



Offered: 4/11/83  
Referred: Finance

Original sponsors: Shults, Lacher,  
Larson and Koponen

1 IN THE HOUSE BY THE RESOURCES COMMITTEE  
2 CS FOR HOUSE BILL NO. 276 (Resources)  
3 IN THE LEGISLATURE OF THE STATE OF ALASKA  
4 THIRTEENTH LEGISLATURE - FIRST SESSION  
5 A BILL  
6 For an Act entitled: "An Act amending the Alaska Agricultural Loan Act;  
7 and providing for an effective date."  
8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:  
9 \* Section 1. AS 03.10.030(a)(1) is amended to read:  
10 (1) may not exceed a term of 30 years, except that a  
11 chattel loan may not exceed a term of seven years;  
12 \* Sec. 2. AS 03.10.030(c) is amended to read:  
13 (c) A short term loan, to be amortized within one year, not to  
14 exceed \$300,000 [\$200,000] to any one borrower may be made for operat-  
15 ing purposes.  
16 \* Sec. 3. This Act takes effect immediately in accordance with AS 01.-  
17 10.070(c).

STATE OF ALASKA  
FISCAL NOTE

Revision Date \_\_\_\_\_, 1983

I. REQUEST

Bill/Resolution No.: HB 276  
 Title: An act amending the ag loan act  
 Sponsor: Schultz and others  
 Requestor: \_\_\_\_\_

II. FISCAL DETAIL

Agency Affected: DNR  
 Program Category Affected: ARLF  
 BRU, Program of Subprogram(s) Affected: \_\_\_\_\_

EXPENDITURES/REVENUES: (Thousands of Dollars)

|                         | FY 83 | FY 84 | FY 85 | FY 86 | FY 87 | FY 88 |
|-------------------------|-------|-------|-------|-------|-------|-------|
| OPERATING               |       |       |       |       |       |       |
| 100 PERSONAL SERVICES   |       |       |       |       |       |       |
| 200 TRAVEL              |       |       |       |       |       |       |
| 300 CONTRACTUAL         |       |       |       |       |       |       |
| 400 COMMODITIES         |       |       |       |       |       |       |
| 500 EQUIPMENT           |       |       |       |       |       |       |
| 600 LAND & STRUCTURES   |       |       |       |       |       |       |
| 700 GRANTS, CLAIMS, ETC |       |       |       |       |       |       |
| TOTAL OPERATING         |       | -0-   | -0-   | -0-   |       |       |
| CAPITAL                 |       | -0-   | -0-   | -0-   |       |       |
| REVENUE                 |       | -0-   | -0-   | -0-   |       |       |

FUNDING: (Thousands of Dollars)

|                        | FY 83 | FY 84 | FY 85 | FY 86 | FY 87 | FY 88 |
|------------------------|-------|-------|-------|-------|-------|-------|
| GENERAL FUND           |       |       |       |       |       |       |
| FEDERAL FUNDS          |       |       |       |       |       |       |
| OTHER (Specify Source) |       |       |       |       |       |       |

POSITIONS:

|           | FY 83 | FY 84 | FY 85 | FY 86 | FY 87 | FY 88 |
|-----------|-------|-------|-------|-------|-------|-------|
| FULL-TIME |       |       |       |       |       |       |
| PART-TIME |       |       |       |       |       |       |
| TEMPORARY |       |       |       |       |       |       |

III. SOURCE OF FUNDS TO OFFSET FISCAL IMPACT OF BILL:

IV. ANALYSIS: Attach a separate page for any Analysis

Prepared By: Sharon Barton Phone: 465-2400  
 Division: Commissioner's Office Date: 4-7-83  
 Approved by Commissioner: \_\_\_\_\_ Date: 4-7-83  
 Department: Natural Resources

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 Copy to Sponsor  
 Copy to Requestor (if different from Sponsor)

3/8/8

The following individuals are expected to testify on CS HB 276  
(Resources):

Representative Dick Shultz, prime sponsor

-----

Sharon Barton, Special Assistant to the Commissioner, Department  
of Natural Resources will be available to answer questions

- (2) designate agents and delegate its powers to them as necessary;
- (3) adopt rules and regulations necessary to carry out its functions;
- (4) establish amortization plans for repayment of loans, which may include delayed payments of principal and interest for not to exceed five years;
- (5) enter into agreements with private lending institutions, other state agencies or agencies of the federal government, to carry out the purposes of this chapter. (§ 4 ch 122 SLA 1953; am § 1 ch 156 SLA 1955; am § 1 ch 41 SLA 1961; am § 1 ch 113 SLA 1982)

Effect of amendments. — The 1982 amendment, effective June 25, 1982, inserted "clearing land for agricultural purposes" in paragraph (1).

**Sec. 03.10.030. Limitations on loans.** (a) A farm development, chattel, or irrigation loan made under this chapter

- (1) may not exceed a term of 30 years;
- (2) may not, when added to the outstanding balance of other loans made under this chapter, exceed a total outstanding balance of \$1,000,000;
- (3) shall be secured by a real estate or chattel mortgage of any priority, except that the portion of a loan that exceeds \$500,000, when added to prior indebtedness that is secured by the same property, must be secured by a first mortgage;
- (4) shall bear interest at a rate that may not be less than eight percent or more than the commercial rate, unless the commercial rate is eight percent or less; in this paragraph "commercial rate" means the prevailing rate of interest at private lending institutions in the state for loans similar to those referred to in this subsection.
- (b) Repealed by § 72 ch 113 SLA 1982.
- (c) A short term loan, to be amortized within one year, not to exceed \$200,000 to any one borrower may be made for operating purposes.
- (d) Repealed by § 72 ch 113 SLA 1982.
- (e) An installment payment is delinquent unless it is mailed by the borrower on or before the 30th day after the date specified for payment in the loan agreement or unless it is received by the department on or before the 30th day after the date specified for payment in the loan agreement. If an installment payment is delinquent, the director may assess a delinquency penalty. The delinquency penalty shall be an amount equal to seven percent of the delinquent payment, but the combined delinquency penalty and loan interest may not exceed 15 percent.
- (f) A farm product processing loan may not exceed \$250,000. A mortgage which secures a farm product processing loan may be of any priority if the total indebtedness on the real estate, including the secured farm product processing loan, does not exceed \$250,000. A farm product processing loan which, if made, would raise the existing

APPENDIX A

STATE OF ALASKA  
DEPARTMENT OF NATURAL RESOURCES  
DIVISION OF AGRICULTURE  
AGRICULTURAL REVOLVING LOAN FUND  
TYPE OF LOANS AND TERMS  
For the Fiscal Year Ended June 30, 1982

Loan Types and Terms

As specified by AS 03.10.030, the following six types of loans are made:

| <u>Type</u>             | <u>Limit</u>   | <u>Current Interest Rate</u> | <u>Terms</u> | <u>Purpose</u>                      |
|-------------------------|--|------------------------------|--------------|-------------------------------------|
| Short-term              | \$200,000  | Not addressed                | 1 year       | Operation of farm                   |
| Chattel                 | Total outstanding balance may not exceed \$1,000,000 when added to other loans | (Note 1)                     | 30 years     | Animals, equipment                  |
| Farm Development        |  |                              | 30 years     | Land, improvements, buildings       |
| Irrigation              |  |                              | 30 years     | Irrigation equipment                |
| Farm Product Processing | \$250,000  | Not less than 8%             | 30 years     | Processing of agricultural products |
| Land Clearing           | \$250,000  | Not less than 8%             | 20 years     | Clear land for planting             |

Note 1: Chapter 113, SLA 1982, effective June 25, 1982, amended the statutory interest rate to not less than eight percent or more than commercial rate, unless the commercial rate is eight percent or less. The Commissioner may establish interest rates for loans within these statutory guidelines.

## BACKGROUND OF HB 276

This bill was introduced at the request of farmer constituents in the Delta area who found inadequacies in Statute AS 03.10.030. In 1981 there was a crop failure - this happens in one of every five years. That year there was a heavy early snow fall that ruined the crop. Also that same year funding of loans for planting was delayed. These incidents prevented many of the farmers from paying back their revolving loans and since the credit limit for loans under this statute was \$200,000 they could not refinance enough to get a crop planted the next year. Some lost as much as \$150,000 due to this bad season. At that time it was impossible for the farmers to get crop insurance. The barley farming was so new that the insurance companies did not have any experience factor to use and so it was unavailable. By increasing the line of credit to \$300,000, the farmers will be able to refinance in the event of an emergency and continue the operation of planting and harvesting. Also this increase in borrowing capacity will enable those farmers who have increased their tillage since 1981 to adequately meet their planting needs.

ANALYSIS OF HB 276

1. The amendment under Section 1, AS 03.10.030 adds except that a chattel loan may not exceed a term of seven years.

This addition makes the statute more consistent with other loaning programs. Chattel mortgages are usually secured by farm equipment and the average life of most equipment is seven years.

2. The amendment under Section 2, AS 03.10.030(c) increases the borrowing capacity of the farmer from \$200,000 to \$3~~5~~0,000.

TELEGRAM

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Alascom Telegraph Office

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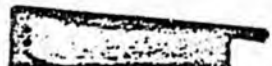
FAIRBANKS AK 99701

02283

I AM IN RECEIPT OF YOUR LETTER CONVEYING RECOMMENDATIONS MADE BY THE AGRICULTURE TASK FORCE AT THEIR FIRST MEETING. AS YOU KNOW I HAVE ALREADY EXPRESSED SUPPORT OF THE RAISING OF THE LOAN LIMIT AS PROPOSED BY CSSB 124. WITH REGARD TO YOUR URGING SUPPORT OF THE GRAIN RESERVE LEGISLATION, I AM INCREASINGLY PURSUADED THAT SOME MARKET CERTAINTY IS IMPORTANT FOR THE UPCOMING PLANTING SEASONS AND THAT ACTION BE TAKEN PROMPTLY. I WOULD BE WILLING, THEREFORE, TO CONSIDER A ONE YEAR PROGRAM THAT WOULD PROVIDE THE ASSURANCE NEEDED FOR THIS YEARS PLANTING BUT WOULD TERMINATE AFTER ONE YEAR. THIS WILL ALLOW TIME FOR THE TASK FORCE AND THIS ADMINISTRATION TO FORMULATE A LONG TERM AGRICULTURAL POLICY FOR ALASKA. I HAVE INSTRUCTED THE APPROPRIATE COMMISSIGNERS AND STATE OFFICIALS TO WORK TOGETHER TO DEVELOP A PROGRAM AND ADVISE ME THIS WEEK WHAT REASONAELE STEPS MIGHT BE TAKEN TO SOLVE THE IMMEDIATE NEEDS OF THE FARMERS.

BILL SHEFFIELD, GOVERNOR

Same as CS 4B 276 (Resources)



# STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

## DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

POUCH M  
JUNEAU, ALASKA 99811  
PHONE: (907) 465-2400

March 31, 1983

The Honorable Richard Shultz  
Alaska State Legislature  
Pouch V  
Juneau, AK 99811

Dear Representative Shultz:

In preparation for the House Resources Committee hearing on HB 276, I would like to offer the following comments on behalf of the Department of Natural Resources:

1. The proposed legislation reduces the term for chattel loans from thirty to ten years. While the Department supported the reduction of term to seven years in SB 124, we believe that fifteen years will exceed the expected useful life of most chattel. Therefore, we would prefer a term of seven years.

2. We support raising the maximum to \$300,000 (as proposed in SB 124) or \$350,000 for operating loans, since that would allow the Board the flexibility to offer larger loans if an operation is large enough to warrant that amount. It should be noted, however, that the \$200,000 maximum represents more than the maximum recommended debt burden for short term monies at the expected level of production on any one farm unit at Delta this year.

If the objective of HB 276 is to offer relief in the current situation at Delta, we would further recommend a disaster provision authorizing the Department to waive or extend the operating limit in times of a declared disaster. The Department is already authorized to waive payments of principal and interest for up to five years.

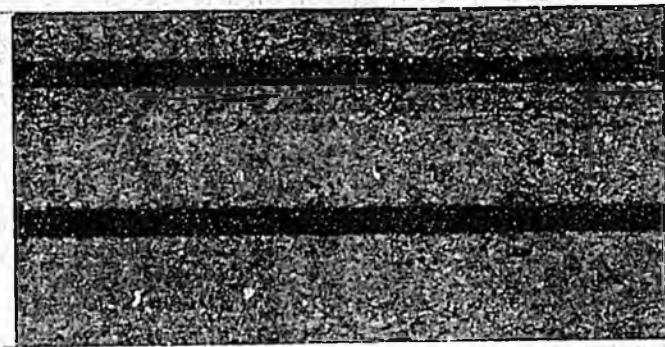
We will be available to testify on this bill as needed.

Sincerely,



Sharon L. Barton  
Special Assistant  
to the Commissioner

**STATE OF ALASKA**



**DIVISION OF LEGISLATIVE AUDIT**  
Juneau, Alaska

A REVIEW OF THE  
DEPARTMENT OF NATURAL RESOURCES  
DIVISION OF AGRICULTURE  
AGRICULTURAL REVOLVING  
LOAN FUND

For the Fiscal Year Ended June 30, 1982

Audit Control Number

10-1089-83-R

Commissioner, Department of  
Natural Resources

Esther Wunnicke

Deputy Commissioners, Department  
of Natural Resources:

Juneau  
Anchorage

Bob Arnold  
Jim Barnett

Agricultural Revolving Loan Fund Board of Directors

Chairman  
Member  
Member  
Member  
Member

John P. Messenger  
Robert J. Gillas  
Stephen K. Hamilton  
Don Breedon  
Dennis D. Green

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PURPOSE OF THE REVIEW

In accordance with the provisions of Title 24 of the Alaska Statutes, a review of the Department of Natural Resources, Division of Agriculture, Agricultural Revolving Loan Fund (ARLF) was conducted to:

1. Determine if the financial statements appearing in the State's Annual Financial Report for the 1982 Fiscal Year are fairly presented.
2. Determine the compliance by the ARLF with the applicable State statutes and regulations governing fiscal activities of the Fund.

ORGANIZATION AND FUNCTION

ARLF, operating under the authority of AS 03.10.010-060 since 1953, promotes the development of agriculture by providing low interest and generally long-term financing to persons engaged in agricultural activities in Alaska. ARLF has been capitalized since inception by direct appropriations from the General Fund currently totalling \$52,500,000. Additional cash for lending has been obtained, from time to time, by sale of assigned notes to the Alaska Department of Revenue. These sales are subject to recourse and totalled \$1,203,415 at June 30, 1982. However, the authority to sell or transfer notes was repealed by Chapter 122, SLA 1980.

## FINDINGS AND RECOMMENDATIONS

### Recommendation No. 1

ARLF should establish procedures to ensure that loans are issued to Alaskan residents.

ARLF may have issued loans, totalling \$2,053,750 as of June 30, 1982, to non-Alaskan residents. The loans were issued to two individuals and two partnerships. We question the residency of these individuals and entities due to the following:

1. Out-of-state addresses were given by the applicants.
2. Out-of-state telephone numbers were given by the applicants.
3. Out-of-state banks were listed by the applicants for their checking and savings accounts.
4. Correspondence between ARLF and the borrowers is to and from out-of-state addresses.
5. ARLF staff stated these borrowers own large farm operations out-of-state and commute between their home state and Alaska.

Alaska Statute 03.10.020 states that loans may be made to individual resident farmers, homesteaders, partnerships or corporations. Under AAC 39.030 ARLF may require proof that the loan applicant is a resident of Alaska and meets the requirements of AS 03.10.020.

The borrowers in question were not required to indicate whether they were Alaskan residents on their loan applications. ARLF has since revised the loan application form to include a statement on Alaskan residency which the applicant certifies is true and correct. However, procedures have not been established to specify the documentation necessary for proof of Alaskan residency.

In addition to the non-residency question, we noted the statutory loan limits were exceeded by a non-resident borrower. Prior to June 25, 1982, Alaska Statutes limited farm development loans to \$500,000. On July 1, 1981, ARLF issued a \$236,500 farm development loan to one of the non-resident partnerships mentioned above. However, one of its partners already had a \$500,000 farm development loan outstanding in his own name. The loans issued under the partnership's name and the individual's name, for all types of loans totalled \$1,124,559 as of June 30, 1982, and were utilized for the same farm unit.

We noted a similar case in our Fiscal Year 1981 audit report in which loans were issued in the name of a borrower's son in order to circumvent the statutory loan limits. We recommended ARLF obtain an opinion from the Attorney General to clarify whether loan limitations should be on a per farm unit basis. In a memorandum dated January 19, 1982, the Attorney General stated the loan limitations should be applied on a per farm unit basis. This prevents one individual through multiple loans from exhausting the loan fund to the detriment of other potential borrowers.

We recommend ARLF promulgate regulations which define and clarify the per farm unit loan limitations. ARLF should also establish specific written procedures for verification of Alaskan residency. These procedures should include, but not be limited to, requesting documentation of Alaskan driver's license, voter's registration, and vehicle registration.

Recommendation No. 2

ARLF should ensure loan notes are properly executed.

We examined 100 percent of the notes held by ARLF as of June 30, 1982, to determine that the notes were signed, notarized, and included all necessary information. We found 23 notes for loans with outstanding balances totalling \$5,076,211 were executed without written repayment terms and maturity dates.

A signed note is proof of the contractual agreement between ARLF and the borrower. If the notes are not complete with the amount of the loan, issue date, interest rate, repayment terms, and maturity date, and a notarized signature of the borrower, the collectibility of the loan may be jeopardized. For example, ARLF presently plans to foreclose on a loan for which the note has no stated repayment terms or maturity date. The borrower has departed from Alaska. ARLF may have difficulties foreclosing on this loan due to the incomplete note.

In addition, we noted five delinquent loans which were not shown as delinquent on the June 30, 1982 loan resume. This was due to the staff being informed that loan extension and/or reamortization agreements were in process. However, no written agreements were ever executed with the borrowers.

ARLF should review the incomplete notes with the Attorney General to determine the proper course of action and ensure future notes are properly completed. The loans for which there may have been verbal extension and/or reamortization agreements should be reviewed. If ARLF determines the terms of the notes need to be modified, approval should be obtained from the Board and written agreements should be executed.

Recommendation No. 3

ARLF should improve its loan processing procedures.

ARLF improved its loan processing procedures during Fiscal Year 1982. A major contribution was the completion of a procedures manual. Our review of loan files concentrated on loans issued during the second half of the fiscal year when the new procedures were to be in effect. Based on our review, we noted the following areas which need additional emphasis for improvement:

A. ARLF should ensure loans are approved in accordance with law and loan board decisions are documented.

We noted a loan for \$40,000 which was denied by the Board was subsequently issued by the ARLF staff despite the denial. Another loan was issued for an amount different from the amount approved by the Board. Additionally, we could find no record of Board or Director approval for two other loans totalling \$43,500.

Alaska Statute 03.10.050(a) requires approval by a majority of the Board for loans in excess of \$25,000. Further, the Alaska Administrative Code, 11 AAC 39.040(e), states that following the Board approval of an application for a loan, the application shall be forwarded for approval to the Commissioner of Natural Resources. The Commissioner will, in his discretion, delegate all or part of his approval authority to the Director of the Division of Agriculture.

The Loan Board Report forms should be completed, signed by the Board Chairman or the Director of the Division of Agriculture depending on the loan amount, and filed in the related loan file.

B. Loan applications should be complete.

ARLF should improve the documentation of the following:

1. Applications or application updates should be submitted with each loan request.
2. Financial statements should be submitted with a borrower's initial application and on an annual basis thereafter in order to receive additional loans.
3. Pro forma financial statements projecting the income and expenses of the following year should be submitted.

4. A statement by the applicant as to the intent of the use of loan proceeds should accompany each loan request.
5. Credit verifications should be performed for all new loan applicants.
6. Real estate appraisals or other reasonable evidence of the loan collateral value should accompany each loan request submitted to the Board.
7. Proof of insurance coverage on loan collateral should be received prior to disbursement of the loan proceeds.

The Alaska Administrative Code 11 AAC 39.030 states all loan requests from the loan fund must be submitted in writing in a form prescribed by the Commissioner. Information that may be required includes: financial statements; pro forma financial statements which show projected income and expense for the following year; a written statement describing how the loan funds will be used; a qualified collateral appraisal; and proof of insurance coverage, naming ARLF as loss payee. The procedures manual adopted by ARLF requires all the aforementioned information and credit verifications to be included in a loan application.

Recommendation No. 4

ARLF should strengthen its guaranteed loan procedures.

When funds are not readily available for an approved loan, ARLF requests interim financing from a local financing institution in an effort to accommodate the needs of its borrowers. To ensure financing, the request includes a guarantee of repayment from ARLF loan proceeds.

Our review of guaranteed loans showed that ARLF does not maintain adequate documentation of its loan guarantee agreements. The following exceptions were noted:

1. ARLF guaranteed loan records are not current.

The ledger cards which list guaranteed loans have not been posted with Fiscal Year 1982 loan information. Additionally, ARLF does not request written confirmation from the lending institution, thus, the borrower's files do not contain documentation to support interim financing approval and repayment.

2. Loan proceeds are made payable to the borrower only.

Since a portion or all of the loan proceeds are guaranteed to the lending institution, ARLF should make checks payable to both the borrower and the lending institution.

This procedure would ensure fulfillment of ARLF's obligation to the lending institution. In our review we noted one case in which a borrower misused interim financing funds. The borrower received \$56,000 in October 1981 of which \$20,000 was to be paid to a lending institution in repayment of a 60-day loan. Due to the borrower's failure to honor his obligation, the loan was not paid until April 1982 by ARLF. Although the funds used by ARLF to pay off the loan were deducted from the borrower's account, the additional controls mentioned above would have prevented the delinquency.

Recommendation No. 5

Loan inspections should be performed by Division of Agriculture personnel.

Loan inspections which include a survey of the farm buildings and equipment are infrequently performed by the ARLF staff. Inspections of ARLF loan collateral should not only be performed before a loan is issued but should also be made on a regular basis to determine the location, continued existence, and condition of loan collateral.

In order to make more efficient use of division personnel, ARLF loan inspections could also be performed by other personnel within the division who make farm visits in conjunction with their regular duties. These staff members could aid ARLF by performing loan inspections during their farm visits. The description of collateral items, including serial numbers, if applicable, could be listed on the ARLF Loan Inspection form. This form then could be given to the staff members for verification of the existence and condition of ARLF collateral.

# STATE OF ALASKA

AUDIT DIVISION  
POUCH W—ALASKA OFFICE BUILDING

## THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

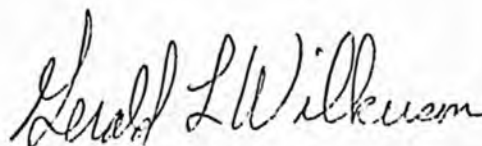
JUNEAU, ALASKA 99811

September 14, 1982

Members of the  
Legislative Budget and Audit Committee:

We have examined the Balance Sheets of the Agricultural Revolving Loan Fund as of June 30, 1982 and 1981, and the related statements of Revenues, Expenses, and Changes in Retained Earnings, and Changes in Financial Position for the years then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of the Agricultural Revolving Loan Fund as of June 30, 1982 and 1981, and the results of operations and the changes in financial position for the years then ended, in conformity with generally accepted accounting principals applied on a consistent basis.



Gerald L. Wilkerson, CPA  
Legislative Auditor  
Division of Legislative Audit

STATE OF ALASKA  
DEPARTMENT OF NATURAL RESOURCES  
DIVISION OF AGRICULTURE  
AGRICULTURAL REVOLVING LOAN FUND  
COMPARATIVE BALANCE SHEET  
June 30, 1982 and 1981

|  | <u>1982</u>         | <u>1981</u><br>Restated<br>(Note 3) |
|--|---------------------|-------------------------------------|
| <u>Assets</u>                                      |                     |                                     |
| <u>Current Assets</u>                              |                     |                                     |
| Cash in Transit                                    | \$ 260,474          | \$ 38,150                           |
| Cash in Treasury                                   | 11,645,781          | 4,797,713                           |
| Accrued Interest Receivable                        | 1,202,925           | 664,730                             |
| Appropriation Receivable                           | <u>10,000,000</u>   | <u>-0-</u>                          |
| <u>Total Current Assets</u>                        | <u>23,109,180</u>   | <u>5,500,593</u>                    |
| <u>Loans Receivable</u>                            |                     |                                     |
| Agricultural Loans Receivable                      | 33,119,263          | 22,200,444                          |
| Irrigation Loans Receivable                        | <u>344,946</u>      | <u>304,381</u>                      |
| Subtotal   | 33,464,209          | 22,504,825                          |
| Less: Loans Sold to State Treasurer                | (1,203,415)         | (1,296,420)                         |
| Allowance for Uncollectible Loans                  | <u>(1,318,675)</u>  | <u>(769,622)</u>                    |
| Net ARLF Loans Receivable                          | 30,942,119          | 20,438,783                          |
| Loans in Progress                                  | 521,210             | 3,827,562                           |
| Repossessed Property                               | 44,225              | 44,225                              |
| Kodiak Slaughterhouse Loan                         | 134,451             | 134,451                             |
| Alaska Farmers' Cooperative Loan                   | <u>1,000,000</u>    | <u>1,000,000</u>                    |
| <u>Total Loans Receivable (Long-Term)</u>          | <u>32,642,005</u>   | <u>25,445,021</u>                   |
| <u>Office Furniture and Equipment</u>              |                     |                                     |
| At Cost  | 9,635               | 6,774                               |
| Less: Accumulated Depreciation                     | <u>(2,467)</u>      | <u>(1,978)</u>                      |
| <u>Total Office Furniture and Equipment</u>        | <u>7,168</u>        | <u>4,796</u>                        |
| <u>Total Assets</u>                                | <u>\$55,758,353</u> | <u>\$30,950,410</u>                 |
| <u>Liabilities and Fund Balance</u>                |                     |                                     |
| <u>Current Liabilities</u>                         |                     |                                     |
| Accounts Payable                                   | 65,611              | 9,409                               |
| Interest Payable                                   | 6,597               | 5,696                               |
| Less: Accrued Interest Receivable<br>on Sold Loans | <u>(6,597)</u>      | <u>(5,696)</u>                      |
| <u>Total Current Liabilities</u>                   | <u>65,611</u>       | <u>9,409</u>                        |
| <u>Other Liabilities</u>                           |                     |                                     |
| Due to General Fund                                | <u>1,134,451</u>    | <u>1,134,451</u>                    |
| <u>Fund Balance</u>                                |                     |                                     |
| Contributions from General Fund                    | 52,500,000          | 28,500,000                          |
| Retained Earnings                                  | <u>2,058,291</u>    | <u>1,306,550</u>                    |
| <u>Total Fund Balance</u>                          | <u>54,558,291</u>   | <u>29,806,550</u>                   |
| <u>Total Liabilities and Fund Balance</u>          | <u>\$55,758,353</u> | <u>\$30,950,410</u>                 |

The Notes to the Financial Statements are an integral part of this Statement.

STATE OF ALASKA  
DEPARTMENT OF NATURAL RESOURCES  
DIVISION OF AGRICULTURE  
AGRICULTURAL REVOLVING LOAN FUND  
COMPARATIVE STATEMENT OF REVENUES, EXPENSES  
AND CHANGES IN RETAINED EARNINGS  
For the Fiscal Years Ended June 30, 1982 and 1981

|  | <u>1982</u>        | <u>1981</u><br>Restated<br>(Note 3) |
|--|--------------------|-------------------------------------|
| <u>Revenues</u>  |                    |                                     |
| <u>Interest Income</u>   |                    |                                     |
| Agricultural Loans   | \$1,602,725        | \$1,034,969                         |
| Irrigation Loans   | 15,809             | 12,896                              |
| Kodiak Slaughterhouse Loan                                       | <u>5,378</u>       | <u>5,378</u>                        |
| <u>Total Interest Income</u>                                     | 1,623,912          | 1,053,243                           |
| <u>Other Income</u>  | <u>24,809</u>      | <u>1,720</u>                        |
| <u>Total Revenues</u>  | <u>1,648,721</u>   | <u>1,054,963</u>                    |
| <u>Expenses</u>  |                    |                                     |
| <u>Administrative Expenses</u>                                   |                    |                                     |
| Loan Losses  | 549,054            | 227,113                             |
| Personal Services  | 277,204            | 156,782                             |
| Travel and Per Diem  | 30,277             | 22,167                              |
| Contractual Services   | 35,632             | 20,513                              |
| Commodities  | 4,324              | 1,402                               |
| Depreciation   | <u>489</u>         | <u>373</u>                          |
| <u>Total Expenses</u>  | <u>896,980</u>     | <u>428,350</u>                      |
| <u>Net Income</u>  | <u>751,741</u>     | <u>626,613</u>                      |
| <u>Retained Earnings, July 1</u>                                 | 1,306,550          | 777,248                             |
| Uncollectible Accrued Interest<br>Recorded in Prior Fiscal Years | <u>-0-</u>         | <u>(97,311)</u>                     |
| <u>Retained Earnings, July 1 as Restated</u>                     | <u>1,306,550</u>   | <u>679,937</u>                      |
| <u>Retained Earnings, June 30</u>                                | <u>\$2,058,291</u> | <u>\$1,306,550</u>                  |

The Notes to the Financial Statements are an integral part of this Statement.

STATE OF ALASKA  
DEPARTMENT OF NATURAL RESOURCES  
DIVISION OF AGRICULTURE  
AGRICULTURAL REVOLVING LOAN FUND  
COMPARATIVE STATEMENT OF CHANGES IN FINANCIAL POSITION  
For the Fiscal Years Ended June 30, 1982 and 1981

|   | <u>1982</u>         | <u>1981</u><br>Restated<br>(Note 3) |
|---|---------------------|-------------------------------------|
| <u>Sources of Working Capital</u>                       |                     |                                     |
| <u>Operations</u>                                       |                     |                                     |
| Net Income  | \$ 751,741          | \$ 626,613                          |
| Items not Requiring Working Capital                     |                     |                                     |
| Depreciation Expense                                    | 489                 | 373                                 |
| Loan Loss Expense                                       | 549,054             | 227,113                             |
| <u>Working Capital from Operations</u>                  | <u>1,301,284</u>    | <u>854,099</u>                      |
| <u>Prior Period Adjustment</u>                          | <u>-0-</u>          | <u>(97,311)</u>                     |
| <u>Contributions from General Fund</u>                  | <u>24,000,000</u>   | <u>14,660,000</u>                   |
| <u>Total Sources of Working Capital</u>                 | <u>25,301,284</u>   | <u>15,416,788</u>                   |
| <u>Uses of Working Capital</u>                          |                     |                                     |
| Increase in Loans to Borrowers                          | 10,959,384          | 7,929,845                           |
| Decrease in Loans Sold to State Treasurer               | 93,005              | 1,070,530                           |
| Loans in Progress                                       | (3,306,352)         | 3,331,827                           |
| Purchase of Equipment                                   | 2,862               | 2,090                               |
| <u>Total Uses of Working Capital</u>                    | <u>7,748,899</u>    | <u>12,334,292</u>                   |
| <u>Net Increase in Working Capital</u>                  | <u>\$17,552,385</u> | <u>\$ 3,082,496</u>                 |
| <br><u>Elements of Net Increase</u>                     |                     |                                     |
| <u>In Working Capital</u>                               |                     |                                     |
| <u>Increase (Decrease) in Current Assets</u>            |                     |                                     |
| Cash in Transit   | 222,324             | (7,615)                             |
| Cash in Treasury  | 6,848,068           | 2,747,218                           |
| Accrued Interest Receivable                             | 538,195             | 341,219                             |
| Appropriation Receivable                                | 10,000,000          | -0-                                 |
| <u>Total Increase in Current Assets</u>                 | <u>17,608,587</u>   | <u>3,080,822</u>                    |
| <u>(Increase) Decrease in Current Liabilities</u>       |                     |                                     |
| Accounts Payable  | (56,202)            | 1,674                               |
| Accrued Interest Payable                                | (901)               | 36,202                              |
| Less: Accrued Interest Receivable on Sold Loans         | 901                 | (36,202)                            |
| <u>Total (Increase) Decrease in Current Liabilities</u> | <u>(56,202)</u>     | <u>1,674</u>                        |
| <u>Net Increase in Working Capital</u>                  | <u>\$17,552,385</u> | <u>\$ 3,082,496</u>                 |

The Notes to the Financial Statements are an integral part of this Statement.

STATE OF ALASKA  
DEPARTMENT OF NATURAL RESOURCES  
DIVISION OF AGRICULTURE  
AGRICULTURAL REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
For the Fiscal Years Ended June 30, 1982 and 1981

Note 1 - Summary of Significant Accounting Policies of the  
Agricultural Revolving Loan Fund

Alaska Statute 37.05.150 requires accounting policies to be in accordance with generally accepted principles of governmental accounting. The following is a summary of significant policies applicable to the Agricultural Revolving Loan Fund (ARLF), an Enterprise Fund.

A. Basis of Accounting

The ARLF annual financial statements are prepared on an accrual basis of accounting. Accrual accounting provides that:

1. Revenues are reported when earned.
2. Expenses are reported based upon a direct association with specific revenues or when the obligation to pay is incurred.
3. Furniture and equipment is stated at cost less accumulated depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the assets.

B. Interest of Loans

The accrual of interest income on loans is discontinued when, in management's opinion, there is doubt as to the collectibility of such income.

Note 2 - Loan Management Policies

ARLF frequently extends, reamortizes, or refinances loans which are or would be delinquent under the original terms of the loans. This policy decreases the amount of delinquent loans, resulting in a lower amount computed for the allowance for uncollectibles.

Note 3

The Balance Sheet at June 30, 1981, and the related Statement of Revenues, Expenses, and Changes in Retained Earnings, and the Statement of Changes in Financial Position for the year then ended are restated to reflect the change in accounting policy stated in Note 1 (B) above.

The effects of the restatement are as follows:

|   |                   |
|---|-------------------|
| A. <u>Balance Sheet</u>   | <u>(Decrease)</u> |
| Retained Earnings   | \$(164,332)       |
| Accrued Interest Receivable   | (164,332)         |
| To write off accrued interest as of June 30, 1981 which is unlikely to be collected.  |                   |
| B. <u>Statement of Revenues, Expenses, and Changes in Retained Earnings</u>   |                   |
| Interest Income on Agricultural Loans   | \$ (62,221)       |
| Interest Income on Irrigation Loans   | (4,800)           |
| Retained Earnings, July 1, 1980   | (97,311)          |
| Retained Earnings, June 30, 1981  | (67,021)          |
| To eliminate accrued interest income earned during Fiscal Year 1981 and prior fiscal years from 1981 income and July 1, 1980 Retained Earnings. |                   |
| C. <u>Statement of Changes in Financial position</u>  |                   |
| Net Income  | \$ (67,021)       |
| Prior Period Adjustment   | (97,311)          |
| To reflect effect of adjustment in (B) above.   |                   |

# STATE OF ALASKA

AUDIT DIVISION  
POUCH W—ALASKA OFFICE BUILDING

## THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

JUNEAU, ALASKA 99811

September 14, 1982

Members of the  
Legislative Budget and Audit Committee:

Our examination was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The information in Appendixes A through C is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the examination of the basic financial statements; and, in our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



Gerald L. Wilkerson, CPA  
Legislative Auditor  
Division of Legislative Audit

APPENDIXES

APPENDIX A

STATE OF ALASKA  
DEPARTMENT OF NATURAL RESOURCES  
DIVISION OF AGRICULTURE  
AGRICULTURAL REVOLVING LOAN FUND  
TYPE OF LOANS AND TERMS  
For the Fiscal Year Ended June 30, 1982

Loan Types and Terms

As specified by AS 03.10.030, the following six types of loans are made:

| <u>Type</u>             | <u>Limit</u>   | <u>Current Interest Rate</u> | <u>Terms</u> | <u>Purpose</u>                      |
|-------------------------|--|------------------------------|--------------|-------------------------------------|
| Short-term              | \$200,000  | Not addressed                | 1 year       | Operation of farm                   |
| Chattel                 | Total outstanding balance may not exceed \$1,000,000 when added to other loans | (Note 1)                     | 30 years     | Animals, equipment                  |
| Farm Development        |  |                              | 30 years     | Land, improvements, buildings       |
| Irrigation              |  |                              | 30 years     | Irrigation equipment                |
| Farm Product Processing | \$250,000  | Not less than 8%             | 30 years     | Processing of agricultural products |
| Land Clearing           | \$250,000  | Not less than 8%             | 20 years     | Clear land for planting             |

Note 1: Chapter 113, SLA 1982, effective June 25, 1982, amended the statutory interest rate to not less than eight percent or more than commercial rate, unless the commercial rate is eight percent or less. The Commissioner may establish interest rates for loans within these statutory guidelines.

APPENDIX B

STATE OF ALASKA  
DEPARTMENT OF NATURAL RESOURCES  
DIVISION OF AGRICULTURE  
AGRICULTURAL REVOLVING LOAN FUND  
GENERAL LOAN INFORMATION  
For the Fiscal Year Ended June 30, 1982

|  | 1982                       |                               |  |   |
|--|----------------------------|-------------------------------|--|---|
|  | <u>Number<br/>of Loans</u> | <u>\$ Amount<br/>of Loans</u> | <u>Percent of<br/>Number<br/>Loans O/S</u> | <u>Percent of<br/>\$ Amount<br/>Loans O/S</u> |
| <u>Total Loans Outstanding (O/S) by Location</u> |                            |                               |  |   |
| Matanuska  | 180                        | \$11,229,739                  | 29.4%                                      | 33.5%   |
| Delta  | 262                        | 17,334,246                    | 42.8%                                      | 51.8%   |
| Tanana   | 80                         | 1,891,457                     | 13.1%                                      | 5.6%  |
| Kenai  | 63                         | 2,061,136                     | 10.3%                                      | 6.2%  |
| Other Areas                                      | 27                         | 947,632                       | 4.4%                                       | 2.9%  |
| <u>Total by Location</u>                         | <u>612</u>                 | <u>\$33,464,210</u>           | <u>100.0%</u>                              | <u>100.0%</u>                                 |
| <u>Loans Delinquent (Note 1)</u>                 |                            |                               |  |   |
| Matanuska  | 36                         | \$ 1,240,054                  | 5.9%                                       | 3.7%  |
| Delta  | 61                         | 3,822,975                     | 10.0%                                      | 11.4%   |
| Tanana   | 12                         | 177,579                       | 2.0%                                       | 0.5%  |
| Kenai  | 12                         | 173,253                       | 2.0%                                       | 0.5%  |
| Other Areas                                      | 10                         | 608,701                       | 1.6%                                       | 1.8%  |
| <u>Total Loans Delinquent</u>                    | <u>131</u>                 | <u>\$ 2,022,562</u>           | <u>21.5%</u>                               | <u>17.9%</u>                                  |
| <u>Loans in Foreclosure</u>                      |                            |                               |  |   |
| Matanuska  | 2                          | \$ 145,492                    | .3%  | .4%   |
| Delta  | 4                          | 45,600                        | .7%  | .1%   |
| <u>Total Loans in Foreclosure</u>                | <u>6</u>                   | <u>\$ 191,092</u>             | <u>1.0%</u>                                | <u>.5%</u>                                    |

Note 1: Determined by loan payments overdue by more than 30 days at June 30, 1982.

APPENDIX C

STATE OF ALASKA  
DEPARTMENT OF NATURAL RESOURCES  
DIVISION OF AGRICULTURE  
AGRICULTURAL REVOLVING LOAN FUND  
RETURN ON INVESTMENT/COST ANALYSIS  
For the Fiscal Year Ended June 30, 1982

| <u>Rate of Return on Total Assets</u> | <u>1982</u>         |
|---------------------------------------|---------------------|
| Total Revenues per Income Statement   | \$ 1,648,721        |
| Total Expenses per Income Statement   | <u>896,980</u>      |
| Net Income                            | <u>\$ 751,741</u>   |
| Average Assets Less Cash in Treasury  | <u>\$31,708,600</u> |
| Rate of Return (Note 1)               | <u>2%</u>           |

Loans O/S per Employee Month

|  |            |
|--|------------|
| Total Number of Loans O/S (Note 2)     | <u>617</u> |
| Total Number of Employee Months        | <u>72</u>  |
| Number of Loans O/S per Employee Month | <u>9</u>   |

Note 1: Rate of Return is defined as follows:

$$\frac{\text{Net Income}}{\text{Average Assets Less Cash in Treasury}}$$

Note 2: Total Number of Loans O/S is defined as follows:

|  |            |
|--|------------|
| ARLF Loans   | 612        |
| Special Appropriations Loans<br>Administered by ARLF | <u>5</u>   |
|  | <u>617</u> |

# STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

## DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

POUCH M  
JUNEAU, ALASKA 99811  
PHONE: (907) 455-2400

November 17, 1982

RECEIVED  
NOV 13 1982

LEGISLATIVE  
AUDIT

Mr. Gerald Wilkerson  
Legislative Affairs Agency  
Division of Legislative Audit  
Pouch W  
Juneau, AK 99811

Dear Mr. Wilkerson:

We have reviewed the Legislative Audit preliminary report on the Agriculture Revolving Loan Fund.

In spite of changes and improvements we have made in the last year, professional management of the ARLF continues to be a source of concern for the Division of Agriculture and for me. A procedures manual, developed with the assistance of the firm of Price-Waterhouse, has been adopted, and it is being refined as needed. Certain additions are being made as a result of this audit. A few months ago, I requested that Deputy Commissioner Jeff Haynes pursue a thorough review of the operation of the fund. His report (attached) was subsequently distributed for review and comment and the recommendations are now being implemented. Since receipt of this year's preliminary Legislative Audit report, I requested a review of all ARLF files. With the assistance of two people from your staff, this project was completed last week. We will see that any deficiencies brought to light in this further review, as well as those noted in the preliminary report, are remedied on an expedited basis. I am confident that the significant progress made prior to the audit in combination with the additional steps recommended in the audit will result in a much more accountable operation.

Our specific comments on the preliminary report are as follows:

Recommendation #1. We concur that it is necessary for the Board to establish criteria for determining the Alaskan

Mr. Gerald Wilderson  
Page Two  
November 17, 1982

residency of applicants. The new application blank requires a statement from the applicant that he is a resident. In the redraft of the ARLF regulations now underway, the board will establish criteria for residency. It should be noted that use of out-of-state addresses, phone numbers or banks does not necessarily mean the borrower is not a resident.

This recommendation carries an additional notation that one non-resident borrower exceeded the statutory limit. The example cited is an issue of interpretation of the statutory loan limits. The Attorney General's memo dated January 19, 1982, stated that the statutory sections dealing with borrower limits were to be applied on a per farm basis.

The loan in question was made to an individual who was a former borrower as a partner in a nearby farm operation; the units were then separate. Those units have since been combined for operational purposes, resulting in loans exceeding the \$1 million limit for the joint farm unit. Even though the collateral remains separate, the intent of the \$1 million limit has been violated. The new regulations being drafted will deal with the definition of a farm unit, the Board policies in dealing with suspected or actual mergers after approval of loan packages, and other related facets of the loan limit question. It may be necessary to require borrowers to agree, as a condition of a loan, that obligations in excess of the \$1 million limit be satisfied before consumation of any merger.

Recommendation #2. All ARLF loan files have been reviewed to insure that all notes and lien assignments were properly executed or that remedial action was taken where necessary. The twenty-three loans with outstanding balances which did not have repayment terms on the note have either been re-executed or, at the direction of the Attorney General's Office, we have appended a letter of intent signed by both the State and the borrower outlining the terms of the note. Steps have also been taken to revise procedures to assure that no loan will be closed without inclusion of repayment terms in the future.

Recommendation #3. On October 1, 1981, procedures were instituted to correct the problems noted.

- A. Approval. The Division and the Board were both aware of the cited instances where loans were made without Board approval, and brought these

Mr. Gerald Wilkerson  
Page Three  
November 17, 1982

and other similar problems to the attention of the auditors for their review. The new procedures should preclude a recurrence.

- B. Complete application. The revised procedure assure submission of a complete, up-to-date application for each loan request.

Recommendation #4. We concur with the analysis and recommendations. A thorough review and overhaul of the guaranteed loan procedures will be completed by January 15, 1983 and instituted by January 30, 1983.

Recommendation #5. We agree with the analysis and recommendation. New procedures were instituted on November 8, 1982, assigning inspection quotas to eight personnel in order to ensure that each borrower has inspection routinely once a year. All new loan applications will have inspection prior to presentation to the Board.

In closing, I would like to express my appreciation for the time and effort Ms. Moser and Mr. Wilkes spent on the follow-up review of ARLF files. Their expertise made the job much easier. If you have any questions, please contact my office.

Sincerely,



John W. Katz  
Commissioner

cc: Nick Carney, Director  
Division of Agriculture

# MEMORANDUM

# State of Alaska

TO: John W. Katz  
Commissioner

DATE: August 23, 1982

FILE NO: 1351

TELEPHONE NO: 465-2400

FROM:   
Jeff Haynes  
Deputy Commissioner

SUBJECT: Report/Agricultural  
Revolving Loan Fund

The Agricultural Revolving Loan Fund (ARLF), established under the Territory of Alaska, served for many years as a source of modest loans for an equally modest agricultural industry. Authorized capitalization remained constant at \$5,000,000 through the 1970s.

In 1978, the State inaugurated the Delta agricultural project as the beginning of an attempt to elevate agriculture to a large scale, integrated Alaskan industry. Proponents of agricultural development contended that comprehensive State financial assistance was a prerequisite for agriculture to become a substantial and eventually self-sustaining industry in Alaska.

Direct financial and other assistance advanced by the State in support of agriculture commencing with the Delta Project has taken a number of forms, including (1) sale of agricultural land under limited title at approximately 15% of fee simple appraised value, (2) application of residency discounts to agricultural land sales, (3) special appraisal methodology for agricultural project sales, (4) favorable terms and conditions in sale contracts for agricultural land, (5) appropriations for capital improvements for agricultural infrastructure, (5) State funded research, data collection, test marketing, and field management studies, and (7) special loan programs with liberal terms for agricultural land clearing. The largest State contribution, however, has been through low interest loans from the ARLF; capitalization of the ARLF has increased 1000% since 1978 to a current level of over \$50,000,000.

Controversy over administration of the ARLF has risen in direct proportion to augmentation of the Fund's capitalization, as might be expected. Because of the persistence of this controversy, you requested that I conduct an inquiry into the operation of the ARLF and supply you with findings and recommendations. I have interviewed Loan Board members, the Division of Agriculture Director and staff, ARLF borrowers, opinionmakers in the agriculture community, legislative auditors, and legislators interested in the ARLF; examined file documents generated from ARLF transactions; and observed proceedings of the Agricultural Revolving Loan Fund Board. While this cannot qualify as a

full scale audit, I have reached a number of conclusions which are set out below.

1. The State has not developed detailed marketing information and assumptions upon which to base its agricultural development objectives, leaving uncertainty over the expected viability of particular agricultural industries as well as the direction and accomplishments expected of the ARLF.

The State has determined that it must provide front-end assistance if Alaskan agricultural industries are to reach the critical mass which will allow them to become self-sustaining. For that reason, development plans and schedules are required to determine the most promising targets for that assistance.

Long term planning by the State for agricultural development has improved over the last two years through initiatives by the Alaska Agricultural Action Council, the Department of Natural Resources, and the University of Alaska. Moreover, there has been extensive research on the necessary components of various potential and existing agricultural industries in the State and the opportunities which may exist for those industries. However, this research has not reached the level of detail constituting a genuine product market analysis such as would be performed by competent businesses in the private sector before committing to production.

Obviously, it is not sufficient to assume that assisting any given Alaskan agricultural industry to reach optimum scale and infrastructure development insures that products emanating from that industry may be sold profitably when State assistance ends. That assumption can only be made after careful comparison of anticipated production and transportation costs and price ranges at optimum scale against those for similar commodities in specific identified markets. Unless these factors are approximately equivalent or there are strategic market advantages not available to producers elsewhere, it is unlikely that Alaskan products can compete successfully without a continuous State subsidy.

A considerable volume of information on markets for various agricultural commodities has been collected by the State, the University, and other sources. However, that information has not been translated into a product-by-product breakdown containing cost and price assumptions determined by the State to be most probable under foreseeable market conditions. Without this level of information, it is extremely difficult for the Agricultural Revolving Loan Fund Board to (1) judge the long term viability of the operations of prospective borrowers, (2)

determine the types of operations and products it should be favoring with available credit, (3) calculate the amount of subsidized capital which will be required by particular agricultural industries until they become self-sustaining, and (4) identify appropriate terms and conditions under which loans should be issued. Moreover, until this market information is formulated and linked to the State's agricultural development objectives, there will not be an adequate mechanism to insure that ARLF lending policies are in consonance with those objectives. 1/

Understandably, this deficiency has created uncertainty among existing and prospective ARLF borrowers, since many do not clearly understand which agricultural pursuits will be financially assisted by the State, which will be expected to exist on their own an ancillary or spinoff industries, and what economic criteria will be applied in the adjudication of loan applications.

An equally important matter receiving inadequate attention to date is the regulatory framework and philosophy which the State intends to employ as the Alaskan agricultural industry develops. Agriculture is one of the most heavily regulated industries in the lower 48 States, largely as an outgrowth of remedial measures instituted during the Great Depression; there is virtually no feature left in the production and marketing of agricultural products which has not been pervaded by government regulations and controls. While some of these regulations are restrictive, others are protective measures designed to insulate the farmer from destructive

---

1/ One of the best efforts to date is a document entitled Financing Agricultural Projects in Alaska, prepared by the House Research Agency in January 1982. It includes a comparison of production costs and transportation to tidewater under eight different levels of State assistance, and the expected level of profitability depending upon yield per acre and world grain prices (pp. 32-37).

Ideally, the ARLF should have a similar breakdown for each of the major agricultural commodities under production in Alaska (including projections for ranges of destination market prices in specific markets) which represents a consensus among State agricultural officials. The Board would then have a means of determining which agricultural enterprises are most likely to be successful, and a standard against which to compare the circumstances of individual borrowers. That same market information could be provided to farmers through extension agents to assist them in designing an optimum credit package which enhances their changes of Board approval and, concurrently, further Alaska's agricultural development objectives.

administration of the fund and the adjudication of individual credit applications. 2/

2. There has been resistance to the imposition of formal administrative procedures necessitated by the elevation of ARLF to one of the State's largest professional lending institutions.

For most of its existence, the ARLF has operated in a climate of relative informality compared to many other state agency programs, a practice which could be afforded given the small volume and amounts of loans and the modest size of the agriculture industry. Since 1978, however, the character of Alaskan agriculture and of the mission of ARLF have expanded; ARLF now has about 570 loans outstanding in amounts up to \$2,800,000 apiece.

In early 1981, three events convinced the Commissioner and Director of Agriculture Carney that the procedures governing administration of the ARLF must be substantially upgraded. First, there were an increasing number of complaints from borrowers regarding inconsistent handling of credit applications, failure to adequately inform the borrower of the process by which the application would be adjudicated, and lack of proper documentation as to the actions taken by the loan staff and the Loan Board on credit applications; a number of these complaints were determined to be valid. Second, the steadily increasing capitalization of the ARLF (which appeared likely to continue) meant that operation of the Fund was becoming vastly more complex; absent more formalized administrative procedures, the Fund could not be managed properly and enjoy public confidence in the exercise of its functions. Third, the prequalifications process for the initial Pt. McKenzie sale (which included ARLF applications as part of the application package and resulted in more than 30 appeals to the Commissioner) made it evident that more specific standards and procedures were necessary if ARLF actions were to meet the requirements of procedural due process of law.

Director Carney selected the firm of Price, Waterhouse to draft a procedures manual for the ARLF, which was subse-

2/ There is not intended any suggestion here that agriculture in general or any specific type of agricultural enterprise is economically unsound. In fact, there appear to be a number of situations where strategic market advantages exist favoring Alaskan production. For example, one of the credit applications recently approved by the Board was for a vacuum cooling unit for lettuce; using proven technology, this unit would extend the shelf life of Alaskan lettuce from 4 to 25 days, and likely permit local lettuce producers to recapture interior markets now supplied by exports from California.

economic conditions. Most, however, have a considerable impact on the economic circumstances under which agricultural products are produced and marketed. By comparison, Alaskan agriculture is largely unregulated except for Federal and State standards on inspections and grading. As part of its agricultural development program, it is advisable for the State to decide to what extent it will follow the lower 48 example and in what instances agriculture will be left to the forces of free and unregulated competition. There appear to be opinions on both sides within the Alaskan agricultural community. Some view the State's involvement as declining once the industry and associated infrastructure reach optimum scale; others appear to believe that various levels of protective regulation and subsidization must become permanent features of the agricultural industry. Regardless of the approach which may best meet the public interest, it is advisable for the selection to be made early so that the State's development assistance programs and its regulatory philosophy are complimentary, and the relationship between them is well understood by entities such as the ARLF Board.

The State's marketing assumptions and its intended regulatory approach to agriculture are two of the most critical factors in its agriculture development program. The absence of a clear understanding on these factors means that Loan Board decisions on individual credit applications are often being made in a vacuum. This necessarily creates controversy when credit applications are turned down on grounds relating to the type of operation or the long term viability of the operation, since it is extremely difficult for the Board to give a truly comprehensive reason for its decision in the context of the State's overall agricultural development program. As the number of large project-size agricultural tracts increase and with them the size of loan applications and potential adverse financial consequences to the applicant, the level of controversy will increase accordingly if remedial action is not taken.

Recommendation: The State must resolve differences of approach to agricultural development caused by divided authority and develop justifiable assumptions on the marketability of individual agricultural products, as well as determine the regulatory framework which the State intends to pursue over the long term. This will necessarily yield relatively specific objectives for the ARLF, which should be followed by the Board and the Department in the

quently reviewed and adopted by the Director. [This manual deals with the handling and processing of ARLF credit applications, but does not contain grading standards for adjudication of the applications.] It is fair to say that the procedures manual has met with resistance from some Loan Board members, loan examiners, and ARLF borrowers who prefer the prior highly informal and flexible approach. A substantial amount of the friction emanating from the ARLF can be traced to the adoption of the procedures manual and actions taken by Director Carney to obtain compliance with the procedures.

Recommendation: While it is unfortunate that the size of the ARLF now requires that it become a more formalized institution, it is a necessity in order to protect both the borrower and the ARLF. The increase in the volume and complexity of credit applications between 1979 and 1981 was accompanied by a decline in the quality of handling applications to the point that some were done very poorly; most of the problems could be attributed to the absence of an administrative system geared to the workload being experienced by the ARLF. Therefore, while the manual may need to be revised from time to time to modify or eliminate those requirements not accomplishing their purpose, it is a reasonable document and must be enforced. The alternative would be a justifiable lack of public confidence in the ARLF which would in turn damage the State's agricultural development program.

3. The Loan Board and Department of Natural Resources Loan Examiners do not have a complete set of grading standards for the adjudication of ARLF credit applications.

Although the Board appears to be meeting minimum legal requirements in the adjudication of ARLF credit applications, there does not exist a detailed system of grading standards against which applications can be compared. There are two reasons why this is lacking.

The first is the absence of agreed upon marketing assumptions and regulatory approaches governing the State's agricultural development program, described in Paragraph 1 above.

Second, there has not been undertaken an analysis of the loan history of various types of credit packages granted by the ARLF to determine the relative success ratios of each and the factors contributing to success or failure. This has been virtually impossible to date because many components of Alaska's agricultural industry are in their earliest stages and their long term success is not yet proven.

The Loan Board and Director Carney have made an effort in the last several months to adopt formal policy statements on the types of agricultural loans which the ARLF will consider or not consider. In addition, Director Carney contracted with John Penson, a professor of agricultural economics with a number of major publications on agricultural financing, to evaluate the possibility of developing a credit scoring model to be used in the adjudication of agricultural loan applications. 3/

Recommendation: The Director and the Loan Board should continue to develop as many written policy statements and guidelines as necessary to fully express the Board's approach to agricultural financing. These policy statements should be adopted by the Director as Division Policies to properly reflect the consensus of the Board and the Department on this subject. In addition, the Board and the Division should have the benefit of continuous representation and advice from the Attorney General's Office on the development of policy statements, revision of regulations to contain standards and procedures used in ARLF adjudications, and to assist the Board in the handling of difficult applications, which to date has been lacking.

The Director correctly concluded (as did Mr. Penson) that an automated credit scoring model for judging ARLF applications would over-mechanize agricultural financing decisions to the detriment of the agricultural development program, particularly given the inadequate track record on many types of agricultural enterprises in Alaska. However, it was recommended that the ARLF organize its loan history data and develop an automated system for storing and retrieving that data to assist the Loan Board and loan staff in a more

3/ To place the situation in perspective, it is doubtful that many private lending institutions leave the outcome of determinations or credit applications entirely to a formal point system or other arithmetical grading system. All loan requests necessarily require a substantial amount of personal judgement, which is the reason for the creation of a Loan Board. However, some borrowers have expressed uncertainty over the policies of the Board on specific types of loans; greater specificity on loan policy and the factors deemed important to the Board and the Loan Examiners in evaluating loan applications would generally improve relations with prospective borrowers.

thorough comparison of loan types. DNR should begin this effort during FY 1983. 4/

4. There does not exist a clear understanding of the respective roles and relationships of the Loan Board, Division of Agriculture Loan Examiners, the Director of Agriculture, and the Commissioner and Department of Natural Resources.

AS 03.10.050 states only the "[t]he commissioner shall administer the loan fund in conjunction with the agricultural revolving loan fund board;" no guidance is given as to the respective responsibilities of the Board and the Department. There are, in fact, four elements of the ARLF system: (a) the Loan Board, composed presently of five members from the private sector, (b) the Director of the Division of Agriculture, (c) the loan administrator and subordinate loan examiners, who handle credit applications before and after Board action and are employees of the Division, and (d) the Commissioner of the Department of Natural Resources, to whom the Director reports. Loan Board appointments are made by the Governor, but do not require legislative confirmation. 5/

The coexistence of these elements has not been entirely harmonious, particularly as the ARLF has grown and the credit application decisions have become more difficult. Some Loan Board members felt that the loan examiners should report directly to the Board without any interference or participation by the Director, and some loan examiners had a similar opinion. The friction reached a peak when the Director adopted the procedures manual, took disciplinary action to obtain compliance therewith by Division employees, requested the Board to place its policies in writing, overturned three Board actions granting loans on the grounds that they were inconsistent with governing regulations, and revised the ARLF application form.

4/ It should be noted that in past years the Board has financed operations at levels in excess of 90%, recently reduced to an average debt/equity ratio in the neighborhood of 75%-25%. Frequently, state land sale contracts constitute part of the collateral offered by the borrower. While relatively high debt/equity ratios are necessary in order to permit borrowers to meet development schedules for agricultural lands, this circumstance highlights the risk capital nature of the ARLF and the importance of developing accurate loan history data to aid the Board in its deliberations.

5/ It should be noted that Loan Board members receive no compensation other than travel and per diem, and their duties are demanding.

In retrospect, none of the parties are entirely faultless. The Board should have given more attention to written policies and procedures and recognized that they are being assisted by the Division of Agriculture, which consists of loan examiners and the Director. Loan examiners should have willingly participated in the development of the procedures manual for the sake of professionalism as well as their own protection, and recognized that they are employees of the Division rather than the Board. The Director, while his actions to upgrade ARLF policies and procedures were fully correct as were his efforts to obtain compliance therewith, should have worked more directly with the Board members during the development stages of the procedures manual and application form revision; nevertheless, his decisions in overturning the three loan actions were proper. Finally, the Commissioner's Office (within which I include myself) should have paid some attention to the Loan Board over the past several years instead of leaving the entire burden on the Director.

It should be emphasized that most of the impetus for upgrading the policies and procedures of the ARLF came from the Director, and he was therefore visited with substantial criticism from a number of quarters for what he did and how he handled it. From my standpoint, with a few minor exceptions, that criticism was unjustified.

Recommendation: A Department Order on the respective responsibilities of the parties involved in the ARLF (a draft of which as been prepared) should be adopted by the Commissioner. General policies on the objectives of the ARLF and the types of loans which will be granted should be agreed upon between the Board and the Department. The loan examiners, under the supervision of the Director, should evaluate credit applications in the context of applicable policies and procedures and make recommendations to the Board. The Board should adjudicate individual credit applications in accordance with their policies.

The Director should not overturn a Board decision unless he believes that it violates state policy or applicable laws and regulations; before formally overturning a loan decision by the Board, he should check with the Commissioner and review the matter with the Board. The Commissioner should entertain appeals of Board actions only in the context of alleged violations of stated policy or applicable laws and regulations. Board decisions should be faithfully carried out by the loan staff recognizing fully the intent behind them. In addition, the Department should develop the best possible working relationship with the Board.

5. The State does not have an adequate extension services system for agriculture which includes assistance to

prospective borrowers in the preparation of their application.

Much of agricultural development in Alaska is at an early stage, and a number of persons who have elected to engage in agriculture do not have extensive experience, particularly with the unique soils, climate, and marketing conditions in Alaska. Moreover, many prospective borrowers from the ARLF are uncertain as to the extent the State will guide and support particular agricultural industries as opposed to letting them exist entirely on their own.

While some extension services are provided by the University of Alaska and by the U.S. Department of Agriculture, they have not risen to the level of the county extension agent concept which is an important and familiar element in lower 48 agricultural communities. Furthermore, because of the relative absence of Production Credit Associations and other financing infrastructure in Alaska, an Alaskan extension service should fully incorporate assistance in obtaining ARLF financing as part of its program.

Recommendation: DNR should include a project in its FY 1984 budget submission for a county agent extension service system for both agriculture and forestry, including assistance in the preparation of ARLF financing requests. This service should be oriented towards maximizing exchange of information within the agricultural community, assisting the farmer in developing optimum types of operations and products (with advice from the Experiment Station and Plant Materials Centers), and aiding the farmer in developing the best possible loan package for consideration by the ARLF Board based on marketing information described in Paragraph one above. This approach should minimize misunderstandings between the Board and ARLF applicants and maximize the success rate of ARLF loans.

6. The Board and the Department do not have a regular program of inspections of operations financed by the ARLF.

Presently, the Board and the Department do not have a comprehensive system for inspecting operations financed by ARLF loans to determine compliance with loan conditions or the relative success of the operation. Inspections conducted to date have revealed important information on the types of farming enterprises which are succeeding and failing as well as borrowers who have not fully complied with the conditions imposed in conjunction with their ARLF loans.

Recommendation: The FY 1984 budget submission by DNR should include increased funding for loan inspections. Inspections should increase to the extent possible in FY 1983.

7. Consideration should be given to altering the structure of the Loan Board or the types of appointments made to the Board to minimize occasions of actual or perceived conflicts of interest.

Traditional practice has been for at least four of the five members of the Loan Board to be from the agricultural business community. As the relatively small agricultural community becomes more integrated, members of the Board are experiencing increasing instances where borrowers are persons with whom they have done business or are otherwise economically related to their own interests. The Board has recently adopted detailed policy guidelines on conflicts of interest; nevertheless, the Board may soon face a situation where enough of the members have excused themselves that a quorum cannot be obtained to act on an application.

Several suggestions have been made to rectify this situation, including moving the ARLF function to the Department of Commerce & Economic Development and integrating it with their business loans program, altering the structure of the Board, and changing the types of appointments made to the Board.

Recommendation: Moving the ARLF to the Department of Commerce would not solve the problem, but merely remove it to another arm of the bureaucracy. Given the size of the ARLF, which is larger than the existing business loans program, it would likely cause a major disruption in the Department of Commerce as well. Moreover, the Department would be abdicating its responsibility over this important area of agricultural development, and it is extremely important that agricultural lending benefit from specialized knowledge and understanding of the agricultural development situation in Alaska.

Another suggestion proffered was to have credit applications adjudicated by a committee of government officials, with the Agricultural Revolving Loan Fund Board acting in an advisory capacity. This would require a statutory change, and it is doubtful if it would be received with enthusiasm by the agricultural community.

A third possibility would be to increase the membership of the Board and/or make additional appointments from the financial and business community or from other government agencies, providing for an assured quorum of persons unlikely to have any conflicts while retaining the agricultural expertise to insure that ARLF remains a practical service to farmers. Appointments from the financial community might be especially desirable; that community has been reluctant to date to engage in financing agricultural ventures, and a greater understanding of the risks and opportunities characteristic in various Alaskan

agricultural enterprises among its members might advance the date at which larger volumes of private financing might be made available. This approach also would require statutory change.

The fourth, and perhaps most promising option, would involve using a concept similar to that presently employed in State government for the approval of contracts. Under this system, the Loan Board would operate as it does now, but all credit applications approved by the Board would have to receive final approval from a committee of state officials reviewing each application for any procedural irregularities, deviation from customary agricultural lending practice, problems with conflicts of interest, and similar matters. The committee would not be empowered to finally disapprove a loan, but only to remand the application to the Loan Board with instructions for further action if they did not believe they could approve it. Procedural problems with loans disapproved by the Board or special questions referred to the committee, which would then direct the Board as to the proper procedural course of action. Under this approach, the Board would continue to perform its intended role and apply agricultural expertise to ARLF loans, while the committee would provide a safeguard against procedural improprieties or serious deviations from acceptable business practices.

8. The ARLF must develop a system for charging of interest rates which avoids permanent dependency by individual enterprises on the Fund and the attraction of applicants whose businesses are predicated on low interest ARLF loans.

For many years, the statutory interest rate for ARLF loans was 6%. As of this legislative session, the interest rate is now a minimum of 8%, and the Board is currently using the 8% figure for its loans.

It must be understood that the ARLF in fact provides two financial advantages to borrowers. First, it offers what amounts to venture capital in that the private financial community has not been inclined to underwrite many Alaskan agricultural enterprises even at market rates of interest (and certainly not in the volume loaned out by the ARLF). Second, the ARLF offers venture capital at substantially less than market rates.

The gap between ARLF interest rates and market interest rates has increased considerably in the past few years. As a result, there is evidence that some enterprises are becoming increasingly dependent on the ARLF and, further that the ARLF has become an extremely attractive source of money upon which businesses may themselves be predicated.

Recommendation: The ARLF statutes now provide that interest rates on Fund loans be at a minimum of 8%; consequently, it is possible for the ARLF to charge greater rates where warranted. It is advisable for the ARLF to develop an interest rate system which preserves the advantages of favorable financing while avoiding the problems described above.

Suggestions have been made that the interest rate for all loans be increased steadily until market rates are reached, or that the rate for individual borrowers increase over time until it equals the market rate. The problem with the first approach is that it does not reflect the differing viability of different types of agricultural enterprises. The second approach risks financing competitors at different interest rates, giving one a government created advantage.

Perhaps the most practical concept would be to establish different interest rates according to the estimated viability of various products or enterprises. For example, loans for operations for a product just getting started in Alaska might be at 8%; as the general efficiency and economies of scale for that product improve, interest rates could be increased accordingly until they reach market rates (coinciding with that product becoming a self-sustaining industry).

In any event, a firm policy on interest rates for ARLF loans must be developed in FY 1983.

9. The ARLF Board has not been regularly consulted by the Department during the planning stages for State agricultural land disposals.

The State has sold well in excess of 100,000 acres of agricultural land in the past four years in the form of both major agricultural project sales and through DNR's annual land disposal program. These lands have been sold under agricultural title to encourage purchasers to commit the land to agricultural pursuits, and some sales have included a development plan as a condition of sale.

Obviously, a substantial percentage of purchasers of State agricultural land will eventually become applicants for ARLF credit. Presently, however, the ARLF board is often not formally consulted in the course of developing agricultural lands sales policy. As a result, their expertise in assisting in the design of such sales to maximize the viability of potential operations (and therefore the likelihood of ARLF financing) is not available.

Recommendation: The Agricultural Revolving Loan Fund Board should be formally consulted by DNR in conjunction with formulation of agricultural land disposal policy.

Introduced: 3/18/83  
Referred: Resources and Finance

BY SHULTZ, LACHER, LARSON  
AND KOPONEN

1 IN THE HOUSE

2 HOUSE BILL NO. 276

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 THIRTEENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act amending the Alaska Agricultural Loan Act;  
7 and providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 \* Section 1. AS 03.10.030(a)(1) is amended to read:

10 (1) may not exceed a term of 30 years, except that a  
11 chattel loan may not exceed a term of 15 years;

12 \* Sec. 2. AS 03.10.030(c) is amended to read:

13 (c) A short term loan, to be amortized within one year, not to  
14 exceed \$350,000 [\$200,000] to any one borrower may be made for operat-  
15 ing purposes.

16 \* Sec. 3. This Act takes effect immediately in accordance with AS 01.-  
17 10.070(c).