

HOUSE FINANCE COMMITTEE
March 30, 2010
1:36 p.m.

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CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 1:36 p.m.

MEMBERS PRESENT

Representative Mike Hawker, Co-Chair
Representative Bill Stoltze, Co-Chair
Representative Bill Thomas Jr., Vice-Chair
Representative Allan Austerman
Representative Mike Doogan
Representative Anna Fairclough
Representative Neal Foster
Representative Les Gara
Representative Mike Kelly
Representative Woodie Salmon

MEMBERS ABSENT

Representative Reggie Joule

ALSO PRESENT

Ted Leonard, Executive Director, Alaska Industrial Development and Export Authority, Department of Commerce, Community and Economic Development; Greg Winegar, Director, Alaska Division of Investments, Department of Commerce, Community and Economic Development; Mark Davis, Economic Development Officer, Alaska Industrial Development and Export Authority, Department of Commerce, Community and Economic Development; Craig Dahl, President/CEO, Alaska Pacific Bank and Vice Chair, Federal Home Loan Bank of Seattle Board.

PRESENT VIA TELECONFERENCE

Mike Burgforg, Executive Director, Made in Mat-Su Association, Mat-Su.

SUMMARY

HB 410 AIDEA LOANS

HB 410 was HEARD and HELD in Committee for further consideration.

HB 412 MICROLOAN REVOLVING FUND

HB 412 was HEARD and HELD in Committee for further consideration.

#hb410

HOUSE BILL NO. 410

"An Act relating to loan participations and development finance projects of the Alaska Industrial Development and Export Authority; and relating to loans from the rural development initiative fund."

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TED LEONARD, EXECUTIVE DIRECTOR, ALASKA INDUSTRIAL DEVELOPMENT AND EXPORT AUTHORITY (AIDEA), DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC DEVELOPMENT, explained that three of the bill's sections deal with AIDEA and one part deals with an AIDEA fund run by the Division of Investments. He detailed that the changes requested by HB 410 would deal with the first part of implementing the strategic plan, the effectiveness of AIDEA programs, and a new development tool related to the loan program.

Section 1. AS 44.88.159(e) is amended to change the method by which AIDEA determines the minimum interest rate to be charged on loan participations that AIDEA finances with AIDEA assets rather than bond proceeds. Current method requires AIDEA to establish a minimum by estimating the true interest cost in AIDEA were to use bond proceeds. The proposed method would allow the minimum to be based on the greater of either the rates achieved by a type of category of financial security in a published nationally recognized market index or the 5-year rate of return on AIDEA's investments.

Mr. Leonard detailed that Section 1 would address how the minimum interest rate is set when AIDEA funds loans with internal funds. Currently, AIDEA sets the rate by going to

the bond market and asking an expert like Goldman Sachs. When the municipal bond market had problems, AIDEA's rates went from the 6 percent range up to the high 9 percent range; the rates have come down but are still shifting. The agency was considering going to an index so that customers and partners could have a more steady interest rate.

Section 2. AS 44.88.159 is amended by adding a new subsection that allows AIDEA to establish in regulation a new program to provide incentive rate rebates to certain loan participations that create jobs, promote rural development or foster other economic development criteria.

- Rate rebates are limited to no more than 1% of the interest rate charged to AIDEA's portion of the loan participation.
- The balance of loans subject to rebates would be limited to no more than 5 % of the outstanding balance of all loan participations.
- The authority may not commit to pay an incentive rebate for more than 5 years.
- Allows AIDEA to establish a separate account for this program.

Mr. Leonard reported that Section 2 would set up a new tool under the commercial finance program that would allow an incentive rebate program to give incentives to businesses meeting certain criteria. For example, if a criterion was to develop 25 new jobs with the investment, AIDEA would not give the rebate unless the jobs were in fact created.

Co-Chair Hawker pointed out that the provision would bring extreme latitude to the agency because the criteria listed are authorized to be established in regulations adopted by AIDEA. Mr. Leonard agreed. He added that AIDEA had considered putting the criteria in statute, but they felt they needed the flexibility to tailor to the areas in which they were trying to incentivize investment.

Representative Kelly asked whether the AIDEA board approved regulations. Mr. Leonard responded in the affirmative. He added that the agency was in the process of modernizing the organizational structure so that loans would go to investment committees made of private sector and management before going to the board.

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Mr. Leonard continued with Section 3:

AS 44.88.172(a) is amended to clarify that AIDEA can own or operate a percentage of a project - not the entire project.

Mr. Leonard detailed that currently there are two sections in statute; an intent section stipulating that AIDEA can own an interest in a project, and another section stating that AIDEA has to own the project. The request would clarify that AIDEA has the ability to own a portion of a project. He noted that the price tags on economic infrastructures are increasing. For example, a plant could be in the \$1 billion to \$2 billion range, past AIDEA's capacity; AIDEA could help the project be successful by owning a portion of it. In addition, evaluating the practices of other development finance organizations has revealed that partnering with the private sector shares the risk.

Co-Chair Hawker clarified that the intent was not to prohibit the practice of full ownership but to widen the latitude to allow AIDEA to be a component investor in projects. He thought the existing language was not clear, but seemed to preclude ownership of the entire project. Mr. Leonard acknowledged the need for more clarity.

Section 4. AS 44.88.610(a) is amended to allow borrowers to have multiple Rural Development Revolving Loan Fund loans and increases the cumulative amount a person may borrow from \$100,000 to \$150,000 and increases the cumulative amount two or more persons may borrow from \$200,000 to \$300,000.

Mr. Leonard explained that the section addresses a fund that AIDEA financed in the past and the Division of Investments currently operates. The fund is one of the few that AIDEA has under its umbrella that is a direct participation loan program. The authority had searched for ways to utilize the money to get more loans into rural areas. The division suggested changing the limits from \$100,000 to \$150,000 for one business and from \$200,000 to \$300,000 for more than two businesses, and then changing the rate from 6 percent to 4 percent (more in line with other programs run by the Division of Investment). He

stressed that the change would allow a successful business to have more than one loan as it grows.

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Co-Chair Hawker clarified that the provision was not changing the rate from 6 percent to 4 percent, but changing the minimum rate. Mr. Leonard agreed.

Vice-Chair Thomas referred to page 3, line 23 addressing business located where the population is 5,000 or less and not connected by road or rail. He asked whether Haines would qualify since the connecting road went through another country.

GREG WINEGAR, DIRECTOR, ALASKA DIVISION OF INVESTMENTS, DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC DEVELOPMENT, answered that that the key is being connected by road or rail; it does not matter that the road goes through another country.

Vice-Chair Thomas thought the language should be changed. Mr. Winegar offered to work to change the language and acknowledged discussion about the where the lines should be drawn. He thought the upcoming census could make a difference in which communities would qualify.

Vice-Chair Thomas recalled other legislation that defined "resident" and wanted clarification.

Representative Austerman queried the position of Haines regarding the definition.

Vice-Chair Thomas replied that in the past the fact of a foreign country had excluded Haines because a connecting road was defined as one with 24-hour access.

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Mr. Winegar responded that Haines did qualify under the existing statute.

Representative Fairclough referenced the the indeterminate fiscal note with zeroes and asked whether costs were anticipated for the incentive rate rebate. Mr. Leonard responded that overall he did not expect cost increases because of the agency's capacity to increase its portfolio

balance on new loans. He pointed out that new loans (even with the 100 basis points reduction) would be more than the opportunity cost of investing internal funds.

Representative Fairclough queried the current capacity of the Gas-To-Liquids (GTL) plant. Mr. Leonard replied that current statute allows \$400 million over a rolling 12-month period. He noted that the House had passed HB 90, which would take out refunding bonds and result in more capacity.

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Representative Fairclough referred to a bill exempting AIDEA from procurement code and asked how investment strategies would be affected. Mr. Leonard did not know and offered to get the information.

Representative Doogan questioned how loan costs would be affected by Section 1. Mr. Leonard responded that AIDEA was considering several different indexes set through regulation, such as the Federal Home Loan Bank index with 5, 10, 15, and 30-year indexes for cost to funds. In addition, AIDEA has a minimum floor for the five-year annualized rate of return to protect the loan portfolio and the state dividend. The authority uses the index plus operation cost on a normal daily rate; if the rate went below that, they would look at the minimum floor. He emphasized that the legislation would set the minimum and allow AIDEA (based on other factors that could come into play, such as loan risk) to have a higher rate. The index would be the minimum rate and would be set by regulation. He added that the index could be changed if a better index came along.

Representative Doogan queried fund costs under the proposed legislation.

MARK DAVIS, ECONOMIC DEVELOPMENT OFFICER, ALASKA INDUSTRIAL DEVELOPMENT AND EXPORT AUTHORITY, DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC DEVELOPMENT, responded that using the 20-year rate of the Federal Home Loan Bank of Seattle against what AIDEA charges currently would amount to 1.04 percent. Over 20 years, AIDEA is essentially charging a point that it does not need to charge in order to recover the rate of funds. He added that the statute currently requires AIDEA to use a cost of funds tied historically to bonds, which are no longer stable. The agency wants to

shift to more a more stable and transparent index. He suggested checking the Federal Home Loan Bank on the Internet to figure out the loan rate; currently Goldman and Sachs calculates the rate. He thought the rates would be lowered over time and be protected against anomalies in the market. The treasury bill is currently at 4.75 for 30 years; 18 months ago it was at minus one, illustrating the instability of the bond market.

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Representative Doogan turned to Section 2 in the sectional analysis, related to establishing a new program that could create jobs, promote rural development, and "foster other economic development criteria." He asked what fostering criteria meant. Mr. Davis responded that the item is the result of AIDEA's effort over the past two years to work on a strategic economic plan. The plan has been released. The agency studied the criteria used by similar industrial development banks in 44 other states. The statute uses job creation because the preamble stipulates the elimination of unemployment. He noted that most development organizations put an emphasis on distressed areas, and that unemployment in rural Alaska tends to be high. Other criteria could relate to distressed economic zones within cities (such as Anchorage), which would track the current federal practices under the Build America Bonds (BABs) and other types of instruments. Alaska could also look at new technology developments that could spur further job creation. The criteria could be adopted through regulation by the AIDEA board.

Representative Doogan pointed to Sections 4 and 5, which he understood as a substantial loosening of loan requirements, both in terms of getting people more money, lower interest rates, and the ability to get more than one loan. He asked why the agency wanted the changes. Mr. Winegar replied that based on public input and internal discussions about lower rates, AIDEA hoped to provide a better rate for businesses, which are creating jobs. The agency would be allowed to create regulations to lower the rate; currently the floor by statute is 6 percent. Other successful programs such as Small Business Development allow rates down to 4 percent. He added that the same holds true for the loan amount. Rates have gone up significantly in the past several years, so the thinking was to provide a higher minimum. Regarding making more than one loan, a business that was successful

after getting a small loan (\$10,000 to \$20,000) would not currently be able to borrow more. The agency thought it made more sense to have the limit based on an amount as opposed to the number of loans.

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Representative Doogan questioned how the agency will be able to monitor the effect of the changes and what it could do if the changes were not financially viable. Mr. Winegar replied that AIDEA carefully monitors all programs. He emphasized that the changes would not be required, but would provide flexibility. He detailed that the lifetime delinquency rate on the program since origination was 4.3 percent. He assured the committee that the agency could make adjustments as needed through the regulation process as well as through the lending decision process.

Representative Kelly wondered why he had not heard about changes related to credit worthiness or about adjusting for risk. Mr. Winegar answered that there would be no difference in evaluation in terms of risk.

Co-Chair Hawker queried the 4.3 percent delinquency statistic. He asked how many Rural Development Initiative Fund loans were outstanding at any given time. Mr. Winegar replied that AIDEA currently had 41 loans out totally \$4 million and \$1.7 million available to lend. Historically, 62 loans totaling \$7.2 million have been made through the program since the program started in 2000.

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Representative Foster directed attention to Section 3 regarding old language about AIDEA owning an entire project. He queried the minimum amount of a project and possible ramifications. Mr. Leonard answered that the issue had been discussed, but a minimum was not considered. He believed using due diligence and project feasibility would result in the percentage of ownership that would maximize the potential of the project.

Mr. Davis commented that the section was a clarification. One statute preamble (AS 44.88.010(a)) currently reads "incur debt to own and operate facilities," which has been interpreted to mean that the entire facility has to be owned and operated. On the other hand, AS 44.88.085 states

that "to acquire an interest in a project as necessary or appropriate," which seemed to indicate that AIDEA could own an interest in a project and have partners. House Bill 410 would clarify the language to say that owning an interest was the appropriate way to read the statute.

Representative Fairclough asked whether AIDEA would be allowed to participate in an in-state gasline project. Mr. Davis replied that the agency could invest in any project with rate of return consistent with statute. He noted that the agency had looked at gas projects in the past and would do so again in the future.

CRAIG DAHL, PRESIDENT/CEO, ALASKA PACIFIC BANK and VICE CHAIR, FEDERAL HOME LOAN BANK OF SEATTLE BOARD, testified in support of the legislation on behalf of the institutions as well as the Alaska Bankers Association. He stated that AIDEA had proven over the years to be a pillar of the state's economic development activity. The various participation loan programs have been successful because of a competitive rate structure that helped induce a lot of business loans and project lending, creating many jobs and helping the economy develop.

Mr. Dahl described the Alaska Pacific Bank as one of the smallest institutions in the state; however, it currently had over \$30 million in loans and has managed to work in concert with the various programs through AIDEA. He believed the same was true for all the state's banks. He felt that AIDEA should be competitive and responsive to the market. He stressed that Alaska has managed to avoid most of the serious impacts from the recession and underlined the importance of the state's economy remaining stable and moving forward. He felt that AIDEA was a critical piece in the success of the state's economy.

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HB 410 was HEARD and HELD in Committee for further consideration.

#hb412

HOUSE BILL NO. 412

"An Act establishing the Alaska microloan revolving fund; making loans for commercial purposes from the

fund; and relating to the fund and loans; and providing for an effective date."

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GREG WINEGAR, DIRECTOR, ALASKA DIVISION OF INVESTMENTS, DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC DEVELOPMENT, informed the committee that HB 412 would create a new loan program aimed at helping small Alaskan businesses access critically needed capital to start new businesses and to grow existing ones. He noted that the program is modeled after a similar program operated through the Small Business Administration (SBA) that is available in 46 other states but not in Alaska because of SBA lender criteria that no institution has met.

Mr. Winegar detailed that the maximum loan given through the program would be \$35,000 for an individual and \$70,000 for two or more individuals. There would be a residency requirement. The loan proceeds could be used for a variety of purposes, including working capital, equipment, and construction. The maximum loan term would be 6 years, patterned after the SBA program. The loans must be collateralized and the interest rate would be prime plus 1 percentage point with a floor of 6 percent and a ceiling of 8 percent. In terms of capitalization, the fiscal note includes \$3.5 million that would come from AIDEA, contingent on passage of HB 411. Operating expenses at \$77,700 would be included to hire a loan officer. He noted that the department worked hard to keep the fiscal note as low as possible.

Mr. Winegar continued that the fund would be set up as a revolving fund; all repayments would come back into the fund and new loan requests would come out of it. In addition, the operating expenses would be covered from earnings of the fund, similar to other programs. He reported that the department was projecting about 75 loans in the first year, 100 in the second, and then the fund could maintain about 25 loans per year from the initial capitalization.

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Co-Chair Hawker queried the prime rate plus one proposed for the program. Mr. Winegar responded that most other programs in the department were based on prime rate so it

was used to be consistent. The rate could be geared to another index.

Representative Kelly asked why there was a cap if the rate was prime plus. Mr. Winegar answered that the cap was put in to offer protection in case of a high interest rate environment.

Representative Kelly registered concerns as the program would be converted from one with a spread to one with a "give-away" element.

Co-Chair Hawker asked whether the notes would be six-year fixed-rate notes. Mr. Winegar answered in the affirmative. He noted that other program regulation required quarterly review and adjustment; at the time the loan is given, the rate is fixed for the term of the loan.

Co-Chair Hawker asked whether a variable rate program had been considered, which would benefit the consumer in low-rate periods but protect in high-rate ones. Mr. Winegar responded that the agency had considered the option; they thought the fixed rate would be make it easier for a borrower to plan. He acknowledged the fund could be set up as a floating rate.

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Representative Foster thought the program was good for rural Alaska. He queried plans to communicate about the program in rural areas. Mr. Winegar replied that the program would be handled like other programs, with outreach work, advertisement, and attendance at various conferences. He noted a contract with the Alaska Business Development Center to assist in outreach efforts. He also anticipated using the Small Business Development Center at the University of Alaska.

Representative Foster queried examples of collateral sufficient to secure the loan. He wondered the lowest level of collateral acceptable. Mr. Winegar answered that standards would be set through regulation; the language was broad to allow as much flexibility as possible to work with businesses. Deeds of trust on property and inventory would apply. The term of the loan would be geared based on collateral. The provision would provide maximum flexibility

to secure the loan in the best way possible; however, the language does not require a certain type of collateral.

Representative Austerman commented that research on economic development has confirmed the need for small businesses to have access to funds through reasonable loans. He questioned the fiscal note, related to the flow of funds. He noted that currently the state receives a dividend from AIDEA that goes into the general fund and that funding for the proposed program would come out of AIDEA dividend receipts. He thought the \$3.5 million requested should be general funds. He also questioned the \$77,700 for the position, which was coming out of AIDEA dividends. He assumed the position would be in the Division of Investments through reimbursable service agreement (RSA) funds from AIDEA. He wanted to fund the position with the general funds through the normal process.

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Representative Fairclough queried the definition (page 3, lines 15 and 16) of an Alaska resident. She pointed to eligibility language (starting on line 4 and on line 10): "to meet the residency requirements of (a) of this section, the applicant (1) must physically reside in the state and maintain a domicile in the state during the twelve consecutive months before the date of the application for the program, but may not declare or establish residency in another state or receive residency or a benefit based on residency from another state." She asked how the stipulation applied. Mr. Winegar replied that the intent was that residency was maintained over the 12-month period.

Representative Fairclough questioned the possibilities of what the language could mean. Co-Chair Hawker agreed that the question was important to consider.

Representative Doogan thought that microloans were much smaller. He queried why the agency considered the loan amounts available as microloans. He also asked what kind of loans would be expected. Mr. Winegar responded that the loan amounts and the term "microloan" came from the SBA program, as did the \$3.5 million limit. The types of loans expected were for working capital for a small business, to be used for leasehold improvements or equipment.

Representative Doogan wondered whether the loans might be too small as expenses were so much higher in rural Alaska. Mr. Winegar answered that there were two other programs for small businesses in rural Alaska, including the Rural Development Revolving Loan Fund, which would offer larger loans for smaller communities. The program proposed in HB 412 would fill a need not filled by the other programs. He emphasized that all areas of the state would qualify for the microloan program, whereas other the programs are for smaller areas. The proposal would fill a gap that SBA covers in most other states.

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Representative Kelly asked whether the agency had considered funding the program "upstream" of AIDEA. Mr. Winegar answered that the position would initially be paid for out of the dividend and then would come out of revolving fund, along with other expenses. Other funding options had been considered at the Office of Budget and Management (OMB) level; the proposed option was considered the best one.

Co-Chair Hawker thought an eligibility requirement in the section on loan limits should be moved to the eligibility section. He pointed to page 3, line 28 about not making a loan to person with a past due child support obligation. He called it the only "moral turpitude" clause in the provision and asked why other groups such as convicted sex offenders or felons were not listed. He asked why child support was targeted. Mr. Winegar replied that the language was modeled on other legislation and that the same language was in all AIDEA programs. He acknowledged the possible need to change the placement of the language.

Co-Chair Hawker questioned whether other restrictions might be appropriate.

Co-Chair Hawker directed attention to the findings section on page 1, line 9, the declaration "essential for the ongoing economic health and well-being of the state and its citizens and families." He asked whether there were families that were not citizens. Mr. Winegar did not know where the language originated.

Co-Chair Hawker moved to line 12 in the findings section, "economic growth and self-employment in small business is

hampered." He did not recall seeing the word "hampered" elsewhere in statute.

Representative Gara wondered whether the business had to be located in the state of Alaska. Mr. Winegar responded that line 17 on page 2 stipulated that loans would be made to eligible applicants to be used for working capital, equipment, and so on "by a business located in the state."

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Co-Chair Hawker requested clarification of earlier comments about "stiffer compliance requirements" that were not being utilized. He asked how the legislation could justify deviating from the underwriting standards of the SBA. Mr. Winegar responded that there had to be an intermediary lender in order to have a SBA microloan program. Lenders have to meet certain criteria; no one in the state has met the criteria.

Co-Chair Hawker asked whether the provision applied only to the microloan program. Mr. Winegar answered in the affirmative. He reported that the agency had talked to SBA about the possibility of the state qualifying as a lender, but states were not eligible.

Co-Chair Hawker informed the committee that staff had noted that the test for child support does not show up on credit reports, so the language indicates a way to address the issue.

Representative Foster queried whether information about collections should be in the fiscal note. Mr. Winegar replied that collections are done in-house and figured in. He added that the loan officer is also a collection officer and can do collections.

Representative Fairclough referred to page 2 of the fiscal note and requested an update on the status of other legislation that would affect the fund. Mr. Winegar replied that there were two bills: HB 411 in the House Resources Committee and SB 301 in the Senate Finance Committee.

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RECONVENED

MIKE BURGFORG, EXECUTIVE DIRECTOR, MADE IN MAT-SU ASSOCIATION, MAT-SU (via teleconference), testified in support of the legislation. He reported that his organization represented value-added manufacturers in the Mat-Su. He stated that the organization's 245 members and affiliates strongly support HB 412 because small business will qualify for the first time. Other programs do not support businesses in the area. He spoke to concerns about the money volume. A survey showed that members would be looking for smaller than \$35,000 to \$70,000 loans. The greatest concern among members was capital for the purchase of raw materials in order to be more competitive in the market. He stressed the importance of the legislation to small businesses in the state.

Co-Chair Hawker asked whether the business community represented had difficulty accessing small lines of commercial credit through traditional financing institutions. Mr. Burgforg replied that most of the members queried had difficulty because of the size of their businesses. They could take personal loans, which did not build their businesses. The microloan program would help build business and establish credit, making them more viable and better business partners in the community.

Co-Chair Hawker queried underwriting criteria. Mr. Winegar responded that the agency would establish underwriting criteria through the regulatory process. The goal was to leave flexibility so that each business could be considered separately.

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Co-Chair Hawker summarized that the intent of the program is to be able to accommodate concerns of small businesses such as those represented by the Made in Mat-Su Association. Mr. Winegar agreed.

Vice-Chair Thomas pointed to letters of support from the Bristol Bay Economic Development Corporation, Anchorage Development Corporation, and others, including commercial fishermen.

HB 412 was HEARD and HELD in Committee for further consideration.

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ADJOURNMENT

The meeting was adjourned at 2:49 PM.