HOUSE COMMITTEE REPORT

(11)

Date referred: 3/23/88 FURTHER REFERRALS:

DATE: 4-13-88

The Finance Committee has considered HB 415

"An Act relating to agricultural industry production credits for dairy products; and providing for an effective date."

RECOMMENDS:

[X] replace with CS HB 415 (FINANCE) [X] the same title

[ ] attached amendment(s) [ ] a new title

[ ] do pass

[ ] do not pass

[X] no recommendation

[ ] individual recommendations

[ ] additional referral to the ____________ Committee

ADOPTS: [ ] ________ letter of intent

ATTACHES NEW FISCAL NOTE(s):

[X] fiscal impact

[ ] zero fiscal note

[ ] zero with analysis

[ ] same as previous fiscal note published ____________

[ ] same as previous zero fiscal note published ____________

SIGNING DO PASS:

Larson Ronald L. Larson

Frank

SIGNING OTHER RECOMMENDATIONS:

Adams Al Adams - DO NOT PASS

Pourchot Pat Pourchot NO REC

Swack NR

Boyer NR

Rieger Steve Rieger No Recommendation

Wallis Kay Wallis DO NOT PASS

Brown Tay Brown DO NOT PASS

Davis Mike Davis NO REC

Al Adams

Chairman's signature

STATE OF ALASKA
1988 LEGISLATIVE SESSION

BILL VERSION : CS HB 415 (Finance)
PUBLISH DATE :

FISCAL NOTE

REQUEST:

Revision Date: 3/28/88
Title : Dairy Production Credits
Sponsor : House Finance Committee
Requestor : House Finance Committee

Agency Affected : Natural Resources
BRU : Agricultural Management
Components : ARLF

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
PERSONAL SERVICES		-0-				
TRAVEL		-0-				
CONTRACTUAL		32.0				
SUPPLIES		-0-				
EQUIPMENT		-0-				
LAND & STRUCTURES		-0-				
GRANTS, CLAIMS		-0-				
MISCELLANEOUS		-0-				
TOTAL OPERATING	-0-	32.0	-0-	-0-	-0-	-0-

CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-

REVENUE	-0-	(1,991.0)	(157.6)	(157.6)	(156.7)	(156.7)

FUNDING: (Thousands of Dollars)

GENERAL FUND		32.0				
FEDERAL FUNDS						
OTHER						
TOTAL	-0-	32.0	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

This fiscal note reflects the effects of a dairy production credit program for the years 1985-1987, with credits applied only to ARLF loans under Title 3. The negative revenues are the result of loans which will not be recovered because of the credits allowed under this bill,

Prepared by : HB Hal Ward
Division : Division of Agriculture
Phone : 745-7200
Date : 3/28/88

Approved by Commissioner : B Willi M Ross
Agency : Natural Resources
Date :

Distribution (by preparer) :
- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

Original sponsors: Larson and Menard

IN THE HOUSE BY THE FINANCE COMMITTEE

CS FOR HOUSE BILL NO. 415 (Finance)

IN THE LEGISLATURE OF THE STATE OF ALASKA

FIFTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to agricultural industry production credits for dairy products; and providing for an effective date."

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

* Section 1. PURPOSE. The purpose of this Act is to permit dairy farmers in the state to achieve parity with milk producers who are located outside the state and to reward those dairy farmers in the state who are productive and who are making a sincere effort to compete on equal terms with milk producers located outside the state.

* Sec. 2. AS 03.05 is amended by adding a new section to read:

Sec. 03.05.017. AGRICULTURAL PRODUCTION CREDITS FOR DAIRY PRODUCTS. (a) In addition to the production credits authorized under AS 03.05.015, the commissioner shall establish a program of agricultural production credits for dairy products. Credits under this section shall be applied against amounts due on agricultural loans made under this title. The credits shall be based on dairy products produced in the state.

(b) The annual credit for the years 1985 - 1987 is $2.68 per hundredweight of dairy products as shown on documents acceptable to the commissioner. The credit shall be applied to the principal on the debts described in (a) of this section. The credits available under this section and AS 03.05.015 are limited to 25 percent of the principal debt incurred.

(c) A credit granted under this section may not be transferred.

* Sec. 3. This Act takes effect immediately under AS 01.10.070(c).

 WORK DRAFT WORK DRAFT

5-1731L
Bradley
3/28/88

Original sponsors: Larson and Menard

IN THE HOUSE BY THE FINANCE COMMITTEE

CS FOR HOUSE BILL NO. 415 (Finance)

IN THE LEGISLATURE OF THE STATE OF ALASKA

FIFTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to agricultural industry production credits for dairy products; and providing for an effective date."

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(b) The annual credit for the years 1985 - 1987 is $2.68 per hundredweight of dairy products as shown on documents acceptable to the commissioner. The credit shall be applied to the principal on the debts described in (a) of this section. The credits available under this section and AS 03.05.015 are limited to 25 percent of the principal debt incurred.

(c) A credit granted under this section may not be transferred.

* Sec. 3. This Act takes effect immediately under AS 01.10.070(c).

STATE OF ALASKA
1988 LEGISLATIVE SESSION

BILL VERSION : CS HB 415 (L&C)
PUBLISH DATE :

FISCAL NOTE

REQUEST:

Revision Date: 3/28/88
Title : Dairy Production Credits

Sponsor : House Labor & Commerce
Requestor : House Finance Committee

Agency Affected : Natural Resources
BRU : Agricultural Management
Land & Water

Components : ~~ARLF~~
~~Public Use~~

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
PERSONAL SERVICES		38.4				
TRAVEL		-0-				
CONTRACTUAL		35.0				
SUPPLIES		1.0				
EQUIPMENT		-0-				
LAND & STRUCTURES		-0-				
GRANTS, CLAIMS		-0-				
MISCELLANEOUS		-0-				
TOTAL OPERATING	-0-	74.4	-0-	-0-	-0-	-0-

CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-

REVENUE	(1991.0)	(157.6)	(157.6)	(157.6)	(157.6)	(157.6)

FUNDING: (Thousands of Dollars)

GENERAL FUND	-0-	74.4	-0-	-0-	-0-	-0-
FEDERAL FUNDS						
OTHER						
TOTAL	-0-	74.4	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME		1				
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

This fiscal note reflects the effects of this program for the years 1985-1987 at $2.68 per cwt of milk produced. The negative revenues are the result of loans which will not be recovered due to the dairy credits allowed under this bill. (Costs based on assumption that application for credits would not be allowed after 12/88.) Continued on Page 2

Prepared by : Hal Ward Dick LeFebvre
Phone : 465-2400
Division : Agriculture Land & Water
Date : 3/28/88

Approved by Commissioner : [signature]
Date : 3/29/88
Agency : Natural Resources

Distribution (by preparer) :
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

RECEIVED
MAR 30 1988
LEGISLATIVE FINANCE

F I S C A L   N O T E

A N A L Y S I S

CONTINUED

CS HOUSE BILL 415 (L&C)

The revenue projections for the loan fund for FY 89 and future years will decrease by the amounts shown because the principal balance due on dairy loans will decrease by approximately 20%.

Operating costs for FY 89 to calculate and apply the retroactive production credits on ARLF loans and agricultural land contracts are as follows:

100 -	38.4	1 Natural Resource Officer I, Range 14A (Division of Land and Water Management)
200 -	-0-	
300 -	30.0	Contracting for special accounting for credits and audit of milk processing records to ensure compliance with this bill. (Division of Agriculture)
-	5.0	Certified mail, public notices, telephone charge associated with land contract and loan credit applications. (3.0 Division of Land and Water Management, 2.0 Division of Agriculture)
400 -	1.0	Commodities for 1 Natural Resource Officer I (Division of Land and Water Management)

Position Title		No. of Positions	Range/Step	Barg. Unit
Natural Resource Officer I		1	14A	GGU

Time Status	Staff Months	Location	Election District
PFT	12	Anchorage	7

Type of Expenditure		Amount
1	2	3
Salary	28,236	
Benefits	10,137	
Premium Pay		
Other		
Total Personal Services		38,373
Travel		
Contractual		35,000
Commodities		1,000
Equipment		
Other		
Total Cost		74,373

Funding Source for Total Cost	
Federal Receipts 1002	
G. F. Match 1003	
General Fund 1004	74,373
GF Program Receipts 1005	
Other	

Justification

This position will be responsible for contracting for special accounting for credits and audit of milk processing records to ensure compliance with this bill.

Request For New Position

Agency Natural Resources

BRU Land and Water Management

Component Land and Water Public Use

Page 1 of

Revised Date

FY 89

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

400 WILLOUGHBY AVE.
JUNEAU, ALASKA 99801-1796
PHONE: (907) 465-2400

March 29, 1988

The Honorable Albert Adams
Chair, House Finance Committee
P.O. Box V
Juneau, Alaska 99811

Dear Representative Adams:

Subject: The House Labor and Commerce Committee Substitute for House Bill 415, which relates to Agricultural production credits for dairy products.

Position: Although the committee substitute for this bill has reduced its impact by establishing a dairy production credit program for only three years (1985-1987), the Department of Natural Resources cannot support this bill.

The loss of loan principal payments resulting from CSHB 415 could be disastrous to the Agricultural Revolving Loan Fund (ARLF), especially when considered in conjunction with the numerous other agricultural loan reduction bills introduced this year. In addition, this bill subsidizes the dairy industry by writing down loans for dairy farmers, regardless of whether they have financial problems.

Background: The original production credit program under AS 03.05.015 (which ends after this tax year) was designed to encourage farmers to finish clearing their land and bring their farms into full production. Dairy and other farmers have benefitted from the original program which reduced the interest due on agricultural loans in proportion to the value of farm products sold. This new program does not encourage farm development or sales, but instead provides dairy farmers with a retroactive credit towards ARLF loan or land contract principal equal to $2.68 per CWT for dairy products produced.

Recommendation: Allow dairy farmers in need of debt relief to restructure troubled debt through the existing ARLF program. Allow the existing production credit program to terminate after this tax year and refrain from establishing the new program described in this bill.

Sincerely,

Judith M. Brady
Commissioner

cc: Committee Members
Bill Sponsors
Bob Evans
Rod Swope

STATE OF ALASKA
1988 LEGISLATIVE SESSION

BILL VERSION : CS HB 415 (L&C)
PUBLISH DATE :

FISCAL NOTE

REQUEST:

Revision Date: 3/22/88
Title : Dairy Production Credits
Sponsor : Labor & Commerce Committee
Requestor : House Labor & Commerce Comm

Agency Affected : Natural REsources
BRU : Agricultural Management
Land & Water
Components : ARLF
Public Use

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
PERSONAL SERVICES		84.0				
TRAVEL		-0-				
CONTRACTUAL		35.0				
SUPPLIES		2.0				
EQUIPMENT		-0-				
LAND & STRUCTURES		-0-				
GRANTS, CLAIMS		-0-				
MISCELLANEOUS		-0-				
TOTAL OPERATING		121.0	-0-	-0-	-0-	-0-
CAPITAL						
REVENUE		(1,991.0)	(157.6)	(157.6)	(156.7)	(156.7)

FUNDING: (Thousands of Dollars)

GENERAL FUND		121.0				
FEDERAL FUNDS						
OTHER						
TOTAL		121.0	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME		2				
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

This fiscal note reflects the changes in this bill and includes the fiscal effects of this program for the years 1985-1987 at $2.68 per cwt of milk produced. The negative revenues are the result of production loans which will not be recovered due to the dairy credits allowed under this bill. (Contd.)

Prepared by : Hal Ward
Phone : 745-7200
Division : Division of Agriculture
Date : 3/22/88

Approved by Commissioner : Tom Hawkins
Date : 3/22/88
Agency : Natural Resources

Distribution (by preparer) :
- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

RECEIVED
MAR 24 1988
LEGISLATIVE FINANCE

The revenue projections for the loan fund for FY 89 and future years will decrease because the principal balance due on dairy loans will decrease by approximately 20%.

The operating costs are as follows:

100 --	1 Natural Resource Manager I Range 18 A	50.0	(DL&WM)
	1 Natural Resource Technician II Range 12 A	34.0	(DL&WM)
200 --	-0-	-0-	
300 --	Contracting for special accounting of credits and audit of milk processing records to ensure compliance with this bill.	30.0	(D of Ag)
	Certified mail, public notice and telephone charges associated with land contract credit applications under this program.	5.0	(3.0 L&W) (2.0 D. Ag)
400 --	Commodities for 2 new positions	1.0	(L&WM)

Position Title	No. of Positions	Range/Step	Barg. Unit
Natural Resource Manager I	1	18A	GGU

Time Status	Staff Months	Location	Election District
PFT	12	Anchorage	

Type of Expenditure		Amount
1	2	3
Salary	37,600	
Benefits	12,400	
Premium Pay		
Other		
Total Personal Services		50,000
Travel		
Contractual		3,000
Commodities		500
Equipment		
Other		
Total Cost		53,500

Funding Source for Total Cost	
Federal Receipts 1002	
G. F. Match 1003	
General Fund 1004	53,500
GF Program Receipts 1005	
Other	

Justification

This position will supervise a NRT II. The team will be responsible for calculating credits pursuant to HB 415

Request For New Position

Agency Natural Resources

BRU Land and Water

Component Public Use

Page 3 of 4

Revised Date

FY 89

Position Title		No. of Positions	Range/Step	Barg. Unit
Natural Resource Techncian II		1	12A	GGU
Time Status	**Staff Months**	**Location**	**Election District**	
PFT	12	Anchorage		

Type of Expenditure		Amount
1	2	3
Salary	24,800	
Benefits	9,200	
Premium Pay		
Other		
Total Personal Services		34,000
Travel		
Contractual		2,000
Commodities		500
Equipment		
Other		
Total Cost		36,500

Funding Source for Total Cost	
Federal Receipts 1002	
G. F. Match 1003	
General Fund 1004	36,500
GF Program Receipts 1005	
Other	

Justification

This position will work under a project leader. Will be involved in recalculating credits for current dairy contracts

Request For New Position

Agency Natural Resources

BRU Land and Water

Component Public Use

Page 4 of 4

Revised Date

FY 89

STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES
OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

400 WILLOUGHBY AVE.
JUNEAU, ALASKA 99801-1796
PHONE: (907) 465-2400

March 29, 1988

The Honorable Albert Adams
Chair, House Finance Committee
P.O. Box V
Juneau, Alaska 99811

Dear Representative Adams:

Subject: The House Labor and Commerce Committee Substitute for House Bill 415, which relates to Agricultural production credits for dairy products.

Position: Although the committee substitute for this bill has reduced its impact by establishing a dairy production credit program for only three years (1985-1987), the Department of Natural Resources cannot support this bill.

The loss of loan principal payments resulting from CSHB 415 could be disastrous to the Agricultural Revolving Loan Fund (ARLF), especially when considered in conjunction with the numerous other agricultural loan reduction bills introduced this year. In addition, this bill subsidizes the dairy industry by writing down loans for dairy farmers, regardless of whether they have financial problems.

Background: The original production credit program under AS 03.05.015 (which ends after this tax year) was designed to encourage farmers to finish clearing their land and bring their farms into full production. Dairy and other farmers have benefitted from the original program which reduced the interest due on agricultural loans in proportion to the value of farm products sold. This new program does not encourage farm development or sales, but instead provides dairy farmers with a retroactive credit towards ARLF loan or land contract principal equal to $2.68 per CWT for dairy products produced.

10-J9LH

Recommendation: Allow dairy farmers in need of debt relief to restructure troubled debt through the existing ARLF program. Allow the existing production credit program to terminate after this tax year and refrain from establishing the new program described in this bill.

Sincerely,

Judith M. Brady
Commissioner

cc: Committee Members
Bill Sponsors
Bob Evans
Rod Swope

Alaska State Legislature

Session Address:
STATE CAPITOL BUILDING
BOX V
JUNEAU, ALASKA 99811
(907) 465-3727

Interim Address:
BOX 53
PALMER, ALASKA 99645
(907) 745-3826 - Palmer
(907) 376-8628 - Wasilla

Representative Ronald L. Larson
District 16B

TO: Representative Al Adams
Chairman, House Finance

FROM: Representative Ron Larson R.L.

SUBJECT: CSHB 415 (Finance)

DATE: March 29, 1988

CSHB 415 (Finance), An Act relating to Agricultural Industry Projection Credits for Dairy Products is before our committee for consideration.

This bill was developed to assist productive dairy farmers in the reduction of their debt load. Many of the farmers have made sincere efforts to create viable dairy farms. Those honest efforts have been supplemented by private monetary investments equaling approximately 12 million dollars.

The bill seeks to reward the producing farmers--as determined by their past production records.

The Finance CS made the following change to the Labor and Commerce CS. In lines 21 and 22 of the first page the words "and AS 44 and amounts due on the sale of agriculture land under AS 38.05" were eliminated. The sentence now reads, "Credits under this section shall be applied against amounts due on agricultural loans made under this title."

The effect of that change will allow for the dairy farmers to be rewarded, in terms of production credits, on their agricultural loans only. In the previous CS production credits applied to both agricultural loans and payments on agricultural land. This modification reduces the fiscal note by eliminating the Division of Land and Water Management's participation in the production credit program.

According to the Department of Natural Resources' fiscal analysis for CSHB 415 (Labor & Commerce) the amendment would result in the following reductions:

84.0	Personal Services
3.0	L&W Noticing
1.0	Commodities
88.0	

HB 415

Alaska Quality Dairy Cooperative, Inc.
P.O. Box 872346
Wasilla, Alaska 99687

Rep. Dave Donnelly
Chairman, House Labor & Commerce Committee
Juneau, Alaska 99811

Dear Rep. Donnelly,

This letter is in support of the proposed legislation now before your committee in regard to production credits for the Alaskan dairy industry.

The legislation calls for a forgiveness of a portion of the debt owed the State of Alaska Agricultural Revolving Loan Fund by commercial dairy farmers throughout the state.

The bill calls for no "new" money to be expended by the fund. It would reduce by a small percentage the total amount of money which would have eventually been due from the farmers in the form of principal payments over the next 20 or 30 years. The annual effect on the fund would thus be very small. But the positive effects on the cash flows and financial positions of the state's dairy farmers would be very large.

The amount of the credit is equal to the amount by which the State of Alaska reduced the price of milk when it took over the Matanuska Maid creamery. All the new dairies received loans from the ARLF based upon the higher price of milk, and the state's reduction in the price has had severe impacts on each of our cash flows and abilities to survive.

Another important effect the principal reduction would have is to bring the total outstanding loans of the dairies under the statutory per-farm-unit limit of $1,000,000. In this way, some of the farms which need expansion or operating capital in order to be more efficient would have the needed lending source again available to them. The State of Alaska, in insisting on limits in the land titles and in holding first mortgages on all the farms, has placed itself in the position of being the only lender available to the farms.

A summary of the production credit reasoning follows.

1. The dairy industry has been severely impacted by the failure of the Matanuska Maid creamery, and by continuing market difficulties.

2. The severe problems were noted by the ARLF when it assumed ownership of the creamery in November, 1984, and made the crucial decision to lower the price of milk below that which the new farms at Point MacKenzie had planned for.

3. A moratorium was granted due to these dislocations. However, moratoriums postpone problems rather than solve them. Interest continued to accrue, worsening the cash flows and financial positions of those farms which continued to produce milk during this period. The activation of a one-time-only principal credit equal to the amount of money lost because of the different milk price would solve a problem the moratoriums only put off.

4. Dairy farms have a very large start-up cost, commensurate with their ability to produce very large on-going benefits in the form of jobs and economic stimulation. The $1 million ARLF lending limit has caused a hardship on all the farms now operating, in their inabilities to obtain adequate operating capital, or where necessary, capital for expansion. This credit would lower the outstanding debt to ARLF sufficiently to allow farms to qualify for needed capital. ARLF is the only lender able to lend to the farms at present, both because of the weakened state of the farms, the weakened state of prospective lenders, and because of the nature of the land title.

5. The reduction in debt would improve the financial positions of the dairies, making them more attractive to other private lenders in the future.

6. The principal reduction production credit has the added advantage of acting to reward only those farms which perservered through the difficult times.

We hope this helps in your deliberations. We are aware of the large number of bills competing for your attention and endorsement. This, we believe, is one that for no further expenditure and relatively little reduction in future receipts, would have a dramatic stabilizing effect on a jobs-intensive industry. If we can answer further questions, please call. Thank you.

Sincerely,

Karen Lee

Karen Lee
Secretary
Alaska Quality Dairy Cooperative, Inc.
(376-0790)

Snowcrest Farms, Inc.
P.O. Box 872406, Wasilla, AK 99687 • 376-3546

Representative Curt Menard
Alaska State Legislature
P.O. Box V (MS 3100)
Juneau, Alaska 99811

March 4, 1988

Dear Curt,

Thankyou for sending me copies of HB 400, 415, 456, and SB 23 and for your request for my opinion

I strongly favor passage of all four pieces of legislation as each is an important piece of the larger puzzle which hopefully will yield success for the agricultural industry and the dairy industry.

Please note that contrary to Mr. Chuck Forch's letter, dated February 12,1988, to you that HB 415 will not reduce the current funds of the ARLF by 2 million dollars. It will reduce yearly the amount returning to ARLF.

We are concerned about the survival of the ARLF, as are they, but the board must remember that if the demands for repayment are to high and unrealistic that money will not revolve back anyway and if they are so concerned about the funds being bleed out maybe they ought to look at the 1.1 million it took to run the fund in 1986 and that near amount again in 1987 with a greater amount anticipated in 1988. The fund that was established to " establish and promote Agriculture in Alaska" is being bled dry to the tune of 1 million per year by the bureaucracy and they have the audacity to critique us in our desire to survive and be productive. I also find it very interesting that that the Loan Board encouraged us to take our plight to the legislature and are now opposing us after having done so.

I appreciate your efforts in helping us resolve these issues and I am certainly willing to provide you with any information needed to support these pieces of legislation.

Sincerely,

H. Ray Hendershot

AGRICULTURAL REVOLVING LOAN FUND

Through the history of the State of Alaska Department of Agriculture the main focus of policy has been the facilitation of the development of agriculture as a renewable resource. A continuing problem has always been that there is little or no financing available for agricultural ventures in what is an essentially agricultural frontier in the continental United States. Private financial institutions have not had the experience in financing agricultural crops and growth, semi-private corporations have not had the financial depth to meet the needs of the agricultural community and personal assets have been rather limited in this state to allow the development of this agricultural base.

The Agricultural Revolving Loan Fund was established by the State of Alaska because of the above problems and with the recognition that in order to develop the many facets of agriculture, as a renewable resource, that it would in some fashion also have to serve as a capital source. The evolution of the Agricultural Revolving Loan Fund has been tied hand in hand with the evolution and implementation of agricultural policy by the various administrations of this state.

We believe it is extremely important that the Agricultural Revolving Loan Fund be left in the Deptartment of Agriculture as it is the only way that agricultural planning and policy can be implemented in this evolving industry. Without the Agricultural Revolving Loan Fund the Dept. of Agriculture is essentially emasculated as a functioning agency. We are all aware of the difference in personalities on the board and in the Dept. of Agriculture which have limited its effectiveness, however, the basic concepts are still valid in its conceptualization and implementation.

We understand that a move is afoot to place the Agricultural Revolving Loan Fund into the Dept. of Commerce. We believe this would be a tragic mistake in administrative policy and would essentially hamstring future policy implementation in this very basic industry.

We believe this administration has a unique opportunity to re-establish credible agricultural policies for the next 8 to 10 years in the State of Alaska. Without the unique combination of the Dept. of Agriculture and its mechanisms of implementing this policy history will only repeat itself as to how the state has left this total industry in disarray.

J. Michael James, M.D.
James Farms, SR Box 5497-S, Wasilla, AK 99687

SUMMARY OF DELINQUENCY AND DEFAULT
STATE LOAN PROGRAMS
4TH QUARTER, FY 87

LOAN PROGRAM	--DELINQUENT LOANS-- $ Amount	Percent	--LOANS IN DEFAULT-- $ Amount	Percent
Indirect Lenders (Bond Sales)				
Alaska Housing Finance Corporation (All Programs)	$831,028,385	19.516%	$129,345,072	3.038%
Alaska Industrial Development Authority				
AIDA Purchased	50,020,603	19.715%	23,769,309	9.368%
Appropriated to AIDA	8,642,046	11.469%	2,585,041	3.431%
Alaska Medical Facility Authority	0	0.000%	0	0.000%
Alaska Municipal Bond Bank	0	0.000%	0	0.000%
Direct Lenders (Appropriations)				
Agriculture Revolving Loan Fund	18,176,063	45.907%	4,792,353	12.104%
Alaska Power Authority				
Power Project Fund	0	0.000%	0	0.000%
Rural Elect. Revolving Loan Fund	0	0.000%	0	0.000%
Alaska Resources Corporation	652,136	7.791%	7,718,760	92.209%
Alternate Tech. Revolving Loan Fund	903,000	8.891%	474,000	4.667%
Bulk Fuel Revolving Loan Fund	169,000	50.659%	4,000	1.199%
Child Care Facility Revolving Loan Fund	146,000	11.281%	184,000	14.217%
Commercial Fishing Revolving Loan Fund	5,646,000	7.385%	3,104,000	4.060%
Fisheries Enhancement Revolving Loan Fund	61,400	0.119%	1,553,900	3.003%
Grain Reserve Loan Fund	1,187	0.262%	33,802	7.474%
Historical District Revolving Loan Fund	86,000	7.998%	0	0.000%
Housing Assistance Loan Fund	5,045,270	3.678%	4,875,346	3.554%
Med. Malpractice Liability Loan Fund	0	0.000%	0	0.000%
Mining Loan Fund	3,778,000	30.754%	3,877,000	31.560%
Power Development Revolving Loan Fund	0	0.000%	0	0.000%
Residential Energy Conservation Fund	339,000	11.806%	118,000	4.109%
Scholorship Revolving Loan Fund	28,275,939	7.723%	49,275,864	13.459%
Small Business Revolving Loan Fund	2,963,000	15.187%	4,343,000	22.261%
Teacher Scholorship Loan Fund	0	0.000%	0	0.000%
Tourism Revolving Loan Fund	102,000	5.196%	108,000	5.502%
Veterans Revolving Loan Fund	7,459,000	11.001%	1,353,000	1.995%
Water Resources Revolving Loan Fund	0	0.000%	0	0.000%

1. Delinquency includes all loans that are more than one day past due at the end of the quarter; the exceptions are the Agriculture Revolving Loan Fund, AIDA and the Scholorship Loan Fund.

2. Loans in default are defined as delinquent loans that have been turned over to counsel for legal action. Scholorship loans are considered to be default if more than 120 days past due.

3. Housing Assistance Loan Fund data includes all Nonconforming Housing Loans and loans from the Rural Owner-Occupied and Rural Non-Owner Occupied programs purchased since the start of FY 83. Mortgages made by the two rural loan programs before July 1, 1982 and mortgages recently transferred to AHFC are included in AHFC delinquency and default data.

Director

FILE NO:

TELEPHONE NO: 745-7200

THRU:

SUBJECT: HB 415

FROM:

Hal K. Ward
Loan Manager

An analysis of the financial effect on the ARLF as a result of the subject legislation is as follows:

1985.......$511,241.28

1986.......$636,047.83

1987.......$823,628.61

Total retroactive loss $1,970,917.72.

Assuming the milk production from Point Mackenzie remains stable with increase of 5% per year through the effective end of the bill as proposed, the cost would increase to a total amount of $5,698,351. This represents over one half of the $10,681,815 investment in current loan balances for ARLF and Land Clearing loans for the dairy farm parcels on Point Mackenzie.

A SPECIAL REPORT ON THE
DEPARTMENT OF NATURAL RESOURCES
POINT MACKENZIE AGRICULTURE PROJECT
MATANUSKA MAID DAIRY

February 5, 1988

Audit Control Number

10-4293-88-S

Commissioner, Department of Natural Resources	Judith M. Brady
Deputy Commissioner, Department of Natural Resources	Lennie Boston-Gorsuch

STATE OF ALASKA DIVISION OF LEGISLATIVE AUDIT

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
P.O. BOX W
JUNEAU, ALASKA 99811-3300

February 5, 1988

Members of the Legislative Budget
and Audit Committee:

In accordance with a Legislative Budget and Audit Committee special request and the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

A SPECIAL REPORT ON THE
DEPARTMENT OF NATURAL RESOURCES
POINT MACKENZIE AGRICULTURE PROJECT
MATANUSKA MAID DAIRY

February 5, 1988

Audit Control Number

10-4293-88-S

Randy S. Welker

Randy S. Welker, CPA
Acting Legislative Auditor
Division of Legislative Audit

TABLE OF CONTENTS

PURPOSE OF THE REPORT

In accordance with a Legislative Budget and Audit Committee request and Title 24 of the Alaska Statutes, this special report has been prepared to document Matanuska Maid Dairy's marketing effort and the State of Alaska's involvement in the Point MacKenzie agriculture project.

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AUDITOR'S CONCLUSION

In 1979 an administrative and legislative decision was made to salvage the dairy industry of southcentral Alaska through the development of a dairy project at Point MacKenzie. The economic feasibility of the project was based on assumptions developed from existing Matanuska-Susitna Valley dairy farms and a small test plot at Point MacKenzie. A plan was developed utilizing the small, family-run farm concept, state provision of infrastructure (roads, electricity, educational facilities), low interest loans, deferred payments, and land at less than market value. It was recognized at the time that the economic feasibility of the project was questionable. As stated in a 1980 study by the Office of Management and Budget: "Any combination of earlier interest payments, higher interest rates, higher construction costs and/or lower than required milk production will substantially alter the time required before operations are financially sound... The margin for costly mistakes is minimal."

As discussed in the following sections of this report, mistakes were made. The project has also been affected by circumstances unforeseen in 1980 such as technological innovations in shipping which allowed competitors to ship milk to Alaska faster and cheaper, the bankruptcy of the only creamery market for project milk -- Matanuska Maid and the subsequent reputation and market share loss resulting from that bankruptcy, and the decline in population in southcentral Alaska in recent years.

The result has been that of the original nineteen dairy parcels sold, eight are producing, all of which are currently delinquent on state loans. Those eight dairies are meeting the production expectations for the entire project; however, at current production levels and at current milk prices all farms are not yet economically viable. The Matanuska Maid creamery is in state ownership, run by contracted management. Although Matanuska Maid pays no debt service and sales in 1987 were in excess of $12,000,000, the dairy operated at a loss of $850,000, primarily due to state policy decisions to purchase more milk than demand required at a higher than market price.

These questions then arise: Can the dairy industry in southcentral Alaska be economically viable? If not, should the State continue to support the industry for other social and economic reasons? The answers to these questions depend on administrative and legislative policy decisions which need to be made. <u>For all project farms to become viable, production levels and/or raw milk prices must increase</u>. <u>For Matanuska Maid dairy to become viable, prices paid to the producers must be modified based on market conditions</u>. In brief, the road to economic viability in the current policy climate is increased demand or reduced number of suppliers.

An increased demand for local dairy products would greatly aid both the farmer's and the creamery's ability to prosper. As discussed in this report, Matanuska Maid is employing a number of marketing strategies aimed at increasing market share. There are also several pieces of legislation which have been or are currently being considered to encourage this to occur. The 1987 Legislative Session saw the passage of a bill giving a seven percent local bidders preference for agricultural products being purchased with State funds. This legislation should bring contracts with large purchasers of dairy products, such as school districts and Pioneer Homes, within Mat-Maid's reach. Legislation being considered includes SB 105 establishing a standardized method of date-labeling milk products which could also favorably impact demand.

If demand does not increase, the number of suppliers will decline. Inefficient or marginal dairy operations will declare bankruptcy or be foreclosed on by their primary creditor, the Agricultural Revolving Loan Fund (ARLF). The result will be a handful of large, well-managed dairy farms meeting demand. The State could then attempt to recapture investment through sale of the assets.

Should viability not occur as a result of these actions, policy makers also have the option to continue state support of the dairy industry in southcentral Alaska for other value received. Advocates of this view point to the following benefits: Alaskan self-sufficiency; pressure on competitors to provide better quality products at lower prices; jobs for approximately 150 Alaskans; access to fresh, quality produce; and investment protection. Several occurrences in 1987 lent credence to some of these arguments. In December of 1987 shipments of dairy products from the Washington area were interrupted which could have resulted in a shortage of fresh products to the consumer had Mat-Maid not been able to meet the increased demand. Division of Agriculture personnel also claimed that the introduction of Mat-Maid yogurt to the market resulted in a reduced price of competitive products by major retailers.

The State has an investment of approximately $20,000,000 in the dairy industry at Point MacKenzie. That investment is comprised of an investment in Matanuska Maid Dairy of $6,000,000, ($3,000,000 in loans prior to foreclosure and an equal amount in contributed capital and operating funds since that time); $11,000,000 in loans including land clearing, chattel, farm development and operating; $1,300,000 for road survey and construction; and $3,000,000 for electrification. Other indirect costs have been associated with the project in the form of loan moratoriums, investment in meat processing facilities to process cull cows and the sale of State land at less than market value.

Unless demand increases substantially, a decision to ensure profitability for all existing Point MacKenzie dairy farms will require continued subsidization. Those subsidies might be seen through price supports such as those which resulted in Matanuska Maid's $800,000 operating loss in 1987; production credits for dairy products as proposed in HB 415 which Division of Agriculture personnel predict would cost an average of $800,000 per year; or further postponement and/or restructuring of installment debt.

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HISTORY OF THE POINT MACKENZIE AGRICULTURE PROJECT

Concept Origination

The Point MacKenzie agriculture project materialized when two major economic situations coincided, the decline in the number of commercially operated Alaskan dairies and the implementation by the State of an aggressive agricultural development program.

The Matanuska Valley, the center of the state's dairy industry, had supported the production demands of the several small creameries from its development in the 1940s until the 1970s. By this time one creamery, Matanuska Maid, had expanded considerably and become the principal producer of Alaskan dairy products. However, although production capabilities had expanded, supply was dwindling. Population growth and development pressure in the Valley was resulting in many farms being sold for commercial, residential, and industrial development purposes.

Matanuska Maid Dairy management and ardent supporters of a local dairy industry turned to the State for assistance. The Department of Natural Resources had already embarked on an agricultural development program for the purpose of creating a renewable resource base. That program was inaugurated in 1978 with the Delta Barley Project. The concept of a state-sponsored dairy project was suggested and quickly gathered political support.

The Point MacKenzie area, then in Matanuska-Susitna Borough ownership, was recommended because of the size and location of the parcel and the feasibility of developing that particular area as recommended in a University of Alaska study entitled Potential Milk Production in the Pt. MacKenzie Area of Southcentral Alaska. Legislative action was taken in the form of creating the Agricultural Action Council within the Office of the Governor to coordinate the state's agricultural programs and funding for the implementation of the Point MacKenzie project.

Project Implementation

The planning phase began during the summer of 1980 and continued through the spring of 1981. The Matanuska-Susitna Borough relinquished land rights to the State. A number of state agencies were involved in the implementation phase including the Agricultural Action Council, the Attorney General's Office, and a number of divisions of the Department of Natural Resources including Forest, Land and Water Management, Agriculture and Technical Services.

Implementation was hampered somewhat by conflicts and confusion in the roles each of these agencies were to play. While planning oversight remained the responsibility of the Agricultural Action Council and project funding was controlled by that Council, it did not possess the statutory authority for carrying out the mandate. Coordination with appropriate state agencies, primarily the Department of Natural Resources, was envisioned. The conflict which resulted not only between the Council and the Department, but within divisions within the Department, contributed to complaints and problems with program implementation.

One such problem revolved around the issue of prequalification. While the Department recommended a streamlined prequalification plan, the Council opted for a more detailed regimen including training and education criteria and farm development plans. Another problem arose from the question of land clearing and timber utilization on the parcels being offered for lottery. The Division of Forest, Land and Water Management desired a two-year timber salvage program while the Council proceeded with an experimental land clearing technique, the chaining method. The Council's actions resulted in an attempt to stop the land disposal, both for the waste of the timber resource and the prequalification requirements.

The result was an out-of-court settlement regarding the timber and a temporary court order which allowed the lottery to happen as scheduled on March 6, 1981 conditional on no land exchanging hands. A final court order issued in May of that year voided the lottery on the basis the State exceeded its authority in prequalifying applicants by requiring farm development plans.

The decision was made by the Agricultural Action Council to proceed with a second lottery without prequalifying the applicants. That lottery was held on September 11, 1982. At that time agricultural interest in twenty-nine parcels was sold.

Project Statistics

The Point MacKenzie Agricultural Project consists of 31 parcels ranging in size from 301.26 acres to 634.03 and totaling 14,613.08 acres. Twenty nine of the parcels were offered for sale by the State of Alaska, while the remaining two were offered by the Matanuska-Susitna Borough. Nineteen of the parcels are designated as dairy parcels, while the remaining twelve are designated non-dairy. Title to all parcels limits use of the land to agricultural purposes only. Other restrictions include prohibitions against selling, leasing or otherwise assigning a part of the parcel without prior approval of the Director of Land and Water Management. No parcel of land less than 40 acres in size may be created by an assignment of interest.

Land Clearing and Farm Development

Each parcel owner submitted a Farm Conservation Plan shortly after the lottery for approval by the Division of Agriculture. That plan, along with a stocking rate schedule for dairy parcels, was approved by the Division and became part of the development contracts entered into with the Division of Land and Water Management. Those contracts additionally imposed a development schedule requiring the clearing of land and planting of the first crop on at least 40% of the class II and III soils within the first three years and clearing and planting of 75% of the class II and III soils within six years.

Land clearing financing was available from the Alaska Agricultural Action Council. The Council approved 31 clearing loans for Point MacKenzie totalling $3,200,000. Draws were taken against them which to date amount to $2,200,000. Terms for these notes were 8% interest, the majority maturing 2026, with payments beginning in 1986.

Land clearing did not proceed as smoothly as planned because of problems with the smoke produced from burning berm piles. The intense public reaction to the problem resulted in regulations being implemented prohibiting burning when weather conditions would worsen the harmful effects, and also limited the amount which could be burned at any given time. In recognition of an expected slowdown in clearing due to the regulations, the Division of Agriculture, which assumed the clearing loan management responsibilities of the Agricultural Action Council when it was terminated, extended the terms of the clearing loans two years in conformance with ch. 166, SLA 1984. Loan contracts now expire in 1990 with loan repayment to begin in 1988.

The farm development schedule required a minimum acreage of 40% (5300 acres) to be in production by September 11, 1985. An official inspection of progress on these contracts was performed by the Division of Agriculture at that time and found approximately 7,000 acres in production, putting the project, as a whole, ahead of schedule. The development schedule further requires a minimum of 75% (9450 acres) be in production by September 11, 1988. Division personnel estimate that at current the project is close to target at 8,000 to 9,000 acres, though progress on individual tracts varies greatly, either behind or ahead of schedule. Another inspection is scheduled for the summer of 1988.

The development schedule also set out minimum stocking rates for dairy parcels. The number of cows to be regularly milked by November 1, 1985 was 883, and when inspected at that time was found to be 1,061. Again, while project totals were ahead of schedule, individual tract schedules varied greatly. Ten farmers were behind the stocking and milking schedule; three corrected deficiencies within 60 days, two were in litigation and foreclosure proceedings were begun against the remaining five. The two in litigation were seeking to amend development requirements in the contracts to combine parcels and use one barn and one set of cows to meet the requirements of two separate contracts.

Four of the dairy owners in foreclosure sought an extension of the schedule. A one year extension was granted if the farmer would stipulate that at the end of the extension he would waive all defenses against the state if not in compliance at that time. Four parcel owners signed the stipulation and were granted extensions to the Fall of 1986. In September of that year the court decided the ongoing litigation by decreeing that the commissioner did not have the authority to waive or amend development requirements in contracts. Shortly thereafter another inspection was performed at Point MacKenzie and three of four farmers with extensions and the two previously in litigation were found to be in compliance. At present the State is in foreclosure proceedings against two dairy parcel owners who have not brought their parcels into compliance with contract terms.

The 1986 inspection revealed that some farmers who had been regularly milking in 1985 had ceased milking or were milking a reduced number of cows. Project farmers were notified that to ensure that the "regularly milking" requirement be met, the farm structures should be designed for and operated as a milking structure twelve months a year. It was advised by the Attorney General's Office that to comply with the contract, they must regularly milk the number of cows required by contract daily and continuously from the 1985 deadline at least until the contract has been satisfied and patent is issued. A recent policy issued by the Division of Agriculture, however, states that if the parcel was in compliance at the 1985 inspection or at the end of the stipulated extension the parcel is considered in compliance.

A final inspection is scheduled for September of 1988. Those farmers in compliance at that time and who have completed land purchase payments will be eligible to receive patent to their parcels. Development from that point on will be at the discretion of the owner provided it is consistent with the agricultural restrictions of the land title.

<u>Development Costs: Estimated vs. Actual</u>

Estimated development costs were developed and published in the project sale brochure using data developed by the University of Alaska in the 1980 feasibility study entitled <u>Potential Milk Production in the Point MacKenzie Area of Southcentral Alaska</u>. Assumptions made in that study to develop the estimated costs include the following:

1. Sufficient state land is available in the Point MacKenzie area for a dairy farm development project.

2. Land price is $100 per acre with a $50 homestead credit making the effective price $50 per acre to the farmers.

3. Land-clearing costs are $220 per acre for project farms.

4. The dairy farms will be designed for forage production in the form of silage and haylage; concentrate, hay, and straw requirements will be met by off-farm purchases.

5. Private slaughter facilities are currently available in the Matanuska Valley to handle cull cows and calves from project lands.

6. Electrical power hook-up will be provided each farm.

7. Roads to each farm will be constructed.

The Department envisioned a project of small family-run farms when putting the Point MacKenzie sale together. However, a number of factors contributed to driving the development costs beyond what could be recovered by small farm operations. The majority of these factors, such as the smoke from land clearing, problems associated with soil conditions and waste disposal were simply the result of developing farms in a previously unfarmed locale and learning to deal with the conditions endemic to that region. Historically, farm development in a previously undeveloped area would be a lengthy process of trial and error, but the Point MacKenzie land purchase contract placed a strict development schedule on the farmers. This necessitated additional expenditures to meet the development deadlines.

Although there is agreement that costs exceeded what was projected, there is disagreement between project farmers and Department of Natural Resources (DNR) personnel as to the extent the overages were necessary. State personnel contend that existing debt load is in part the result of bad management decisions by the farmers. It is acknowledged that the State's easy farm credit contributed to the bad management. Project farmers contend that development contracts were based on unrealistic assumptions, and that state management of those contracts has not been sufficiently flexible in times of economic change.

The result of the high development costs coupled with a declining demand for milk resulting from declining population has been an inability for some project farmers to meet their debt obligation to the Agricultural Revolving Loan

Fund (ARLF). The Department, utilizing its authority granted at AS 03.10.020(4), placed the loans in moratorium. That moratorium was ended December of 1986.

Although loan repayment was postponed and all milk produced has been purchased at a subsidized rate, all farms are currently delinquent on loan repayment. Review of dairy financial statements by ARLF personnel during recent applications for loan restructuring indicated not all delinquencies were the result of inability to pay, however. Some, in fact, could be attributed to a lax enforcement policy of the Division as documented in previous financial audits of the Loan Fund by the Division of Legislative Audit.

MATANUSKA MAID DAIRY

Background

The Matanuska Maid Dairy is comprised of a creamery in Anchorage and a feed mill and wholesale/retail store located in Palmer. Until the business was acquired at foreclosure sale by ARLF in November of 1985, it was operated by Matanuska Maid, Inc. an agricultural cooperative corporation.

The same economic factors which lead to the initiation of the Pt. MacKenzie Dairy Project, namely an increased demand for dairy products, a reduction in number of producing dairy farms in southcentral Alaska and improved shipping technology from competitive markets, caused financial problems for Matanuska Maid. The creamery expanded its plant to meet the growing demand but found itself with a declining inventory of milk to process. During the period September 1979 through October 1980 Matanuska Maid received four loans from ARLF totalling $2,900,000 secured by real property, inventory and accounts receivable. A chapter 11 reorganization petition was filed in bankruptcy court by the Corporation in November of 1983 with ARLF receiving permission to foreclose. Through a series of settlement proceedings, title to inventory was obtained, culminating in the purchase at foreclosure sale in 1985 by offset bid from ARLF.

During this period a contract was let with the Small Business Development Center of Washington State University (WSU) to study the feasibility of successfully reorganizing Matanuska Maid Inc. That study, released July 1984, concluded that "With strong fiscal and management control and the assumption of a aggressive marketing posture, reorganization of Matanuska Maid is feasible." That study made recommendations such as waiver of past due interest and principal and a moratorium of future interest and principal against state debts for both the creamery and producers for a period of at least three years. It also recommended consideration of legislation which would limit the shelf life for milk produced in the lower 48 states and transported to Alaska.

The ARLF Board of Directors assumed directorship of Matanuska Maid after foreclosure. Recognizing their lack of expertise in the creamery business, a management contract was let for the day to day management of the creamery. The directorship of the creamery proved to be very time consuming for the ARLF Board. The Board decided that retention of the creamery in state ownership was not in the best interest of the state. Offers to purchase were requested during the spring of 1986 but all were found to be unacceptable.

A new strategy for moving Matanuska Maid from state to private ownership was born in 1987. The incorporation of an entity named Alaska Dairy, Inc. (ADI) has been proposed to provide oversight management for Matanuska Maid. The ADI board would consist of an ARLF Board representative, four dairy farmers, the director of the Division of Agriculture, the manager of Matanuska Maid and six public representatives. The ADI Board was to assume directorship in January 1988 under a one-year agreement. The agreement specifies that payable accounts will be kept current, the management contract would be honored, and that all profits and/or losses generated by the creamery operation would belong to ARLF. ARLF will provide up to a maximum of $60,000 a month for the initial six months to cover operating losses. If losses exceed this ceiling milk prices paid to dairy farms must be adjusted accordingly.

The primary motivation in the new strategy is to allow the dairy farmers ". . . to participate in the management oversight for the creamery, which is currently the only entity which will purchase the milk produced on their farms."

<u>Milk Pricing: The Double Edged Sword</u>

The price of milk paid to the producers has been the basis of a difficult policy dilemma. The ability of Pt. MacKenzie dairy farmers to produce adequate income to cover operating costs and cover debt incurred, primarily to ARLF, is predominantly effected by the price they receive for milk produced. The ability of Matanuska Maid to be economically viable also depends on that entity's ability to adjust the price of milk paid to producers. As concluded in the 1984 WSU study: "Crucial to the future survival of Mat-Maid are strong controls and a rethinking of the relationship between producers and the creamery. Price paid to producers should be adjusted and modified based upon market conditions and the ability to compete effectively as the creamery is the market extension of the producers rather than a buyer of raw milk at producer-directed prices."

Although Alaska is exempt from federal milk price controls which effectively place both ceiling and floor on the price paid to producers, it competes with producers from the Puget Sound area which are controlled. The Puget Sound area produces one of the largest milk surpluses nationally and Alaska has traditionally been a primary market for that surplus. Thus, prices paid to local producers must be maintained sufficiently low so when added to production and delivery costs the final price to distributors competes with delivered cost of Puget Sound surplus milk. Ironically, the Puget Sound area is also the market for Alaskan surplus, which results in an extremely low price being received for Alaskan milk shipped to that market.

The Division of Agriculture, an advocate for agricultural interests in the state, and the ARLF Board have had to balance the needs of the dairy farmers with the need to cover operating costs of the creamery. As previously discussed, a number of debt relief methods had been implemented to assist Pt. MacKenzie farmers. The policy decision of the Division of Agriculture in 1987 to not reduce the price of milk to producers when market forces (i.e. increased production from Pt. MacKenzie and decreased market demand due to shrinking population) necessitated it then became, in essence, another form of state support of the Alaska dairy industry. This action resulted in operating losses for Mat-Maid which were covered by ARLF in 1987 in the amount of $800,000.

The proposed contract between ARLF and ADI would limit the amount of operating losses which will be covered by ARLF to $60,000 per month. It also includes the following language regarding pricing. "ADI may not increase the price of milk as it exists on November 1, 1987 paid to dairy farms if the creamery shows an operating loss. ADI may lower the price of milk paid to dairy farms at any time; however, ADI will lower the price of milk paid to dairy farms if the operating loss exceeds $60,000 in any one month during the period January 1, 1988 to June 30, 1988." If this agreement is entered into it will reflect a change in policy for the Division of Agriculture from subsidizing the dairy industry through price supports towards creating a more open market system where price is determined by supply and demand.

Marketing: Problems and Strategy

The need for a more aggressive marketing posture by Matanuska Maid was discussed in the 1984 WSU study and has continued to be a source of criticism of the creamery by Alaskan dairy farmers. Since the State assumed ownership in 1984 Matanuska Maid management has been making a significant effort to address this problem. From a virtually nonexistent advertising budget, the creamery began spending between $5,000 to $10,000 a month in 1986, predominantly in radio and television spots and a total of $218,000 in 1987.

The creamery has also increased its product lines by 40 items, including introducing two new products in 1986, another two in 1987 with plans for two more in 1988. The new items which have been added are cottage cheese, sour cream, ice cream base which is sold to an independent producer, and yogurt. These products have done well and yield a higher profit margin to the creamery than does the sale of bottled milk.

Plans for 1988 include the introduction of cheese which, for the first time in Mat-Maid history will give the creamery a way of utilizing surplus milk. Other methods of using surplus milk, namely converting it to powdered milk or to butter have not been used because of the high capitalization cost for producing powdered milk and insufficient fat content to produce butter. The inability to utilize surplus milk lead to the situation in 1987 whereby surplus milk was purchased by Mat-Maid then dumped or exported to Seattle. Once cheese production begins that situation should not occur again.

An additional benefit to cheese production is that it should allow Mat-Maid to participate in a Federal program which will purchase and store the cheese produced in excess of local demand. Although this situation will allow purchase of virtually all milk produced in state, a new pricing structure for price paid to producers will have to be implemented. It is a common industry practice that milk purchased as surplus milk for conversion to a product with a long shelf life is purchased at a lower price than that purchased for conversion to bottled milk.

The most difficult marketing challenge has been the general public which Mat-Maid is attempting to win through advertising, promoting the benefits of locally produced products. They have seen results in the form of increased market share only to have those results reversed by pricing strategies of retail distributors. Though Mat-Maid has attempted to produce a competitively priced product, they cannot control the price charged to the consumer by the retail distributor.

The majority of dairy products sold in southcentral Alaska are sold by the two major retail grocery chains. Both chains distribute Mat-Maid as a secondary product line, utilizing various techniques such as pricing and shelf space allotted to encourage the primary line be sold first. Pull-dating procedures by competitive producers also effects consumer interest. There is currently no governmentally imposed standards for what date appears on the product thus identically dated milk may differ significantly in age. Mat-Maid has adopted a conservative dating policy in an effort to develop and maintain a reputation for quality. Mat-Maid also guarantees repurchase of past-dated products where the primary product line may not. To woo the general public, therefore, Mat-Maid must not only create a public awareness of its product, but demonstrate a superiority of a locally produced product which justifies the price differential charged by retail distributors.

Matanuska Maid continues efforts to become a primary product line with the major retailers while exploring other avenues of distributing its product lines. The corporation has worked with private distributors offering home delivery which has seen a resurgence in popularity recently as well as distributors for restaurants and small stores. The number of small retail operations is limited, however, because of the declining economic condition of the State combined with a Mat-Maid policy of discontinuing service to retailers whose delinquent accounts exceed 60 days.

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

400 WILLOUGHBY AVE.
JUNEAU, ALASKA 99801-1796
PHONE: (907) 465-2400

March 17, 1988

RECEIVED
MAR 22 1988
LEGISLATIVE
AUDIT

Mr. Randy S. Welker, CPA
Acting Legislative Auditor
Division of Legislative Audit
P.O. Box W
Juneau, Alaska 99811-3300

Dear Mr. Welker:

I appreciate the opportunity to comment on the preliminary report for the Point MacKenzie Agricultural Project. I compliment you on a thorough effort, and believe that you have provided an accurate perspective on the history of the project and on the new direction being adopted by the Division of Agriculture.

You may wish to consider the following comments and observations:

1) The continued evolution of the Point MacKenzie project is likely to result in the failure of some of the farms, as well as successes for others. Critical factors in this evolution include not only future milk prices and state subsidies (or lack thereof), but also the management ability of individual producers, the amount of private capital available to producers, and the implementation of a restructuring program for existing debt.

A restructuring program has been developed for ARLF borrowers. It effectively reduces debt service on ARLF loans for those who cannot meet original loan terms by providing for repayment at reduced rates of interest over a longer period of years.

2) You note in the third paragraph of page three ("Auditor's Conclusion") that at current production levels and at current milk prices, all farms are not yet economically viable. This statement is true. It is also true that the use of loan funds and personal funds varied considerably among producers. <u>Some undoubtedly made excessive</u>

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expenditures for non income producing assets (e.g. homes and unnecessary equipment) while others used a higher percentage of funds for milk cows and other necessary assets -- resulting in higher income potential for the invested dollar. Thus, the fact that a farm is not economically viable may be the result of management strategies that were not as efficient as they could have been.

3) The statement in the third paragraph that Matanuska Maid loans are "in moratorium" probably should be modified. The Matanuska Maid real estate was purchased at a foreclosure sale by offset bid on November 29, 1985. The state now owns the business and assets, and the loans receivable were converted to assets at cost. New funds advanced are considered as investment in the asset, not as loans to a business.

4) With respect to the fourth paragraph of page three, I have already noted that the department believes that it is not likely that all of the operating dairies on the project will prove viable under existing management. Again, this is because of inevitable differences in financial strength and management abilities of the operators, and forces of competition that we believe to be healthy and necessary if efficient farming is to be encouraged.

5) The department disagrees with the statement on page 12 that a lax enforcement policy on loan collections is the reason for the delinquency rate on Point MacKenzie farms. The department has worked for over 14 months to develop and implement a trouble debt restructure program. This was initiated immediately after the period during which Point MacKenzie loans were in legal moratorium, as soon as it became clear that some, if not all, of the Point MacKenzie farmers were financially distressed and unable to make payments. The intent of the department was to develop a program to handle this troubled debt and to minimize financial losses to the ARLF, and we are now both restructuring debt and collecting on loans made to borrowers who do not qualify for restructuring. We will continue this policy and program for all borrowers, including those at Point MacKenzie.

6) Finally, it may be helpful to note that we are continuing to pursue options to place the creamery operation into

the private sector, and are trying to do so without exposing the state or the industry to undue risk from unqualified management or to an ownership group lacking the assets to operate the business.

I hope these comments prove helpful.

Sincerely,

Judith M Brady

Judith M. Brady
Commissioner

Offered: 3/23/88 5-1731B
Referred: Finance

Original sponsors: Larson and Menard

IN THE HOUSE BY THE LABOR AND COMMERCE COMMITTEE

CS FOR HOUSE BILL NO. 415 (L&C)

IN THE LEGISLATURE OF THE STATE OF ALASKA

FIFTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to agricultural industry production credits for dairy products; and providing for an effective date."

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

* Section 1. PURPOSE. The purpose of this Act is to permit dairy farmers in the state to achieve parity with milk producers who are located outside the state and to reward those dairy farmers in the state who are productive and who are making a sincere effort to compete on equal terms with milk producers located outside the state.

* Sec. 2. AS 03.05 is amended by adding a new section to read:

Sec. 03.05.017. AGRICULTURAL PRODUCTION CREDITS FOR DAIRY PRODUCTS. (a) In addition to the production credits authorized under AS 03.05.015, the commissioner shall establish a program of agricultural production credits for dairy products. Credits under this section shall be applied against amounts due on agricultural loans made under this title and AS 44 and amounts due on the sale of agricultural land under AS 38.05. The credits shall be based on dairy products produced in the state.

(b) The annual credit for the years 1985 - 1987 is $2.68 per hundredweight of dairy products as shown on documents acceptable to the commissioner. The credit shall be applied to the principal on the debts described in (a) of this section. The credits available under this section and AS 03.05.015 are limited to 25 percent of the principal debt incurred.

(c) A credit granted under this section may not be transferred.

* Sec. 3. This Act takes effect immediately under AS 01.10.070(c).

Introduced: 1/29/88
Referred: Labor & Commerce
and Finance

5-1731A

IN THE HOUSE BY LARSON AND MENARD

HOUSE BILL NO. 415

IN THE LEGISLATURE OF THE STATE OF ALASKA

FIFTEENTH LEGISLATURE - SECOND SESSION

A BILL

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(b) The annual credit for the years 1985 - 1991 is $2.63 per hundredweight of dairy products as shown on documents acceptable to the commissioner. The credit shall be applied to the principal on the debts described in (a) of this section. The credits available under this section and AS 03.05.015 are limited to 50 percent of the principal debt incurred.

(c) A credit granted under this section may not be transferred.

* Sec. 3. This Act takes effect immediately under AS 01.10.070(c).