
AIDEA's Answers to Questions Posed by the House Committee on Tourism and Economic Development Regarding HB 119: AIDEA Procurement and Projects

Question #1

Is AIDEA not allowed not to invest in a company which has a development project as its sole asset because those investments are seen as being of higher risk? And if so what will AIDEA be doing to minimize this risk?

AIDEA's Response

AIDEA was not allowed to invest in projects through use of a limited liability or corporation because it was set up originally as an Authority which would use its own funds to own and operate projects which supported delineated forms of economic development. It would appear the risk of the investment was not a factor in the use of this sole ownership structure. Rather, the requirement that AIDEA have sole ownership in a project reflected a state policy that the Authority would develop and own projects which would not otherwise be built by the private sector. AIDEA, therefore, was designed to own and operate facilities and projects which supported development of natural resources, tourism and energy (which was added in 1993).

So risk aversion was not a factor in this sole ownership structure. In fact, AIDEA sole ownership of industrial sites and buildings increased the risk for the Authority. Sole ownership meant that AIDEA could not leverage its funds and that AIDEA took all the risk in owning the project. Moreover, sole ownership put all the assets of the Authority on the line should the development project fail or incur some type of liability from an industrial accident.

So AIDEA's statutes were not designed to mitigate risk, but rather to add state capital to the developing Alaska economy. At that time, the prevalent view was that a state could use its own capital to build a facility which would not otherwise be built with private capital. In a newly formed and developing state, this model worked.

Over time, however, this view has changed. The current view of economic development is that state development agencies should be working with the

private sector as partner in developing needed infrastructure. Such public – private partnerships are often referred to as PPPs. PPPs permit the state agency to leverage its funds while decreasing both the risk of financial default and risk of liability arising from the operation of the project.

One change AIDEA now seeks through HB 119 is designed to increase use of PPP projects. The change will permit the Authority to own a percentage of a development finance project – though use of a limited liability company or corporation.

For most of its history, AIDEA was authorized to “own” a development project under AS 44.88.172. This reference to owning a project was interpreted to mean that AIDEA had to own 100% of a project and could not partner with other investors. As a result, AIDEA developed projects in which it was the sole owner, such as the FedEx hangar at Anchorage Airport or the Delong Mountain Transportation System, which is an industrial road and port that supports the Red Dog mine.

Last session, AIDEA sought and received legislative approval for a change in AS 44.88.172 to authorize the Authority to own a percentage of a development project. In this way, AIDEA could partner with other investors, leverage its funds, and lessen its risk. This change also reflected the trend, noted above, for state agencies to work with private entities in economic development.

As AIDEA has worked with this new legislative authority, it was asked by several potential private partners to form an LLC or a corporation as a way to own and manage joint ownership of a proposed project or facility. This use of an LLC or corporation is common in development projects because it sets up a methodology to operate the project. For example, in an LLC, the members can elect a managing member to run the day-to-day operations of the entity. The use of an LLC also mitigates risk because in the event of a default, creditors know that for their recourse, they are limited to the assets of the LLC. This mitigation of risk is important because as AIDEA works with junior companies in sectors such as mining and oil and gas, the Authority will be the investing party which has the most assets, and could be viewed as a deep pocket.

In sum, the change in ownership structure sought through HB 119 is designed to minimize risk, permit AIDEA to engage with private capital, and allow ADIEA to leverage its funds so that it can participate in more economic development projects than it could if it has to fund 100% of each project.

Question 2

This bill also expands the definition of Development Projects. AIDEA may want to include projects which “enhance or promote economic development associated with transportation, community public purposes, technological innovations, prototype commercial applications of intellectual property, or research.” Please give one example for each type of project listed. AIDEA would also be allowed to invest in Federal facilities- please give rationale.

AIDEA's Response

Transportation Project: An example would be a project such as fuel storage at Anchorage Airport which supports transportation, but is not linked to transporting natural resources, energy, industrial production, or tourism infrastructure.

Community Public Purposes: An example would be a health care clinic.

Technical Innovations: An example would be development of an industrial plant utilizing new technology which was not supporting natural resources, energy or tourism. Currently, for example, the Authority is looking at a development finance project involving innovative technology in the fishing industry, which involves a natural resource. However, at present, AIDEA could not support a plant using innovative technology in textiles, even though it may have that opportunity.

Prototype Commercial Applications of Intellectual Property or Research: An example would be providing financing for the development of a commercial application of a new process, such as the commercialization of a patent. This would be especially the case when the prototype plant to test commercial feasibility of a patent or innovation may not immediately lead to production which is readily saleable.

Federal Facilities: The rationale for this change is that AIDEA wants to be able to support a significant sector of the Alaskan economy: the federal military. AIDEA has been approached by federal agencies that are interested in AIDEA developing facilities which would be leased to a federal agency. This reflects a trend in federal procurement under which federal agencies do not want to own facilities and instead seek to lease them on a long- term basis.

AIDEA would like to offer this service to federal agencies because states and regions that can offer leased premises are attractive to the federal government. This in turn encourages the location of more federal employees to these areas. In the current economy with tightening federal spending, it is reasonable to

treat the federal government like any other sector of the economy. This is particularly the case when this spending represents a significant portion of the economy. Therefore, it is appropriate to offer the federal government incentives and programs that will encourage federal agencies to locate in Alaska and which can bring in new jobs and investments. Leasing to a federal agency is the same as AIDEA leasing a hangar to FedEx at the Anchorage Airport, or leasing port facilities at Skagway.

Secondly, executing long term leases with a reliable tenant such as a federal agency offer AIDEA a good investment and return on its capital. Finally, at the end of the lease, these facilities will revert back to AIDEA and can then be sold into the private market. This will create economic opportunities and increase property taxes for local communities in which the facilities are located.

Question 3

So right now does AIDEA have to follow the same procurement rules as DCCED? How does this change help?

AIDEA's Response

AIDEA, like most state agencies such as the Department of Commerce, falls under Alaska's State Procurement Code. See AS 36.30.005 (centralization of procurement) and AS 36.30.990(1)(A) (definition of included entities includes departments). The current procurement code, however, excludes certain public corporations, such as Alaska Housing Finance Corporations (AHFC) and the Alaska Aerospace Development Corporation. See AS 36.30.015(f) and AS 36.30.990(1)(B)(iii) and (vi). AIDEA submits that its need to do development projects and interface with the private sector in development projects means that it should be granted the same exclusion from the Procurement Code as its fellow public corporations.

The procurement change in HB 119 would assist AIDEA in accomplishing its economic development mission in several ways. First, AIDEA is often approached by a developer at a stage when the project is seeking financing. At this stage, the developer will usually have a business plan and a detailed design for the project, including architectural and engineering drawings. All of these materials will often be at hand because they are needed to budget the cost of the project. This is a critical component in developing a finance package. Developers are used to having this level of detail when they seek conventional bank financing, for example.

However, if AIDEA decides to finance all or part of a project, it must essentially start all over again and develop a whole new set of plans and specifications for the project - based on the Procurement Code. This includes soliciting new bids on each aspect of the project, even if detailed plans already exist. It has been AIDEA's experience that this can be a barrier to working with a potential client who has expended considerable time and money in developing detailed plans for the project.

Moreover, AIDEA is moving toward a development finance model in which it often will own only part of a project, such as 20%. This limited investment is designed to use state capital only to the extent it is needed to move a project to completion, and to minimize AIDEA's risk if the project does not perform as expected. However, under the current law, AIDEA's minority ownership in a project would mean that the entire project is subject to the Procurement Code.

Another advantage to the proposal in HB 119 is that it permits AIDEA, just like AHFC, to set out an open and fair procurement process by adopting new regulations with oversight from the AIDEA Board. In the event that there is a bid protest, the matter can be heard expeditiously by the AIDEA Board and a decision reached. In contrast, under the Procurement Code, an AIDEA protest would be heard by the DOT&PF Commissioner and then by the Commissioner of Administration. This process is time consuming. In contrast, HB 119 would permit the AIDEA Board to determine bid protests. This places the decision making process in front of an entity familiar with economic development financing.

Question 4

Last session we passed a bill to expand AIDEA's board from 5 to 7 and to increase private sector participation on the Board. Has this process been completed? Am I right in suspecting that an expanded board may be particularly important to AIDEA if this bill passes and AIDEA gains a broader mandate? OR: In what ways might the expanded Board be even more important if this bill passes?

AIDEA's Response

While AIDEA did not request the Board change, the Authority welcomes the participation of additional private sector members. AIDEA's Strategic Plan calls for the Authority to expand the effectiveness of its programs, and this includes forming important private-public partnerships to finance needed economic

development. The five public members of the board bring their expertise and experience to the decision making process, and the new, larger Board allows for the formation of Board subcommittees to review proposed projects and investment opportunities outside of the formal Board meeting process. Their private sector backgrounds assist AIDEA in reviewing both the benefits and possible pitfalls of proposed partnerships with private sector interests in developing a project.

The change in the Board's composition is consistent with the goals of HB 119 to expand and clarify the scope of the agency's economic development mission. The addition of three additional public members means that the Board's composition reflects broader business and geographic experience. This will assist Management and the Board in carrying out the expanded scope of economic development projects contemplated in HB 119.

Question 5

What sources were used to draft the language in HB 119 regarding the proposed list of the types of projects AIDEA can undertake?

AIDEA's Response

As AIDEA began development of its Strategic Plan, it conducted a review of the programs and statutes used by its sister development agencies in other states. In particular, AIDEA focused on the New Jersey Development Corporation, the Wyoming Business Council, the Vermont Economic Development Authority (VEDA), Mass Development, and the Bank of North Dakota.

One constant that appeared from this review is that most state development authorities have programs tied to the nurturing and development of existing economic sectors, as well as having programs to attract new businesses into the state and diversify the economy.

As part of this process, AIDEA retained Western Financial to do a “Strength-Weakness-Opportunities-Threats (SWOT) analysis” of Alaska’s economy, as well as an outreach program to the business community for an environmental scan of the economy. This SWOT and scan analysis became cornerstones of AIDEA’s Strategic Plan.

At page 33 of AIDEA’s Strategic Plan, there is a chart that sets out the economic sectors this analysis indicated should be supported by AIDEA. For example, this list included traditionally important areas of the economy such

as fisheries and tourism, but also includes newer or less well-defined areas such as the federal government, logistics, aerospace, and health care.

In addition to tracking economic sectors identified in AIDEA's Strategic Plan, the expanded list of projects listed in HB 119 reflects the type of economic development work undertaken by development authorities in other states. In 2008, AIDEA and DCDED jointly began a comprehensive review of what other states were doing to support economic growth and diversification in their respective economies.

DCDED was engaged in looking at the programs being offered by state development authorities in over 40 states. Commerce staff surveyed these authorities' web sites, interviewed officials in some states, and researched the statutory powers of these disparate state development authorities, comparing their approaches to AIDEA's statutes. This research showed that while AIDEA was pursuing some of the same economic goals of other states, on the whole its statutory powers were more limited in scope.

As Ted Leonard noted in his testimony last week, the Authority is essentially aimed at promoting economic development projects in four sectors: (1) natural resources; (2) industrial sites; (3) energy; and (4) tourism infrastructure.

In contrast, most other state development authorities have powers to effectuate a broader range of projects. For example, the various Port Authorities in Ohio (which are that state's development mechanism) are authorized by Ohio Statutes [Ohio Rev. Stat. 4582.0] to support a variety of projects:

"Authorized purposes" or "purpose" means either of the following:

- (1) Activities that enhance, foster, aid, provide, or promote transportation, economic development, housing, recreation, education, governmental operations, culture, or research within the jurisdiction of the port authority..."**

Ohio also has its Enterprise bond fund which makes loans of up to \$1.5 million for eligible businesses include manufacturing, research and development, and distribution. Retail projects are ineligible.

Another factor this review noted was the support many development authorities offered for new technologies and innovative businesses. For example, one of the best known U.S. development agencies is the New Jersey Economic Development Authority. New Jersey is authorized to finance what it terms Technology and Life Sciences, which encompasses biotechnology. New

Jersey also offers financial support for information and communication technologies as well as offering early state investment funding.

Similarly, Mass Development and the Wyoming Business Council are set up to support new technologies and innovative businesses.

Another factor that emerged from the review is that few development agencies own and operate development projects as does AIDEA. One exception is the West Virginia Economic Development Authority. The WVEDA under Chapter 3, Article 15 31-15-16(a) can “acquire, construct... and operate projects within the state...”. This is similar to the language found in AS 44.88.172(a) which permits AIDEA to own and operate development finance projects. What differentiates Alaska from West Virginia is that AIDEA can and does own and operate much larger projects than the WVEDA.

The upshot of this joint research effort was AIDEA’s Strategic Plan which, in part, called for seeking legislative authority for AIDEA to broaden and expand the type of projects it could support. One factor was simply to modernize AIDEA’s list of permissible projects by adding industries and sectors that did not exist when AIDEA’s statutes were first drafted; an example would be communications, which now encompasses the internet and cell phones. This was simply not an important economic sector when AIDEA was formed in the late 1960s. Indeed, the last time AIDEA’s list of permissible projects was expanded was 18 years ago, in 1993 when energy was added as a project development category.

In sum, HB 119’s list of new permissible AIDEA projects is an effort to keep the authority in sync with changes in Alaska’s economy and provide a basis for supporting enterprises which could lead to greater diversification of the economy.