

ALASKA LEGISLATURE

1445

HOUSE and SENATE FINANCE COMMITTEE FILES, 1995-1996

the Fund's investment strategy. The Board of Trustees discussed the matter and presented the following draft legislation which allows more flexibility by making minor changes in two categories of investment. These changes should allow the Permanent Fund to take better advantage of current and changing market situations, and earn more for the Fund. This is also important for the state's financial picture, considering that a one percent increase in Permanent Fund earnings currently amounts to approximately \$152 million.

The proposal for changes to AS 37.13.120 consists of:

- Eliminating the restriction against investing in BBB-rated (investment grade) bonds;
- Eliminating the limitation to five percent for investing in A-rated bonds; and
- Excluding foreign bonds from the category which restricts investment in equities and foreign bonds to 50 percent or less (so that a full 50 percent can be invested in equities, not just 45 percent, as is the case now).



**ASSET ALLOCATION
CONSIDERATIONS**

PREPARED FOR

**THE ALASKA PERMANENT FUND
CORPORATION**

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CALLAN ASSOCIATES

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CONSIDERATIONS**

**PREPARED FOR
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CORPORATION**

JANUARY, 1996

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Section I

INTRODUCTION AND OVERVIEW

Annually, Callan Associates Inc. provides an analysis of the Alaska Permanent Fund Corporation's strategic asset allocation policy. This analysis is developed over two or more meetings with the Board.

At the initial meeting, we will discuss the modeling approach utilized, review historic capital market returns, risks and correlations of one asset class to another. We also will discuss our key assumptions and contrast each with recent and long-term results. This year, our asset allocation review will be unusually comprehensive. We will review not only those asset categories available to the APFC, but also those frequently used by other institutional investors. In addition, at later stage in the process, we will focus on a broad range of critical implementation issues such as equity manager structure, rebalancing policies, and liquidity management.

In this first phase, we will ignore your statutory and policy constraints and consider the full theoretical range of potential policy options. It is important to note that Callan does not advocate any particular policy. Our goal is to enable the Board to fairly, objectively and consistently consider the trade-offs associated with a range of potentially viable alternatives. In this process, we do not make specific point forecasts. We create reasonable ranges of expected returns for individual asset classes and for combinations of major asset classes. This process and approach are widely accepted in the professional asset management business and are identical to the approach used in prior years.

At the second meeting, we will present an analysis of the risk and return characteristics for your current policy and a range of viable alternative policies that explicitly recognize your statutory constraints. In this second analysis, we also will include alternative policies developed using other input assumptions that you believe worthy of consideration.

In Section II of this initial report, we provide a non-technical overview of the theory behind strategic asset allocation. In Section III, we describe our capital market projection process and review historic return and risk characteristics for the major asset classes. In Section IV, we provide a detailed description of our 1996 projections and evaluate the return and risk characteristics for a full range of alternative "efficient" policies.

Michael J. O'Leary, Jr., CFA
Executive Vice President
January, 1996

Section II

THE THEORY BEHIND STRATEGIC ASSET ALLOCATION

The theory behind asset allocation is relatively straight-forward, and can be seen as a formalized extension of the wisdom contained in the phrase, "Don't put all your eggs in one basket." If an investor holds one asset in a portfolio, the return for the portfolio is high when the return on the asset is high and low when the return on the asset is low. If the investor is satisfied with the return on the asset and its variation over time, then the simple strategy of holding that one asset can be used. However, the returns on individual assets are almost always much too volatile for a prudent investor. Rather than holding one asset, the prudent investor will combine assets into a portfolio. A portfolio containing more than one type of asset is said to be diversified.

The reason that a prudent investor will combine assets in a portfolio rather than holding just one asset, is that a combination of assets will tend to have less expected volatility or risk associated with it than will any single asset with the same expected return. The reason for this has to do with the co-movement (or correlation) of the return of the assets being held. In general, different assets will have different responses to changes in the economy. While some stocks might drop in value during periods of high inflation, others may drop less or actually increase in value. By holding two stocks that have the opposite reaction to a period of high inflation, you can create a portfolio that has less volatility than either of the single stocks held in isolation. When one stock in your portfolio moves up, the other moves down and the value of the portfolio remains relatively stable.

In the spectrum of investable assets there are, unfortunately, very few instances of assets that always move in the exact opposite direction of one another. However, to the extent that two assets do not move in exactly the same direction, there is still some risk-reduction benefit to combining them. Asset mix optimization (the technique used in this study) is a process which searches for the most effective way to exploit the advantages of combining assets in a portfolio. By examining the co-movements and the associated risks and expected returns for a set of assets, optimization analysis can find the combinations of those assets that should yield the absolute lowest level of risk for a given level of return. These portfolios are known as efficient portfolios and the entire universe of efficient portfolios makes up what is known as the efficient frontier.

Strategic asset allocation is an investment philosophy which has its roots in the process of portfolio optimization. Under a strategic asset allocation policy, the investor identifies a mix of assets which is risk/return efficient and reflects a level of risk that the investor feels comfortable with. The investor then invests assets in the proportions suggested by this strategic mix. As the ebbs and flows in the different asset markets push the investor's actual allocation away from this strategic mix, the investor will rebalance the portfolio to remain on track.

This process of rebalancing is perhaps one of the most critical components of a successful policy. Without periodic rebalancing the portfolio will naturally tend to overweight asset classes which have performed well in recent periods (due to their relative appreciation) and underweight those

that have performed poorly (due to their relative depreciation). By rebalancing the portfolio, the investor diverts assets out of an asset class, which has perhaps just topped out, into an asset class which has just reached a low point. Over time, this passive dynamic strategy will naturally shift assets from potentially overvalued investments into potentially undervalued investments resulting in enhanced long-run returns. Furthermore, these returns will be realized at a risk level significantly lower than that experienced by a similar portfolio that is either not efficient, or does not employ rebalancing.

Thus, by employing asset mix optimization in developing a strategic portfolio, and by periodically rebalancing that portfolio back to the efficient allocation, an investor can successfully minimize the volatility associated with the long-run rate of return on the portfolio.

Section III

THE CAPITAL MARKET PROJECTION PROCESS AND A REVIEW OF HISTORIC RISK AND RETURN CHARACTERISTICS

In most standard portfolio optimization routines, such as Callan's ASSETMAX program, the analyst must provide several inputs characterizing the expected future performance of the asset classes which are being considered. These performance characteristics include the expected future return for each asset class, the expected future volatility (risk) of the asset's returns, and the expected future correlations between the asset class returns. The future in this case represents the capital market expectations. This section summarizes the methodology Callan uses to derive its capital market expectations and then reviews historic return and risk statistics.

There are four distinct steps which act as inputs to the formation of Callan's capital market expectations:

- (1) Development of a five-year economic outlook for the U.S. and other major industrial economies. This outlook involves understanding the range of possible economic scenarios in addition to an evaluation of their likelihood.
- (2) Examination of the historical relationship between major economic and financial variables and five-year asset performance characteristics.
- (3) Examination of historical interrelationships of performance characteristics among the asset classes. This involves searching for inequality relationships among the risks and correlations that indicate which risks and correlations have tended to be higher than others over time and over various economic cycles.
- (4) Fine tuning of preliminary estimates within prespecified ranges so they provide reasonable results in standard optimization routines.

The first step in our process is the development of a five-year economic outlook. The need to develop this outlook arises from the consideration of a five-year investment horizon. When developing expectations about future performance of an asset class, it is important to understand the major factors influencing the variation of this performance. Our research, as well as other academic and professional research, indicates that much of the intermediate/long-term variation in the performance of most asset classes is closely related to the behavior of the U.S. economy and other industrial economies. Thus, a five-year projection of asset performance should explicitly consider the expected state of the economy over the next five years.

Callan's economic outlook is derived using a combination of in-house empirical models and consensus forecasts from the business economics industry. The in-house models focus particular attention on longer-term structural relationships which are particularly important in intermediate/long-term capital market movements.

The second step in the process links our economic outlook with an outlook on asset performance. We study how the economic and financial markets interact in all types of economic and financial environments. We then attempt to apply historical relationships between variables to today's situation.

The third step in our process involves an examination of the historic returns, risks, and correlations for inequality relationships that have persisted through most or all economic periods. For example, the standard deviation of returns on the S&P 500 has been below the standard deviation of returns on the small capitalization stock index for every five-year period since 1946. Likewise, in almost all post-World War II periods, the correlation between high-grade corporate bonds and the S&P 500 has been higher than the correlation between high-grade corporate bonds and small capitalization stocks. These inequality relationships are quite common among risk and correlation measures.

The final step in our capital market process involves fine-tuning these preliminary estimates within specified ranges so that they behave well in a standard optimization environment. The resulting optimal portfolios are subjected to a careful examination to determine:

- (1) Whether the portfolios represented fall within the range of currently held institutional portfolios, and assure that no asset class is under- or over-weighted in any of the optimal portfolios for the associated level of risk.
- (2) Whether there is continuity as we move from safer to riskier portfolios so that a small movement along the efficient frontier does not cause a large (percentage) change in the portfolio weightings.

On a basis of this analysis, the return, risk, and correlation values are adjusted (within predetermined ranges) until reasonable portfolios are produced.

By following this process, we are able to develop values that are consistent with historical economical and financial market behavior, incorporate the current market environment, and behave well in a standard optimization environment.

HISTORIC RETURN AND RISK CHARACTERISTICS

When developing our assumptions for return and risk, we carefully consider how various asset classes have performed over a number of different holding periods and in varied economic environments. Unfortunately, many of the most commonly used market indices have comparatively limited histories and/or significant weaknesses in their composition.

When considering domestic equities, we use a series of market indices that segment the domestic stock market by market capitalization. The aggregation of these component indices, the Callan Broad Market Index, includes 2,000 stocks on a capitalization-weighted basis. Three major sub-indices make up the Broad Index. They are: the Callan Large Cap, the Callan Mid Cap and the Callan Small Cap. The largest 150 companies are the Large Cap. The next 350 companies constitute the Mid Cap and the next 1,500 stocks are included in the Small Cap Index. The combination of the large and mid cap indices is very similar to the S&P 500. The Large Cap Index accounts for approximately 55% of the Broad Market Index. The Mid Cap is 24% of the Broad Market Index. The Small Cap Index, while including 75% of the 2,000 largest companies, only accounts for 21% of the total Broad Index. Since the S&P 500 is widely used as a measure of the large cap component of the U.S. stock market, we are using it and the Callan Small Cap Index to model the full U.S. equity market. We think that using the S&P 500 creates a good historic context for our assumptions. We hasten to note that the assumptions used for the S&P are entirely consistent with those that we develop for the appropriate components of the Callan Broad Market Index.

When considering the bond market, we utilize the Lehman Bond Indices. Lehman's broadest index is the Lehman Aggregate Index. It is composed of two components: the Lehman Government/Corporate Bond Index and the Lehman Mortgage Index. These indices include essentially all investment-grade, publicly-traded debt securities on a market value-weighted basis. It is important to note that the mortgage index includes securities backed by mortgage pools of the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. It does not include securities that are derived from these underlying securities, as such inclusion would result in double counting. It is also important to recognize that these bond market indices are constantly changing as new bonds are issued and existing bonds mature, are refinanced or prepaid.

This year, we are using the Lehman Government/Corporate as the proxy for the bond market. The primary reason for using this index is that its duration is more predictable than that for the Aggregate. It has lower and/or more predictable prepayment risk. It, therefore, is more practical in an optimization analysis. The Aggregate, in our judgment, is a better measure of the total investment grade bond market and is often the preferred benchmark for performance evaluation and portfolio structure analysis.

We use the Morgan Stanley Capital International market indices to model international stocks. The MSCI Europe, Australia and Far East Index (EAFE) is one of the oldest, best constructed

and commonly used indices of non-U.S. developed market performance and is the specific index used to consider the benefits of international diversification. This index does not include emerging markets, nor does it include Canada or Mexico. EAFE is a capitalization-based index that attempts to capture approximately 60% of the market capitalization of the various international markets. The index is therefore heavily influenced by the Japanese, United Kingdom, German, and French markets.

The table on the following page details recent performance for each of the indices mentioned above and also includes data for other major indices commonly used in performance evaluation.

**Historical Capital Market Total Returns
Periods Ended 12/31/95**

Asset Class	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
Domestic Equity						
Standard & Poor's 500	37.51	15.25	16.57	14.84	14.78	14.57
Standard & Poor's 400	30.95	12.89	19.30	15.64	16.66	--
Callan Large	39.50	14.86	15.37	14.56	14.03	--
Callan Medium	32.96	13.67	18.26	14.22	14.66	--
Callan Small	30.99	14.67	20.34	13.49	14.72	--
Domestic Fixed-Income						
Lehman Aggregate	18.46	8.07	9.47	9.63	11.87	10.06
Lehman Govt/Corp	19.24	8.51	9.80	9.65	11.79	10.03
Lehman Government	18.34	8.16	9.36	9.38	11.43	9.90
Lehman Corporate	22.24	9.61	11.15	10.46	12.85	10.52
Lehman Govt/Corp Int	15.34	7.16	8.62	8.82	10.96	9.66
Lehman Govt/Corp Long	29.93	11.93	12.71	11.64	13.78	10.98
Lehman Brothers G/C Ex Baa	19.02	--	--	--	--	--
First Boston High Yield	17.40	11.40	18.54	11.91	--	--
T-Bills	5.71	4.37	4.50	5.85	7.53	7.71
International						
MSCI EAFE Index	11.21	16.69	9.37	13.63	14.00	14.39
MSCI Europe Index	21.63	17.17	11.63	13.97	14.20	13.51
MSCI Pacific Index	2.78	16.31	7.39	13.35	13.83	15.67
MSCI Emerging Markets Free	-6.94	13.33	20.55	--	--	--
MSCI World	20.71	15.83	11.73	13.10	13.20	13.19
Salomon Brothers Non-US Govt	19.56	13.41	12.18	13.65	--	--
Other						
Callan Real Estate	7.43	5.13	0.84	3.27	6.48	8.04
NCREIF	8.27	5.17	0.88	3.09	6.14	8.26
NAREIT	18.30	12.22	16.55	7.54	10.57	13.75
Venture Capital 100	39.92	18.51	29.09	11.42	7.15	--

In addition to historic returns, it is important to consider risk. We use annualized standard deviations of quarterly returns to measure risk. By definition, standard deviation measures the range of returns around the mean return. One standard deviation captures two-thirds of the observations around the mean. The greater the standard deviation, the greater the range of observed returns. The table on the following page indicates that standard deviations are lower in recent years than in many other periods. This table shows the rolling annualized standard deviations over the last three years, five years, and ten years.

**Historical Capital Market Annual Standard Deviation
Periods Ended 12/31/95**

Asset Class	3 Year	5 Years	10 Years
Domestic Equity			
Standard & Poor's 500	8.32	9.07	14.80
Standard & Poor's 400 MidCap	9.50	13.44	17.36
Callan Large	8.76	9.40	14.33
Callan Medium	8.98	10.21	16.09
Callan Small	9.61	13.39	18.48
Domestic Fixed-Income			
Lehman Aggregate	5.31	5.08	5.29
Lehman Govt/Corp	5.81	5.51	5.64
Lehman Government	5.59	5.43	5.60
Lehman Corporate	6.53	5.86	5.89
Lehman Govt/Corp Int	4.37	4.42	4.22
Lehman Govt/Corp Long	9.53	8.43	9.34
First Boston High Yield	5.27	8.60	8.71
T-Bills	0.58	0.59	0.87
International			
MSCI EAFE Index	7.97	11.00	19.87
MSCI Europe Index	7.24	10.78	15.21
MSCI Pacific Index	15.99	17.48	26.47
MSCI Emerging Markets Free	27.87	26.45	--
MSCI World	5.14	8.24	16.01
Salomon Brothers Non-US Govt	8.46	11.11	13.50
Other			
Callan Real Estate	1.48	3.68	3.18
NCREIF	1.98	3.71	3.03
NAREIT	13.12	13.40	13.39
Venture Capital 100	20.53	28.31	31.73

The final critical statistical measure used in modeling is the correlation coefficient. This statistic measures how two assets are related to each other. A positive correlation of 1.00 would indicate that two assets are perfectly positively correlated. A correlation of -1.00 indicates that two assets are perfectly inversely correlated, when one goes up the other goes down. Most financial assets are positively correlated with one another but are far from perfectly correlated.

The following tables depict correlations between asset classes, equity benchmarks, fixed income benchmarks and international benchmarks over the last three, five and ten years.

**Correlations Among Major Asset Categories
Periods Ended 12/31/95**

Last 3 Years							
	S&P 500	Callan Small	MSCI EAFE	Lehman G/C	Salomon Non-US	Callan RE	VECO 100
Callan Small Cap	0.83						
MSCI EAFE	-0.17	0.01					
Lehman Govt/Corp	0.78	0.66	0.24				
Salomon Non-US Govt	0.40	0.30	0.12	0.54			
Callan Real Estate	0.34	-0.01	-0.38	0.25	0.09		
Venture Capital 100	0.43	0.69	-0.44	0.07	-0.02	-0.01	
T-Bills	0.70	0.34	-0.59	0.39	0.17	0.82	0.34
Last 5 Years							
	S&P 500	Callan Small	MSCI EAFE	Lehman G/C	Salomon Non-US	Callan RE	VECO 100
Callan Small Cap	0.79						
MSCI EAFE	0.30	0.12					
T-Bills	0.62	0.27	0.41				
Salomon Non-US Govt	0.17	-0.24	0.39	0.67			
Callan Real Estate	-0.09	-0.17	0.19	-0.14	-0.10		
Venture Capital 100	0.55	0.89	-0.13	-0.08	-0.42	-0.12	
T-Bills	0.59	0.38	-0.08	0.34	0.08	0.22	0.37
Last 10 Years							
	S&P 500	Callan Small	MSCI EAFE	Lehman G/C	Salomon Non-US	Callan RE	VECO 100
Callan Small Cap	0.92						
MSCI EAFE	0.58	0.51					
Lehman Govt/Corp	0.21	0.14	0.25				
Salomon Non-US Govt	-0.11	-0.21	0.35	0.53			
Callan Real Estate	-0.04	-0.10	0.17	-0.08	-0.03		
Venture Capital 100	0.77	0.92	0.33	-0.02	-0.26	-0.18	
T-Bills	0.12	-0.02	-0.03	0.17	-0.03	0.33	-0.07

**Correlations Between Equity Benchmarks
Periods Ended 12/31/95**

Last 3 Years

	S&P 400 MidCap	Callan Large	Callan Medium	Callan Small
Callan Large	0.80			
Callan Medium	0.95	0.85		
Callan Small	0.98	0.74	0.95	
Standard & Poor's 500	0.87	0.98	0.93	0.83

Last 5 Years

	S&P 400 MidCap	Callan Large	Callan Medium	Callan Small
Callan Large	0.82			
Callan Medium	0.96	0.86		
Callan Small	0.96	0.71	0.93	
Standard & Poor's 500	0.88	0.99	0.93	0.79

Last 10 Years

	S&P 400 MidCap	Callan Large	Callan Medium	Callan Small
Callan Large	0.91			
Callan Medium	0.97	0.93		
Callan Small	0.97	0.87	0.97	
Standard & Poor's 500	0.94	0.99	0.97	0.92

**Correlations Between Fixed Income Benchmarks
Periods Ended 12/31/95**

Last 3 Years

	Lehman Agg	Lehman G/C	Lehman Govt	Lehman Corp	Lehman G/C Int	Lehman Long	FB Hi-Yield
Lehman Brothers G/C	1.00						
Lehman Brothers Govt	0.99	1.00					
Lehman Brothers Corp	1.00	1.00	1.00				
Lehman Brothers G/C Int	0.99	0.99	0.99	0.99			
Lehman Brothers G/C Long	0.98	0.99	0.99	0.98	0.96		
First Boston High Yield	0.81	0.80	0.80	0.81	0.83	0.74	
T-Bills	0.44	0.38	0.38	0.42	0.38	0.46	0.06

Last 5 Years

	Lehman Agg	Lehman G/C	Lehman Govt	Lehman Corp	Lehman G/C Int	Lehman Long	FB Hi-Yield
Lehman Brothers G/C	1.00						
Lehman Brothers Govt	0.99	1.00					
Lehman Brothers Corp	0.99	0.99	0.98				
Lehman Brothers G/C Int	0.99	0.99	0.99	0.97			
Lehman Brothers G/C Long	0.97	0.98	0.98	0.97	0.94		
First Boston High Yield	0.36	0.33	0.29	0.44	0.37	0.28	
T-Bills	0.39	0.34	0.32	0.41	0.39	0.43	0.46

Last 10 Years

	Lehman Agg	Lehman G/C	Lehman Govt	Lehman Corp	Lehman G/C Int	Lehman Long	FB Hi-Yield
Lehman Brothers G/C	1.00						
Lehman Brothers Govt	0.99	1.00					
Lehman Brothers Corp	0.98	0.98	0.97				
Lehman Brothers G/C Int	0.99	0.98	0.98	0.96			
Lehman Brothers G/C Long	0.97	0.98	0.98	0.97	0.91		
First Boston High Yield	0.39	0.39	0.36	0.49	0.35	0.42	
T-Bills	0.20	0.17	0.17	0.14	0.14	0.12	-0.17

Correlations Between International Benchmarks Periods Ended 12/31/95

Last 3 Years

	MSCI EAFE	MSCI Europe	MSCI Pacific	MSCI Emerging	MSCI World
MSCI Europe Index	0.01				
MSCI Pacific Index	0.93	-0.37			
MSCI Emerging Markets Free	0.02	0.64	-0.21		
MSCI World Index	0.78	0.36	0.58	0.10	
Salomon Brothers Non US Govt	0.12	0.31	0.00	-0.24	0.34

Last 5 Years

	MSCI EAFE	MSCI Europe	MSCI Pacific	MSCI Emerging	MSCI World
MSCI Europe Index	0.55				
MSCI Pacific Index	0.88	0.09			
MSCI Emerging Markets Free	-0.08	0.18	-0.18		
MSCI World Index	0.91	0.61	0.74	0.06	
Salomon Brothers Non US Govt	0.39	0.48	0.21	-0.40	0.37

Last 5 Years

	MSCI EAFE	MSCI Europe	MSCI Pacific	MSCI Emerging	MSCI World
MSCI Europe Index	0.55				
MSCI Pacific Index	0.88	0.09			
MSCI Emerging Markets Free	-0.08	0.18	-0.18		
MSCI World Index	0.91	0.61	0.74	0.06	
Salomon Brothers Non US Govt	0.39	0.48	0.21	-0.40	0.37

Section IV

DISCUSSION OF 1996 CAPITAL MARKET PROJECTIONS AND THEORETICAL EFFICIENT ALTERNATIVE POLICIES

Asset Category Projections

To develop a range of alternative efficient asset mix policies, it is necessary to first develop three critical inputs for each asset category. The return and risk estimates for the key asset categories are presented below. All the projections are internally consistent with one another and reflect Callan's expectations regarding the central tendency for a range of possible returns. In formulating these estimates, we focused on a five-year timeframe. If pressed to estimate returns for either shorter or longer periods, we would have similar estimates.

Asset Class	1996 Expected Return	1995 Expected Return	Change	1996 Expected Risk	1995 Expected Risk	Change
Equities						
Large Cap (S&P 500)	9.50	9.80	-0.30	13.30	12.70	0.60
Small Cap (CAI Small)	10.50	10.80	-0.30	19.20	18.50	0.70
International (MSCI EAFE)	10.20	10.30	-0.10	18.70	19.00	-0.30
Fixed Income						
Domestic (LB G/C)	6.80	7.50	-0.70	6.00	6.00	0.00
Int'l (SB Non-US Gov)	6.80	7.50	-0.70	12.00	12.00	0.00
High Yield (First Boston)	7.50	8.00	-0.50	9.20	8.50	0.70
Other						
Real Estate	8.00	8.60	-0.60	18.00	18.00	0.00
Alternative Investments	13.00	13.00	0.00	33.50	30.00	3.50
Cash Equivalents	4.80	4.80	0.00	0.80	0.80	0.00
Economic Variable						
Inflation	3.50	4.00	-0.70	N/A	N/A	N/A
Real GDP	2.40	2.50	-0.10	N/A	N/A	N/A

The projected correlations are:

	1	2	3	4	5	6	7	8	9
1 Large Cap	1.0000	0.7900	0.5000	0.4500	0.1000	0.5200	0.2200	0.6600	-0.0500
2 Small Cap Equity	0.7900	1.0000	0.4200	0.3200	-0.1500	0.5300	0.2200	0.8500	-0.0500
3 Int'l Equity	0.5000	0.4200	1.0000	0.4300	0.3700	0.3500	0.2200	0.3300	-0.2100
4 Domestic Bonds	0.4500	0.3200	0.4300	1.0000	0.6200	0.4600	0.2000	0.2200	0.0500
5 Int'l Bonds	0.1000	-0.1500	0.3700	0.6200	1.0000	0.2000	0.0500	-0.1500	0.0500
6 High Yield	0.5100	0.5400	0.3500	0.4600	0.2000	1.0000	0.2200	0.4600	-0.0100
7 Real Estate	0.2200	0.2200	0.2200	0.2000	0.0500	0.2200	1.0000	0.2000	0.2100
8 Alternative Inv	0.6600	0.8500	0.3300	0.2200	-0.1500	0.4500	0.2000	1.0000	0.0500
9 Cash Equivalents	-0.0500	-0.0500	-0.2100	0.0500	0.0500	-0.0100	0.2100	0.0500	1.0000

The projected return statistics are similar to, but slightly lower, than those utilized last year. Domestic equity returns are 30 basis points below those used last year. International equity expected returns are 10 basis points lower.

Bond expected returns, both domestic and international, were reduced 70 basis points. Real estate's expected return is 60 basis points lower. Expected risk levels were adjusted slightly to incorporate recent trends.

In sum, the adjustments to expected returns were driven by two primary forces. First, they recognize the exceptional strength in the U.S. equity market. Second, the estimates reflect the marked decline in long-term interest rates. The lower interest rate structure, and recovery in many real estate markets, explain the reduction in expected real estate returns.

The basic pattern of long run expected returns remains unchanged. Domestic and international stocks are expected to earn more than real estate which, in turn, is expected to achieve a greater return than bonds. Expected real returns (nominal returns less expected inflation) are consistent with long run ranges.

Unconstrained Efficient Portfolios

In prior years, we have excluded potential alternative policies that would be impossible to implement under your governing statute. Thus, we have excluded asset categories such as high yield bonds and venture capital. We also historically have constrained maximum equity exposure and combined equity and real estate exposure to adhere to your statutory limits.

This year, in this initial phase, staff felt and we concur, that it would be useful to consider an unconstrained set of alternatives.

The table below reflects a broad range of efficient alternative policies. The policies toward the left are lower risk; lower return alternatives while those toward the right are "efficient" higher risk, higher return alternatives. These unconstrained efficient portfolio alternatives utilize two asset categories (high yield bonds and alternative investments/ventures) that are not currently permitted by statute. In addition, alternatives 5 and 6 include equity commitments in excess of the current statute.

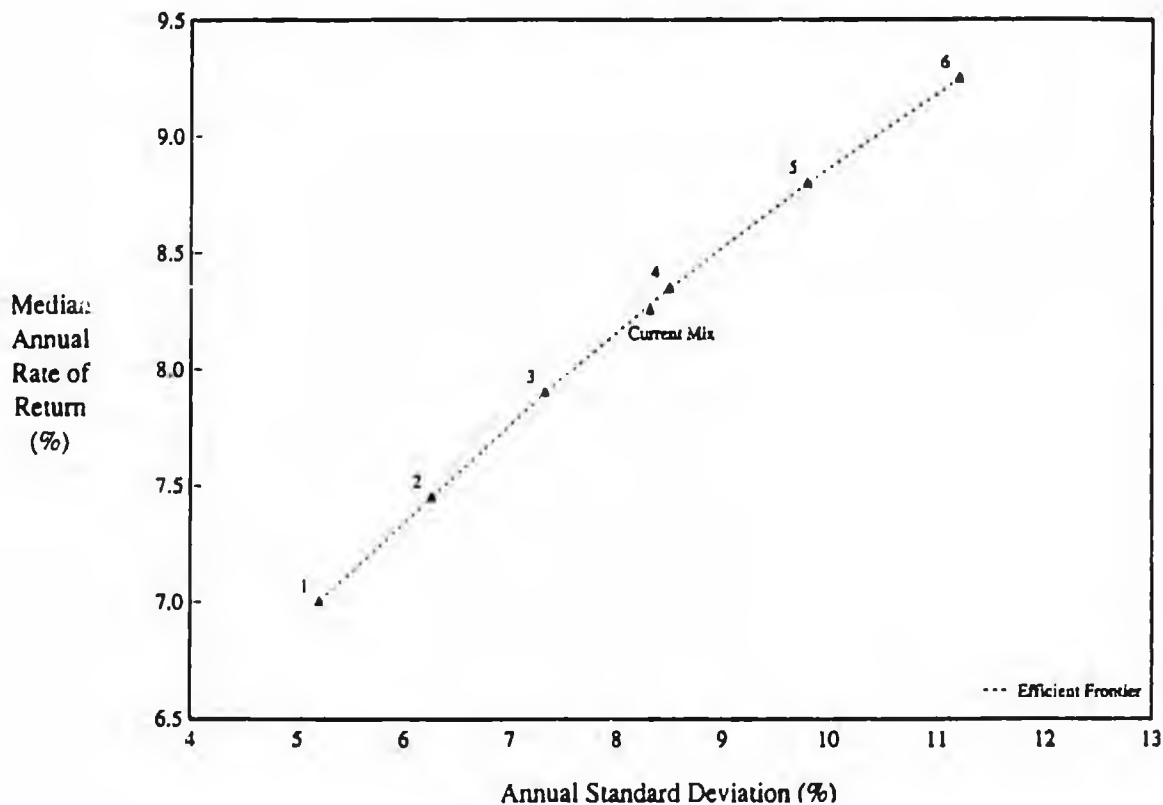
Optimal Portfolios

Portfolio Component	Current Mix	Limits		Asset Mix Alternatives					
		Min	Max	1	2	3	4	5	6
S&P	30	0	100	15	18	22	28	35	41
CAI Small	5	0	100	1	1	1	3	5	6
EAFE	10	0	100	6	7	8	12	16	20
LB G/C Bd	45	0	100	34	41	48	32	15	0
SB WGNONUS	0	0	100	0	0	0	4	8	11
Real Estat	10	0	100	4	5	6	7	8	9
Alt Inv	0	0	100	1	1	1	2	3	5
T-Bills	0	0	100	29	15	0	0	0	0
Hi Yield	0	0	100	10	12	14	12	10	8
Totals(%)	100			100	100	100	100	100	100
Median(%)	8.26			7.00	7.45	7.90	8.35	8.80	9.25
Std Dev(%)	8.30			5.20	6.26	7.32	8.48	9.79	11.20

On the following page is the graphical representation of the table above. Each triangle represents an asset mix from the table while the dashed line between the triangles represents other asset mixes which are also efficient but are not shown on the table. The combination of the portfolios represented by the triangles and the dashed line constitutes what is known as the "efficient frontier."

The three areas of interest on the graph are above the frontier, below the frontier and the frontier itself. All points above the efficient frontier are return and risk combinations which are not attainable, e.g., while it would be desirable to have a portfolio with the same risk as mix 2 but with a return of 8.0%, it is not possible to create one given the returns and risk of the assets under consideration. Conversely, points below the efficient frontier are attainable but not desirable. For example, a portfolio with the same risk as mix 2 and a return of 7.3% can be created with the assets in the study but, since it has a lower return for the same level of risk, mix 2 is preferred. Only portfolios on the efficient frontier have the highest return for any given level of risk.

Asset Mix Risk & Return



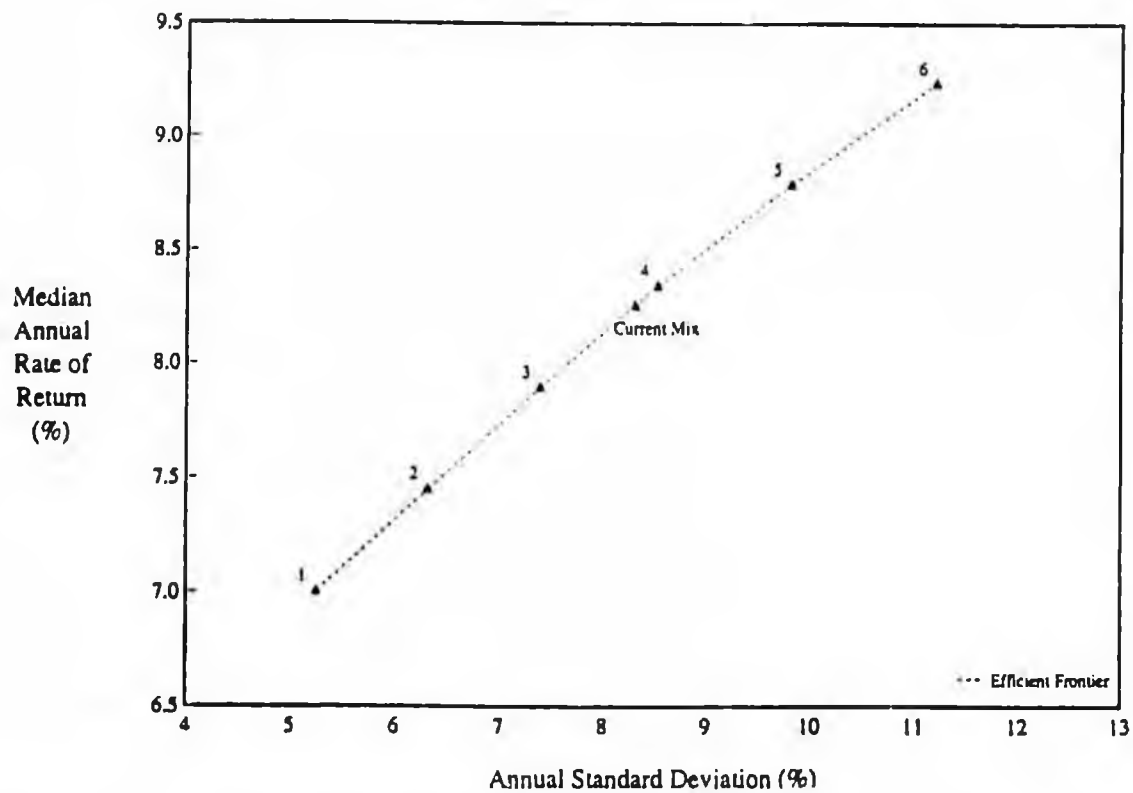
This analysis suggests that APFC's risk/return profile could be improved marginally with the expansion of allowable investments. While the percentage exposure varies, the aggregate exposure to high yield bonds and alternative investments ranges from 10-15%.

The table presented on the following page is similar to the first table, except high yield bonds and alternative investments are excluded from consideration. As in the first table, several of the alternatives are not allowable under current statute (Alternatives 5 and 6). These alternatives have more than 50% total equity exposure. Comparison of the two tables suggests that differences are comparatively minor. While overly simplifying, inclusion of high yield bonds and alternative investments generally result in lower equity exposures (particularly small cap equities) and also less investment grade bond exposure. The risk/return improvement is achieved through a slight reduction in standard deviation.

Optimal Portfolios

Portfolio Component	Current Mix	Limits		Asset Mix Alternatives					
		Min	Max	1	2	3	4	5	6
S&P	30	0	100	16	19	22	29	35	41
CAI Small	5	0	100	3	4	5	8	12	15
EAFE	10	0	100	6	7	8	11	15	19
LB G/C Bd	45	0	100	38	46	53	39	20	2
SB WGNONUS	0	0	100	1	1	2	5	9	13
Real Estat	10	0	100	5	6	7	8	9	10
T-Bills	0	0	100	31	17	3	0	0	0
Totals(%)	100			100	100	100	100	100	100
Median(%)	8.26			7.00	7.45	7.89	8.34	8.79	9.24
Std Dev(%)	8.30			5.25	6.32	7.38	8.52	9.81	11.20

Asset Mix Risk & Return



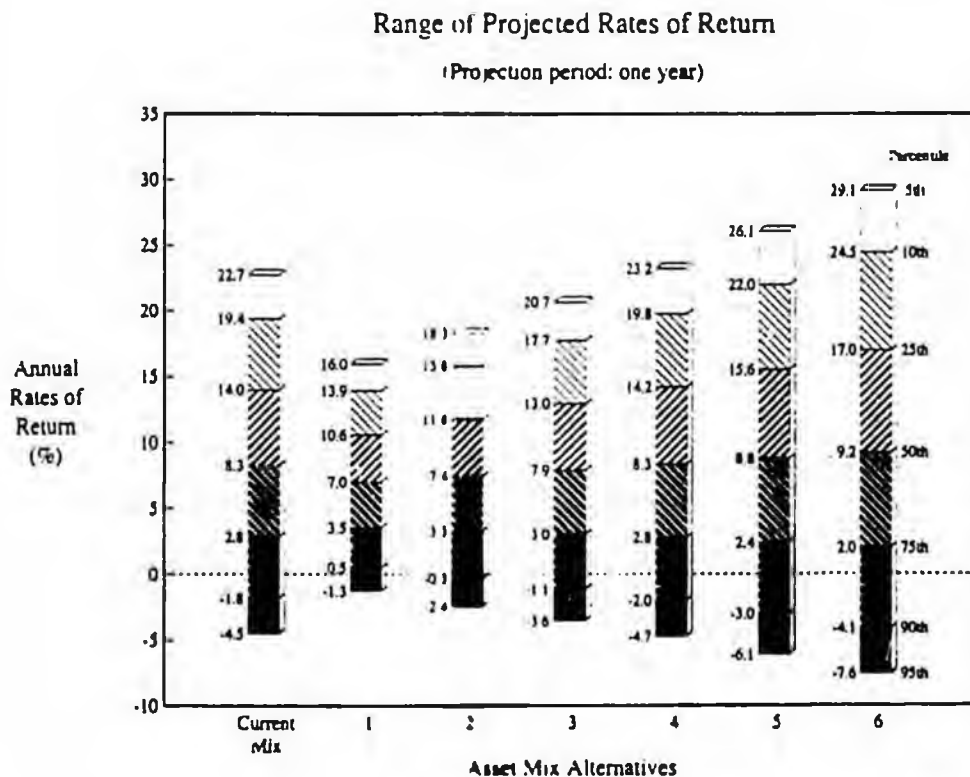
While not readily apparent from the tables, the greatest diversification gains are achieved through inclusion of international stocks and real estate.

Range of Projected Rates of Return (Excluding High Yield and Alternatives)

As a result of the risk (volatility) associated with each asset mix, the actual outcome can vary substantially in any one year. The graph below shows the range of possible returns that each asset mix could produce over a one-year holding period. The median returns are shown as the 50th percentile values, the best-case returns are represented by the 5th percentile, and the worst-case returns by the 95th percentile.

This graph is intended to show how return and risk characteristics of efficient portfolios differ. In each case, moving from a given mix to a more aggressive mix leads to an increase in the median return of the portfolio. For example, moving from mix 1 to mix 2 increases the median return at the 50th percentile from 7.0% to 7.4% due to the higher returns associated with more aggressive investment strategies under normal conditions.

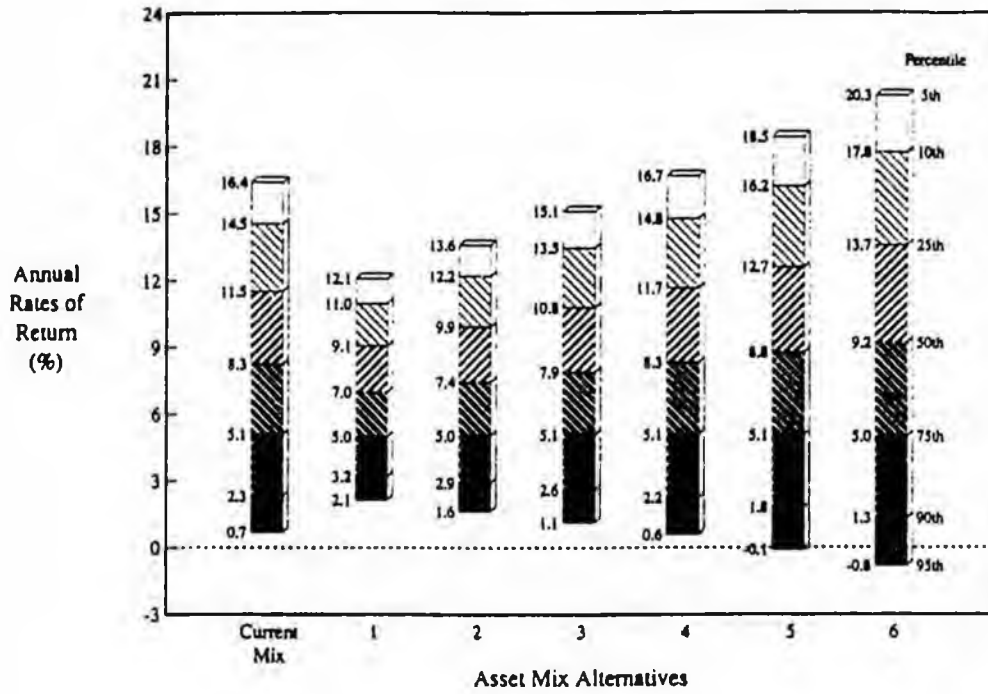
It is generally true that more aggressive mixes have a wider range of potential returns as shown by the increasing width of the bars in the graph. Looking again at mixes 1 and 2, the graph indicates that mix 2 returns 2.3% more than mix 1 in the best-case 5th percentile while it returns -1.1% less in the worst-case 95th percentile. The other mixes follow the same pattern of more aggressive mixes providing higher median-case returns with more return volatility.



The following graphs show a similar return distribution for a three-year, five-year and 10-year projection horizons. Notice that both the best and worst case scenarios are less extreme than in the one-year case. This is due to time diversification.

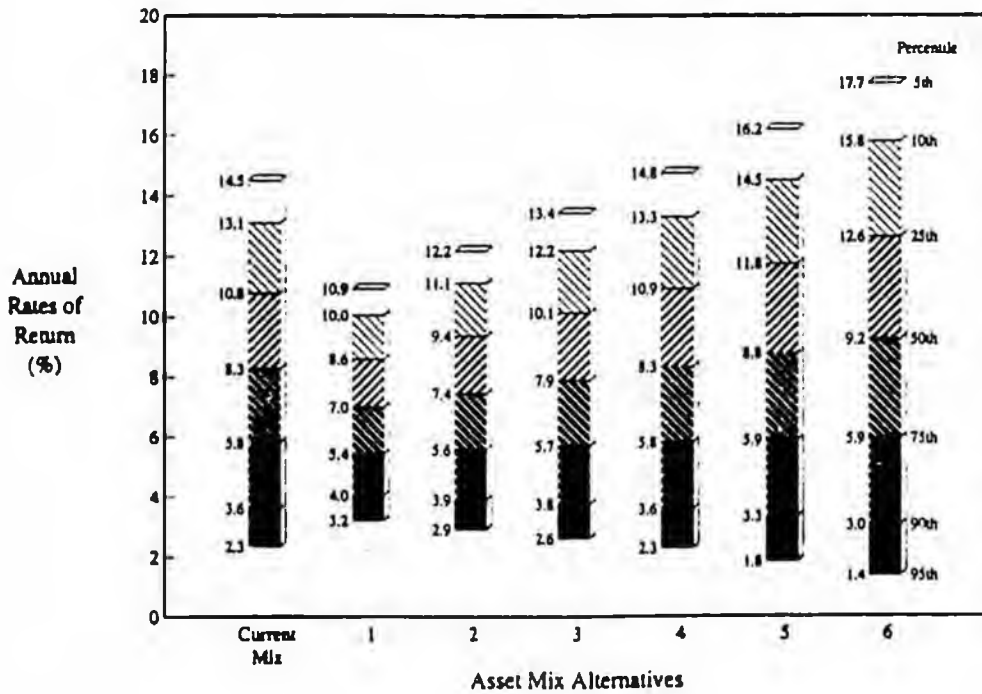
Range of Projected Rates of Return

(Projection period: 3 years)



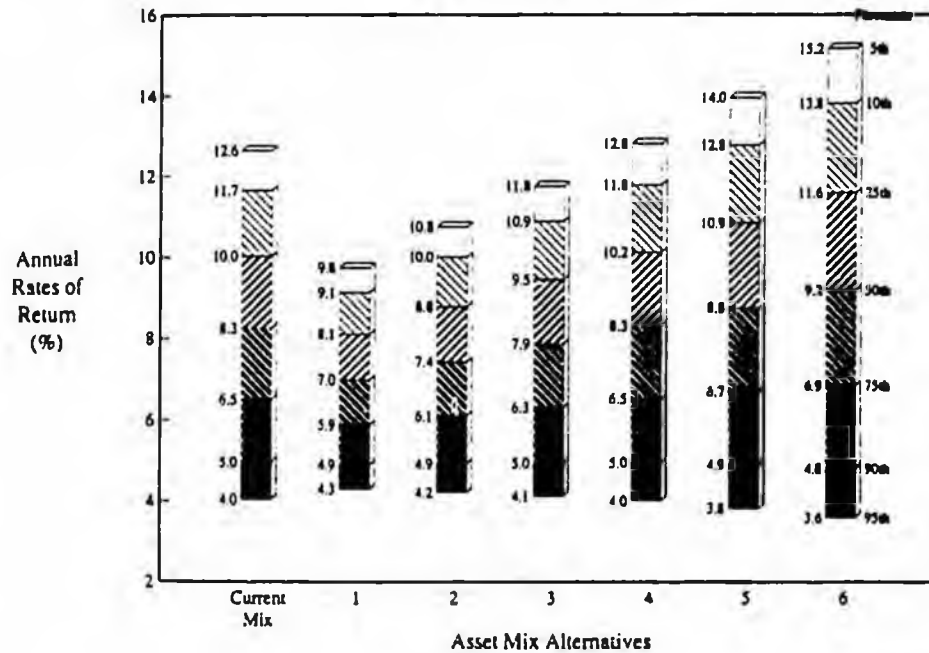
Range of Projected Rates of Return

(Projection period: 5 years)



Range of Projected Rates of Return

(Projection period: 10 years)



Threshold Rates of Return

The table on the next page shows the probabilities of each of the asset mixes exceeding the threshold rates of return shown in the first column. For example, there is an 85.1% probability that one year from now the current mix will have a return that is at least as high as 0%.

There are three rates of return which are examined in these tables: 0%, 3.5% and 7.5%. The 7.5% return corresponds to an investment objective of a 4% real rate of return on investments. There are also four time periods examined: 1, 3, 5 and 10 years.

There are three trends which are apparent in these tables. First, more conservative mixes have higher probabilities of achieving a positive return than more aggressive mixes. For a one-year projection horizon, the most conservative mix, mix 1, has a 91.6% probability of achieving a positive return while the most aggressive mix, mix 6, has only an 80.7% probability of attaining the same goal. Generally, more aggressive mixes are less likely to have positive returns because they have a higher equity exposure. Equities have greater short-term loss potential than assets such as bonds which are more heavily concentrated in the conservative mixes.

The second trend is more aggressive mixes have greater probabilities of higher returns. The same assets in aggressive mixes which can cause negative returns can also produce high positive returns. Conversely, the assets in conservative mixes that protect against negative returns are unlikely to have a very large upside. For example, of all of the mixes, mix 6 has the highest probability of achieving a rate of return greater than 7.5% for every time horizon.

A third trend that is apparent is the probability of surpassing the 0% and 3.5% return targets increases with the passage of time regardless of the asset mix. This is the result of the expected returns greater than the these return targets for each of the portfolios. As the returns over time regress to their expected values, the probability of exceeding the targets increases. This time diversification effect is the strongest in the more aggressive mixes.

Probability (%) of Exceeding Threshold Annual Return over 1 Year

Threshold Return	Current Mix	Asset Mix Alternatives					
		1	2	3	4	5	6
0.00	85.1	91.6	89.0	86.7	84.7	82.6	80.7
3.50	72.2	75.1	73.8	72.9	72.0	71.1	70.2
7.50	53.7	46.2	49.7	52.1	54.0	55.3	56.3

Probability (%) of Exceeding Threshold Annual Return over 3 Years

Threshold Return	Current Mix	Asset Mix Alternatives					
		1	2	3	4	5	6
0.00	96.4	99.2	98.3	97.3	96.2	94.8	93.4
3.50	84.6	88.0	86.6	85.5	84.4	83.2	82.1
7.50	56.3	43.5	49.4	53.7	56.9	59.1	60.8

Probability (%) of Exceeding Threshold Annual Return over 5 Years

Threshold Return	Current Mix	Asset Mix Alternatives					
		1	2	3	4	5	6
0.00	99.0	99.9	99.7	99.4	98.9	98.2	97.4
3.50	90.6	93.5	92.3	91.4	90.4	89.3	88.2
7.50	58.1	41.6	49.3	54.8	58.8	61.7	63.8

Probability (%) of Exceeding Threshold Annual Return over 10 Years

Threshold Return	Current Mix	Asset Mix Alternatives					
		1	2	3	4	5	6
0.00	99.9	100.0	100.0	100.0	99.9	99.9	99.7
3.50	96.9	98.4	97.8	97.3	96.8	96.1	95.3
7.50	61.4	38.2	48.9	56.8	62.4	66.3	69.1

Conclusion

Optimization analysis is a useful tool when developing strategic asset allocation policy. Naturally, the output is only as good as the input. Hopefully, this first step in the asset allocation process has provided a useful framework for further deliberations. It should be apparent that the interrelationships among asset categories are many and complex. The more asset categories considered, the greater the number of required inputs and the greater the probability of resulting error. We attempt to minimize this risk by restricting the number of asset categories considered and using only those with meaningful history and reasonable stability. We also attempt to err on the side of conservatism. For example, our assumption regarding expected risk for real estate is very high. Using a lower risk level would suggest a much heavier allocation to real estate. Similarly, we have not used emerging markets as an asset category because the historic data is very limited and the data series commonly employed have changed radically in recent years. Hence, the inputs used would be highly subjective and could be grossly in error. This should not preclude consideration of emerging markets as an asset category in a well diversified program. Rather, it simply suggests that the category be considered at a later stage once broad overall risk and return parameters have been established.

In the optimization analysis, the data series used for alternative investments was based on the performance of venture capital based high growth companies. Many funds have made significant commitments to "private equity" investments which include both venture capital funds and management buyout funds. In many respects, such investments present similar problems to real estate in asset allocation modeling. The actual observed volatility is generally significantly less than that of publicly traded securities. Intuitively, we all recognize that the true economic risk must be greater. We reconcile this conflict by using the Venture 100 series, forecasting a premium return and a very high risk level. Even with these biases, the optimizer, if permitted, likes a small allocation. Many sponsors deal with this issue by excluding private equity from optimization analysis, but then allocating a portion of their equity commitment to the sector.



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HB

525

SFIN

FILE

SENATE FINANCE COMMITTEE REPORT

DATE: 3/11/96

FURTHER: SFC REPORTED OUT OF
4/27/96

DATE TURNED INTO OFFICE: 4-27-96

The Finance Committee considered **HOUSE BILL NO. 525**
Relating to permanent fund investments.

and recommends:

- be replaced with _____ CS _____ (_____)
- adopt previous _____ CS _____ (_____)
- attached amendment(s)
- adopt Letter of Intent by _____ Committee
- further referral to the _____ Committee

- Senate Bill:**
- same title
 - new title
- House Bill:**
- same title
 - technical change
 - new: SCR# _____

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	NR	DNP	AM
<i>[Signature]</i>	✓	<i>[Signature]</i>	✓		
<i>[Signature]</i>	✓	<i>[Signature]</i>			
<i>[Signature]</i>	✓				
Co-Chair: <i>[Signature]</i>	✓	Co-Chair: <i>[Signature]</i>			
Co-Chair: <i>[Signature]</i>		Co-Chair: <i>[Signature]</i>	✓		

NEW FISCAL NOTE(S):

Department	Date	Zero	Fiscal

PREVIOUS FISCAL NOTE(S):*

Department	Date	Zero	Fiscal
#1 DOR (APFC)	7/28/96	0	

APPROPRIATION -- no fiscal note

*include fiscal notes accompanying Governor's bill

FISCAL NOTE

No. 1
Bill Version: HB 525
(H) Publish Date: 3/6/96

Revision Date: _____ Dept. Affected: Revenue
 Title: An Act designating certain permissible investments BRU: APFC
by the Alaska Permanent Fund Corporation... Component: APFC
 Sponsor: House Finance
 Requestor: House Finance COMPONENT SERIAL NO. 109

Expenditures/Revenues: (Thousands of Dollars)

	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
OPERATING EXPENDITURES						
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ()						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1007 GF/Mental Health						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY96) cost \$ _____

POSITIONS:

FULL-TIME					
PART-TIME					
TEMPORARY					

ANALYSIS: (Attach a separate page if necessary)

(See attached memorandum dated February 27, 1996 from Byron I. McIatt to the members, House Finance Committee.)

Prepared by: Byron I. McIatt, Executive Director Phone: (907) 465-2047
 Division: Alaska Permanent Fund Corporation Date: 2/27/96
 Approved by Commissioner: [Signature] Date: 2/27/96
 Agency: Department of Revenue

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Alaska Permanent Fund Corporation
P.O. Box 25500 Juneau, Alaska 99802-5500
(907) 465-2047

MEMORANDUM

DATE: February 27, 1996

TO: Members, House Finance Committee

FROM: Byron I. Mallott
Executive Director

SUBJECT: Projected Effects of Passage of HB 525, Relating
to Permanent Fund Investments

The purpose of the bill is straight forward: to give the Board of Trustees an opportunity to earn more income for the Permanent Fund over the long term by allowing the Board to allocate a higher percentage of the Fund's assets to equities and to lower-level investment-grade debt securities.

The benefits of the bill, hopefully, will be expressed in increased dollars earned by your Permanent Fund in future years. Exactly how much additional income will be generated by these proposed changes is dependent on how the financial markets perform in the future, but the following analysis provides an illustrative example.

Permanent Fund Equities at Market Value

<u>Current Holdings</u>	<u>Maximum under HB 525</u>	<u>Difference</u>
\$8.665 billion	\$9.336 billion	\$671 million

If the Trustees were to allocate the maximum 50% to equities (given the Fund's current \$18.7 billion market value), they would be increasing the Fund's percentage holdings of an asset class which has an expected total return over the next five years ranging from 9.5% for U.S. large cap stocks, to 10.2% for non-U.S. stocks to 10.5% for U.S. small cap stocks. Simultaneously, the Fund would be decreasing its percentage holdings in an asset class with an expected total return over the next five years of 6.8% (fixed income). The difference in annual return for \$671 million earning 9.5% instead of 6.8% is \$2,300,000.

Impact of Increasing Permanent Fund Holdings of A- and Baa-Rated Corporate Debt Securities

Given the \$8.2 billion market value of the Fund's fixed-income portfolio as of January 31, 1996, the Trustees would have to increase the Permanent Fund's holdings in A-rated paper by \$240 million and Baa-rated paper by \$480 million to equal the percentage weighting in these investment-grade securities held in the corporate component of the Lehman Brothers Government/Corporate Index.

(Note: This is very much the type of flexibility being sought in this legislation. The Trustees would like to be able, through the Fund's in-house investment staff and/or the new external fixed-income managers, to take advantage of investment opportunities in this component of the investment-grade corporate universe, if and when they arise.)

In any event, if the Fund were to purchase the A-and Baa-rated paper as indicated above, and if future fixed-income returns were to equal the average historical returns for the period 1991-1995, the Fund would earn an additional 39 basis points on the increased A-rated securities (11.14% for A vs. 10.75% for AA) and an additional 111 basis points on the Baa-rated securities (11.86% for Baa vs. 10.75% for AA).

Increase in "A"	\$240 million	x	39 bp	=	\$936,000
Increase in "Baa"	\$480 million	x	111 bp	=	<u>\$5,328,000</u>
					\$6,264,000

The combined potential increase in income from increased holdings of equities and lower-rated investment grade corporate debt securities, given the above assumptions, would thus total \$8,564,000 (\$2,300,000 in stocks plus \$6,264,000 in bonds). Over five years, that total increase in income would amount to more than \$40 million.

It should be noted, of course, that increased opportunities for return also bring increased risks. Increased percentage holdings of equities and debt securities in investment grades below AA could lead to more volatile annual returns in the short term. The Trustees believe, however, that the slight increase in risk is manageable in the short term, and will provide meaningful returns in the long term

House Bill 525
February 27, 1996
Page 3

Finally, it should also be noted that the Trustees view this legislation as remedial because, even with these changes in investment authorization, the allowable asset allocation of the Fund essentially tracks the current median of the plan sponsor universe. In order to compete effectively in the financial markets of the 21st century, it may be necessary to seek additional legislative authorization to optimize future Permanent Fund risk and returns.

HOUSE BILL NO. 525

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

BY THE HOUSE FINANCE COMMITTEE BY REQUEST

Introduced: 2/21/96

Referred: Finance

A BILL

FOR AN ACT ENTITLED

1 "An Act designating certain permissible investments by the Alaska Permanent
2 Fund Corporation in taxable municipal or state debt securities and corporate debt
3 securities; changing the allocation limits on domestic and nondomestic government
4 and corporate securities, nondomestic corporate promissory notes, domestic and
5 nondomestic corporate stocks, and taxable government debt securities; and
6 providing for an effective date."

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

8 * Section 1. AS 37.13.120(g)(7) is amended to read:

9 (7) domestic corporate debt securities that are rated investment grade
10 [A OR BETTER] by a nationally recognized rating service, or nondomestic corporate
11 debt securities of comparable quality;

12 * Sec. 2. AS 37.13.120(g)(19) is amended to read:

13 (19) taxable municipal or state debt securities that are rated investment

1 grade [A OR BETTER] by a nationally recognized rating service;

2 * Sec. 3. AS 37.13.120(i) is amended to read:

3 (i) The fund may at no time own more than five percent of the voting stock
4 of a corporation. Domestic stocks, except for bank and insurance company stocks,
5 must be listed at the date of purchase on an exchange registered with the Securities
6 and Exchange Commission. At the time of each investment, the aggregate investment
7 of the fund in each stated category of investment may not exceed the following stated
8 percentage of the total investments of the fund:

9 (1) mortgages under (g)(13) of this section - 15 percent;

10 (2) real estate investments under (g)(16) of this section - 15 percent;

11 (3) certificates of deposit, term deposit, or bankers' acceptances under
12 (g)(15) of this section - 20 percent;

13 (4) [SECURITIES OF NONDOMESTIC GOVERNMENTS,
14 NONDOMESTIC GOVERNMENT AGENCIES, AND NONDOMESTIC
15 CORPORATIONS UNDER (g)(7), (17), AND (18) OF THIS SECTION,] domestic
16 and nondomestic corporate stocks under (g)(14) and (18) of this section [, AND
17 SHORT-TERM NONDOMESTIC CORPORATE PROMISSORY NOTES UNDER
18 (g)(8)(B) OF THIS SECTION] - ~~50~~ percent [; 40%]

19 (5) DOMESTIC CORPORATE DEBT SECURITIES THAT ARE
20 RATED A AND NONDOMESTIC CORPORATE DEBT SECURITIES OF
21 COMPARABLE QUALITY UNDER (g)(7) OF THIS SECTION, AND TAXABLE
22 MUNICIPAL OR STATE DEBT SECURITIES THAT ARE RATED A UNDER
23 (g)(19) OF THIS SECTION - FIVE PERCENT].

24 * Sec. 4. AS 37.13.120 is amended by adding a new subsection to read:

25 (o) For purposes of (g) of this section, "investment grade" means a Standard
26 & Poor's Corporation rating BBB or better, or Moody's Investors Service, Inc., rating
27 of Baa or better, including a rating with a "+" or "-" designation or other variations
28 that occur within these ratings, or a comparable rating by another nationally recognized
29 rating organization.

30 * Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

FISCAL NOTE

Revision Date: _____ Dept. Affected: Revenue
 Title: An Act designating certain permissible investments BRU: APFC
 by the Alaska Permanent Fund Corporation... Component: APFC
 Sponsor: House Finance
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FULL-TIME					
PART-TIME					
TEMPORARY					

ANALYSIS: (Attach a separate page if necessary)

(See attached memorandum dated February 27, 1996 from Byron I. Mallott to the members, House Finance Committee.)

Prepared by: Byron I. Mallott, Executive Director
 Division: Alaska Permanent Fund Corporation
 Approved by Commissioner: [Signature]
 Agency: Department of Revenue

Phone: (907) 465-2047
 Date: 2/27/96
 Dcte: [Signature]

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In any event, if the Fund were to purchase the A-and Baa-rated paper as indicated above, and if future fixed-income returns were to equal the average historical returns for the period 1991-1995, the Fund would earn an additional 39 basis points on the increased A-rated securities (11.14% for A vs. 10.75% for AA) and an additional 111 basis points on the Baa-rated securities (11.86% for Baa vs. 10.75% for AA).

Increase in "A"	\$240 million	x	39 bp	=	\$936,000
Increase in "Baa"	\$480 million	x	111 bp	=	<u>\$5,328,000</u>
					\$6,264,000

The combined potential increase in income from increased holdings of equities and lower-rated investment grade corporate debt securities, given the above assumptions, would thus total \$8,564,000 (\$2,300,000 in stocks plus \$6,264,000 in bonds). Over five years, that total increase in income would amount to more than \$40 million.

It should be noted, of course, that increased opportunities for return also bring increased risks. Increased percentage holdings of equities and debt securities in investment grades below AA could lead to more volatile annual returns in the short term. The Trustees believe, however, that the slight increase in risk is manageable in the short term, and will provide meaningful returns in the long term

House Bill 525
February 27, 1996
Page 3

Finally, it should also be noted that the Trustees view this legislation as remedial because, even with these changes in investment authorization, the allowable asset allocation of the Fund essentially tracks the current median of the plan sponsor universe. In order to compete effectively in the financial markets of the 21st century, it may be necessary to seek additional legislative authorization to optimize future Permanent Fund risk and returns.

REPRESENTATIVE
TERRY MARTIN
CHAIRMAN
BUDGET & AUDIT COMMITTEE
MEMBER
HOUSE FINANCE COMMITTEE

Alaska State Legislature



MAY 15 - JAN 15 258-8169
716 W. 4TH. SUITE 650
ANCHORAGE, AK 99504
JAN 15 - MAY 15 465-3783
STATE CAPITOL
JUNEAU, AK 99801-1182
HOME 333-6990
355 DONNA DRIVE, #11
ANCHORAGE, AK 99504

SPONSOR STATEMENT HB 525

An Act designating certain permissible investments by the Alaska Permanent Fund Corporation in taxable municipal or state debt securities and corporate debt securities; changing the allocation limits on domestic and nondomestic government and corporate securities, nondomestic corporate promissory notes, domestic and nondomestic corporate stocks, and taxable government debt securities; and providing for an effective date.

A joint meeting of the Legislative Budget and Audit Committee and the Revenue Subcommittee of the House Finance Committee was held on February 7 to examine why the state's PERS, TRS and SBS funds were performing better than the Permanent Fund. It was revealed at the hearing that 90 percent of the performance difference was due to the difference in portfolio makeup between the funds. While the state's retirement funds have to follow only the prudent investor rule in their investment decisions, the Permanent Fund is bound by statutes which restrict types of investments purchased, and amounts which can be invested in specific areas. Consequently, the retirement funds have the flexibility to take advantage of market changes, where the Permanent Fund does not. Specifically, the Permanent Fund is restricted in the amount of equities it may purchase. Also, the Permanent Fund must hold very high ratings of fixed income investments, further reducing the possible return on those investments. The equities market has been performing very well recently and the retirement funds have taken advantage of the situation by increasing their equity holdings. The Permanent Fund currently cannot do this.

At the February 7 joint hearing, Chairman Terry Martin told the Permanent Fund's Executive Director and members of the Board of Trustees that his committee would be happy to present legislation providing more flexibility in



the Fund's investment strategy. The Board of Trustees discussed the matter and presented the following draft legislation which allows more flexibility by making minor changes in two categories of investment. These changes should allow the Permanent Fund to take better advantage of current and changing market situations, and earn more for the Fund. This is also important for the state's financial picture, considering that a one percent increase in Permanent Fund earnings currently amounts to approximately \$152 million.

The proposal for changes to AS 37.13.120 consists of:

- Eliminating the restriction against investing in BBB-rated (investment grade) bonds;
- Eliminating the limitation to five percent for investing in A-rated bonds; and
- Excluding foreign bonds from the category which restricts investment in equities and foreign bonds to 50 percent or less (so that a full 50 percent can be invested in equities, not just 45 percent, as is the case now).



Alaska Permanent Fund Corporation

P.O. Box 25500 Juneau, Alaska 99802-5500

(907) 465-2047

MEMORANDUM

DATE: March 12, 1996

TO: Members, Senate Finance Committee

FROM: Byron I. Mallott *BIM*
Executive Director

SUBJECT: HB 525: Relating to Permanent Fund Investments

The purpose of the bill is straight forward: to give the Board of Trustees an opportunity to earn more income for the Permanent Fund over the long term by allowing the Board to allocate a higher percentage of the Fund's assets to equities and to lower-level investment-grade debt securities. It passed the House unanimously, without opposition last week.

The benefits of the bill, hopefully, will be expressed in increased dollars earned by your Permanent Fund in future years. Exactly how much additional income will be generated by these proposed changes is dependent on how the financial markets perform in the future, but the following analysis provides an illustrative example.

Permanent Fund Equities at Market Value

<u>Current Holdings</u>	<u>Maximum under HB 525</u>	<u>Difference</u>
\$8.665 billion	\$9.336 billion	\$671 million

If the Trustees were to allocate the maximum 50% to equities (given the Fund's current \$18.7 billion market value), they would be increasing the Fund's percentage holdings of an asset class which has an expected total return over the next five years ranging from 9.5% for U.S. large cap stocks, to 10.2% for non-U.S. stocks to 10.5% for U.S. small cap stocks. Simultaneously, the Fund would be decreasing its percentage holdings in an asset class with an expected total return over the next five years of 6.8% (fixed income). The difference in annual return for \$671 million earning 9.5% instead of 6.8% is \$2,300,000.

**Impact of Increasing Permanent Fund Holdings of
A- and Baa-Rated Corporate Debt Securities**

Given the \$8.2 billion market value of the Fund's fixed-income portfolio as of January 31, 1996, the Trustees would have to increase the Permanent Fund's holdings in A-rated paper by \$240 million and Baa-rated paper by \$480 million to equal the percentage weighting in these investment-grade securities held in the corporate component of the Lehman Brothers Government/Corporate Index.

(Note: This is very much the type of flexibility being sought in this legislation. The Trustees would like to be able, through the Fund's in-house investment staff and/or the new external fixed-income managers, to take advantage of investment opportunities in this component of the investment-grade corporate universe, if and when they arise.)

In any event, if the Fund were to purchase the A-and Baa-rated paper as indicated above, and if future fixed-income returns were to equal the average historical returns for the period 1991-1995, the Fund would earn an additional 39 basis points on the increased A-rated securities (11.14% for A vs. 10.75% for AA) and an additional 111 basis points on the Baa-rated securities (11.86% for Baa vs. 10.75% for AA).

Increase in "A"	\$240 million	x	39 bp	=	\$936,000
Increase in "Baa"	\$480 million	x	111 bp	=	<u>\$5,328,000</u>
					\$6,264,000

The combined potential increase in income from increased holdings of equities and lower-rated investment grade corporate debt securities, given the above assumptions, would thus total \$8,564,000 (\$2,300,000 in stocks plus \$6,264,000 in bonds). Over five years, that total increase in income would amount to more than \$40 million.

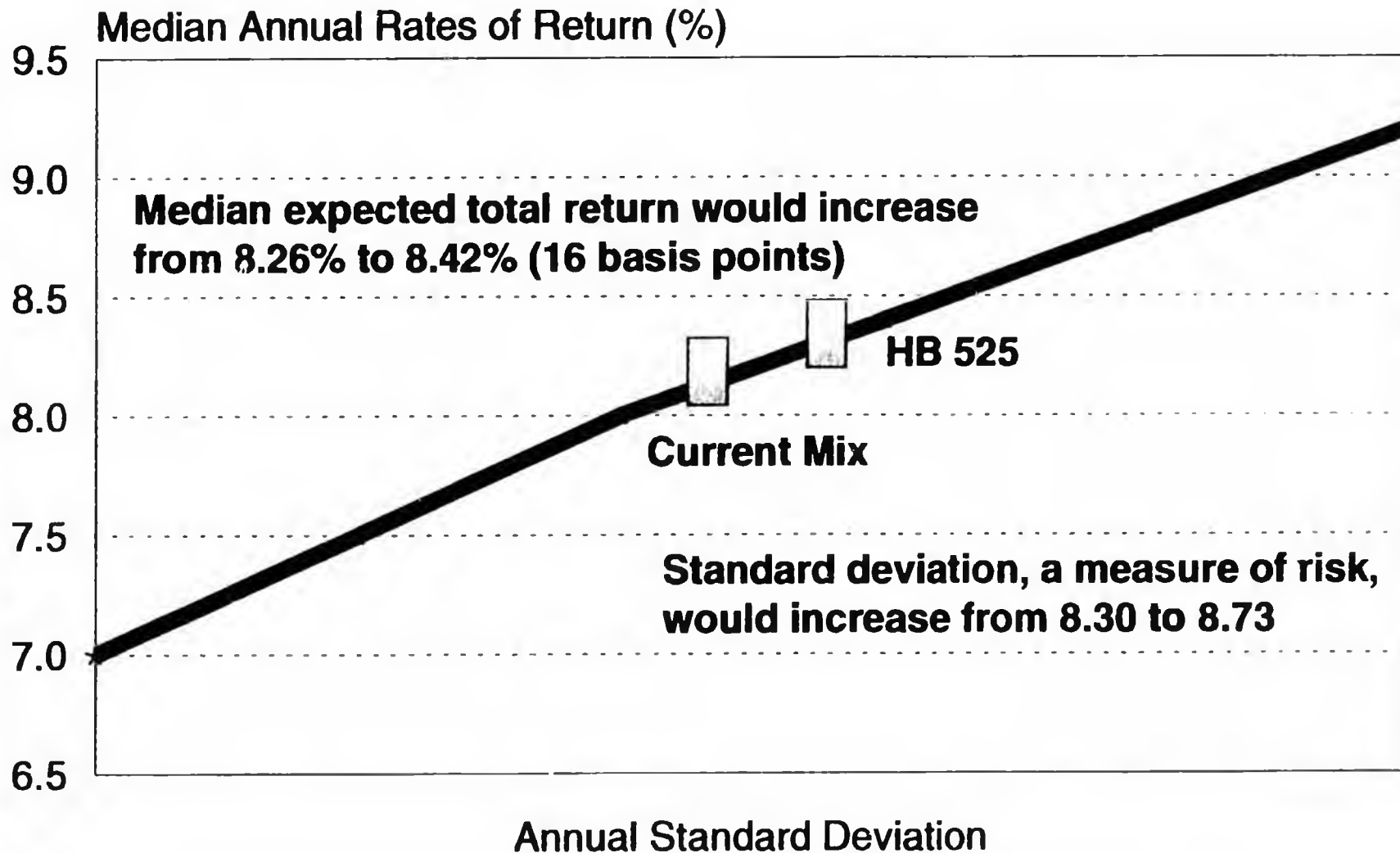
It should be noted, of course, that increased opportunities for return also bring increased risks. Increased percentage holdings of equities and debt securities in investment grades below AA could lead to more volatile annual returns in the short term. The Trustees believe, however, that the slight increase in risk is manageable in the short term, and will provide meaningful returns in the long term

House Bill 525
March 12, 1996
Page 3

Finally, it should also be noted that the Trustees view this legislation as remedial because, even with these changes in investment authorization, the allowable asset allocation of the Fund essentially tracks the current median of the plan sponsor universe. In order to compete effectively in the financial markets of the 21st century, it may be necessary to seek additional legislative authorization to optimize future Permanent Fund risk and returns.

Impact of House Bill 525

Efficient Frontier/Asset Mix Risk & Return



REPRESENTATIVE
TERRY MARTIN
CHAIRMAN
BUDGET & AUDIT COMMITTEE
MEMBER
HOUSE FINANCE COMMITTEE

Alaska State Legislature



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355 DONNA DRIVE, #11
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SECTIONAL ANALYSIS

HB 525

Proposing changes to the statute which describes how Permanent Fund monies may be invested, to allow the Corporation more flexibility to take advantage of changing market situations.

Section 1.

Amends AS 37.13.120(g)(7) to allow investment in "investment grade" domestic corporate debt securities (bonds) by the Permanent Fund. The current statute allows investment only in A-rated or better bonds. Investment grade is from BBB to AAA (Standard and Poor's Corporation rating service). The bill allows the Fund to invest in BBB-rated bonds, which is currently not allowed.

Section 2.

Amends AS 37.13.120(g)(19) to allow investment in "investment grade" taxable municipal or state debt securities (bonds) by the Permanent Fund. The current statute allows investment only in A-rated or better bonds. Investment grade is from BBB to AAA (Standard and Poor's Corporation rating service). The bill allows the Fund to invest in BBB-rated bonds, which is currently not allowed.

Section 3.

Amends AS 37.13.120(i) to remove foreign bonds from a category containing foreign bonds and domestic corporate stocks. This action increases the limit of investment by the Permanent Fund on domestic corporate stocks to 50 percent, compared to the previous 45 percent. This section also eliminates the five percent limitation for investment in A-rated bonds.



Section 4.

Adds a new subsection to AS 3.900 which defines (for the purposes of this (g) of this section) "investment grade" and the commonly used domestic corporate bond rating system.

Section 5.

Allows for the act to take effect immediately upon passage.

HB

526

HFIN

FILE

HOUSE COMMITTEE REPORT

(11)

Date Referred to Committee: March 18, 1996

FURTHER REFERRALS:

Date of Committee Action: 3/29/96

The FINANCE Committee considered:

HB 526

HOUSE BILL NO. 526

AIDEA OPERATIONS/PROJECTS/LOANS

"An Act relating to the financing authority, programs, operations, and projects of the Alaska Industrial Development and Export Authority; providing an exemption from the procurement code for certain projects of the authority; and providing for an effective date."

recommends it be replaced with the following committee substitute

CS HB 526 (FIN)

the same title
 a new title

additional referral to _____ Committee

attached amendment(s)

ADOPTS: _____ Letter of Intent

ATTACHES NEW FISCAL NOTE(S): (Dept)

APPROVES PREVIOUS: (Dept/Date)

fiscal note(s) _____

fiscal note(s) _____

zero fiscal note(s) _____

zero fiscal note(s) DCED 3/18/96

SIGNING WITH RECOMMENDATIONS	DP	DNP	NR	AM
<i>Richard Foster</i> FOSTER	X			
<i>Mark Henley</i> Henley	X			
<i>Thomas Mullen</i> mullen			X	
<i>James Martin</i> martin			X	
<i>Sean R. Powell</i> POWELL			X	
<i>Lee Kohring</i> Kohring			X	
<i>Ben Grussendorf</i> GRUSSENDORF	X			
<i>Pell Kelly</i> Kelly			X	
<i>Gene Hennrich</i> HENNRICH			X	
<i>Tam Brown</i> BROWN			X	
<i>Mike ...</i> ...				

CO-CHAIR'S SIGNATURE

Mark Henley *Richard Foster*

FISCAL NOTE

No. 1
 Bill Version: CSHB 526(L&C)
 (H) Publish Date: 3/18/96

**STATE OF ALASKA
 1996 LEGISLATIVE SESSION**

Revision Date: _____
 Title: Financing authority, programs and projects of AIDEA

Department: Commerce and Economic Development
 BRU: AIDEA
 Component: AIDEA

Sponsor: House Labor & Commerce
 Requestor: House Labor & Commerce

COMPONENT SERIAL NO. _____ 1234

Expenditures/Revenues

(Thousands of Dollars)

OPERATING EXPENDITURES	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
-----------------------------	-----	-----	-----	-----	-----	-----

CHANGE IN REVENUES	0.0	0.0	0.0	0.0	0.0	0.0
---------------------------	-----	-----	-----	-----	-----	-----

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 General Fund						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY 96) cost: \$ 0.0

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Bonds will be sold to finance projects and will have no fiscal impact on the General Fund. Program changes will have no fiscal impact on the General Fund.

Prepared by: William R. Snell, Executive Director
 Division: AIDEA
 Approved by Commissioner: William L. Hensley
 Agency: Commerce and Economic Development

Phone: 907-561-8050
 Date: March 8, 1996
 Date: 3-8-96

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COMMITTEE COPY

3/29/96

9-LS1549C.2

Cook

3/28/96

NO OBJ - adopted

AMENDMENT II

OFFERED IN THE HOUSE

TO: CSHB 526(L&C)

- 1 Page 7, line 10:
- 2 Delete "\$60,000,000"
- 3 Insert "\$85,000,000"

3/29/96

9-LS1549 (C.I)

Cook

3/28/96

NO/OBJ

AMENDMENT I

OFFERED IN THE HOUSE

TO: CSHB 526(L&C)

- 1 Page 1, lines 11 and 12:
- 2 Delete "if those bonds would affect the credit of the authority"
- 3 Insert "to assist in the financing of a development project under AS 44.88.172 -
- 4 44.88.177"



ALASKA INDUSTRIAL DEVELOPMENT
AND EXPORT AUTHORITY



480 WEST TUDOR

ANCHORAGE, ALASKA 99503

907 / 269-3000

FAX 907 / 269-3044

February 23, 1996

Ms. Anne Ringstad, Senate State Affairs Committee
c/o The Honorable Senator Bert Sharp
Alaska State Legislature
State Capitol
Juneau, AK 99811

Dear Anne:

As requested, the purpose of this letter is to provide information on why the moral obligation of the state has been requested for the purchase of the Snettisham hydroelectric project, versus issuing general obligation debt of the Alaska Industrial Development and Export Authority (AIDEA).

There are both market related reasons and policy related reasons for requesting that the Snettisham bonds be issued as State moral obligation bonds, rather than as AIDEA general obligation bonds. The circumstances outlined below present the classic situation in which the state moral obligation induces the market to pay significantly more for the bonds, while presenting a minimal-to-zero risk to the state and are the exact set of circumstances where attachment of the state moral obligation is most appropriate and beneficial.

Market Impacts:

Bond Rating: The State of Alaska is presently rated AA, making a Snettisham state moral obligation bond potentially a AA- bond issue. AIDEA received an A rating on our most recent bond issue (May 17, 1995). Based on the rating disparity, an AIDEA bond issue could expect a penalty of approximately 15 basis points.

Marketability: The Snettisham project will be a unique bond with its requirement of Congressional action and the 10 year history of the potential sale. It will, therefore, need to be actively marketed to institutional investors. A state moral obligation, in and of itself, is potentially the single most important characteristic a bond can have. Bonds with identical ratings sell at significantly different prices, depending in large part upon the nature of the credit enhancements that provided the ratings. A state moral obligation is an enhancement the market is accustomed to in analyzing revenue bond

financings, and therefore, provides maximum marketability leverage compared to other forms of credit enhancement when the underlying source of revenue [e.g. Alaska Electric Light & Power (AEL&P)] is unrated and unfamiliar to the market.

Insurability: It is likely that the Snettisham bond will benefit from being insured. Insurance will be significantly more economical, and more readily purchased, if the bond carries the state moral obligation.

Risk:

By its nature, the Snettisham bond presents a very minimal risk to the state under the moral obligation. The project is complete, and has operated successfully for nearly 20 years. Juneau's load now uses practically all the firm energy produced by Snettisham and load projections show that all firm energy and most of the average annual surplus will be consumed by the commercial and residential market in the near future. In addition, 100% of Snettisham's annual surplus energy has already been sold. Thus, the project will be fully utilized from the day of acquisition by AIDEA. These factors make AEL&P's take-or-pay obligation easy to meet without a rate change. In addition, the risk is limited with a rate covenant that will be included in the underlying revenue contract. The rate covenant will require AEL&P to collect whatever rates are necessary to meet the take-or-pay obligation even in the highly unlikely instance that load declines.

Policy and the Impacts on AIDEA:

Ability to meet AIDEA's primary mission: While attaching the state moral obligation to the Snettisham bond will not measurably affect the State of Alaska, issuing AIDEA general obligation debt could affect AIDEA and its future ability to enhance economic development in Alaska. Issuing AIDEA debt to purchase Snettisham could reduce AIDEA's future ability to incur obligations for economic development projects. Projects which AIDEA has bonded in the past (e.g. Federal Express maintenance facility, Unalaska Dock expansion) generally met a narrow "private activity" purpose, unlike Snettisham, which is a highly traditional public purpose financing and as such, a classic vehicle for the state moral obligation.

Industry Concentration: At June 1996, AIDEA will have outstanding approximately \$115 million in bonds, other than bonds related to the Red Dog Project. AIDEA has authority to and anticipates going to the bond market in 1996 for the Healy Clean Coal Project (\$85 million). If both the Healy and Snettisham projects are issued as AIDEA general obligations, nearly 62% of AIDEA's June 1996 debt, on a proforma basis, will be concentrated in two power generation facilities, with the corresponding concentration of revenues. Rating agencies and the bond market view such concentrations as unhealthy and the result of that may decrease the marketability of future AIDEA bonds.

Debt ratios: Adding \$185 million (\$85 million to finance Healy and an assumed \$100 million issuance for Snettisham) to AIDEA's general obligation debt will increase AIDEA's debt ratios. This, again will hurt AIDEA's abilities to market debt and may decrease the Authority's ability to fulfill its primary economic development mission.

Precedents and Previous State Commitments:

Precedents: The Alaska moral obligation has been attached in the past to revenue financing for hydroelectric projects as a matter of course, helping to finance hydroelectric projects throughout the state. It currently applies to: the Bradley Lake project, which benefits all railbelt consumers; the refinancing of the Sitka hydroelectric project; the Anchorage-Fairbanks Intertie project; and the Four Dam Pool projects.

Previous commitments: The sale of Snettisham has been pending for nearly ten years awaiting Congressional action. During the federal hearings and negotiations, the State represented that the bonds would be Alaska moral obligation bonds. The pricing mechanism for the acquisition was negotiated based on this assumption. The purchase agreement was finalized based up this representation, and the Alaska congressional delegation, the utility, and the City and Borough of Juneau all based their approval and support of the transfer to the Snettisham project based upon the state moral obligation on the bond.

When the purchase agreement was approved by the Alaska Energy Authority, the entity had the clear legislated authority to use the Alaska moral obligation for such a financing. No subsequent legislative approval was required or suggested at the time the purchase agreement was executed and duly approved. Only the subsequent subdivision of the AEA, its oversight transfer to AIDEA, and subsequent changes in AEA statutes have created the requirement for legislation specifically allowing the state moral obligation. However, the basic contracts with the United States and AEL&P preceded these statutory revisions.

I hope that the explanation provided above helps to clarify the reasons and purpose of providing the state moral obligation on the Snettisham bonds. If you require additional information, please do not hesitate to contact me.

Sincerely,



William R. Snell
Executive Director

Ms. Anne Ringstad
February 23, 1996
Page 4

cc: Pat Pourchot, Office of the Governor
David Ramseur, Office of the Governor

Ms. Anne Ringstad
February 23, 1996
Page 5

bcc: Wilson Hughes, Chairman
Ross Kinney, Deputy Commissioner, Department of Revenue
William A. Corbus, President, Alaska Energy and Resources Company
Larry Markley, Markley & Company
Robert LeResche, LeResche & Co.



ALASKA INDUSTRIAL DEVELOPMENT
AND EXPORT AUTHORITY



DLB

480 WEST TUDOR

ANCHORAGE, ALASKA 99503

907 / 269-3000

FAX 907 / 269-3044

March 13, 1996

VIA FACSIMILE (907) 465-2070

The Honorable Senator Bert Sharp
State Capitol
Mailstop 3100, Room 514
Juneau, Alaska 99801-1182
ATTN: Ms. Ann Ringstad

Subject: DeLong Mountain Transportation System Expansion
Increase in Request for Bond Authorization

Dear Senator Sharp:

The Alaska Industrial Development and Export Authority (the Authority) has received a request from Cominco Alaska, Inc. (CAK) to increase the bond authorization for an expansion of the DeLong Mountain Transportation System (DMTS) from \$60 million to \$85 million.

As explained on the attached March 1, 1996 letter from D. J. Charlton, General Manager of CAK, to the Authority's Project Manager, the reason for the request for increased authorization is a revised budget caused primarily by a recently completed re-evaluation of the ore grade at the mine. By recognizing an ore reserve grade increase from 17.8% Zinc to 19.5% Zinc, another 160,000 tons of ore concentrates will be produced annually. This raises the expected annual throughput at the DMTS port to 1,250,000 tons, and requires a consequential enlargement of facilities. This and other refinements in the budget, explained in Mr. Charlton's letter, have been reviewed with staff of the Authority. We believe the revised budget reasonably represents the total of costs for the DMTS expansion. The scope of construction has been sufficiently defined through preliminary engineering, and sufficient monetary reserves have been established for us to feel comfortable the Project can be completed for the bond authorization requested.

The increased production from the mine and throughput at the port will improve the competitiveness of the Red Dog Mine in world markets. It will also increase

The Honorable Senator Bert Sharp

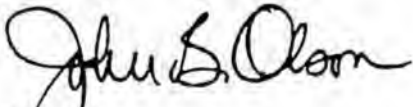
March 13, 1996

Page 2

employment by 80 full time and 25 seasonal jobs (this adds to approximately 350 jobs currently). We continue to believe the DMTS expansion represents a valuable project for the state, and look forward to working with CAK to make it a sound investment for the Authority.

If you have any further questions, please let me know.

Sincerely,



~~For~~ William R. Snell
Executive Director

Attachment

March 1, 1996

Mr. John Wood
Project Manager
Alaska Industrial Development and Export Authority
480 West Tudor
Anchorage, Alaska

Dear Sir,

As previously indicated, a review of ore reserves at Red Dog Mine has recently been completed. The new ore reserve calculation reflects the 1995 exploration program and mining activity for recent years. The new reserve calculation also reflects our most recent experience with the dilution factor utilized to calculate the ore reserves. This dilution factor is less than was originally estimated and results from minimizing the amount of waste rock that is extracted with the ore.

The result of the new ore reserve calculation is that the ore reserve grade for the existing main pit increased from 17.8% Zn (current 5 year production plan Dec. 2, 1995) to 19.5% Zn. Normal mining practice is to mine an ore body at reserve grade and as a result, Cominco Alaska will be adjusting the Mine production plan to reflect the higher grade and will commence processing the higher grade feed as the mine development plan allows.

More importantly, the higher feed grade changes the scope of work for the proposed production rate increase. The major change is that the concentrate production rate will be higher than originally estimated and consequently additional concentrate storage facilities, loadout facilities, and accommodations will be required. This change in scope will increase the Capital cost of the project to a total of \$85,000,000.

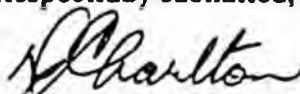
The increased concentrate production will also require an additional 30 employees including Cominco Alaska Inc. and Contractors.. The total new jobs created is now estimated to be 80 regular jobs and 25 seasonal jobs.

The \$85,000,000 Capital Cost is the estimate of the funding required for the DMTS (Port) expansion project. I would ask that the request for funding now before the Legislature, be revised to reflect the higher funding requirement.

Please find attached the revised Scope, Schedule and Capital Cost estimate in support of the Waiver Request for the "Sole Source" procurement, for the Cominco Alaska, Red Dog Mine Production Rate Increase. This scope of work defines work necessary to expand the DeLong Mountain Transportation System in support of the Red Dog Mine production increase.

Please let me know if there is any other information required.

Respectfully submitted,


D. J. Charlton
General Manager

**COMINCO ALASKA INC.
RED DOG MINE
PRODUCTION RATE INCREASE**

**SCOPE OF WORK - DELONG MOUNTAIN TRANSPORTATION SYSTEM
- REVISED FEB. 28, 1996 (*)**

PORT FACILITIES

The seaport facilities that are impacted by the proposed increase in production are identified below with their associated scope.

A. Construction Facilities

- *provide Construction support facilities including Construction camp, equipment, utilities, Construction offices, concrete batch plant and concrete aggregate
- provide additional laydown area sufficient to handle both the new construction at the storage building, receipt and storage of material for the minesite construction and the activity of the sealift.
- provide Construction management
- provide material management and freight
- *-provide for cost of Catering and Housekeeping for Construction activity

B. Fuel Storage

- current existing capacity of 10.8 million gallons will be modified by the addition of one 2.4 million gallon tank and relocation of the existing 1.2 million gallon tank to the minesite.

C. Power, Waste Heat and Standby Boiler

- *two of the existing 3508 generators will be retained and a new unit consisting of 2 - 1 megawatt units will be installed.
- provision will be made to utilize waste heat from the diesel generators for heating of the Accommodation complex.
- a standby boiler will be provided for emergency heating

D. Accommodation

- * present accommodation unit is too small, requires upgrading and is only set on wood cribbing. Settlement of the cribbing is causing structural problems. The present 60 man unit composed of 40 permanent and 20 temporary units will be relocated to form a new Mine Seasonal camp and a new 100 man PAC (32 single rooms/ 36 double rooms) complete with offices will be constructed.

E. Utilities

- *fresh water system will be upgraded or replaced to provide for 100 man camp (32 single rooms/ 36 double rooms). Additional storage capacity may be required.
- present Sewage system, with minor modifications, is considered adequate for the 100 man camp.

-*present incinerator is too small and must be replaced to accommodate the increased activity. The incinerator will be housed in a new building. Emission controls, appropriate to Air Quality standards, must be provided.

-existing communication system will be upgraded by the installation of a satellite link and associated equipment upgrade.

F. Concentrate Storage

-*the minimum additional storage capacity required is 416,000 swt. This requirement would be provided by a second Concentrate storage building approximately 1200 ft. in length.

-the new CSB will include a Wash bay and Equipment maintenance/ lubrication bay.

-provision will be made for settling sumps on the ground water diversion ditches.

G. Storage System

-*truck dump building will be extended to allow improvement in truck dump cycle.

-discharge rate from the existing truck dump hopper will be increased and subsequent conveyor system sized to handle the increased discharge rate.

-a new concentrate storage conveyor system, capable of feeding either building is required.

-installation of tripper conveyors will maximize utilization of the storage capacity.

H. Upgrade Conveyors

-demolition of existing storage conveyors is required due to reallocation of storage areas and extension of the existing tripper conveyor.

J. Loadout System

- #7- 8 conveyor system will be modified to provide a 2000 swt/hr transfer rate.

-*increased horsepower will be installed on #9a/9b conveyors

-*opportunities to decrease barge loading time will be investigated by reviewing #10 and #11 conveyor capacities and transfer chutes for increase.

-*a Dolphin will be installed in the vicinity of the shallow water dock to provide improved protection for the loadout conveyor gallery from accidental damage from lightering barge and fuel barge activity.

COMINCO ALASKA INC
 PRODUCTION EXPANSION
 DELONG MOUNTAIN TRANSPORTATION SYSTEM

CAPITAL COST ESTIMATE

CODE TITLE	Dec. 13/95 TOTAL \$	Feb. 27/96 TOTAL \$	Variance \$
A. CONSTRUCTION FACILITIES	8,070,000	16,225,000	8,155,000
B. FUEL STORAGE	2,840,000	1,030,000	-1,810,000
C. POWER HOUSE	2,936,000	3,400,000	464,000
D. ACCOMODATIONS	1,698,000	5,400,000	3,702,000
E. UTILITIES	1,900,000	2,000,000	100,000
F. CONCENTRATE STORAGE BUILDING	17,415,000	22,500,000	5,085,000
G. STORAGE SYSTEM	7,732,000	8,000,000	268,000
H. UPGRADE CONVEYORS	1,488,000	1,500,000	12,000
J. LOADOUT SYSTEM	3,021,000	4,300,000	1,279,000
TOTAL DIRECTS	47,100,000	64,355,000	17,255,000
INDIRECTS	4,400,000	3,700,000	-700,000
AIDÉA	0	650,000	650,000
OWNER'S COST	2,100,000	1,495,000	-605,000
SUBTOTAL	53,600,000	70,200,000	16,600,000
CAPITALIZED INTEREST, BOND ISSUANCE	3,000,000	9,800,000	6,800,000
CONTINGENCY	3,400,000	5,000,000	1,600,000
PROJECT TOTAL	\$60,000,000	\$85,000,000	25,000,000

COMINCO ALASKA INC
PRODUCTION EXPANSION
DELONG MOUNTAIN TRANSPORTATION SYSTEM

CAPITAL COST ESTIMATE - VARIANCE

CODE TITLE

A. CONSTRUCTION FACILITIES	underestimated equipment and freight cost, camp costs not in o
B. FUEL STORAGE	overestimated
C. POWER HOUSE	underestimated, provide for 2 - 1 mw units
D. ACCOMMODATIONS	provide for replacement of PAC on permanent foundations
E. UTILITIES	provide fire sprinkler system for Accommodations and Power hou
F. CONCENTRATE STORAGE BUILDING	increase CSB from 930 ft. to 1200 ft. in length
G. STORAGE SYSTEM	increase capacity
H. UPGRADE CONVEYORS	
J. LOADOUT SYSTEM	provide for a dolphin to protect loadout conveyor system at sh
INDIRECTS	some engineering transferred to contracts
AIDEA	
OWNER'S COST	AIDEA shown separate
CAPITALIZED INTEREST, BOND ISSUANCE	capitalized interest underestimated and project duration incre
CONTINGENCY	increased to reflect overall project cost



ALASKA INDUSTRIAL DEVELOPMENT
AND EXPORT AUTHORITY



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AIDEA Programs Overview

AIDEA's programs can be defined in three exclusive categories:

- Loan Participation
- Loan Guarantee
- Development Finance Program

Loan Participation Programs:

- Tax Exempt Program
- Taxable Program

AIDEA can buy up to 80% participation in a bank originated loan to develop, acquire or enhance Alaska business enterprises. AIDEA's participation may not exceed \$10 million.

Loan Guarantee Programs:

- Business Assistance Program

AIDEA can guarantee up to 80% of a bank originated loan of an Alaskan business up to \$1 million under the Business Assistance Program. Maximum interest rate is Prime plus 2 3/4% fully floating. AIDEA also offers a streamlined approval process for guarantees on unsecured loans of \$75,000 or less aimed at assisting entrepreneurs in rural areas, but available to all Alaskans.

- Export Assistance Program

Under the Export Assistance Program, AIDEA can guarantee up to 90% of a \$1 million loan which provides capital for an eligible export transaction for a 6 - 9 month period.

Development Finance Program:

AIDEA can develop, own and operate facilities within Alaska such as roads, ports and utilities which are essential to the economic well-being of an area; are financially feasible; and are supported by the community in which they are located. AIDEA refers to these facilities as "projects" and manages them through private sector users. The Legislature must approve any project over \$10 million. Since the program's inception in 1986, AIDEA has ownership of four projects ranging from the road and port at the Red Dog Mine to the Skagway Ore Terminal and the Authority is assessing the economic benefit and feasibility of many others.

AIDEA programs are enhancing Alaska's economy and putting Alaskans to work. AIDEA is financing Alaska's future.



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AIDEA Loan Participation Program

AIDEA can provide 80% or up to \$10 million in permanent financing for loans of any size secured through a qualified originator. AIDEA's participation is provided through funds available in the enterprises development account.

To be considered for tax-exempt financing, the loan must be eligible under provision of the IRS code. Taxable financing can be issued to participate in loans for newly constructed, acquired or refinanced business enterprises such as fishing, boats, shopping centers, office buildings, warehouses and airplanes.

In brief, borrowers apply at a financial institution (bank) for a loan. The bank, in turn, applies to AIDEA for participation in the loan. The bank retains a minimum of 20% share in the loan and the banks share may be amortized more rapidly than AIDEA's (see attached). Terms can be up to 15 years for personal property or 25 years for real property based on a 75% loan to value ratio.

To apply to AIDEA the bank must pay a \$200 application fee. Other fees include a 1% commitment fee on AIDEA's portion of the loan and a 1% funding fee.

Specifically, AIDEA's participation:

- 1) May not exceed \$10 million;
- 2) Its limited to loans that do not exceed 90% of the cost of the project, 75% of the appraised value of the project or 75% of the purchase price, whichever is less, unless the amount of the loan in excess of this limit is federally insured or guaranteed or is insured by a qualified mortgage insurance company;
- 3) May not be for a term longer than three-quarters of the economic life of the project or 25 years from the date the loan is made, whichever is earlier;
- 4) Shall be secured as to repayment by a first mortgage or security instrument in the manner the Authority determines feasible to assure timely repayment under a loan agreement entered into with the borrower;
- 5) The project applicant is not, or, if the applicant is not a single proprietorship, all members of the business enterprise or enterprises constituting the project applicant are not in default on another loan made by the state or by a public corporation of the state;
- 6) At least 20% of the principal amount of the loan is retained by the loan originator, and

7) The project is located in Alaska.

Application to the Authority by the financial institution must include:

- A) Letter of transmittal;
- B) Loan summary, including originator loan committee approval;
- C) A signed loan application including a list of other unpaid loans from the state or other public corporations of the state to the applicant or, if the applicant is not a single proprietorship, all members of the applicant's business enterprise, along with the originator certification that each unpaid loan is current and no other loans exist;
- D) A current report of the credit history of the applicant and the guarantors, if any;
- E) A current report of the financial statement, including a profit-and-loss statement, of the applicant's business and the business of the guarantors;
- F) Either copies of the applicant's federal income tax returns or the audited financial statements for the three tax years preceding the tax year in which the application is made;
- G) Copies of the earnest money receipt and agreement, option to purchase, contract to purchase, or invoice for the purchase of land, land and improvements, or tangible personal property related to the project;
- H) Copy of a lease for land or improvements to the project;
- I) Preliminary plans and specifications for construction of the project and a detailed description of real or tangible personal property to be acquired for the project;
- J) A detailed construction cost estimates;
- K) Fair market value appraisal of any real or personal property being used to secure the loan;
- L) Copies of leases or agreements;
- M) A financial feasibility analysis;
- N) An environmental risk assessment; and
- O) Any other information necessary to evaluate the application.

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Accelerated Amortization Program/Incentive

Purpose: AIDEA's accelerated amortization program, established in 1991, is an incentive for loan originators to provide financing for long-term loans which may not have been financed under previous regulations.

Scope: Under AIDEA's accelerated amortization program, borrowers may be able to obtain long-term financing through financial institutions for manufacturing facilities, real estate and equipment under the following AIDEA financing programs;

- Tax Exempt Program
- Taxable Program

How It Works: On a case-by-case basis, AIDEA may allow the loan originator to amortize its portion of the loan using an accelerated amortization schedule if the project can support the increased debt service and if the shortened amortization schedule is necessary for originator participation.

Term: The originator's term must be at least half of AIDEA's amortization term or 10 years, whichever ever is less*. In example:

AIDEA: 25 years
AIDEA: 22 years
AIDEA: 15 years

Originator: 10 years
Originator: 10 years
Originator: 7.5 years

Once the originator has completely amortized their portion of the loan, the originator's portion of the payment is applied to the principal remaining on AIDEA's portion of the loan, thereby reducing AIDEA's amortization schedule.

Loans secured by real property may not exceed 25 years or 75% of the estimated economic life of the property, whichever is less. Loans secured by tangible personal property may not exceed 15 years or 75% of the estimated life of the property whichever is less.

.....

*Accelerated amortization schedule may be revised whereby the originator's term is half of AIDEA's term in all cases.



Business Assistance Program Summary

A Guarantee Program for:

- 1) New loans;
- 2) Refinance of existing loans.

Funds guaranteed:

Outstanding principal balance and liquidation expenses.

Amount of Guarantee:

Not to exceed \$1,000,000. cumulative

•Percentages:

- 1) 60% to refinance a loan currently held by the financial institution originating the loan;
- 2) 80% of other loans.

Application Types:

A) Short Form Application - New loans of \$75,000 or less*.

- 1) Loan summary including bank's loan approval form;
- 2) Bank certification that credit has been checked and is satisfactory.

B) Regular Form Application - All loans over \$75,000.

- 1) Loan summary including bank's approval form;
- 2) Signed loan application;
- 3) Financial statement (current within 90 days);
- 4) Project description/use of proceeds detail;
- 5) Credit history;
- 6) Three years tax returns;
- 7) Appraisal;
- 8) Environmental risk assessment;
- 9) Refinance - existing loan facts.

Loan Requirements:

- A)
 - 1) First lien - real estate, tangible personal property, inventory and/or accounts receivable;
 - 2) Unsecured Waiver - a loan guarantee of \$75,000 or less, five years term or less, may be granted a collateral waiver at the Authority's discretion.
- B) 75% loan to value (LTV) maximum.

C) Term:

- 1) One year if secured only by inventory and/or accounts receivable;
- 2) Five year maximum if working capital and/or unsecured by special waiver;
- 3) Fifteen years maximum if secured by tangible personal property;
- 4) Twenty year maximum if secured by real estate.

D) Alaskan resident majority ownership required.

E) Maximum interest rate allowed is Prime plus 2 3/4% fully floating.

F) Fees:

- 1) \$200 application fee;
- 2) 2% Guarantee fee.

*This streamlined approval process may be unsecured. These loans are available to all Alaska businesses but targeted especially to assist entrepreneurs in rural areas.



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Export Assistance Program

Effective June 1987, the Alaska Industrial Development and Export Authority (AIDEA) abilities were expanded to include a financing program to encourage and expand the exports of Alaskan goods, services and raw materials. It was the Legislature's intent to help relieve problems of unemployment and to create additional employment opportunities within Alaska through implementation of an export assistance program.

Export Assistance Program:

The Authority's Export Assistance program is designed to facilitate financing, if needed, for the export of Alaskan goods, services and raw materials by guaranteeing loans made for eligible export transactions. The guarantee program is intended to function through Alaskan financial institutions and to encourage those institutions to extend export financing to small and medium-sized Alaskan businesses involved in export trade. By doing so, the Authority may help maintain and/or create employment and expand business opportunities for Alaskans.

In addition, the Authority works with federal and other state agencies to provide financial and technical assistance to Alaskan exporters.

Pre-shipment Export Guarantee applies when financing is required prior to shipment of the related goods. The guarantee applies up to 90% of each eligible transaction or \$1 million, whichever is less, provided that the Foreign Credit Insurance Association (FCIA) or another insurer covers the post-shipment credit risk on the transaction and has made its own inspection to determine that the exporter is viable (evidenced by issuance of a short term policy which is valid throughout the requested guarantee period). Alternatively, the related export may be covered by a letter of credit confirmed by a U.S. bank or issued by a first-class bank in an acceptable country. AIDEA's Pre-shipment Export Guarantee does not cover any of the risks assumed by the FCIA, does not cover other risks of non-payment of financing extended by the financial institution caused by the exporter's liability to the Authority, the Authority will look to the exporter for repayment of amounts paid to the financing institution. The financing institution is required to take collateral equal in value to the guaranteed loan and to share that collateral pro rata with the Authority in the event of claim payment. In brief:

- good for 270 days;
- P & I guaranteed;
- 90-day extension may be applied for (covers only P);
- guarantee fee is 1% of the guaranteed amount;

- **guarantee** covers 90% of loan or up to 1 million, whichever is less;
- **security** real or tangible personal property or other security deemed appropriate by the Authority; and
- **interest** - lesser of the rate charged under the promissory note or two and three quarters percentage points above the prime rate of interest as reported in the Wall Street Journal.

Post-Shipment Export Guarantee, covers, after shipment of the related goods, up to 90% of each eligible export transaction or \$1 million whichever is less, provided that FCIA or an other insurer covers the foreign buyer risks on the transaction and has made its own investigation to determine that the exporter is viable or that the transaction is covered by a letter of credit. The Authority's post-shipment export guarantee provides short-term coverage. It covers risks of non-payment after shipment caused by the exporter's inability or unwillingness to perform according to the export contract. It does not cover any of the risks assumed by FCIA or the other insurer, In brief:

- good for 180 days;
- P & I guaranteed;
- guarantee fee is 1% of the guaranteed amount;
- 90-day extensions may be applied for (extensions cover only P);
- guarantee cover 90% of loan up to \$1 millionm whichever is less;
- security - real or tangible personal property or other security deemed appropriate by the Authority; and
- interest - lesser of the rate charged under the promissory note or 1% over the U.S. Treasury note rate.

Eligible Exports: AS 44.88.310 defines an eligible export transaction as one which, in the judgment of the Authority, will create or maintain employment in the state and which is 25% or more Alaskan value-added. specifically, an eligible export transaction promotes the sale abroad of raw materials extracted in the state, goods whose final state of production occurs in the state, and the rendering of service abroad by a business located in Alaska, or a combination of the above.

Eligible Exporter: An eligible exporter is one whose place of business is domiciled in Alaska, services rendered abroad are of an Alaskan based business, or whose goods are produced in Alaska.



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Development Finance Program

AIDEA can assist Alaskans through its ability to develop, own and operate basic installations and facilities within the state, especially those which advance the prosperity of a region. Roads, ports, airports, utilities, infrastructure for tourism destinations facilities or other public use facilities which are essential for the economic well being of an area and are able to produce adequate revenues to repay the bonds sold to finance the project are considered eligible projects. Specifically:

- **Project Eligibility**

Detailed information regarding the scope and characteristics of the project is submitted to the Authority for review. Staff and legal counsel determine whether or not the project is eligible and satisfies the development criteria for AIDEA participation and if the project can meet tax-exempt financing status under the U.S. Treasury Code. AIDEA statutes define a project as: 1) a plant or facility used or intended for use in connection with making processing, preparing, transporting, or producing in any manner, goods, products, or substances of any kind or nature or in connection with developing or utilizing a natural resource, or extracting, smelting, transporting, converting, assembling, or producing in any manner, minerals, raw material, chemicals, compounds, alloys, fibers, commodities and materials, product, or substances of any kind; 2) a plant or facility demonstrating technological advances of new methods and procedures and prototype, commercial applications for the exploration, development, production, transportation, conversion, and use of energy resources; and 3) infrastructure for a new tourism destination facility or the expansion of a tourism destination facility.

The following are the most relevant criteria for obtaining the Authority's participation in the project:

1. The project and its development under AS 44.88 must prove to be economically advantageous to the state and to the general public welfare and must contribute to the economic growth of the state;
2. The project applicant is financially responsible;
3. The project is economically and financially feasible and able to produce revenue adequate to repay the bonds or loans with which it is financed;
4. Increased demand on public facilities that might result from the project will be provided for;

5. The project will provide or retain employment reasonably related to the amount of the financing by the Authority, considering the amount of investment per employee for comparable facilities, and other relevant factors;
6. The scope of the project is sufficient to provide a reasonable expectation of the benefit to the economy of the state;
7. The project is in compliance with applicable law; and
8. Issuance of the bonds is not expected to affect adversely the ability of the state or any political subdivision of the state to market other bonds.

The Alaska State Legislature must approve all projects over \$10 million.

- **Project Financing Plan and Features**

The Authority will undertake its own economic analysis and financing plan for the project (third party review). The cost of the analysis may be included in the total cost of the project to be repaid through user fees. The study includes not only development cost estimates, but also maintenance and operation cost projections, market analysis and a table detailing sources and uses of funds.

The third party economic analysis and financing plan must include an estimate of the total cost of the project and a description of the sources of money that will be used to finance the project. The finance plan must also include an estimate of the operational costs of the completed project, as well as a description of the source of the money that is to be used to pay the operational and maintenance costs.

In addition to these requirements, the Authority's Board of Directors has directed staff to give preference to projects that do not require financial assistance above and beyond the collective benefits that the project is capable of producing.

Various components that might be included in this type of benefit calculation include:

- Annual taxes paid to state and local government;
- Value added from in-state construction
 - Construction employment
 - Alaska Fabricated Components;
- Annual operating payroll
- Consequential benefits
 - Other related payroll
 - Other in-state goods and services

While the components listed are not intended to be all inclusive, they are intended to illustrate the types of benefit calculations that staff will perform when negotiating its return on investment. There is a floor, of course, below which AIDEA cannot go: our cost of money plus a minimum fee for the use of our credit rating, capital reserve funds and financing ability.

- **Land and Title Interest of Facility**

The Authority would require the project sponsor to provide AIDEA with clear title or lease to the portion of land on which AIDEA's portion of the project would be developed. This would be a condition of the agreement so long as debt was outstanding. Once the debt is retired, title could revert back to the project sponsor at fair market value, unless reversion is prohibited by the financing mechanism used. Bond counsel will evaluate this issue.

The project sponsor should be prepared to provide information on land ownership, acquisition costs, if any, and environmental baselining information available.

- **Development and Construction Contract Issues**

The project sponsor should provide the Authority with a written engineering report outlining the current status of design and permitting activities.

In addition, a detailed milestone chart or CPM schedule outlining the development sequence of events (up to the in-service date) should be provided along with any preliminary engineering drawings and a definitive cost estimate.

The parties will need to determine the roles and assignment of design and construction responsibilities best suited for undertaking a joint approach for project development. Decisions resulting from these discussions will determine what contracting and procurement methods will be employed. It could well be that the Authority's only active role in the project would be financing, and oversight leaving all other development responsibilities to the project sponsors.

In all likelihood the project, if developed under the Authority's Development Finance Program, would be classified as a "public works project" thereby requiring that Davis-Bacon Wages be paid during the construction phase.

- **Maintenance and Operations Responsibilities**

Under any scenario to be considered by the Authority, it would be AIDEA's intention to assign maintenance and operating responsibilities back to the project sponsor.

Since the Development Finance program's inception in 1986, AIDEA has ownership of five projects ranging from the DeLong Mountain Transportation System (road and port at the Red Dog Mine near Kotzebue) to the Skagway Ore Terminal, Unalaska Marine Center Dock, Federal Express Aircraft Maintenance Facility and the Healy Clean Coal Project, currently under construction. The Authority continues to assess the economic benefit and feasibility of many other projects.

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AIDEA Development Projects

(In Operation, Construction, or Design)

<i>Project</i>	<i>Location</i>	<i>Bonded Amount</i>	<i>Status</i>
DeLong Mountain Transportation System and Port Expansion	Kotzebue	\$103 million (original)	Complete. 350 jobs created.
		\$60 million (expansion); legislative bonding authorization pending.	Planning and design underway.
Skagway Ore Terminal	Skagway	\$25 million	Project is complete and in operation. Year round jobs supported by the facility.
Ballyhoo Dock Expansion	Unalaska	\$7 million	Complete and in operation.
Federal Express Aircraft Maintenance Facility	Anchorage	\$28 million	Complete and in operation.
Healy Clean Coal Project	Healy	\$85 million (total project cost \$267 million)	Under construction. Approximately 200 construction jobs created. Project will be complete in 1998 creating 35 permanent jobs.
Alaska Seafood Center	Anchorage	\$50 million (authorized)	Awaiting additional private sector financing.
Kodiak Launch Facility	Kodiak	\$20 million (authorized)	Planning.
Snettisham Hydroelectric Project	Near Juneau	\$100 million (legislative authorization pending)	Congressional approval to transfer the project provided. Tax exemption pending.
Craig Industrial Marine Facility	Craig		In discussion with City of Craig. City has obtained necessary permits for construction.

House Labor & Commerce Committee

State Capitol
Juneau, Alaska 99801-1182
907-465-4954

CS HB 526 (L&C) SPONSOR STATEMENT

The Alaska Industrial Development Authority (AIDEA) was created to promote employment in Alaska through a variety of tools. Among others, these tools consist of the Development Assistance Program, the Loan Participation Program, and the Business Assistance program. Properly utilized, these mechanisms have the potential of having a positive impact on the economy of Alaska. For instance, AIDEA's involvement with the DeLong Mountain Transportation System and Port Expansion has yielded 350 full time jobs in the Kotzebue area.

Changes in economic, legal, and financial conditions have made it desirable to examine several statutory provisions pertaining to AIDEA. CS HB 526 (L&C) addresses a variety of issues presented by those changed conditions.

CS FOR HOUSE BILL NO. 526(L&C)
SECTIONAL ANALYSIS
(9-LS1549C)

Section 1- Limited Procurement Exemption.

Section 1 creates a procurement exemption for AIDEA contracts related to integrated transportation and port facilities owned by the Authority. This procurement exemption is intended to apply to DeLong Mountain Transportation System (DMTS) contracts of the Authority, therefore eliminating the need for any sole source waivers.

Background. Procurement exemptions or waivers are generally required for AIDEA development finance projects. Under AIDEA's development finance program, AIDEA must own and operate the projects. AIDEA contracts with the principal user of each project and that user becomes responsible for all the project costs. In order to maintain this legal relationship, it is desirable for AIDEA to contract with the principal user to act as AIDEA's agent for the completion of the construction and other project work. To accomplish this, a procurement exemption or a sole source waiver is generally required.

Currently, two specific procurement code exemptions apply to AIDEA contracts. First, AS 36.30.850(b)(8) creates an exemption for acquisition of property and other contracts relating to airports under AS 44.88. This exemption applies to, among other things, AIDEA contracts related to the Federal Express hangar at Anchorage International Airport. The second existing procurement exemption (AS 36.30.850(b)(22)) relates to AIDEA contracts for a clean coal technology demonstration project and currently applies only to the Healy Clean Coal Project.

AIDEA has adopted Procurement Plans and Procedures covering all of AIDEA procurements including those covered by procurement exemptions. Under the Procedures, AIDEA requires competition that is practical under the circumstances, and Alaska hire. It should be noted that, since adoption of the AIDEA Procurement Plan, Legislative Budget and Audit has undertaken several AIDEA procurement audits and has never found procurement discrepancies.

Section 2- AIDEA Bonding Authority

Section 2 of the bill relates to AIDEA's ability to issue bonds. Currently, AIDEA may not issue bonds, except refunding bonds, without the approval of the legislature. Section 2 of the bill restores AIDEA's ability to issue bonds without legislative authorization if the principal amount of the bonds is \$10,000,000 or less. For bonds greater than \$10,000,000 the bill would require legislative approval if the bonds "would affect the credit of the authority." The meaning of this last phrase is unclear as all bonds (with the possible exception of conduit revenue bonds) have impact on AIDEA's credit.

Background. On July 1, 1985, a delayed amendment to AIDEA's statutes took effect which removed AIDEA's authority to issue bonds other than refunding bonds. The current bonding limitation prevents AIDEA from issuing any bonds (other than refunding bonds) and curtails AIDEA's ability to fulfill its statutory mission. Most recently, AIDEA was unable to issue conduit revenue bonds to support the development of the Fort Knox mine. Although the bonds would not have obligated AIDEA's assets, current law prevented the issuance.

Sections 3-5- Technical Changes

Sections 3 through 5 make technical changes to AIDEA statutes covering AIDEA's loan participation program. Specifically, AS 44.88.159(a), (b), and (e) are each amended to clarify that AIDEA purchases participations in loans from financial institutions under its loan participation program, and does not finance loans directly.

Section 6- Technical Change Regarding Annual Reporting

Section 6 of the bill amends AS 44.88.205(b) to clarify that the members of the Authority are not required to take formal action to make available the annual financial report to the legislature. AS 44.88.205(b) requires that a report regarding the finances of the Authority be made available to the legislature by January 10th of each year. Because it is not always possible for the AIDEA board to meet to adopt the report prior to the statutory deadline, historically it has fallen on the executive director of the Authority to certify the report and make it available to the legislature. The technical correction in section 6 clarifies the statute to allow this practice to continue.

Sections 7-13 - Modifications To Business Assistance Loan Guarantee Program.

The bill amends AIDEA's business assistance loan guarantee program to make it more effective in light of the recent changes to the federal Small Business Administration loan guarantee program.

Background. Historically AIDEA's business assistance program has not been widely used by the Alaska business community. Until recently, the federal Small Business Administration (SBA) has offered a loan guarantee program which was preferred by both borrowers and lenders. In fiscal year 1995, the SBA Alaska office issued \$49 million dollars in loan guarantees. The SBA recently made changes to its program that reduce the percentage of a loan that may be guaranteed and significantly increase the cost of these guarantees. The Alaska banking community has indicated to AIDEA that the changes made to the SBA program have left a significant financing void for Alaska small businesses. The modifications made to AIDEA's business assistance program under the bill will create additional financing alternatives for Alaska businesses to help fill the void.

Section 7- Amends AS 44.88.500(a) to eliminate AIDEA's business assistance fund. Under current law, AIDEA's business assistance program is conducted

through a separate fund and the beneficiaries of guarantees may only seek recourse against the assets of the fund. The proposed change will allow the authority to issue guarantees from its general assets. The total amount of guarantees that may be issued by AIDEA remains limited to \$50,000,000 under AS 44.88.540. Additionally, section 7 makes minor technical amendments.

Section 8- Makes a minor technical change to AS 44.88.530 to clarify the provision.

Section 9- Amends AS 44.88.535 to make several technical and program changes to the business assistance program.

Under current law, AIDEA may waive collateral for loan guarantees of \$75,000 or less if the loan has an amortization period of 5 years or less. The bill would modify existing law to allow AIDEA to waive collateral for loan guarantees of \$100,000 or less under the same circumstances.

Under current law, loan guarantees may only be made to businesses in which a majority interest is held by Alaska residents. AIDEA is prevented from issuing loan guarantees if a business is not majority Alaska owned, even if the proceeds of the loan will benefit a business conducted in Alaska. The bill would allow AIDEA to issue loan guarantees if the proceeds of the loan will benefit a business conducted in Alaska.

Under current law, AIDEA may not guarantee interest under the business assistance program. Limited interest guarantees (up to 90 days interest) were a principal ingredient of the Small Business Administration program. The bill would allow AIDEA to guarantee interest for a period of the time and in the manner to be established by regulation.

This section of the bill also makes minor technical clarifying amendments to AS 44.88.535.