2d 909, 920-921 (Utah 1993) (state may consider non-economic factors in management of public trust lands); *id.* at 923 (Durham, J., concurring) (same); *Colorado State Board of Land Commissioners v. Colorado Mined Land Reclamation Board*, 809 P.2d 974, 987 (Colorado 1991) (same); *Price v. State of Hawaii*, 921 F.2d 950, 955-56 (9th Cir. 1990) (same). The United States Supreme Court has made clear in the context of the United States' trust relationship with Native Americans that governmental trust obligations must be accommodated with other governmental obligations. *Nevada v. United States*, 463 U.S. 110, 128 and 141-43 (1983). And it is clear that not all private trust principles apply to public land trusts. For example, general private trust law principles flatly prohibit a private trustee from purchasing trust land. *See Restatement (Second) of Trusts* § 170 comment b (1959) (a trustee "is under a duty not to sell [trust property] to himself either by private sale or at auction" and "[i]t is immaterial that the trustee acts in good faith in purchasing trust property for himself, and that he pays fair consideration"). *Lassen* and numerous other cases make clear that a

When the state takes land from private parties for its own use, it generally pays the full fair market value at that time. *See, e.g.*, AS 09.55.360 (court "shall" set aside and annul condemnation proceeding and restore possession to private landowner if money to compensate landowner not obtained). In AS 37.14.150, however, the legislature took a different approach to compensating the school land trust for redesignating school land as general grant land. AS 37.14.150 requires that one-half of one percent of all state land revenues (including federal mineral revenue-sharing payments) be deposited in the public school trust fund annually -- i.e., the legislature chose to compensate the school land trust over time instead of with a single lump sum payment. In *Lassen*, n. 6 *supra*, the Court stated that "deferred payment arrangements" could be made when a state takes school trust land. 385 U.S. at 461 n. 21. There accordingly is no legal problem under public land trust law with the legislature choosing to compensate the school land over time instead of with a single lump-sum payment. There accordingly is no legal problem under public land trust law with the 1978 legislation that redesignated the school trust land as general grant land.[8]

AS 37.14.150 is a statute of indefinite duration. In other words, it remains in effect until amended or repealed. As a result, payments to the public school trust fund either have exceeded, or at some point in the future will exceed, the fair market value of the land removed from the school land trust by the 1978 redesignation legislation.

The certainty that the public school trust fund either has or will receive more money under AS 37.14.150 than is required to compensate the trust for the fair market value of the school trust land redesignated as general grant land presents a legal problem under the Alaska Constitution's

---

state as trustee of a public land trust may permissibly sell land to itself as long as it pays fair market value.

[8] The same 1978 legislation also redesignated mental health trust land as general grant land and provided that the mental health trust would be compensated by dedicating one and one-half percent of state land revenue to a mental health fund. Unlike the statutory dedication to the public school trust fund, however, the statutory dedication to the mental health fund was made "subject to legislative appropriation of sufficient funds." AS 37.14.050, enacted as part of sec. 4, ch. 182, SLA 1978. The legislature never appropriated any funds to the mental health fund, and the Alaska Supreme Court held that the portion of the 1978 legislation redesignating mental health trust land as general grant land without compensation was a breach of the federally-created trust and invalid, and directed that the mental health land trust be reconstituted. *State v. Weiss*, 706 P.2d 681, 683-84 (Alaska 1985). Because the school land trust is automatically compensated through the statutory dedication of one-half of one percent of state land revenues with no requirement that the legislature appropriate the funds, the Department of Law has concluded that "there are no legal problems [with the redesignation of school trust land] similar to those raised in the mental health lands litigation." 1988 Inf. Op. Atty Gen. (April 28; file no. 663-88-0306) at 1.

prohibition on dedicated funds.[9] The problem was summarized in 1985 Inf. Op. Atty Gen. (August 13; file no. 366-403-85), at 3-4 (footnote omitted):

> Under AS 37.14.150, the commissioner of the Department of Revenue is to transfer one-half of one percent of state land revenues, as well as federal mineral revenue-sharing payments, to the public school fund. This has been construed by your department as authorizing the transfer without appropriation by the legislature. 2/ This is a clear example of a dedicated fund. Dedicated funds are unconstitutional under article IX, section 7, of the Alaska Constitution unless "required by the federal government for state participation in federal programs" or in the event "the dedication for special purposes exist[ed] upon the date of ratification of this section by the people of Alaska."
>
> Here, the legislature has removed the lands from a federally-created trust and substituted a monetary fund. We believe the exceptions to the prohibition on dedicated funds contained in article IX, section 7, of the Alaska Constitution -- i.e., for dedicated funds "required by the federal government" or "existing upon the date of ratification of this section by the people of Alaska" -- authorize the dedication of revenues to the public school fund, since the dedication of revenues is an alternate form to the pre-statehood federal dedication of lands. However, the dedication is authorized only to the extent it is necessary to fully compensate the trust for the fair market value of the lands removed. Any continued dedication of funds over and above the fair market value of the lands removed would go beyond the requirements of federal law and would exceed the dedication existing at the time the constitution was ratified (i.e., the dedication of the lands).
>
> Accordingly, the proper approach is to assess the fair market value of the lands as of 1978. That amount could then be paid over time by the automatic deposit of revenue as provided in AS 37.14.150. At the time the debt is completely retired, the automatic deposit under AS 37.14.150 should cease. Additional deposits beyond that point would conflict with the dedicated fund prohibition in that they no longer would be required by federal law as compensation for the pre-existing dedication of lands.

---

[9] Article IX, sec. 7 of the Alaska Constitution provides:

Dedicated Funds. The proceeds of any state tax or license shall not be dedicated to any special purpose, except as provided in Section 15 of this article [the Alaska Permanent Fund provision] or when required by the federal government for state participation in federal programs. This provision shall not prohibit the continuance of any dedication for special purposes existing upon the date of ratification of this section b the people of Alaska.

In short, the dedication is permissible until the amount deposited in the public school fund equals the fair market value of the lands.

This brings us to your questions.

Question 1: Does the state have enough information at this time to stop paying the one-half of one percent of state land revenues to the public school trust fund as required by AS 37.14.150?

No. As stated in 1985 Inf. Op. Atty Gen. (August 13; file no. 366-403-85) at 4,

> the proper approach is to assess the fair market value of the lands as of 1978. That amount could then be paid over time by the automatic deposit of revenue as provided in AS 37.14.150. At the time the debt is completely retired, the automatic deposit under AS 37.14.150 should cease.

(Footnote omitted.) As the fair market value of the land as of 1978 has not been determined and Department of Revenue staff advises that there is some remaining question about how much has been paid to the public school fund, the state does not have enough information at this time to stop paying the one-half of one percent of state land revenues to the public school trust fund.

Question 2. If not, what does it still need to know?

The state needs to know two things before stopping payments to the public school fund: (1) the fair market value of the school trust land at the time the land was redesignated as general grant land in 1978; and (2) whether payments to the public school fund equal or exceed that amount.

The background materials that your staff provided include two memoranda from Department of Natural Resources staff outlining three options for making that determination through procedures similar to those used to value mental health trust land. All three approaches described in those memoranda would seem to comply with basic legal requirements for such determinations under *Lassen v. Arizona ex rel. Arizona Highway Dept.*, 385 U.S. 458 (1967). At issue in *Lassen* was a school land trust established in the Arizona and New Mexico Enabling Act, 36 Stat. 557, the Act admitting those states to the Union. The Act specified that school trust land be sold or leased only to "the highest and best bidder at public auction." Despite that restriction, the Court held that Arizona did not have to follow that procedure when taking the land for its own use. Because Arizona could condemn the land through its power of eminent domain even if the land were first sold at auction, the Court recognized that requiring it to follow the auction procedure "would sanction an empty formality." 385 U.S. at 464. The Court concluded:

> The trust will be protected, and its purposes entirely satisfied, if the State is

> required to provide full compensation for the land it uses. We hold, therefore, that Arizona need not offer public notice or conduct a public sale when it seeks trust lands for its highway program. The State may instead employ the procedures established in the Commissioner's rules, or any other procedures reasonably calculated to assure the integrity of the trust and to prevent misapplication of its lands and funds.

385 U.S. at 465. Accordingly, the state may use any valuation procedures "reasonably calculated to assure the integrity of the trust and to prevent misapplication of its lands and funds." The procedures outlined in the Department of Natural Resources' memoranda appear to meet those criteria.

The state also will need to determine whether the total payments to the public school fund equal or exceed the fair market value of the land. Department of Revenue staff is in the process of determining precisely how much has been paid to the public school fund since the 1978 redesignation legislation.

If it is determined that amounts paid to the public school fund equal or exceed the fair market value of the school trust land redesignated as general grant land by the 1978 legislation, it would be legally permissible as a matter of trust law to stop payment of the one-half of one percent of state land revenues to the public school fund under AS 37.14.150. And, for the reasons set out in 1985 Inf. Op. Atty Gen. (August 13; file no. 366-403-85), stopping payment of the one-half of one percent of state land revenues to the public school fund under AS 37.14.150 is required under art. IX, sec. 7 of the Alaska Constitution if amounts paid to the fund equal or exceed the fair market value of the school trust land redesignated as general grant land in 1978.

Question 3: Should the payments of one-half of one percent of state land revenues to the public school trust fund be considered as including both a contribution to the principal of the fund and a payment of interest on the unpaid balance until the full fair market value has been paid?

No. Under AS 37.14.110(b)(2), all of the money transferred to the public school fund under AS 37.14.150 was deposited to the principal of the fund which, under AS 37.14.110(c), must be "perpetually retained in the fund for investment purposes."

That is not to say, of course, that the trust was not entitled to interest on the unpaid balance. Indeed, that was the conclusion in 1985 Inf. Op. Atty Gen. (August 13; file no. 366-403-85) at 4, n. 3:

> 3/ Under Lassen, 385 U.S. at 469 n.21, "deferred payment arrangements" would seem to be permissible. However, general principles regarding trust management -- e.g., the duty to preserve the trust property (see Restatement (Second) of Trusts

§ 176 (1959)) and the duty to make the trust property productive (see Restatement (Second) of Trusts § 181 (1959)) -- would seem to require that the public school fund also receive an amount equal to what the unpaid balance would have earned, probably calculated at the same rate at which the general fund earns income (since otherwise the general fund would benefit from earnings properly attributable to the public school fund).

In this context, it also is worth noting that "[t]he trustee is accountable for any profit made by him through or arising out of the administration of the trust, although the profit does not result from a breach of trust." *Restatement (Second) of Trusts* § 203 (1959) at 455.

Under the facts here, however, it is unlikely that the state has any current liability for such amounts because of the state's large annual appropriations for public education. Generally speaking, "interest on debts payable on demand" is considered income to a trust, and therefore available for expenditure for trust purposes, and not principal to be retained for investment. *Restatement (Second) of Trusts* § 235, comment a (1959) at 568. AS 13.38.020(a)(2) similarly provides that "interest on money lent" is considered trust income and not principal. Interest on the unpaid balance of the fair market value of the school trust land redesignated as general grant land in 1978 accordingly would be considered income to the trust which, if paid, would be available for expenditure for public education.[10]

Any determination of state liability to the trust for failure to pay interest that would then have been available for expenditure for public education, however, would take into account the substantial state expenditures for public education during the same period. Indeed, under *State v. Weiss*, 706 P.2d 681 (Alaska 1985), and *Southwest Region School District v. Department of Education*, 723 P.2d 636 (Alaska 1986), the state would be entitled to set off money it has appropriated for public education against any liability it might have for interest owed on the unpaid balance to the public school fund. *Weiss* held that the state was entitled to a set-off for

---

[10] As noted above, under AS 37.14.110(c) the commissioner of revenue "shall determine the net income of the [public school trust fund] in accordance with investment accounting principles and in a manner that preserves the distinction between principal and income and that excludes capital gains or losses realized on principal." Department of Revenue staff advise that there are no general "investment accounting principles" governing that determination. In determining net income in a manner that "preserves the distinction between principal and income," accordingly, it is entirely appropriate to look to general trust law principles as found in the *Restatement (Second) of Trusts* and the state statutes defining principal and income for the purpose of administering trusts. *See State v. Weiss*, 706 P.2d 681, 683 n. 3 (Alaska 1985) ("reliance on basic trust law principles finds ample support in the precedents of this court and the United States Supreme Court"). While that statement must be taken with some caution, *see* n. 7 *supra*, such reliance is appropriate here in the absence of specific "investment accounting principles" for making the required determination.

mental health expenditures when calculating the state's liability to the mental health trust for mental health trust land that it had sold where the federal law creating the trust required the state to spend sale proceeds for mental health purposes.[11] 706 P.2d at 684. In *Southwest Region School District*, the Court relied on *Weiss* to hold that the state could assert public school expenditures as an offset against any liability it might have to a school district for failing to pay over funds as required by law during a given year. 723 P.2d at 637.

Thus, to the extent that amounts spent on public education in any given year since 1978 equal or exceed the amount the public school fund would have earned during that year on the unpaid balance owed the public school fund, the state has no liability to the trust for unpaid interest. It is my understanding that state public school expenditures since 1978 have been so large that it is extremely unlikely, regardless of what the 1978 fair market value of the school trust land ultimately is determined to be, that the state would have any liability to the trust for unpaid interest. To the extent amounts spent on public education in any given year since 1978 do not exceed the amount that the fund would have earned on the unpaid balance owed the trust, however, the state owes a debt to the trust which, when paid, should be considered income available for appropriation by the legislature for public education in the future.

Question 4. <u>If too much money has been paid to the public school trust fund to compensate the school land trust for the 1978 redesignation of the school trust land as general grant land, can the overpayment be recovered and returned to the general fund?</u>

Yes. A similar situation arose in the 1980s with the improper deposit in the public school trust fund of a portion of federal mineral revenue sharing payments from oil and gas leasing in the National Petroleum Reserve - Alaska ("NPRA"). In *Barrow v. State*, 1JU-85-2634 CI (Alaska Super., March 18, 1986), the Court concluded that the deposit of federal mineral revenue sharing payments from NPRA in the public school trust fund was improper because the federal statute under which the state received the funds, 42 U.S.C. § 6508, required that the state in allocating

---

[11] Unlike the school land trust where either the land or its monetary equivalent must be retained in perpetuity with only the income spent for public school purposes, sec. 202(e) of the Alaska Mental Health Enabling Act, P.L. 84-830, 70 Stat. 709 (1956), required that sale proceeds as well as income from the land "first be applied to meet the necessary expenses of the mental health program of Alaska." It was apparently for that reason that the Court authorized a set-off of state mental health expenditures against liability to the trust for mental health land that had been sold and thus could not be returned to trust status. Because there is no authorization in federal law for the state to spend the proceeds from the sale of school trust land, *Weiss* provides no authority for the state to set off state public education expenditures against liability to the school trust for the fair market value of school trust land redesignated as general grant land in 1978. It does, however, provide authority for the state to set off state public education expenditures against liability to the trust for interest which, if paid, would have been considered income available for expenditure for that purpose.

those funds "give priority" to the use by political subdivisions impacted by NPRA leasing before using them for any other purpose. *See* 1986 Inf. Op. Atty Gen. (May 28; file no. 883-86-0126) at 2-4. In a series of memoranda, the Department of Law advised that such allocation errors may be corrected administratively. *See* 1986 Inf. Op. Atty Gen. (August 8; file no. 663-87-0003) at 4-5; 1987 Inf. Op. Atty Gen. (June 22; file no. 663-87-0003) at 5-7 (cautioning, however, that "the safest approach, both legally and politically, is to seek explicit legislative authority (through an appropriation) when dealing with state funds"); 1990 Inf. Op. Atty Gen. (September 6; file no. 663-90-0175) at 2. Such an administrative approach to correcting any over-allocation to the public school trust fund may be followed here.[12]

Question 5: Is the current method of calculating income available for expenditure from the public school trust fund's investments in domestic equity pools, under which increases in share values attributable to ordinary dividends are treated as income and increases (or decreases) attributable to capital gains (or losses) are credited (or debited) to principal, consistent with the state's public school trust obligation and the statutes governing administration of the fund?

Yes. At the outset, it should be noted that under private trust law principles there is no fixed definition of "income" that cannot be changed: "[T]he gift of 'income' does not confer a right that the definition of the term be immutably fixed as that which existed under the law at the testator's death." *Manufacturers Hanover Trust Co. v. Bartram*, 255 A.2d 828, 833 (Conn. 1969). Defining income available for expenditure, as a matter of general trust law, accordingly requires only that the state act consistently with its basic obligation to preserve the principal of the trust and use the earnings from the trust solely for public education. The current method of allocating increases in share values to both principal and income is certainly consistent with that obligation as it balances the duty to preserve the principal of the trust[13] with the goal of generating income to be expended to support public schools.

It also seems consistent with the statutes governing administration of the fund. Under AS 37.14.110(c), "[t]he commissioner of revenue shall determine the net income of the fund in accordance with investment accounting principles and in a manner that preserves the distinction between principal and income and that excludes capital gains or losses realized on principal." There are rather detailed provisions in general trust law for allocating corporate distributions of

---

[12] For reasons set out in the Conclusion below, however, you may wish to consult with various individuals or groups or seek judicial guidance before taking unilateral action administratively.

[13] In *Weiss*, the Court made clear that the state has a duty "to preserve the corpus" of a public land trust. "Corpus" is Latin for "body" or "substance," and as used here means "[t]he principal or capital, as distinguished from the interest or income, as of a fund or estate." *The American Heritage Dictionary of the English Language* (3d Ed. 1992) at 421.

stock or cash. *See Restatement (Second) of Trusts* § 236 (1959) and AS 13.38.050. They are not particularly helpful here because the domestic equity pools under discussion do not make actual distributions. Instead, receipts from the pools' domestic equity holdings -- whether they would be attributable to principal or income under general trust law -- are simply credited to the value of the shares in the pools. According to Department of Revenue staff, there are no published "investment accounting principles" governing this situation, and there are no cases directly on point.

Under AS 37.14.110(c), however, the procedure currently being followed is a reasonable approach to implementing the dual goals of generating income to support the state's public education program while preserving the principal of the public school trust fund. Were the domestic equity pools' investment earnings distributed similarly to mutual fund earnings -- i.e., as dividends and short- and long-term capital gains -- the dividends would be ordinary income and the capital gains would be principal under AS 13.38.050(c).[14] It would elevate form over substance to conclude that the manner in which the domestic equity pools handle investment earnings -- both ordinary dividends and long- and short-term capital gains -- governs the determination of the fund's net income.

Indeed, attributing all of the increase in share values to principal without considering the source of the increase (i.e., whether the underlying source of the increase was attributable to principal or income under general trust law) might be found to violate the requirement in AS 37.14.110(c) that the commissioner of revenue determine the net income of the public school trust fund "in a manner that preserves the distinction between principal and income and that excludes capital gains or losses realized on principal." Failing to consider the source of the increases in share values, it could be argued, would not preserve the required "distinction" between principal and income. It might also be found to violate the requirement in AS 37.14.170 that the commissioner "invest the fund to provide increasing net income over long-term periods to the fund's income beneficiaries."

At the same time, the provisions of AS 37.14.110(c) and 37.14.170 give the commissioner considerable flexibility in investing and determining net income from the fund, and treating increases in the share values of domestic equity pools in other ways might be legally permissible. Suffice it to say that, in light of that considerable flexibility, it appears consistent with the statutes governing the public school trust fund to treat as income increases in the share values of the fund's investments in domestic equity pools that are attributable to dividends and to credit (or debit) increases (or decreases) in share values that are attributable to capital gains (or losses) to principal.

---

[14] Under AS 13.38.050(e), the trustee "may rely upon a statement of the distributing corporation as to a fact relevant under a provision of this chapter concerning the source or character of dividends or distributions of corporate assets."

Question 6: What options does the state have for dealing with public school trust fund income that exceeds projected income and, as a consequence, has not been appropriated for school purposes by the legislature?

Public school trust fund earnings that are available for expenditure do not lose that status even though they were not appropriated by the legislature. It accordingly remains available for appropriation for public school purposes. That result follows directly from AS 37.14.140, which provides in part that "[t]he commissioner of revenue shall invest realized net income that has not been appropriated or that has been appropriated but not expended until the income is appropriated and expended."

In the event it is determined that state public education expenditures do not exceed whatever interest the state may have owed the trust as a result of compensating the school land trust over time (*see* question 4 above), any payments now made would be considered income and therefore would be available for appropriation by the legislature for public education purposes.

III. Conclusion

I hope the foregoing answers your questions. In light of the controversy that arose over the mental health land trust, however, it might be prudent to discuss the foregoing and any actions you contemplate as a result with the Public School Fund Advisory Board created under AS 37.14.120, the state Board of Education, and members of the legislature. To the extent you find that actions you would like to take encounter opposition, AS 13.36.035(a)(3) authorizes the courts to "determine any question arising in the administration or distribution of any trust including questions of construction of trust instruments, instruct trustees, and determine the existence or nonexistence of any immunity, power, privilege, duty or right." An appropriate action could be filed to determine the permissibility of any action you would like to take.

Please contact me at your convenience if I can be of any further assistance.

MEMORANDUM
DEPARTMENT OF NATURAL RESOURCES

STATE OF ALASKA
Division of Land

TO: John Shively
Commissioner

FROM: Ron Swanson, Director

DATE: May 5, 1995

SUBJECT: School Fund

Do you want $50 million. Have I got a deal for you!

We may be in violation of the dedication of funds prohibition of the Alaska Constitution (Article IX, Section 7). Pursuant to AS 37.14.150, we have deposited into the Public School Fund one-half of one percent of the total receipts derived from the management of school land. Currently the balance in this fund is around $126,500,000.

On August 13, 1985, The Attorney General's Office issued an opinion (attached) that addressed the dedication of revenues to the Public School Fund. The conclusion was:

> Dedication (of revenues) is authorized only to the extent it is necessary to fully compensate the trust for the fair market value of the lands removed . Any continued dedication of funds over and above the fair market value of the lands removed would be an impermissible dedication because it would go beyond the requirements of federal law and would exceed the dedication existing at the time the constitution was ratified.
>
> Accordingly, the proper approach is to assess the fair market value of the lands as of 1978. The amount could then be paid over time by the automatic deposit of revenue as provided in AS 37.14.150. At the time the debt is completely retired, the automatic deposit should cease. Additional deposits beyond that point would conflict with the dedicated funds prohibition in that they no longer would be required by federal law as compensation for the pre-existing dedication of lands.

There are 105,116 acres of school land. None of this acreage was ever appraised for their 1978 value. This land should be appraised as soon as possible as it is very likely that the money in the fund exceeds the 1978 fair market value. For example, the 1987 value for mental health land (surface values only) averaged $670.00 per acre. Using this figure the total value of the school land would be approximately

$70,500,000. This means there is about $56 million that could be transferred to the general fund and no reason for us to continue to place additional funds into the public school fund.

The only difficulty is appraising the land in a defensible manner so that if we are ever challenged in court, we can pass the red face test. Attached to this memo are detailed cost estimates for three alternate proposals. The costs vary depending on the depth of title research required. The overall approach is similar to what we did for the Mental Health land. The details of this are attached. No matter what scenario we use we do not have the staff to do all the work in house without the work causing a significant negative effect on other programs.

1. The least expensive proposal ($201.6) involves reviewing all school land without consideration of disposals, leases, and encumbrances. This would involve the pulling of status plats, delineating the school land, and giving the information, to a appraisal team.

2. The mid-range proposal ($206.0) involves reviewing all school trust land and identifying disposals that reduced the corpus of the trust as of 1978. The plats and disposal documents would be given to the appraisal team.

3. The last proposal ($379.3) involves identifying all encumbrances, leases, and disposals as of 1978. This information would be identified on the status plats and the appraisal team would receive copies of the documents.

I recommend using option 3 as it the most defensible and accurate. In addition to being the most accurate, option 3 has the potential of "paying its own way" as the total appraised value of the land will go down as encumbrances, leases and sales are backed out of the overall land base.

The last issue is the funding source. The needed funds for the appraisal should come from the Public School Fund which will require a legislative appropriation. The request can either come from the Governor or I can pursue friendly legislation with the chairmen of our budget sub-committees. I will wait your word on how to proceed.

attachments

cc: Marty Rutherford
Nico Bus

Public School Fund Evaluation Process

Land

Would be responsible for general planning and oversight of the project. In-house tasks include preparing RFP's for aerial photography and appraisal services, preparing appraisal instructions and appraisal report forms, assigning subparcel numbers for subdivision lots, preparing physical descriptions for parcels in urban locations such as Anchorage, arranging for appraisal panel facilities, initiating and monitoring the panels, reviewing appraisals, and preparing a summary report.

Appraisals

I recommend hiring a three-person panel for Northern Region, and a three-person panel for the Southcentral Region. there are few school parcels in Southeaster. I recommend an RFP to a single appraiser.

Appraisers who worked on the recent Mental Health panels agreed it would be extremely hopeful to have the parcel boundaries delineated on aerial photography. The photography work can be contracted out.

The Mental Health panels had a detailed physical description for each parcel. Based on our discussions with the members, such descriptions were of little use, except for parcels located in urban areas. Members stated that the accuracy of the descriptions was less than desirable due, in part, to lack of appraiser oversight. We recommend that a DNR appraiser research and describe selected urban parcels. This should improve the quality and relevancy of the information provided to the panel.

Forestry

I recommend we use the same process, i.e. hire consultants to evaluate the timber from aerial photographs.

Oil and Gas

Jim Hansen expects to do in-house valuation work, assuming he is given adequate lead time. Given short notice, he would contract out the work at a cost of @25.0 - $50.0. This additional cost is not included in the estimate.

Mining

We estimate about 3 months of work that could be done in-house. We would use the deminimus approach as was used on the mentai health parcels.

Support Services

DNR's appraisal sub-system will be used. This will allow the appraisers to research historical comparables and appraisals containing overviews of historical markets and infrastructures. The system needs some repairs. We will also need help setting up hardware and software for the panels' use. Unlike Mental Health, which had an elaborate, computerized comparable sale research system and report form, the school project can use manual report forms or forms generated by Foxpro or Excel.