THE STATE of ALASKA
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MEMORANDUM

TO: Representative Craig Johnson

DATE: Monday, February 03, 2014

FROM: Commissioner Susan Bell

RE: Questions on House Bill 177

Thank you for your memorandum dated January 31, 2014 with questions concerning House Bill 177. Division Director Joe Jacobson assisted me with the responses below. He will be present at the committee meeting on February 4 to answer any further questions.

1) **This bill allows the interest rate for Commercial Fishing Revolving Loan Fund (hereafter CFRLF) loans to be set as low as three percent – regardless of current market rates. Does DCCED have any objection to a variable floor coupled to the prime rate?**

DCCED does not have any objection to a variable floor coupled to the prime rate. While the bill does not set a variable floor coupled to the prime rate in statute, CFRLF interest rates for the Product Quality Improvement (PQI) and Engine Fuel Efficiency Programs are clearly set in regulation. For example, 3 AAC 80.055 (k) (1) dictates:

(1) The interest rate is based on the cost of funds to the state as defined in AS 16.10.320 (m) for loans made
- (a) to upgrade existing vessels and gear for the purpose of improving the quality of Alaska seafood products; or
- (b) for engine efficiency upgrades.

AS 16.10.320 (m) further specifies the cost of funds is prime plus one plus additional costs to represent risk of loss and other costs.

2) **Low interest rates are likely to lead to increased funds being loaned out of the fund balance. With lower interest rates, loan repayments will be lower, leading to slower fund replenishment. What safeguards are in place to ensure the funds' health is not put at risk?**

The PQI and EFE Programs within the CFRLF represent less than six percent of the total assets in the CFRLF and are relatively inexpensive to administer in comparison to other loans. Historically, interest rates for these two programs were three percent from inception (1992) until 2012, when rates were changed to current rates as defined under AS 16.10.320(m). During this period, the CFRLF never experienced poor fund replenishment. In fact, between 1994 and 2012, the total equity of the CFRLF increased from $92,414,000 to $104,420,000. Based on this experience, which spanned multiple financial crises and a collapse in the salmon market, there is nothing to indicate that this change would have a negative impact on the fund.

3) **It was mentioned in the January 28th House Resources Committee that staff and administrative costs for the Commercial Fishing Revolving Loan and the Community Quota Entity Revolving Loan Programs are paid out of the funds' balances. What safeguards are in place to ensure that administrative costs, when combined with increased draws on the funds and decreased repayments, do not reduce the funds' balances to unhealthy levels?**

All loan funds administered by the Division of Economic Development (DED) are subject to a large amount of scrutiny and regulation. The loan funds are subject to complex and comprehensive annual audits where the fund's financial statements are analyzed to ensure the loan funds are managed prudently, in compliance with statutes and regulations, and that standard Governmental Accounting Procedures are being adhered to. Annual reports and the audit findings are furnished to the legislature.

4) **How is the interest rate for these loans determined, and by whom? What factors are considered when making this determination?**

Determining the interest rates for all loans in the CFRLF is done through a process set out in Statute (AS 16.10.320) and Administrative Code (3 AAC 80.055(k). The prime rate is taken from the Wall Street Journal and then interest points are added or subtracted as required by statute or administrative code. The process is generally carried out by the Division's Operation Manager.

5) **What oversight structure is in place to ensure that the determined interest rate serves to preserve the health of the fund, and serves the State's interests?**

DED submits annual reports to the legislature indicating the fund's performance and undergoes regular audits. Additionally, the total administrative cost of new loans made under PQI and EFE funds in FY 13 was $14,800. Under current interest rate (4.25%), the total value of these funds ($2,100,000) would accrue $89,250 per year. In a scenario with the interest rate at 3%, the funds would accrue $63,000 per year. Under both scenarios, the interest accrued far outpaces costs.

6) **The proposed bill would allow DCCED to give lower-cost financing to fishermen to improve their vessels and sell higher-quality fish. What would be a reasonable estimate of the favorable impacts of this to the state in terms of economic growth or job growth?**

Between 2002 and 2012, the average ex-vessel price/lb. for Alaska salmon increased 350% from $0.26 to $0.91, halibut increased 254% from $1.65 to $4.19, and black cod increased 173% from $2.04 to $3.53. During this same period, Alaska resident crew employment increased 28% from 8,520 to 10,923 while seafood processing employment rose 24.5% from 20,162 to 25,112. While it is impossible to attribute this growth to product quality alone, it is a critical driver of these increases. Given that the industry still has significant room for product quality improvement—in Bristol Bay, only 60% of the drift boat catch is chilled—it would not be unreasonable for similar gains to occur over the next decade.

In addition to product quality, the EFE loans allow fishermen to take home more money and minimize the impact of the fishery on the environment. New engines typically improve efficiency between 20-30%. With the price of gasoline exceeding $7/gallon in prominent fishing communities like Dillingham, these savings add up over the course of a season.

7) **Has the CFRLF ever required recapitalization through a legislative appropriation? If so, please explain the circumstances leading to the recapitalization(s) and any corrective actions taken by the Department to prevent the CFRLF from requiring recapitalization in the future.**

The last infusion of general funds into the CFRLF occurred in 1985 in response to the growing demand for loans as the fishing industry developed under the relatively new Limited Entry System. Of the state's $60 million investment in the fund, it has repaid $120 million over its lifetime and generates sufficient cash flow to cover loan demand and operations.