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SENATE COMMITTEE REPORT

FURTHER:

FINANCE

3/10/87

DATE TURNED INTO OFFICE _____

Mr. President:

RESOURCES _____ Committee considered SB 9

financing of fish processors and agricultural and timber processors and harvesters by the Commercial Fishing and Agricultural Bank.

and recommended:

replace with CS FOR SB9 Resources same title
 or adopt _____ CS FOR _____) new title

attached amendment(s) and

do pass

do not pass

no recommendation

individual recommendations

further referral to _____

letter of intent adopted _____

Committee attached or adopted fiscal note(s)

new updated or previous
 zero fiscal impact

MEMBERS SIGNING DO PASS

OTHER RECOMMENDATIONS

McElean
Julius Stuzguler
J. J. Jones

[Signature]
Chairman signature and recommendation

Committee Backup Attached

Alaska State Legislature

Senate Resources Committee



Sen. John B. (Jack) Coghill, Chairman
Sen. Paul Fischer, Vice-Chairman
Sen. Lloyd Jones
Sen. Arliss Sturqulewski
Sen. Jim Duncan
Sen. Fred Zhatoff
Sen. Dick Eliason

Box V
Juneau, Alaska 99811
(907) 465-4907

TO: SENATE RESOURCES COMMITTEE
FROM: COMMITTEE STAFF
DATE: APRIL 15, 1987
RE: SB 9 "An Act related to fish processors. .CFAB"

CONTENTS

1. SPONSOR'S BILL ANALYSIS BY SECTION
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5. BACKGROUND FROM CFAB
6. UFA POSITION



SENATOR FRED F. ZHAROFF
ALASKA STATE LEGISLATURE

P.O. BOX 405, KODIAK, ALASKA 99815 (907) 486-5269

DURING SESSION:

P.O. BOX V, JUNEAU, ALASKA 99811 • (907) 465-3473 • 465-3474

DISTRICT N

ALASKA PENINSULA • ALEUTIAN CHAIN • BRISTOL BAY • KODIAK ISLAND • LAKE CLARK/LAKE ILIAMNA • PRIBILOF ISLANDS • SHUMAGIN ISLANDS

SECTIONAL ANALYSIS

Senate Bill No. 9 -- "An Act relating to financing of fish processors and agricultural and timber processors and harvestors by the Commercial Fishing and Agriculture Bank."

SECTION 1

LEGISLATIVE FINDINGS.

- (1) Fish processing, agricultural and timber facilities, regardless of ownership, are important to Alaska.
- (2) Regardless of ownership, they contribute to Alaska's economy.
- (3) Regardless of ownership, they provide jobs for Alaska residents.

SECTION 2

44.81.210(c): New subsection. Allows CFAB to make loans to businesses engaged in shorebased fish processing, timber processing or harvesting, or agricultural processing and harvesting that are not majority owned by Alaskan residents. CFAB would have access to a broader market in which to make loans. The companies, however, must be majority owned by U.S. residents, not foreign interests.

STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

Bill Version: SB 9

Publish Date: _____

REQUEST: _____

Revision Date: _____
Title: Financing Fish, Agriculture & Timber Processors by CFAB
Sponsor: Zharoff, Eliason, Jones
Requestor: Senate Labor & Commerce

Agency Affected: Department of Revenue
BRU: Treasury

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
OPERATING						
PERSONAL SERVICES	-	-	-	-	-	-
TRAVEL	-	-	-	-	-	-
CONTRACTUAL	-	-	-	-	-	-
SUPPLIES	-	-	-	-	-	-
EQUIPMENT	-	-	-	-	-	-
LANDS & STRUCTURES	-	-	-	-	-	-
GRANTS, CLAIMS	-	-	-	-	-	-
INCIDENTALS	-	-	-	-	-	-
TOTAL OPERATING	-	-	-	-	-	-
CAPITAL	-	-	-	-	-	-
REVENUE	-	-	-	-	-	-

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	-	-	-	-	-
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	-	-	-	-	-
TOTAL	-	-	-	-	-	-

POSITIONS:

FULL-TIME	-	-	-	-	-	-
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	-	-	-	-

ANALYSIS: (Attach a separate page if necessary)

Prepared By: Milt Barker MB
Division: Treasury

Phone: 465-2350
Date: January 26, 1987

Approved by Commissioner: [Signature]
Agency: Department of Revenue

Date: 1/26/87

Distribution (by preparer):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)
- Senate Secretary

STATE OF ALASKA 1987 LEGISLATIVE SESSION FISCAL NOTE

Revision Date : _____

REQUEST

Bill/Resolution No. : SB 9
 Title : Financing of fish processors & agricultural & timber processors & harvestors by the Commercial Fishing & Agriculture Bank.
 Sponsor : Sen. Zharoff
 Requestor : Senate Labor & Commerce
 Date of Request : _____

FISCAL DETAIL

Agency Affected : Department of Commerce & ED
 BRU : CFAB
 Components : _____

EXPENDITURES/REVENUES : (Thousands of Dollars)

OPERATING	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-

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

REVENUE	-0-	-0-	-0-	-0-	-0-	-0-
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FUNDING : (Thousands of Dollars)

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

POSITIONS :

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS :

CFAB is not a state agency nor subject to the Executive Budget Act (AS 37.07).

Prepared by : Mark K. Johnson, Counsel Phone : 465-3822
 Division : Senate Labor & Commerce Committee Date : 3-9-87

Approved by Commissioner : _____ Date : _____
 Agency : _____

Distribution (by Agency preparing fiscal note) :

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

**DEPARTMENT OF COMMERCE &
ECONOMIC DEVELOPMENT**
OFFICE OF COMMERCIAL FISHERIES DEVELOPMENT

POUCH D
JUNEAU, ALASKA 99811
Phone: (907) 465-2018

February 12, 1987

M
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Honorable Tim Kelly
Chairman
Senate Labor and Commerce
Committee
Alaska State Senate
P.O. Box V
Juneau, AK 99811

Dear Senator Kelly:

Re: SB 9 - Enlarging CFAB's lending base

CFAB was created to assist the development of the renewable resource industries, and its mission was initially limited to lending to Alaskan owned businesses. Since the initial legislation was passed, changes have been made to clarify CFAB's relationship to the state and to put it on its own two feet. It is now a cooperative bank with initial capitalization provided by the state which must be paid back in full. This office supports the expansion of CFAB's lending base for three major reasons.

First, CFAB serves an important function to the industry. Access to capital and financing are often impediments to fisheries development in Alaska, particularly to young, growing Alaskan processing companies. It is difficult to develop the necessary expertise. Those who do get involved limit their involvement to the most creditworthy applicants involved in the lowest risk fisheries. The recent crash in king crab has exacerbated that tendency. This makes it very difficult to finance developing fisheries, especially for Alaskans, who frequently don't have a lot of other assets to pledge.

Few banks are active in the fishing industry, due to the risk involved and the complexity of the business. Yet, at one time or another, virtually every Alaskan owned processing company has had a loan with CFAB. CFAB has accumulated considerable experience in fisheries and is working to develop more. It is well positioned, if it can offer reasonable rates, to play a significant role in developing fisheries. It can, of course, adjust loan terms to account for risk. To do this, however, it needs a base of "suror" borrowers.

Honorable Tim Kelly

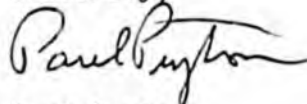
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February 12, 1987

Secondly, CFAB needs to lower its rates to attract the more credit-worthy borrowers who have alternatives. Right now, its rates are quite high by comparison. To provide reasonable cost loans to the industry, it must expand its lending base to larger loans, which have lower costs, and it must be able to attract lower cost lending capital. It is now dependent for lending capital on the Farm Credit system, which has many problems and expensive money. Commercial banks will lend CFAB money at lower rates but will want to see a broader lending base with larger and more proven companies than can be provided just using Alaskan owned operations. Thus, for CFAB to better serve the Alaskan sector of the industry, it needs access to more of the industry. Note that it would be limited to lending to shorebased operations only.

Third, CFAB needs to be given a chance to repay the state's investment. The limits the state has placed on the lending base will make it difficult for CFAB to either serve its intended clients or to repay the state its initial investment. That situation should clearly be rectified. Thus, though initially it appears contradictory for a state capitalized institution to provide services to nonresidents, it is necessary, if CFAB is to be a competitive and viable financial institution capable of serving those it was originally intended to serve.

Sincerely,



Paul Peyton
Director

PP/ss0237r
021287a

MEMORANDUM

TO: Ed Crane
FROM: Larry Linegar
DATE: October 21, 1985
SUBJ: SUMMARY/ANALYSIS OF SEAFOOD PROCESSOR OWNERSHIP

At your request, I have compiled the attached breakdown of seafood processors licensed to do business in the State of Alaska. From our discussions, it is my understanding that the motivation for initiating this project was to establish an understanding for the market potential of seafood processors that are not presently eligible to do business with CFAB. The reason why these companies would not be eligible would be because their ownership is greater than 50% non-Alaskan.

The primary source for the information necessary to perform the analysis was the State of Alaska. Several state agencies declared the information requested confidential. However, the Department of Commerce and Economic Development provided a complete list of all processors licensed to do business in the state for the years 1984 and 1985. From this list, copies of corporate bi-annual reports, which provided limited information on stock ownership, was requested. However, many processors do business as d/b/a's, partnerships or as individuals for which bi-annual reports were not available. Information on the ownership of these operations were identified through interviews with knowledgeable individuals and direct contacts.

The Department of Fish and Game provided a report categorizing processors both by sales in dollars and by pounds purchased. They were not able to provide exact figures but were willing to provide a list that grouped processors into broad categories.

The attached compilation was assembled from these two lists. While the ownership of shorebased operations stays relatively constant, floater processors tend to change significantly from year to year. The information presented is based upon year-end 1984 information.

In general, the report indicates that Alaskan owned shorebased processing operations (those with greater than 50% ownership being Alaskan residents) are primarily concentrated in the smaller, single plant operations.

Of the processors with \$10,000,000 or more in sales, only 5 out of a total of 22 companies were controlled by Alaskans. This was less than 23% by number and an even smaller percentage by total sales. Comparatively, Alaskans controlled 20 or 61% of the total of 33 companies with sales of \$1,000,000 to \$10,000,000. Of companies with sales less than \$1,000,000, only 3 out of the total of 23 were controlled by non-Alaskan residents.

Momo/Ed Crane
October 21, 1985
Page 2 of 2

To date, CFAB has done business at one time or another with four out five of the companies not eligible in the \$10,000,000 or more sales category. Of the 20 companies noted eligible in the \$1,000,000 to \$10,000,000 sales category, CFAB has provided financial services to 13.

For the floater processors, Alaskan residents had only a minor presence in the total category. Of the 14 floater processor operations with \$10,000,000 or more in sales, only 3 or 21% could be considered controlled by Alaskans. When considering the total number of vessels in this category, Alaskans had less than 10%.

Certainly from the numbers presented, one could assume that there does exist significant market potential for CFAB should its legislation be amended to allow for financing of non-Alaskan residents. However, beyond market potential, the inclusion of the larger processors could have a stabilizing effect on the bank's loan portfolio both from a volume and a risk standpoint.

Companies in the \$10,000,000 or more sales categories tend to be more financially stable. They have multiple plant operations in diverse locations throughout the state. If one area has a low production, another plant in a different area can generally make up the difference. The companies also tend to have developed a diversified product mix, not just focusing on crab, salmon or bottom fish but on a number of different species and product types such as both canned and frozen. The larger companies also tend to be more sophisticated in the planning, budgeting and marketing processes all of which adds to their financial stability.

CFAB's current market is essentially the smaller companies which do not have the market and production diversity of the larger companies nor the management sophistication which has put the Bank at greater risks.

LLL:0730V

SUMMARY

<u>SALES</u>	<u>NUMBER</u>	<u>INELIGIBLE BY STATUTE</u>	<u>PER- CENT</u>	<u>ELIGIBLE</u>	<u>PER- CENT</u>
<u>Shorebased</u>					
10,000,000 or More	22	17	77	5	23
\$1.0 to \$10.0 Million	33	8 13	24	25 26	76
\$.25 to \$1.0 Million	<u>23</u>	<u>3</u>	13	<u>20</u>	87
Total	<u><u>78</u></u>	<u>28 33</u>	36	<u>50 45</u>	64
<u>Floater</u>					
\$10,000,000 or More	14	11	78	3	22
\$1.0 to \$10.0 Million	24	20	83	4	17
\$.25 to \$1.0 Million	<u>5</u>	<u>4</u>	80	<u>1</u>	20
Total	<u><u>43</u></u>	<u><u>35</u></u>	81	<u><u>8</u></u>	19
Grand Total	<u><u>121</u></u>	<u><u>63</u></u>	52	<u><u>58</u></u>	48

0759V



2550 Denali Street, Suite 1201
P.O. Box 4-2070
Anchorage, Alaska 99509-2070
(907) 276-2007

February 18, 1986

Senator Fred F. Zharoff
Alaska State Senate
Box V (M.S. 3100)
Juneau, Alaska 99811

Dear Senator Zharoff:

Enclosed is a discussion piece intended to provide (1) background regarding CFAB's circumstances during the Spring of 1985; (2) a recounting of the significant events and changes between then and year-end; and (3) an expression of the basic business arguments in favor of a broadened lending authority.

It is longer than you perhaps anticipated or intended when you made your request for information. I believe the arguments can be condensed and simplified; they are difficult to advance and defend, however, unless one has an understanding of the context which may be gained through at least one reading of the enclosed. My discussions over the past ten months with various of your colleagues have led me to the conclusion that there is much understandable confusion about the purposes and objectives expressed for CFAB by the 1978 Legislature and about the "real world" business and financial environment in which it operates. It seems to me that it is important for CFAB to attempt to make clear that there are sound business considerations underlying our request for broadened lending authority and that they are very much in the interest of the State of Alaska and its resident fishermen-borrowers. If the question is viewed or treated simply as an abstract one, as a policy issue, it will become a basic "should/shouldn't" argument which may not be worth pursuing.

Senator Zharoff, we appreciate your interest in CFAB and the efforts you have made to become knowledgeable about its circumstances and about the extent and limitations of its services to the Alaska fishing, agricultural, and timber industries. We stand ready to commit whatever CFAB resources as may be appropriate in support of an effort to strengthen the institution by broadening its market and capital base.

Very truly yours,

Edward E. Crane
President

EEC:1024V
Enclosure
cc: Bill Hall, Senate Advisory Council

February 10, 1986

BACKGROUND - SPRING, 1985

In late March and throughout the month of April in 1985, CFAB officers and directors made numerous visits to Juneau to discuss the institution's circumstances with legislators and with administration officials. Those visits, and their substance, were precipitated by a number of factors:

1) Although CFAB's year-end audit by an independent accounting firm (Touche Ross & Company) was not yet complete, it was known with certainty that there had been a loss approaching \$10.0 million for 1984; that there was an impairment of stockholders' equity; that CFAB had become illiquid, with no cash or other unencumbered liquid assets available; and that a major portion of the loan portfolio - almost 34 percent (in dollars) of a \$94.8 million total - was in a serious default, or non-earning, status.

2) The critical imbalance between CFAB's projected 1985 income (based on the large volume of non-earning loans) and its projected 1985 cash interest expense, and basic operating expenses, foretold the likelihood of another significant loss.

3) CFAB and its staff and Board of Directors had been somewhat traumatized by the relative suddenness and severity of the circumstances (or the realization of them); its chief executive officer had resigned in late February; and it was being managed on an interim basis by an individual who, although familiar with the organization and its pressures, essentially was an unknown factor.

4) CFAB's lender, the Spokane Bank for Cooperatives, had taken increasingly aggressive and obtrusive positions with CFAB. SBC's representatives had expressed strong reservations about CFAB's ability to overcome its immediate difficulties and had indicated that SBC would accept no further deterioration in its position. CFAB's loan commitments from SBC had been reduced to 30-day increments, leaving CFAB constantly on the brink of a forced bankruptcy filing.

The basic thrust of CFAB's efforts in Juneau was to seek consideration of an early investment of an additional \$10.0 to \$12.0 million of State capital. This was essentially a "time-buying" strategy. The funds, if invested, would have been used to reduce CFAB's borrowings from SBC. This would have lowered CFAB's interest payment requirement to a level which could be met by the interest income from its own performing loans and would, it was intended, be accompanied by SBC agreement that the existing borrowing relationship would not be disturbed for at least two or three years. Relief from those pressures would in turn permit CFAB to address the liquidation

February 10, 1986

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or conversion of non-performing loans on rational bases and would also allow the opportunity for internal restructuring and corrections.

CFAB was not successful in obtaining further State investment. This was undoubtedly due in part to the lateness (relative to the legislative session) of the effort and to the somewhat uncoordinated and unprofessional approach, coupled with the "tight money" atmosphere in Juneau. Another factor, at least within the administration, seemed to be that CFAB was an "orphan" with no agency or individual charged with responsibility. In addition, there appeared to be a widespread lack of understanding as to the origin, nature, structure, and constituency of CFAB. Yet another burden was the recollection of some of CFAB's early flamboyance and excesses and attendant unfavorable press exposure. Finally, there seemed to be a perception that the effort was a thinly-disguised attempt to "bail out" the Spokane Bank for Cooperatives; that was an understandable reaction, but it is not supported by the realities of the legal relationships between the State, SBC, and CFAB.

SUBSEQUENT EVENTS

Since the Spring of 1985 CFAB's directors, management, and staff have attempted to address each and all of the negative factors and pressures with all available resources. Although not all objectives have been met, there has been modest success. Some of the efforts have admittedly been augmented by fortuitous events and circumstances external to CFAB. The net effect is that CFAB's condition has today become stabilized to a degree that exceeds the March 1985 expectations of its interim (now permanent) management.

The corrective efforts and measures have fallen into several broad categories, as follows:

Liquidation/Conversion/Prevention of Non-Performing Loans and Other Assets - There has been a major and consistent effort to rationally and realistically deal with non-performing loans and other non-earning assets on an item-by-item, account-by-account, basis. This has required an extensive commitment to developing the analytical and communications skills of loan officers, to the control and direction of legal counsel, and to the education of borrowers. There has been a similar commitment to the creative and efficient marketing or other disposition of acquired assets. Finally, and again through the re-direction of loan officers' attention and energies, there was in 1985 a successful program of early attention to delinquencies on performing loans for the purpose of preventing them from evolving into serious problems.

Reduction of Operating Expenses, and Increases in Effectiveness - Beginning in June 1985, there was a determined effort to identify and eliminate excessive operating expenses and other barriers to maximum efficiency. In the four years ending December 31, 1984, CFAB's operating expenses have averaged \$3,227,000 annually. 1984 operating expenses had totaled \$3,260,000; there was \$3,288,000 budgeted for 1985. As of May 31, 1985, actual operating expenses for the year to date had been slightly greater than those budgeted. Management's objective was to reduce those expenses to the necessary minimum for the remainder of 1985 and to position CFAB to enter 1986 with projected expenses of \$1.0 million less than the historical \$3.2 million level.

Financial Restructuring - While the cash flow deficit, the capital impairment, the excessive debt load, and the projected net income shortfall all represented immediate threats to CFAB's existence and required urgent attention, they also carried severe negative implications for the long term. CFAB has a statutory obligation to repurchase the State's \$31.8 million investment by the year 2000. CFAB has absolutely no sources of cash except (1) borrowings, (2) earnings, and (3) investment by owners. Its borrowing capacity had been virtually exhausted in early 1985; there were no bases on which to credibly project net cash earnings in the foreseeable future; and there had never been significant cash investment by owners (other than the State), nor was there any mechanism in place to provide for such investment. It seem imperative in early 1985 that, assuming CFAB's short-term survival, a foundation be laid that would over the long term enhance CFAB's ability to borrow, to earn, and to attract owner investment.

Business Development - The written record suggests clearly that a primary consideration in the conception and establishment of CFAB was to provide greater access to credit for "small" individual fishermen. While the performance over the ensuing five years tends to be obscured by the large dollar volumes associated with fish and timber processing accounts and by the dramatic impact of misadventures and imprudence, a close scrutiny of the number and sizes of loans results in a clear conclusion that it is the body of individual fishermen who have been best served by CFAB. It is they - existing individual borrowers and their non-borrowing peers - who have benefited most from CFAB's existence and who would suffer most severely were CFAB to be liquidated. Unfortunately, it is a costly market to serve, it is a market which represents unusual concentration of nearly uncontrollable risk, and it is a market of individuals whose ability to respond to financial pressures is limited. It is on that body of borrowers that the effect of CFAB's 1984/1985 circumstances fell most harshly (in the form of interest rates maintained at a burdensome level.) One of the

results of that was the flight of better, i.e., more creditworthy, borrowers to other lenders; this served only to exacerbate the pressure on remaining borrowers and to further threaten CFAB's stability. That trend continued through 1985, and it became critical to attempt to develop loan programs which would make CFAB more attractive to existing and potential borrowers, particularly those who represented stability and good performance.

1985 RESULTS AND YEAR-END CIRCUMSTANCES

At December 31, 1985, CFAB's fundamental financial circumstances were greatly improved over those of a year earlier or of the Spring of 1985. That improvement can be quantifiably expressed in a number and variety of ways:

- 1) At December 31, 1984, non-earning loans totaled \$31,979,000; at December 31, 1985, the total was \$15,653,000. While about \$3.5 million of the net reduction was due to charge-offs, the greater portion resulted from liquidations and from re-structurings.
- 2) At December 31, 1984, CFAB had 189 delinquent loans (including non-earning loans). A year later, the number was 115.
- 3) During 1985, the book value of acquired assets (which are also non-earning assets) was reduced from \$2,361,000 to \$1,606,000.
- 4) CFAB began 1985 with \$80,574,000 of interest-bearing debt and only \$69,110,000 of earning loans. At year-end those balances stood at \$48,268,000 and \$55,312,000 respectively.
- 5) In contrast to the 1984 loss of \$9,978,000, CFAB in 1985 had net income of \$114,000. Most of the \$10,092,000 difference can be attributed to the lack of major new credit losses in 1985. However, another major element was the effective reduction of operating expense. Although the reduction effort was not initiated until June, and although certain of the cost-containment actions involved relatively large one-time costs themselves, CFAB concluded 1985 with operating expenses exactly \$400,000 below those budgeted. CFAB has prepared and is committed to a 1986 operating expense budget approximately \$1.0 million below the historical \$3.2 million average.
- 6) The Spokane Bank for Cooperatives routinely examines and evaluates CFAB's loan portfolio, which is the basic collateral underlying CFAB's borrowings from SBC. At

April 30, 1985, SBC calculated that, by its (SBC's) standards, the collateral was worth \$13,400,000 less than the borrowings it secured. At year-end, CFAB had reduced that collateral deficit - measured by the same standards - to \$3,100,000, an improvement of over \$10.0 million.

7) The borrowing relationship with SBC has improved in other, less quantifiable, ways. After nearly a year of very limited commitments, CFAB was able in September 1985 to negotiate a six-month SBC loan commitment. Indications are that the next commitment, effective April 1, 1986, will also be for six months or possibly twelve months.

* * * * *

As indicated earlier, a critical long-term need for CFAB was to develop a mechanism and structure to attract owner investment. Such investment, over a period of time, would in turn positively influence CFAB's earning prospects and borrowing ability. During the last half of 1985, with the assistance of specialized legal counsel, CFAB developed a new member/borrower equity investment program. That program, which became effective January 1, 1986, requires that each new borrower (including "old" borrowers acquiring new loans) purchase a modest amount - 5 percent of the borrowing - of stock in CFAB. That stock represents a true equity investment, i.e., risk capital. While this new program will have an almost insignificant effect on CFAB's current condition, it does lay the foundation for genuine and long-term capital growth.

Two other significant but unglamorous programs were developed in 1985 and made effective at the beginning of 1986. Each of them is designed to make CFAB financing more attractive and/or more effective, especially to individual fishermen. One program in particular will permit CFAB to be more aggressive and more competitive in seeking and retaining more creditworthy borrowers.

* * * * *

It is not unreasonable to assert that CFAB has effectively moved itself back from the brink of imminent disaster and has diffused the air of crisis which influenced the day-to-day activities during much of 1985. However, its most difficult challenges lie ahead of it. The most obvious and most quantifiable is the statutory requirement that the \$31.8 million State investment be repurchased in, or by, the year 2000. Perhaps a good illustration of the magnitude of that requirement is to point out that if CFAB were to make 14 annual cash payments to a fund earning eight percent annually, those payments would need to be slightly more than \$1,313,000 in order to reach the \$31.8 million objective. CFAB does not have a

current ability to generate \$1,313,000 of cash annually, nor can such an ability be credibly projected for the near future. If such a program were necessarily deferred until there were only ten years remaining, the annual payment amount would be slightly over \$2,195,000. Obviously, time is of the essence in the effort to build CFAB's ability to generate cash.

The second major challenge, somewhat more difficult to express than the first, lies in the fact that CFAB is clearly caught in a classic spiral, an "adverse selection" process, which has been the downfall of many lending institutions. The process is not necessarily irreversible but, as the "spiral" descriptor implies, does gain momentum with each passing day. Since, beginning back in late 1983 or early 1984, such a large volume of CFAB's loans have been in a non-earning status, CFAB has had to attempt to maximize its gross income on the remaining portion of its loan portfolio in order to meet its own interest and expense obligations. This has meant maintaining interest rates at a level perceived to be "high" by most borrowers and which, in fact, have generally been higher than those offered by other lenders to more attractive borrowers. Over the past 18 months, many of those attractive borrowers have elected to re-finance their CFAB loans with other lenders. It is not possible to ascribe motivation to every such re-financing, but CFAB's management estimates conservatively that \$12.0 to \$18.0 million of loan volume has been lost in this way through December 31, 1985, and the trend is continuing. This is alarming. CFAB's loan portfolio is gradually being peeled away to a core of "small" individual borrowers, individuals who have few, if any, alternative sources of financing and who are least able to bear the burdens of increased interest rates, insurance premiums, and other expenses. They are the borrowers who are most costly to serve, and each notch of interest rate (or other) pressure creates a certain number of new problem loan accounts, which cause additional servicing or collection costs for CFAB, which in turn cause a need for greater interest income. Despite the recent success at reducing CFAB operating expenses, it must be recognized that a certain large portion of those expenses are "fixed" and cannot be further reduced no matter how much CFAB's loan volume may shrink. In addition, it must be recognized as axiomatic that if and as CFAB's loan portfolio contains a greater percentage of marginal or problem loans, expenses will actually increase.

The foregoing discussion places emphasis on a context of marginal or problem credit situations. In reality, CFAB - if it is limited by circumstances, statute, or otherwise to financing only those who appear to have the greatest need for its services (the "small" individual fishermen) - may prove to be an economically unfeasible enterprise under the best of conditions. A somewhat oversimplified analysis of a few basic facts illustrate the point:

February 10, 1986

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A. The average CFAB loan to an individual fisherman today has a balance of about \$45,000.

B. The average interest "spread" on such loans - that is, the difference between the interest rate CFAB charges and the rate it must pay on its own borrowings - is about 3 1/2 percent.

C. CFAB's annual net interest income on an average loan, then, is \$1,575 (3 1/2% X \$45,000).

D. In order to cover a basic operating expense budget of \$2.2 million (again, \$1.0 million below historical levels) CFAB needs the net interest income from 1,397 "average" loans (\$2,200,000 divided by \$1,575).

The above allows nothing to cover non-operating expenses, accumulation of a reserve for loan losses, capital expenditures, funding of the \$31.8 million obligation, etc. It assumes no credit losses, no significant delinquencies, no unusual difficulties of any kind. It is not realistic. CFAB has never had more than 700 "average" fisherman loans and could not make and service 1,397 such loans without a significant and costly increase in staff. The financing of a fisherman, particularly within the context of Alaska's geography, is an expensive, cumbersome, and risky venture. The romance of fishing may tend to obscure the financial implications, but it is a capital-intensive business which is also characterized by nearly uncontrollable major costs (insurance and fuel, for example); it is a business in which its members have no control of the basic resource. Its members at best have only the right to compete with each other for a share of resources controlled by other human, political, natural, and international forces. It is a business in which an unusual - and unpredictable - number of individual failures are inevitable.

The financing of fishermen - which, in most cases, involves vessel security - is cumbersome and therefore costly. The procedures for taking a lien on a vessel are unlike those for any other kind of personal or business asset (at least in the United States). They are the province of a virtually unregulated and unique agency. They are subject to a body of law rooted in centuries past and recognized by the legal profession as a specialty, which again translates into unusual costs. When the inevitable failures occur, the vessel lien foreclosure process represents an additional and inevitable creditor's nightmare. In the best of circumstances, a case in which the vessel owner/borrower is cooperative, the lender will spend about \$6,000 in Marshal's fees, court and attorney's costs, insurance, moorage, etc., before it has ownership and possession of the vessel. According to a major Anchorage law firm, a more typical vessel foreclosure cost would be \$12,000 to

\$16,000 (the annual net interest income on 8 to 10 average loans). When the foreclosure process is complete, the liquidation process becomes one more opportunity for almost certain loss. Again, the scenario is different than for almost any other form of foreclosed collateral. The market for fishing vessels is limited, close-knit, and highly subjective. Because of the unique procedural requirements related to vessel ownership, it is literally impossible to camouflage the nature and circumstances of such a sale. The bottom line is that, except in unusual cases, the proceeds realized from collateral liquidation will be significantly less than the loan balance involved, creating yet another loss which can only be charged against the interests of performing borrowers.

All of the above factors were almost certainly among the primary reasons that the need for "a CFAB" was perceived in the late 1970's; traditional, profit-oriented, and regulated commercial lenders abstained from widescale financing of individual fishermen because it was, and is, a market characterized by limited potential for profit but bearing inordinate risk of loss.

The creation of CFAB was a visionary response to a clear need. Implementation of the unique concept has been characterized by some dramatic errors and misjudgments, the effects of which have been exacerbated by major unforeseeable and uncontrollable external forces. The result, after nearly six years of actual credit operations, is that the institution has significant financial weaknesses which must be, and are being, addressed. The reality of those weaknesses and the appeal of criticizing their existence and causes, however, should not be allowed to overshadow the fact that CFAB has met the financing needs of hundreds of individual fishermen. It has served the interests of countless others simply by its existence in the market; CFAB's presence as an alternative lender has provided the financially stronger and more creditworthy fishermen with additional leverage in their negotiations with other credit sources. In short, that fundamental purpose is being served. While CFAB is in a position, albeit weakened, to continue that service today, a commitment to that purpose without addressing the long-term risks and effects is imprudent to an extreme.

CFAB has the theoretical ability to modify the financial and operational effects discussed in the foregoing through loans to the agriculture and timber industries and to the processing segment of the fishing industry. Ignoring for the moment the realities and other constraints which limit that ability to a theoretical one, and assuming creditworthiness among the processors in general, the potential benefits to CFAB and its individual borrower-members are great. For example, term loans of \$2.5 million each to five processors will yield net interest

income of \$437,500 (\$12.5 million X 3.5%) annually; and the servicing demands on CFAB are not significantly greater than those of an equal number of loans to individual fishermen. Numbers of that magnitude translate into increased net earnings and equity growth, which in turn translate into enhanced financial stability and lending capacity.

Of those additional markets cited, the greatest potential opportunity, in dollars, lies among the seafood processors. Under present circumstances, however, the existence of that opportunity is illusory; it must be referred to an "theoretical." This is due to the nature and origin of the capital investment in the Alaska seafood processing industry, coupled with the strictures of AS 44.81.210.(a)(1). That statute provides in part that CFAB may make loans only to those corporations (most major seafood processors are corporate entities) of which the majority ownership and control is vested in Alaska residents.

The statute effectively makes a large part of the industry ineligible to borrow from CFAB. It is not unrealistic to generalize that larger processors tend to be more financially stable and more creditworthy than smaller processors. In some instances, economies of scale are significant - more general positive characteristics, though, are multiple plants and diversified operations; highly developed levels of management, marketing, planning, and budgeting expertise; and broad product mixes.

During 1985, CFAB carried out a survey and analysis of the ownership of Alaska seafood processors. Complete ownership information is difficult to obtain in many cases; however, a variety of sources was consulted, and the findings are believed to be credible. A total of 78 shorebased processors entities (in addition to 43 "floater" processors) was identified, as follows:

<u>Annual Sales</u>	<u>Number</u>
\$10.0 million or more	22
\$ 1.0 million to \$10.0 million	33
Less than \$1.0 Million	<u>23</u>
Total	<u>78</u>

The distribution of ownership, in terms of statutory eligibility for CFAB financing, is interesting. Of the 18 processors, 45 of them - slightly over 57 percent - are eligible. Twenty of those 45, however, are in the group with annual sales of less than \$1.0 million. They represent limited financing opportunities and requirements. Many of them are privately financed and/or integrated harvesting/processing operations, or are highly specialized and limited operations financed by their market base.

Of the remaining 25 eligible processors, 20 are in the \$1.0 million to \$10.0 million sales group. It is difficult to generalize about those 20. CFAB has, or has had, credit relationships with 13 of them. Some of them have been extremely good loans; others are, or have been, among CFAB's most grievous credit problems. At best, the group does not appear to offer a broad base of financing opportunities.

The group of 22 larger (sales of \$10.0 million or more) processors clearly holds the greatest promise for major CFAB financing opportunities; however, only five of those processors are statutorily eligible. CFAB has, or has had, credit relationships with four of them; they have included some of CFAB's most reliable and highest quality loans. They are viewed as attractive and profitable borrowers by other lenders.

It is not known, and not asserted, that all of those 22 processors are creditworthy. Neither can it be asserted that if CFAB were given access to that group that competition would be readily or immediately overcome. However, the statutory barrier to that market represents a significant handicap to CFAB (within the context of its original and documented legislative intents and purposes); it magnifies the risks of financing concentrated in a very small market; it places strong upward pressure on the costs which must be borne by individual fishermen-borrowers; and it serves no useful purpose with regard to Alaskan interests. Ownership of a corporation - at least as expressed and implied by the statute - is not a valid credit factor.

That group of processors own extensive facilities in Alaska. They purchase, add value to, and market Alaska fish. They pay local taxes. They deal with Alaska fishermen. They purchase supplies in Alaska. They employ Alaska workers. They pay fish taxes to the State of Alaska. When they borrow money for capital investments or to finance operations, the money does not disappear - it is repaid, dollar for dollar, to the lender whether that lender is a Seattle commercial bank, a New York insurance company, or CFAB; and interest is paid to that lender also. That interest obviously can only be taken from the gross proceeds from the marketing of Alaska seafoods. If the interest is paid to CFAB it is a beneficial increment to CFAB and, therefore, its owners which consist of the State of Alaska and Alaska fishermen, farmers, and timber harvesters.



UNITED FISHERMEN OF ALASKA

Jack Cadigan
Executive Director
907-586-2820
1-800-478-FISH

UNITED FISHERMEN OF ALASKA
RESOLUTION 86-22
(DRAFT)

WHEREAS, the Commercial Fishing and Agriculture Bank (CFAB) was created by the Alaska Legislature for the purposes of providing sources of credit for Alaskan fishing businesses and encouraging the harvesting, processing and marketing of underutilized fish species as well as the technological development necessary to accomplish the foregoing, and

WHEREAS, CFAB is a lending cooperative whose cost of doing business is shared by all of its member-borrowers by the interest and loan fees that they pay; and

WHEREAS, the ability of CFAB to have access to the broadest market of potential borrowers within the fishing industry is necessary for it to have the greatest profit potential which translates into lower interest rates for its members; and

WHEREAS, CFAB is restricted by statute from lending to seafood processors that are not beneficially owned by a majority interest of Alaska residents; and

WHEREAS, the majority of long established, financially strong Alaska seafood processors do not fit this criteria; and

WHEREAS, this category of seafood processors represents a potential market for CFAB that offers the possibility of lower losses and greater profits; and

WHEREAS, the Alaska seafood industry is in great need of capital investments in modern processing and marketing facilities that will serve to enhance the quality and value of its seafood products; and

WHEREAS, all segments of the Alaska seafood industry will benefit from increased investment in the seafood processing industry that will provide more jobs for Alaskan workers and more market opportunities for Alaskan fishermen.

NOW THEREFORE BE IT RESOLVED, that the United Fishermen of Alaska requests the Alaska legislature to amend the statutes defining CFAB's lending authority so as to permit it to make loans to corporations beneficially owned by a majority interest

of United States residents engaged in the processing and marketing of seafood products for the purpose of constructing or operating shoreside facilities within the state.

PLEASE NOTE: The language "beneficially owned by a majority interest of United States residents" was used so as not to prevent a corporation with minority foreign stockholders in it from being eligible to apply to CFAB loans. This may or may not meet the intent of the amendment passed at the UFA board meeting. However, it should be considered as it would permit U.S. residents to utilize and control the use of capital provided by foreign investors in a seafood processing or marketing business. The addition of the word "shoreside" between "operating" and "facilities" should meet the other purpose of the amendment. It is also important to note that the resolution speaks only to corporations engaged in seafood processing and marketing.



Jack Cadigan
UFA Executive Director



Bob Blake
UFA President

FRANK

329-333 Katlian Street

Sitka, Alaska 99835



March 9, 1986

Senator Arliss Sturgulewski
Chairman, Resources Committee
Room 508, Capitol Building
Juneau, Alaska 99811

Re: Senate Bill 410 (By Sharoff) (Same as SB 9)

Dear Senator Sturgulewski:

I am writing in support of the above-mentioned Senate Bill 410, for I believe it is important for the Alaska Commercial Fishing and Agriculture Bank to expand its base, and be allowed to take part in financing of shorebased plants other than those who meet the present eligibility requirements.

My company is 100% owned by Alaskan residents at present and I do not feel that this proposed expansion of the Bank's lending base would cause any hardship whatsoever. I feel that this legislation will enable the Bank to broaden its base and do a better job for all fishing industry in Alaska.

I wish to thank you for any consideration you may give on the above,

Sincerely,

A handwritten signature in cursive script, appearing to read "T. E. Thompson".

T. E. Thompson
President

Copy: Senator Richard Eliason

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