

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672
1591 SCOMM 59: JNT. COMMITTEE ON ECONOMIC RECOVERY, 1988

1388

population and we do start having growth again, there will be real estate developers who have learned a lot of good lessons from all of this and they're going to go out and they're going to build better product to compete, unless Dave Rose's suggestion happens that there's a building moratorium, which I will fight to my dying day. But this bad product is going to remain bad product, because when the economy turns around and we have population and we have jobs again, there will be more opportunities for growth and those properties are just going to fall by the wayside because they were functionally obsolete properties to begin with. Whether they're new or not is immaterial. Yes, I agree with that.

MALONE: So, in other words, one of the big scares that people hold up saying, well, if this outfit or the FDIC or somebody else dives in and dumps everything on the market, they're just going to submerge the Anchorage real estate market. What they're probably going to do is find out there either aren't any buyers or, if there are buyers, they're going to be very low prices, but that the better quality properties - the ones that people want -- are not going to be greatly affected by that one way or the other.

YOSHIMURA: The better quality properties are full. They have a low vacancy factor. You may not have the rental income that you'd like from those properties, but they're full. They don't have that bad a vacancy factor.

Anyway, those are my comments and I appreciate the opportunity to speak before you.

MALLOTT: Good. Thank you very much.



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Residential Homes For Sale By Price Range Multiple Listing Service

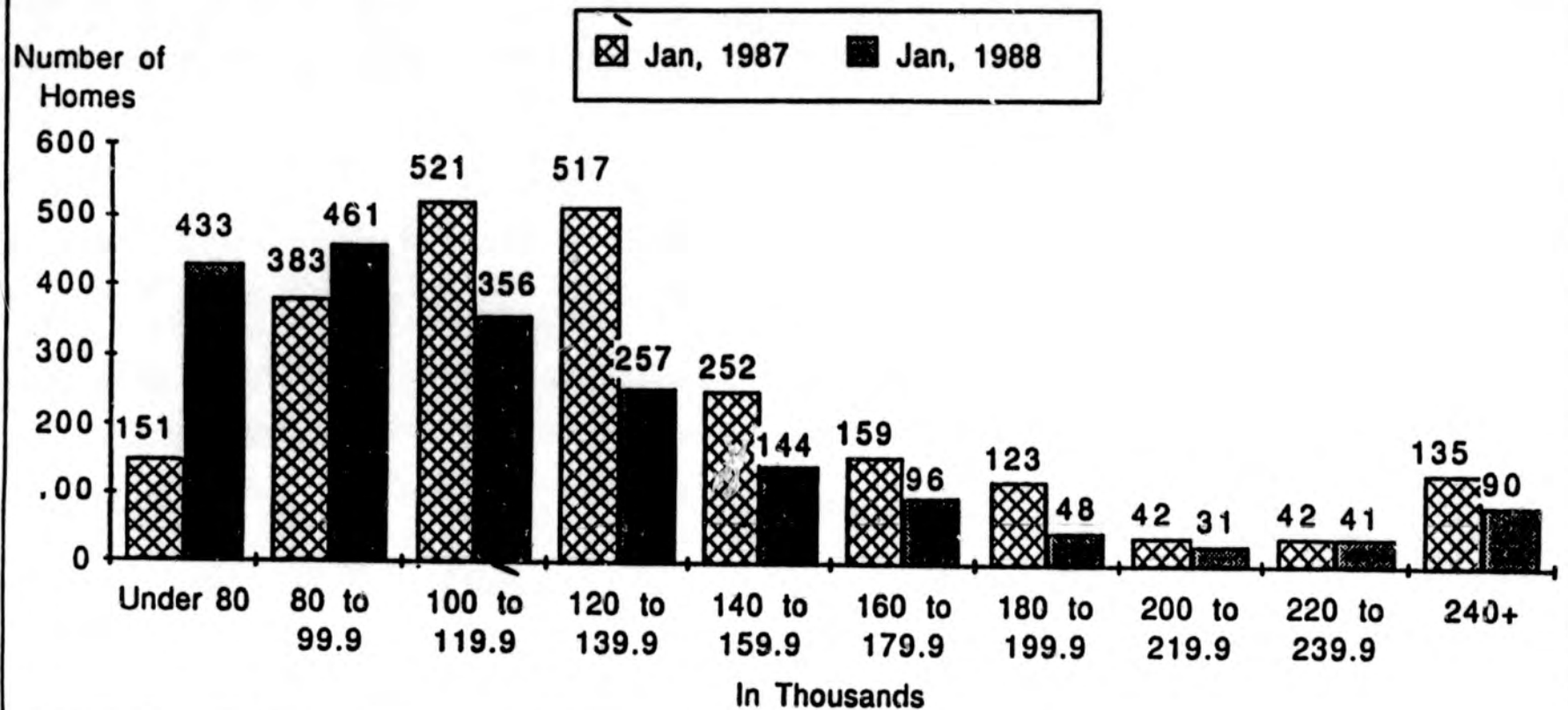


Chart Preparation: FORTUNE PROPERTIES, INC.

Condominium Active Units For Sale By Price Range Multiple Listing Service

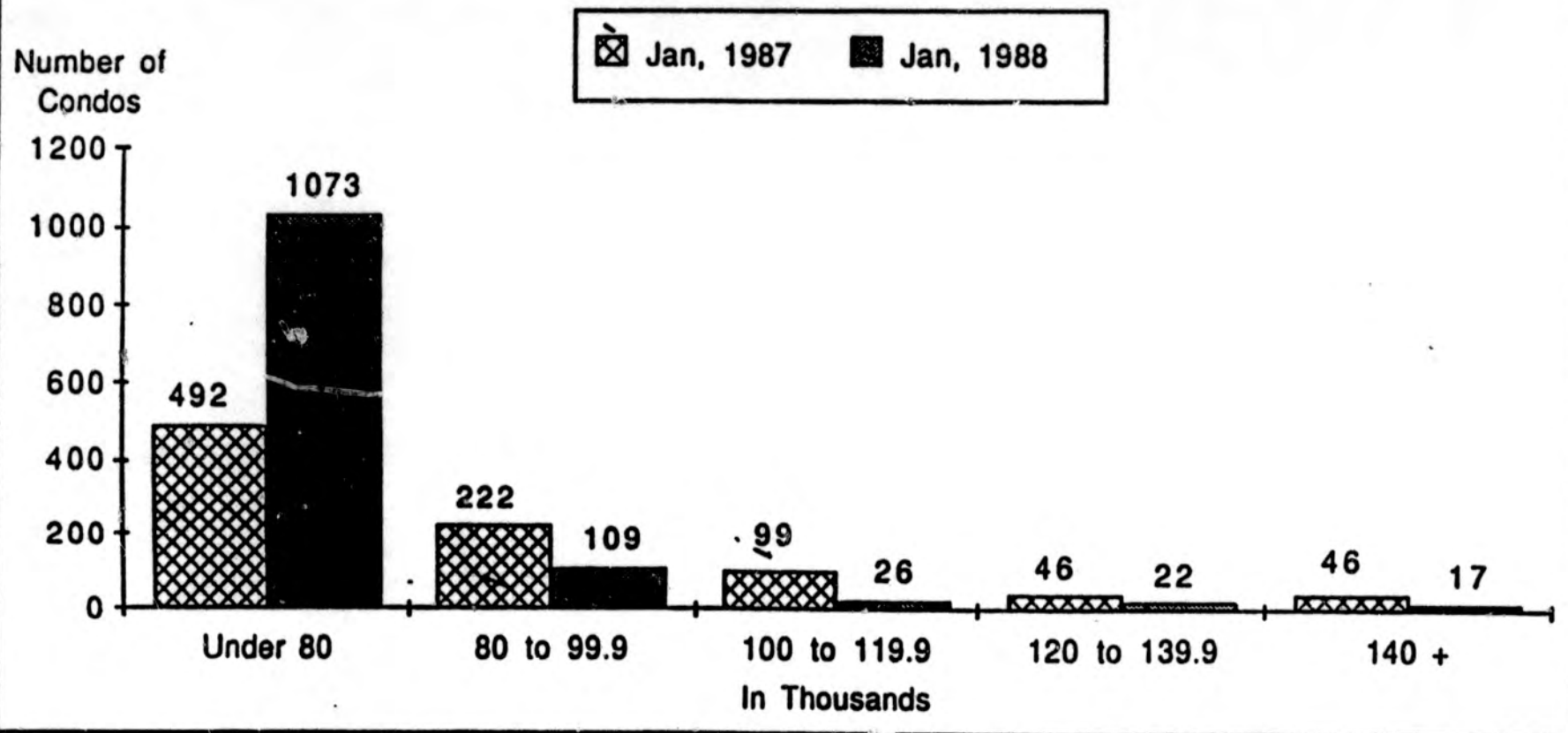
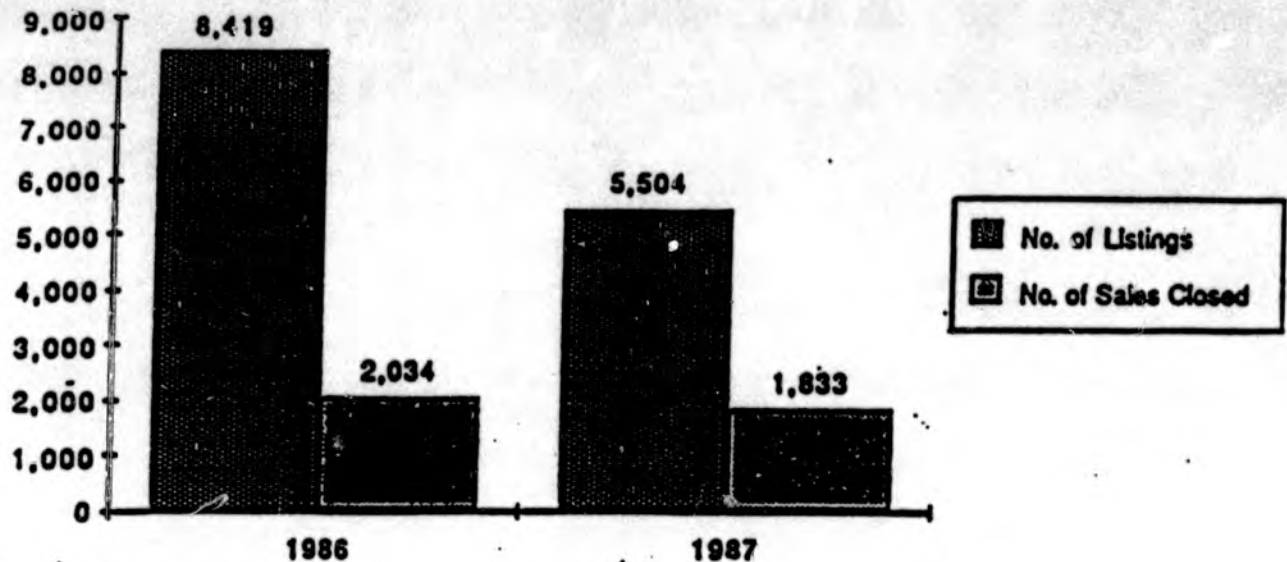


Chart preparation by: FORTUNE PROPERTIES

Residential Inventory and Sales 1986 vs. 1987



35% decline in inventory vs. only a 10% drop in sales units.

Source: Multiple Listing Statistical Year End 1987

COMMENTS:

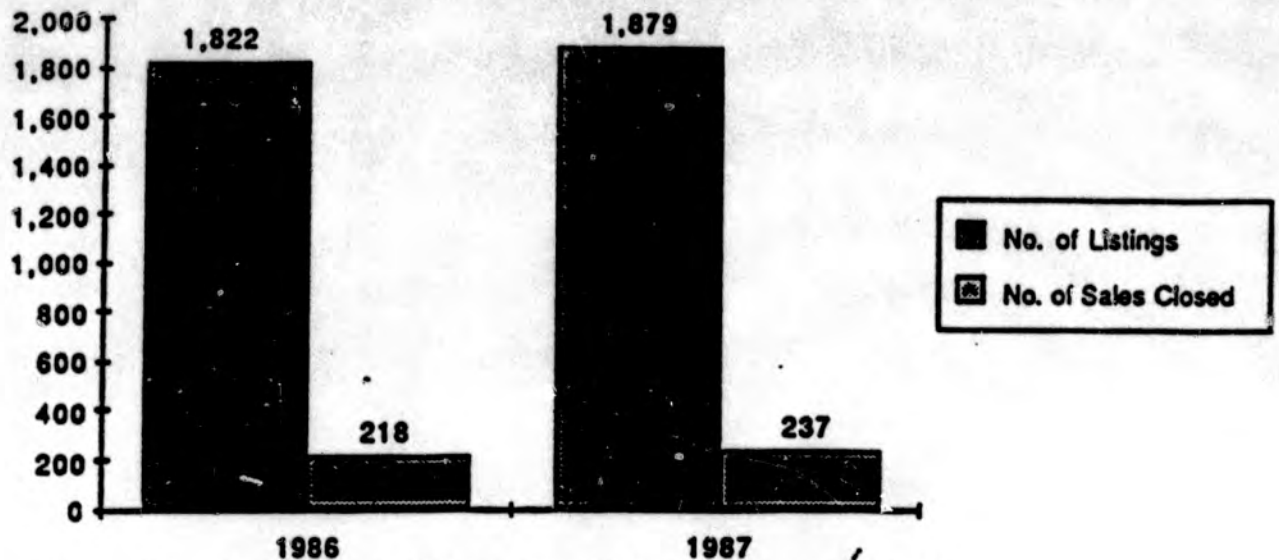
If there is any good news in the Anchorage real estate market, it is the fact that residential inventory (classified as single family and zero lot line properties) had a significant 35% drop in number of units available.

This figure is particularly significant in the fact that sales, measured by unit count, and not dollar value, declined by only 10%. This indicates a fairly healthy absorption of property in Anchorage.

There is no problem selling property in Anchorage according to these statistics. The only problem is in the value that is obtained for residential properties. This value, however, has indicated considerable stability and it is anticipated that little, if any, further decline will take place in value for single family and zero lot lines.

This market, if left alone, will continue its absorption. There is no recommended action for the single family and zero lot line market. Given all the economic circumstances of the times, it is functioning well.

Condominium Inventory and Sales 1986 vs. 1987



Inventory Increased 4%; Sales Volume Increased 9%

Source: Multiple Listing Service Year-End Statistics

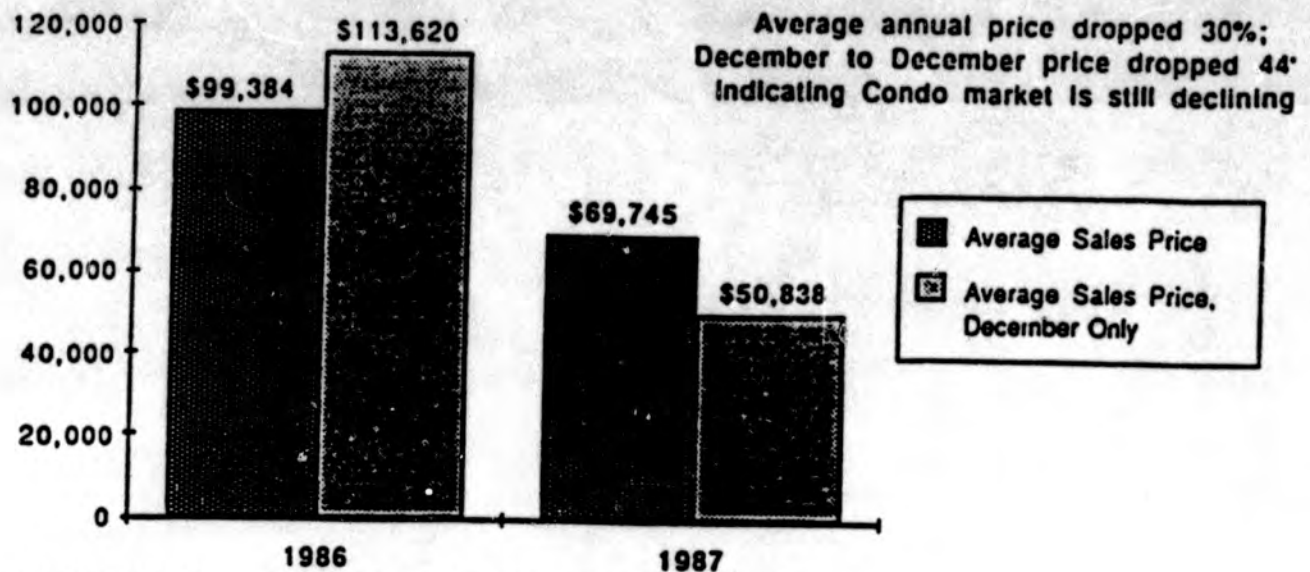
COMMENTS:

From the above chart, it is obvious that the condominium market is virtually stagnant. Neither inventory nor sales have increased or decreased a significant amount.

It is an interesting note, however, which is not on the graph that closed sales for the month of December 1987 was exactly double that of 1986, or 34 compared to 17. Doubling the number of closed condominium sales is admirable, which was accomplished primarily through the marketing efforts of MGIC, but it does not address the basic problem of oversupply. Other action must be considered.

At the current absorption rate, assuming no new inventory, there is a nine year supply of condos within the Municipality of Anchorage.

Condominium Sales Prices 1986 vs. 1987



**Additional Information: 17 Condo Closed Sales In 1986;
34 Closed Condo Sales In 1987**

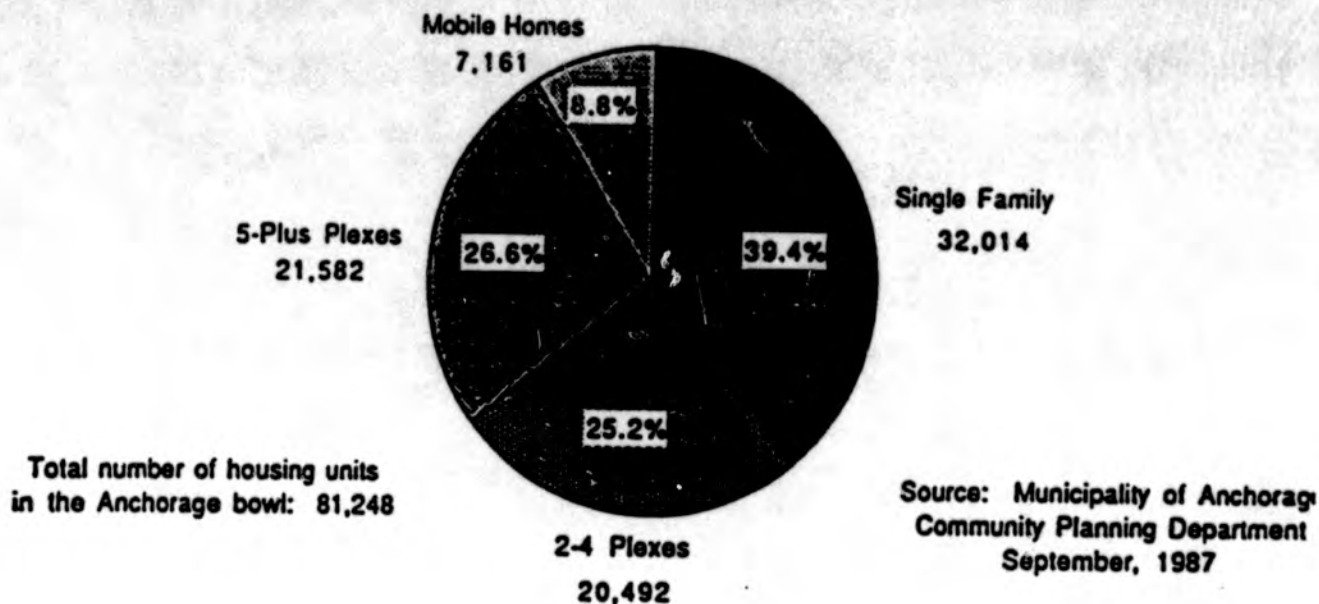
Source: Multiple Listing Service Year-End Statistics

COMMENTS:

By comparing December 1986 to December 1987, it is obvious that the condominium market is still in its downward spiral. The year end statistics show a drop of 30% in value from 1986. However, the December comparison shows that the drop is 44%. Since the December statistic is not averaged and is the most current, it is obvious that the present value is 44% of last year's value and not the 30%.

There is no reason to think with the oversupply that exists that all condominiums will not continue to decline in value unless steps are taken to take properties off the market, either through warehousing or rentals.

1987 Population and Housing Unit Statistics Housing Unit Types

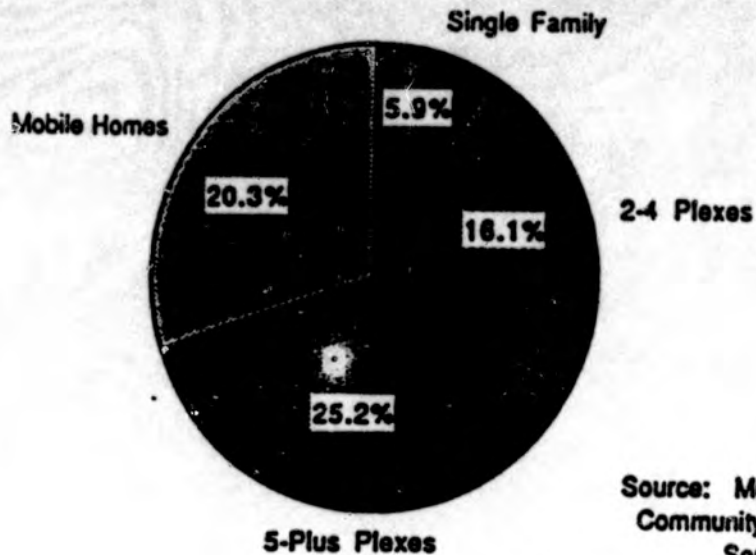


COMMENTS:

Nobody knows for sure how many condominiums there actually are in Anchorage, Alaska. The reason for this is that the Municipality of Anchorage counts housing units by physical building type. This means that condominiums fall within the 2-4 plex category, if they are in a building of that size or in the 5-plus category if located in a larger structure. The majority of condominiums fall within the 5-plus structures.

AHFC has over 7,000 condominium loans, the vast majority of which are in Anchorage. Condominiums could probably best be counted by taking a survey of investors because most condominiums were financed at the time of purchase.

1987 Population and Housing Unit Statistics Census Vacancy Rates—Anchorage Bowl



Source: Municipality of Anchorage
Community Planning Department
September, 1987

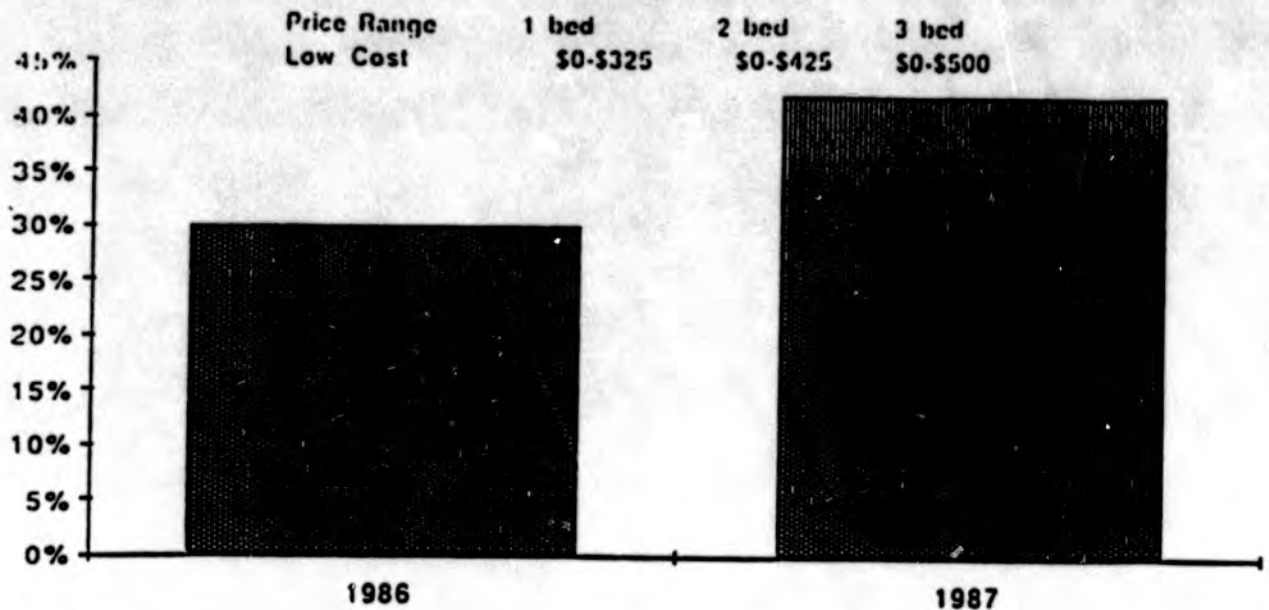
COMMENTS:

This pie-chart shows a 25% vacancy in the 5-plus category, which demonstrates that renters prefer to live in as low a density as possible.

This chart measures physically vacant properties which were inspected by the Municipality during the second quarter of 1987. As you can see, it indicates all product type.

The overall vacancy for the Anchorage bowl is 14.9% taking into consideration all product type. The chart breaks down this overall vacancy into percent of product type.

Fourth Quarter Low Cost Apartment Vacancy Rates 1986 vs. 1987



There has been a 40% Increase in low cost apartment vacancies.

Source: Shorett and Riely Appraisers, Ken Kincaid

COMMENTS:

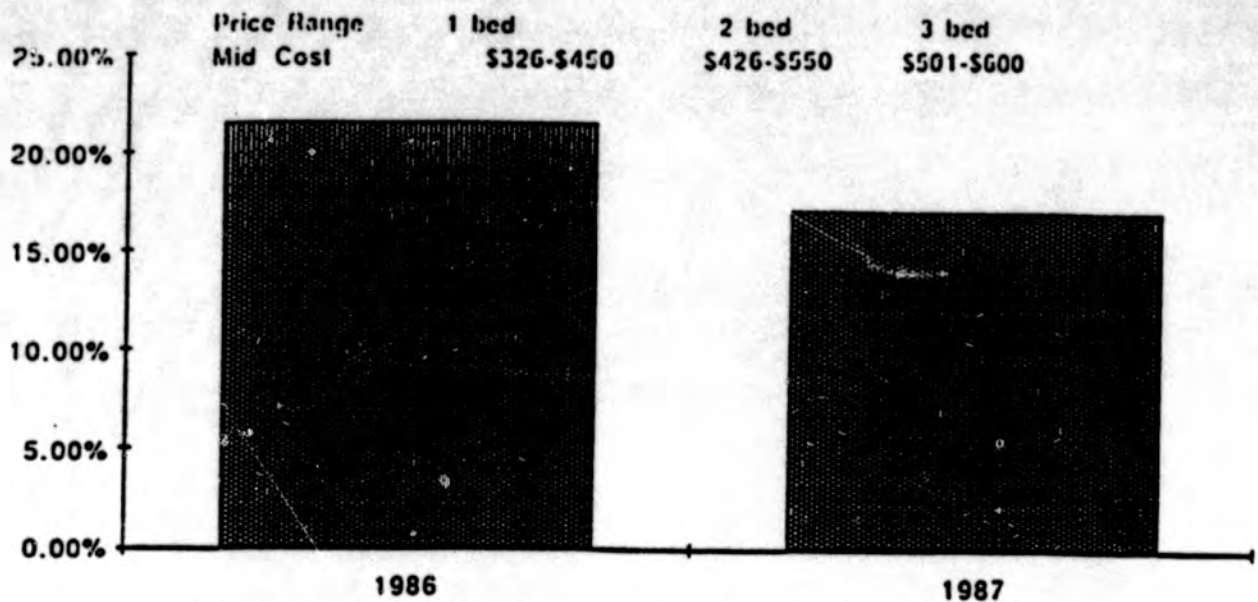
The most revealing statistic from the 5,000 unit survey completed by Shorett and Riely was the fact that there had been an increase of 40% in the vacancy of low cost apartments.

This substantiates a flight to quality that is being taken advantage of by savvy renters, as well as upgrading home buyers. There are certain areas of Anchorage which, without extensive urban renewal projects, are not going to be repopulated for many years. These areas include Mt. View, parts of Spenard, some pocket areas of the Eastside, as well as areas in Muldoon.

The apartment projects in these areas are functionally and cosmetically obsolete and with loss of rental income are in dire need of maintenance and repair which the owners cannot afford to make at this time. Many of these properties should probably be torn down. Even the newer four-plexes, etc., which were built in these areas suffer from higher vacancy factors.

There is a definite flight to the southside of Anchorage. Although Anchorage lost 10% of its population in the past two years, the southside of Anchorage, defined as being south of Tudor Road, has had an increase in population. In fact, the elementary schools on the southside of town, such as Rabbit Creek, O'Malley, Huffman, and Spring Hills are considered to be overcrowded, and there has been purchase of a new elementary school site off Huffman Road.

Fourth Quarter Mid Cost Apartment Vacancy Rates 1986 vs. 1987



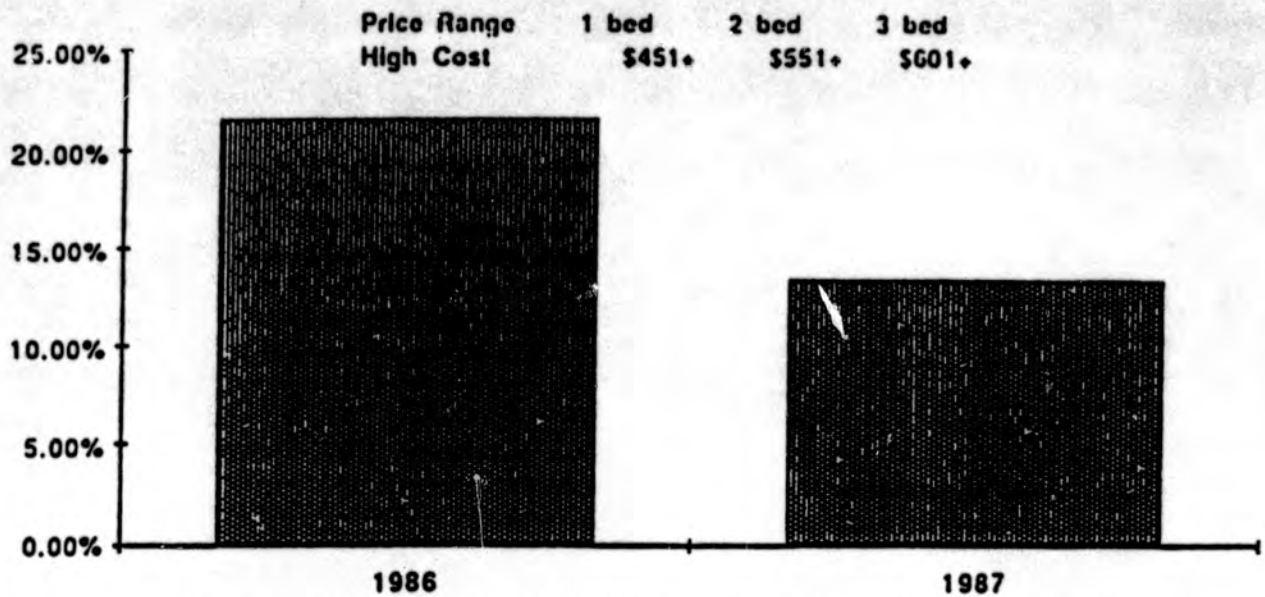
There has been a 21% decrease in mid cost apartment vacancies.

Source: Shorett & Riely, Real Estate Appraisers

COMMENTS:

Although there has been a substantial decrease in mid-cost apartment vacancies, it is important to note that these apartments were probably at one point in time considered high cost. In other words, just as vacancies have declined in this price range so as the rental rate. This is the flight to quality in rentals previously commented upon.

Fourth Quarter High Cost Apartment Vacancy Rates 1986 vs. 1987



There has been a 37% decrease in high cost apartment vacancies.

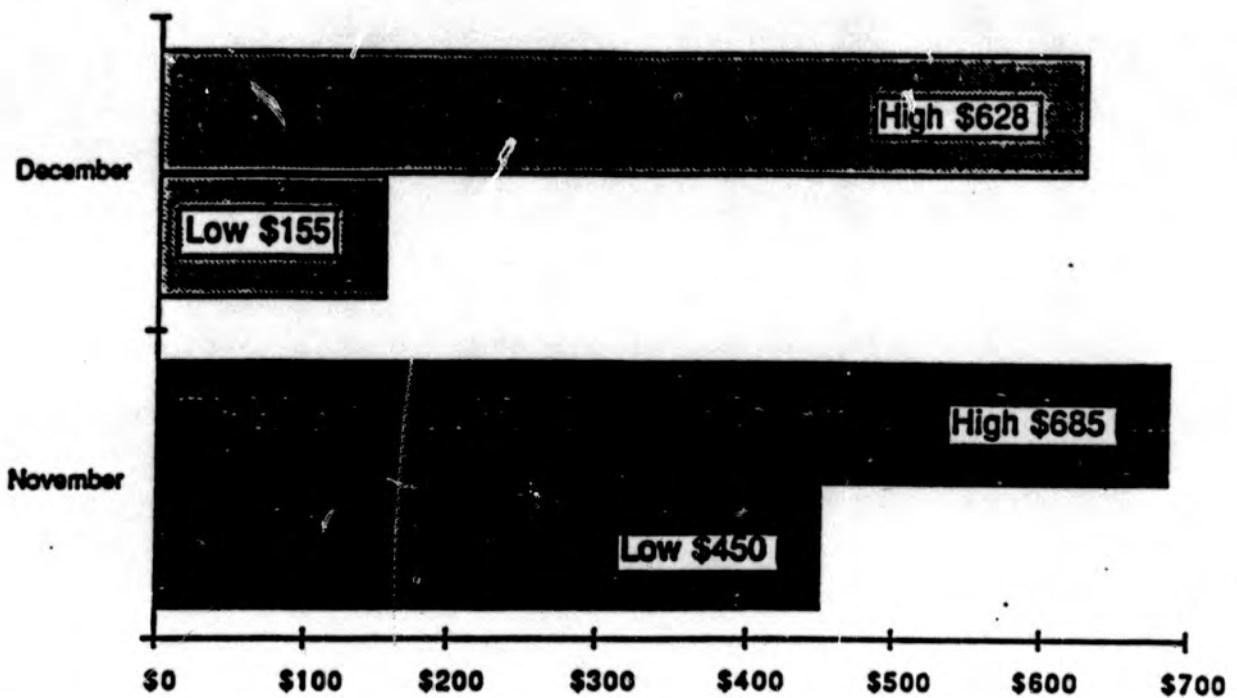
Source: Shorett & Riely, Real Estate Appraisers

COMMENTS:

The decrease in vacancies for pricey apartments is signification. Again, however, it must be pointed out that this decrease in vacancy is a result of only lower rents being charged for these apartments.

These charts point out, however, that the trend to quality is overwhelming and that there is probably no market force great enough to deter it except more population.

**Analysis of Rental Rates for 2 Bedroom Condos
As Advertised in the Anchorage Daily News and Anchorage Times
November, 1987 vs. December, 1987**



Information Provided by Kay E. Eliason

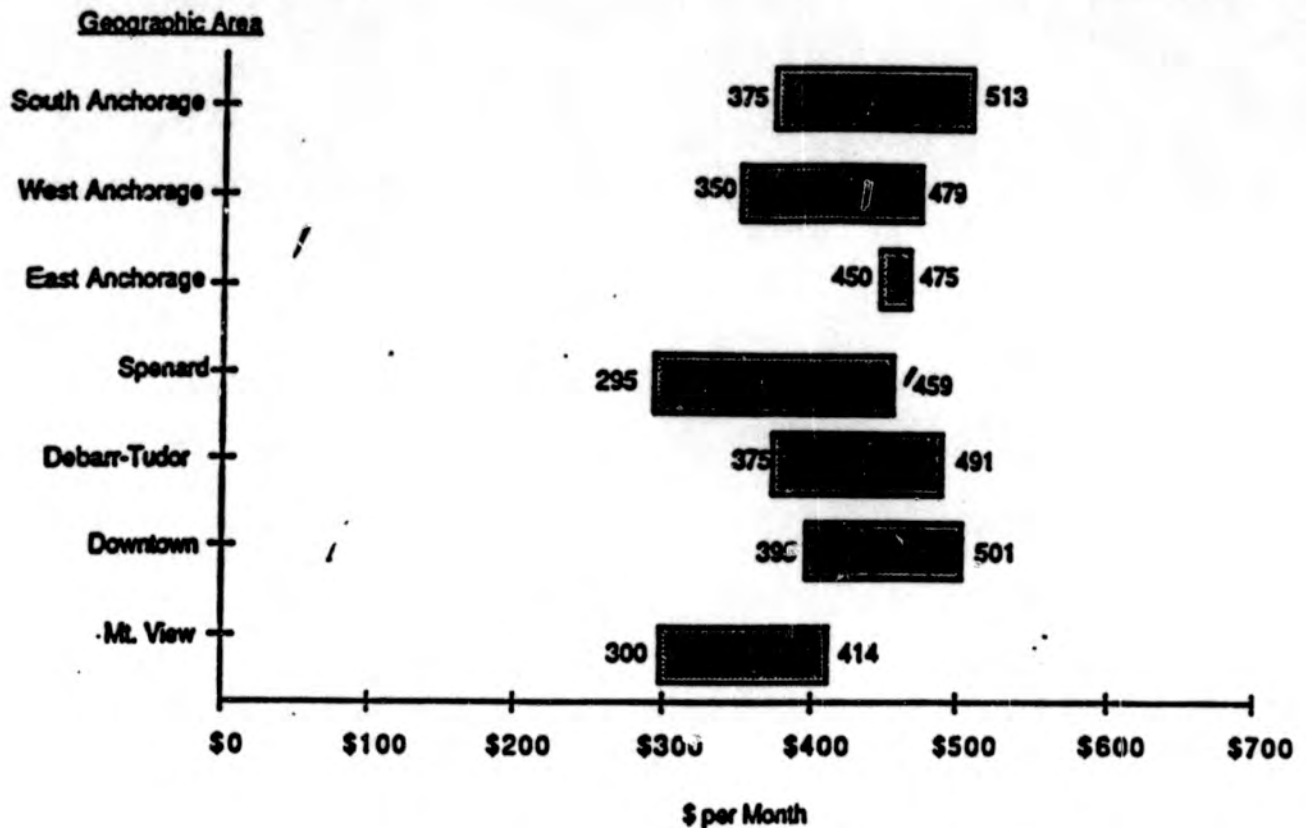
COMMENT:

This newspaper survey was done by a private consultant who used Sunday's Anchorage Times and News to do a comparison of rental rates...

This chart demonstrates from November to December that rental rates fell for two bedroom condos a significant amount. The high rate in November advertised in the paper was \$685. In December that rate dropped to \$628.

The number of ads for November was 39; for December 41.

**Rental Rate Analysis
of Two-Bedroom Unfurnished Apartments
According to Classified Advertising
Anchorage Daily News and Times Classified Ads
December 6, 1987**



Information Provided by Kay E. Eliason

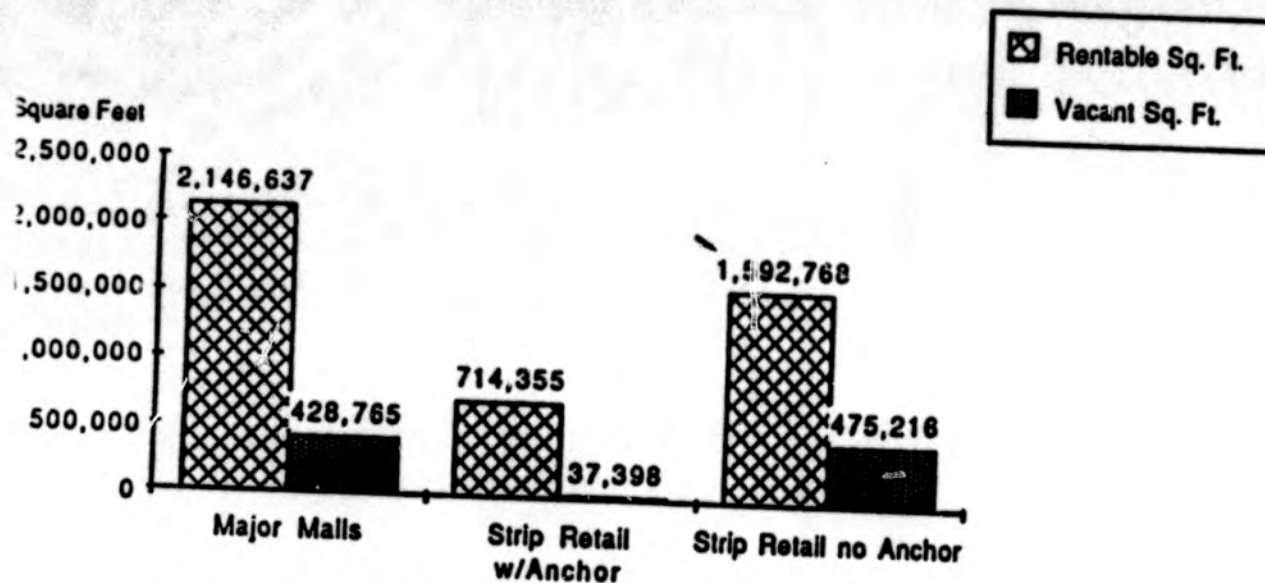
COMMENTS:

This chart demonstrates the asking rental rates for two-bedroom unfurnished apartments as advertised for sale on Dec. 6, 1987.

The two-bedroom unfurnished apartments were selected for analysis because MGIC condos fall into the two bedroom, unfurnished classification as rental properties.

This chart, therefore, gives you an idea of what can be expected for rental income in the various geographical locations. Utilities are not factored into these asking rental prices.

Anchorage Retail Inventory and Vacancies by Type of Mall



SOURCE: Alaska Valuation Services
Fred Ferrara, President

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

P.O. BOX 5
JUNEAU, ALASKA 99811-0400
PHONE: (907) 465-2300

February 19, 1988

The Honorable Max F. Gruenberg, Jr.
Chairman, Joint Committee on Economic Recovery
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Representative Gruenberg:

At the meeting of the Joint Economic Recovery Committee Thursday February 18, you asked whether I believed the legislature should consider social responsibilities as opposed to only considering what to do about the contraction that has occurred in the Alaska economy.

My answer was that I thought of the word "economic" as encompassing both the financial issues and the social and political issues.

I realize that may have been a confusing answer. Perhaps this will make it more clear.

State spending was the driving force behind the recent "oil boom." If we had spent at lower levels, and had much more moderate growth, then the adjustment would have been much easier. Hundreds of condos would not have been built, and would not stand empty today.

As pointed out by Erickson, and other economists, letting the real estate decline (or market correction) settle out will result in lower costs, and a quick growth rate because of that.

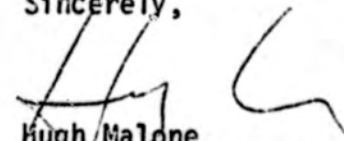
If the state intervenes, we will bias normal investment decisions, and make private dollars less productive than they otherwise would be. Economic recovery will be slowed, and the uncertainty and hardship will be prolonged. (Of course, if we could return spending to the per capita level of a few years ago, and keep it there, we will still be in fat city. But we can not - although we can squander our limited revenue).

Therefore, I think the most socially, politically responsible, and useful, thing we can do is to let the market correct itself.

The Honorable Max F. Gruenberg, Jr.
February 19, 1988
Page

Intervening is not social responsibility. At best, it is tinkering. At worst, it will waste what money we have and create an enormous sense of unfairness. I am not suggesting we let anyone starve, or freeze in the dark. I am suggesting we foster a private economy.

Sincerely,



Hugh Malone
Commissioner of Revenue

HM:m11
88-46

cc: Members, Joint Committee on Economic Recovery



ALASKA INDUSTRIAL DEVELOPMENT
AND EXPORT AUTHORITY

1577 "C" STREET • SUITE 304 • ANCHORAGE, ALASKA 99501-5177 • (907) 274-1651

March 10, 1988

Honorable Kay Brown
State of Alaska
House of Representatives
P.O. Box V
Juneau, Alaska 99811

Dear Representative Brown:

Below is the additional information I promised to forward to you which explains the Small Business Administration (SBA) charts sent to you on March 7, 1988. (Those same charts are attached for your convenience.)

First of all, the chart, MARS 526, illustrates SBA's loan performance measurement system. This chart accounts not only for SBA loan guarantees, but also for SBA direct loans. Thus, on the chart, there is no distinction made between the direct loans or the guarantees which SBA has made over the last few years. However, you should be aware that SBA direct loans are minimal. The majority of business SBA sees is for loan guarantees.

The terms used in MARS 526 mean:

- | | |
|-----------------------|---|
| Cases Disbursed - | means the number of direct and guaranteed loans made in that year by SBA. |
| Failures (#'s) - | means the number of direct or guaranteed loans originated in that year which have failed. E.G. of 227 direct or guaranteed loans originated in 1986, 11 of those loans failed, not necessarily in 1986. |
| Percentage (by #'s) - | equals failures divided by cases disbursed, within the State of Alaska. |
| Region 10 Average - | refers to the SBA's Region 10 which includes Boise, Idaho; Portland, Oregon; Seattle and Spokane, Washington; and Alaska. |
| National Average - | refers to the average using the nation as a whole. |
| Cases Charged Off - | means actual number of loans that have been charged off as losses. |
| Dollars Disbursed - | means number of dollars for SBA's direct or |

guaranteed loans originated for the particular year.

Dollars Charged Off - means number of dollars that have been charged off as a loss.

Percent (by \$'s) - equals dollars charged off divided by dollars disbursed, within the State of Alaska.

Region 10 Average - refers to the SBA's Region 10 which includes Boise, Idaho; Portland, Oregon; Seattle and Spokane, Washington; and Alaska.

National Average - refers to the average using the nation as a whole.

The second chart, MARS 515, illustrates the number of direct loans and guaranteed loans extended by SBA during the years 1978 through 1987. This chart refers to Region 10 and the numbers you will see on the left hand side under the word "Office" correspond to each locale within Region 10. "1040" refers to Fairbanks; and "1084" refers to Anchorage. Here again, the chart is easier to understand when you consider that:

Disbursed in Dollars - means that direct loans or loan guarantees were extended by SBA in the amount of dollars shown for each corresponding year.

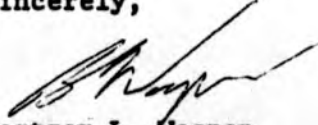
Purchase in Dollars - means that the SBA has had to disburse funds to honor guarantees. "purchase in dollars" does not necessarily mean that SBA is seeing a loss. E.G., the loan may have been rewritten.

Purchase Rate
in Dollars - equals purchase in dollars (i.e. buy backs) divided by the total dollar amount of disbursed dollars to show the rate in dollars bought back by SBA.

I hope that this information helps you to more fully understand the SBA charts. I believe that this information is helpful in that it shows that AIDEA should approach any loan guarantee program with caution. This is because loans guarantees are not a profitable business. In reality, the Authority is lending its balance sheet and taking on a future liability.

If you have any questions, please feel free to call me in Anchorage at 274-1651.

Sincerely,



Bertram L. Wagnon
Executive Director

BLW/ga

Attachments

DATE RUN 10/16/87

SMALL BUSINESS ADMINISTRATION
LOAN PERFORMANCE MEASUREMENT SYSTEM
AS OF 09/30/87
(DOLLARS IN THOUSANDS)

*Plus Loans,
Including Direct*

PAGE 93 MARS 520

ANCHORAGE, ALASKA

	YR-1 1986	YR-2 1985	YR-3 1984	YR-4 1983	YEAR OF APPROVAL			YR-6 1981	YR-7 1980	YR-8 1979	YR-9 1978	YR-10 1977	FIVE-YEAR SUMMARY YEARS YEARS YEARS 86-82 81-77 76-72		
					YR-5 1982										
	FAILURE RATES (LOANS IN LIQUIDATION OR CHARGED OFF)														
CASES DISBURSED	227	298	466	342	283	125	107	181	133	132	1616	678	760		
FAILURES (#'S)	11	40	82	51	33	17	20	18	22	18	217	95	81		
PERCENTAGE (BY #'S)	4.8	13.4	17.6	14.9	11.7	13.6	18.7	9.9	16.5	13.6	13.4	14.0	10.7		
REGION 10 AVERAGE	3.5	11.5	16.6	15.5	21.0	26.8	26.7	23.0	16.7	15.3	14.0	21.8	13.7		
NATIONAL AVERAGE	3.1	10.2	16.1	16.8	21.7	26.2	29.7	26.5	23.7	21.9	13.6	26.0	22.7		
	CHARGE-OFF RATES														
CASES CHARGED OFF	1	12	24	14	11	6	12	13	17	13	62	61	72		
DOLLARS DISBURSED	55623	67353	98401	73656	56502	20149	15540	19253	17140	18596	351536	90680	72035		
DOLLARS CHARGED OFF	39	1231	1644	1389	1055	1264	1112	617	1250	445	5561	4690	17		
PERCENT (BY \$'S)	0.1	1.8	1.9	1.9	1.9	6.3	7.2	3.2	7.3	2.4	1.6	5.2	2.4		
REGION 10 AVERAGE	0.3	1.4	2.6	3.1	6.9	14.5	12.7	10.1	6.3	4.4	2.8	9.9	4.9		
NATIONAL AVERAGE	0.1	1.1	3.2	4.3	8.0	13.5	14.6	11.7	10.5	9.7	3.0	12.1	11.4		

REGION 10

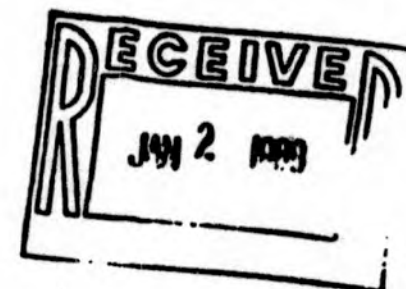
PERIOD ENDING FY 87

PAGE 19
MARS 515
(% IN THOUSANDS)

		DISBURSED IN DOLLARS									
		1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
OFFICE		-----	-----	-----	-----	-----	-----	-----	-----	-----	-----
1013		0	39,257	46,846	44,084	21,199	21,867	34,313	39,429	26,257	14,681
F 1040	✓ Anchorage	0	1,303	1,229	1,955	1,397	380	0	0	0	0
A 1084	✓ Fairbanks	0	17,624	17,462	17,056	54,487	71,215	90,442	63,752	54,258	17,715
1086		0	34,480	55,600	42,277	21,891	24,888	21,222	18,530	14,985	13,345
1087		0	22,466	24,367	20,604	18,424	25,985	22,050	16,237	16,752	11,574
1094		0	18,608	19,128	16,335	6,367	10,377	13,955	12,155	27,590	10,788
TOTAL		0	133,739	164,633	142,311	123,764	154,712	182,022	150,104	129,050	68,103

		PURCHASE IN DOLLARS									
		1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
OFFICE		-----	-----	-----	-----	-----	-----	-----	-----	-----	-----
1013		0	2,121	5,513	5,684	2,061	1,363	2,592	4,035	485	0
F 1040	✓ Fairbanks	0	0	0	0	0	0	0	0	0	0
A 1084	✓ Anchorage	0	1,050	677	1,552	4,536	6,421	9,793	5,161	2,642	0
1086		0	2,696	3,869	1,801	2,545	3,008	982	2,079	282	157
1087		0	932	1,952	659	1,759	2,468	1,648	1,607	800	24
1094		0	614	1,313	338	449	745	640	345	199	0
TOTAL		0	7,413	13,324	10,034	11,350	14,006	15,655	13,228	4,409	181

		PURCHASE RATE IN DOLLARS									
OFFICE		1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
F A	1013	0.0	5.4	11.8	12.9	9.7	6.2	7.6	10.2	1.9	0.0
	1040 Fairbanks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	1084 Anchorage	0.0	6.0	3.9	9.1	8.3	9.0	10.8	8.1	6.9	0.0
	1086	0.0	7.8	7.0	4.3	11.6	12.1	4.6	11.2	1.9	1.2
	1087	0.0	4.2	8.0	3.2	9.5	9.5	7.5	9.9	4.8	0.2
	1094	0.0	3.3	6.9	2.1	7.1	7.2	4.6	2.8	4.1	0.0
	TOTAL	0.0	5.5	8.1	7.1	9.2	9.1	8.6	8.8	3.4	0.3



ALASKA

REVIEW OF SOCIAL AND ECONOMIC CONDITIONS

University of Alaska Anchorage, Institute of Social and Economic Research February 1988, Vol. XXV, No. 1

Alaska Housing and the Recession

The recession that started at the end of 1985 turned the Alaska housing market on its head. Prices of houses, condominiums, and mobile homes—especially the last two—have come down so far that Alaskans have been left queasy and disbelieving. Recent ISER economic projections are for the recession to end in 1988, and a *gradual* economy recovery to begin—if oil prices remain stable in the \$16- to \$20-per-barrel range. Oil prices are the crucial element in ISER's projections. But if the Alaska economy does begin to recover in 1988, the effects of the recession on the housing market will not disappear overnight.

Since the end of 1985 Alaska has lost jobs, population, and income.¹ We now have much more housing than there is demand for. In Anchorage alone in 1987 nearly 14,000 housing units—including both owner-occupied and rental units—were vacant.² Thousands of Alaska houses, condominiums, and mobile homes have been foreclosed on over the past two years. Even after the economy bottoms out, the housing market will be slow in recovering. This is particularly true of the market for condominiums and mobile homes in Anchorage.

Recent ISER work indicates that it will likely be well into the 1990s before real—adjusted for inflation—condominium prices in Anchorage regain their 1985 levels. There are hundreds more mobile homes in Anchorage right now than are likely to be occupied by 1992. Very few condominiums or apartments

will be built in Anchorage over the next few years: the units that already exist will more than meet the projected demand.

Single-family houses should fare better—because most buyers prefer houses when they can afford them. Lower prices in the past two years have put single-family houses within the reach of some buyers who in the early 1980s might have bought condominiums or mobile homes.

Economic conditions will of course be crucial in determining the future health of the Alaska housing market. But after economic conditions, how the major lenders handle their big inventory of foreclosed properties will make the most difference to the stability of the Anchorage housing market in the next few years. If they try to quickly sell large numbers of those properties, they will further depress prices and increase loan defaults.

Depressed prices and large numbers of loan defaults are serious problems for all Alaska homeowners and mortgage lenders—but particularly for AHFC, which holds more than 60 percent of the outstanding residential mortgages in the state.

This publication has two main parts. The first part describes conditions in the Alaska housing market in 1987, and contrasts them with conditions during the economic boom of the early 1980s. Those descriptions set the stage for the second part, which

This Review is the second of two publications based on Alaska's Economy and Housing Market, a report ISER recently prepared for the Alaska Housing Finance Corporation (AHFC). AHFC commissioned the report to help the corporation in its efforts to stabilize the Alaska housing market. The first publication summarized the economic forecasts in the ISER report; this one discusses the report's findings on the housing market.

¹See "Alaska's Economy: What's Ahead?" *Alaska Review of Social and Economic Conditions*, December 1987, Vol. XXIV, No. 2, University of Alaska Anchorage, Institute of Social and Economic Research.

²Vacancies as of July 1987, as reported by the Municipality of Anchorage's Community Planning Department in 1987 *Anchorage Population Profile*, December 1987.



Winter scene in a residential area of south Anchorage. Photo: Rob Hallinen/Anchorage Daily News

ALASKA REVIEW OF SOCIAL AND ECONOMIC CONDITIONS

VOL. XXV, No. 1, February 1988

Published by

Institute of Social and Economic Research
University of Alaska Anchorage

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Alaska Housing and the Recession

This publication is based on several chapters of *Alaska's Economy and Housing Market*, an October 1987 report by O. Scott Goldsmith, Matthew Berman, Lee Huskey, Linda Leask, and Teresa Hull. All the authors except Huskey are ISER faculty and staff members. Huskey is associate professor of economics with UAA's School of Economics and Public Policy.

reports on how various policies available to AHFC and other lenders might affect the housing market.

ALASKA MORTGAGES AND FORECLOSURES

National Secondary Lenders

Alaskans planning to buy houses generally apply for mortgage loans at banks or savings and loans or mortgage companies. These institutions—known as primary lenders—process the applications, approve or disapprove the loans, and collect the monthly mortgage payments. But very rarely do the banks themselves actually hold the mortgages: they sell almost all of them on the secondary market. In fact, primary lenders as a rule won't make a mortgage loan without first determining that a secondary lender will buy it. This system greatly reduces the risks for primary lenders in making long-term loans and frees their money for other uses.

The biggest secondary lenders nationally were created by the federal government to help increase the amount of home mortgage money available—on the grounds that a healthy housing industry is important to the U.S. economy. Of these, by far the biggest is the Federal National Mortgage Association (FNMA)—widely known as Fannie Mae—which holds about \$100 billion in mortgage loans. Another—much smaller—secondary lender is the Federal Home Loan

Mortgage Corporation (FHLMC, or Freddie Mac).

The Federal Housing Administration (FHA) and the Veterans Administration (VA) are federal agencies that do not actually buy mortgage loans but rather insure or guarantee them. Loans insured by FHA or guaranteed by the VA sell easily on the secondary market because they carry government backing. Most FHA-insured or VA-guaranteed loans go on to the secondary market through mortgage-backed securities that are issued by yet another federal organization—the Government National Mortgage Association (Ginnie Mae)—and are sold to investors. FHA and VA are often thought of as secondary lenders, because their backing for a loan generally insures its marketability.

The Farmers Home Administration is another federal agency that makes home loans, but only to farmers and to low-income Americans living in rural areas. This agency holds its own mortgages.

Alaska Housing Finance Corporation

The national lenders and insurers described above all operate in Alaska, but here the state government has also created several secondary lenders. The biggest is of course the Alaska Housing Finance Corporation, which holds more than \$4 billion in Alaska residential mortgages, or about 60 percent of the outstanding home mortgage debt in Alaska in 1987.

AHFC is a public corporation created by the

Alaska Legislature in 1971. As a public corporation, AHFC is under the control of the state government, but it has more autonomy than traditional state agencies, and it can sell bonds to raise mortgage money.

The state legislature originally established AHFC to help Alaskans with low or moderate incomes get housing at reasonable costs. Alaska officials said that the high cost of housing in the state, the lack of mortgage money in many rural areas, and other factors was making it hard for many Alaskans to buy houses.

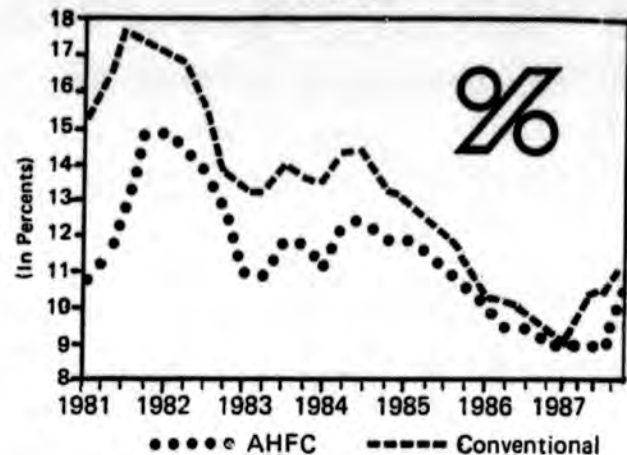
At the start of the 1980s the state legislature made several decisions that quickly transformed AHFC into the dominant mortgage lender in Alaska. National mortgage interest rates were at all-time highs, peaking above 17 percent. The legislature decided to begin subsidizing home mortgage interest rates. As Figure 1 shows, in 1981 Alaska borrowers could get a \$135,000 loan from AHFC for less than 11 percent—or they could go to a national lender and pay more than 15 percent. AHFC's interest rate advantage narrowed in later years as the legislature tied AHFC's rates closer to its costs of borrowing money, but through 1985 AHFC loaned money at significantly lower rates than the national lenders.

The legislature also decided to open AHFC's lending programs to virtually all Alaskans by removing the income ceilings for borrowers, and to establish special new programs that would make it easier for more Alaskans to buy houses. Examples of those programs are the mobile home program that makes long-term mortgages available for mobile homes in trailer parks, and the Home Ownership Assistance (HOF) program that pays part of monthly mortgage payments for borrowers whose incomes aren't high enough to qualify them for conventional loans.

AHFC's lower interest rates and special programs drew 80 percent of Alaska borrowers to AHFC in the first half of the 1980s. In the past several years AHFC's share of Alaska mortgages has declined steadily. Market interest rates began dropping off sharply in 1985, and in 1987 they reached their lowest point since the 1970s. At one point in 1987 rates under AHFC's biggest loan program were the same as those of other lenders (see Figure 1).

As national interest rates fell, special conditions and restrictions on AHFC loans prompted more borrowers to look to other lenders. For example, most AHFC loans written before 1985 couldn't be assumed, and before 1986 AHFC didn't have the authority to refinance loans. Also, in 1982 the corporation had adopted the Alaska Building Equity (ABE) payment system that increases mortgage payments five percent a year from the fourth through the ninth year of the loans. Still, in 1987 AHFC remained the biggest single buyer of mortgages written for home sales.

Figure 1. Home Mortgage Interest Rates, AHFC Taxable Program and Conventional,* 1981-1987



*Mortgage rates for a \$135,000 loan under AHFC's taxable program and under FNMA's 30-year, fixed-rate mortgages.

Since 1980 AHFC has raised several billion dollars in mortgage money by selling bonds. The legislature appropriated about \$1 billion for AHFC mortgage subsidies between fiscal years 1981 and 1984. For the past several years, AHFC has had a revolving loan fund and received no subsidies.

Other Sources of Mortgage Money

The Alaska Department of Community and Regional Affairs also acts as a secondary lender, but it buys loans only in the most remote areas of Alaska. Its operations are small as compared with AHFC's, and it gets its loan money not through bond sales but through state appropriations.

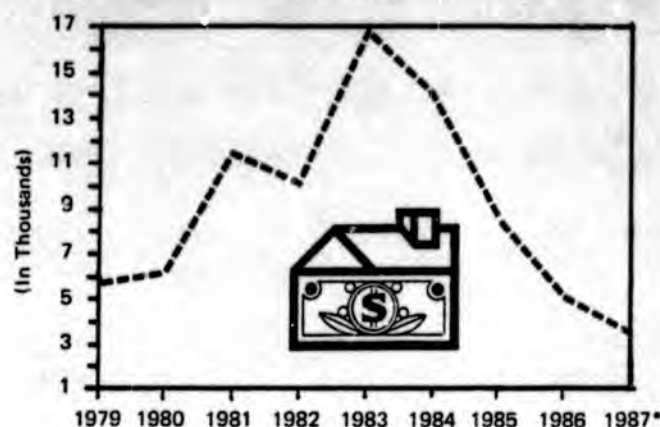
The managers of the Alaska Permanent Fund and the state pension funds (the Public Employees Retirement System and the Teachers Retirement System) also buy some residential mortgage loans—but not many as compared with the other secondary lenders, and frequently those that exceed the loan limits of other lenders. In recent times, however, those agencies have bought very few loans.

There are a variety of others who hold some Alaska mortgage loans. Credit unions hold rather than sell some mortgages. Individuals sometimes finance the sale of their own houses. Figures on mortgages held by those and others are not available, but they are few compared with those held by the big lenders.

Mortgage Activity, 1979-1987

Figure 2 marks the ups and downs of housing sales in Alaska from 1979 through 1987: it shows the numbers of mortgages written for home sales. (The figure excludes mortgages for refinancing, which are shown in Figure 3.)

Figure 2. Alaska Mortgages Written for Home Sales, 1979-1987*



*1987 figure is an estimate based on numbers for the first six months of the year.

About 5,500 mortgages worth \$380 million were written in Alaska in 1979. That was a slow year as compared with what was to come. The economic boom created by construction of the trans-Alaska pipeline was over; some people were leaving the state; and mortgage interest rates were on their way up. Mortgage activity in 1980 was not much higher, but the stage was set for the next boom. High oil prices were fattening the Alaska treasury. The state government began spending its oil revenues in many ways that sparked unprecedented economic growth. At the same time, the legislature also voted to subsidize mortgage interest rates.

The economic boom created by state spending drew tens of thousands of people into the state. The combination of a burgeoning population, growing incomes, and special programs tripled numbers of new

mortgages between 1979 and 1983, when more than 16,500 mortgages for home sales were written. Numbers of new mortgages began dropping in 1984, but it was in 1985 that the really sharp decline started.

The recession began toward the end of 1985, as state spending declined. In 1986 the recession worsened as oil prices plummeted. Fewer than 5,000 mortgages for home sales in Alaska were written in 1986—fewer than had been written in 1979. And in 1987 an estimated 3,000 mortgages were created for home sales in Alaska.

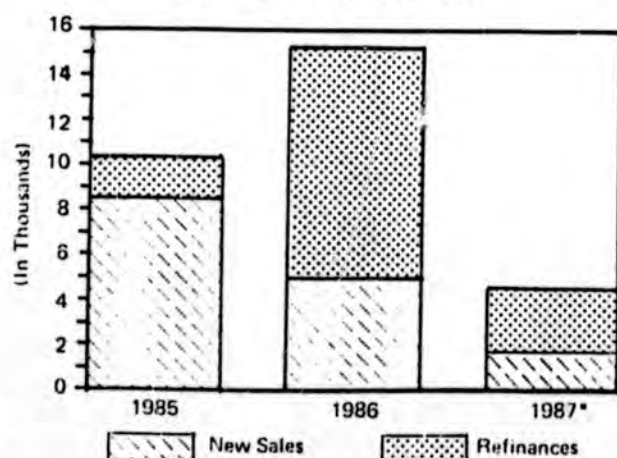
Home Refinancing

In 1985 national interest rates began dropping sharply, and many Alaskans who held home loans at much higher rates refinanced their houses. As Figure 1 shows, AHFC's subsidized rates in 1982 were as high as 14 percent; by late 1985 conventional and AHFC rates were below 11 percent. And in 1986 and early 1987 rates were near 9 percent.

Firm figures on how many mortgages are written for Alaskans refinancing their homes are hard to get. Figure 3 shows our estimates of how many mortgages written in Alaska in 1985, 1986, and the first half of 1987 were for refinances and how many for sales. Presumably there was very little refinancing before 1985, when interest rates were much higher.

The figure shows that in 1985 less than 20 percent of the 10,000 mortgages created in Alaska were for refinancing. In 1986, 15,000 mortgages were written—but more than 10,000 of those, or 70 percent, were for refinancing. In the first half of 1987, more than 60 percent of new Alaska mortgages were for refinancing.

Figure 3. Alaska Mortgages Written for Home Sales and Refinancing, 1985-1987*



*The 1987 figure is just the first six months.

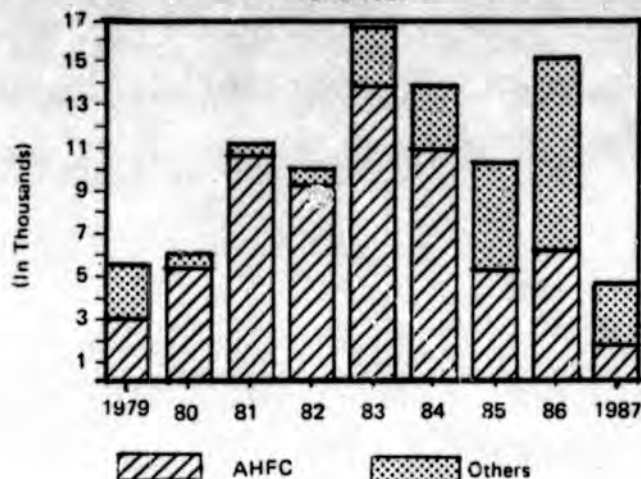
AHFC's Market Share

Figure 4 clearly shows why AHFC is the biggest mortgage holder in Alaska: it identifies shares of total mortgages (including those for sales and for refinances) AHFC and other lenders bought each year from 1979 through the first half of 1987. From 1980 through 1982, when AHFC's rates were several percentage points below those of other lenders, AHFC bought 90 percent or more of new mortgages. Through 1984 AHFC still had 80 percent of the market. In the past several years interest rates and terms of other lenders became more competitive. AHFC's share dropped from about 50 percent in 1985 to less than 40 percent in the first half of 1987.

1987 Mortgage Holdings of Major Alaska Lenders

What is at stake in the Alaska housing market? How much home mortgage debt is there in the state? Table 1 shows the mortgage holdings of major Alaska lenders as of mid-1987.

Figure 4. AHFC's Share of New Alaska Mortgages,^a
1979-1987^b



^aIncludes mortgages for sales and for refinances.

^bFigures for just the first six months of 1987.

In 1987 the major lenders in Alaska held more than 84,000 home mortgage loans worth \$7 billion dollars. The biggest mortgage holder is AHFC, which as of June held more than 52,000 home mortgages with an outstanding balance of about \$4.3 billion. Other state government entities held another 3,000 loans with a balance of \$230 million.

National lenders and insurers are also carrying tens of thousands of loans. AHFC holds some FHA-insured and VA-guaranteed loans; to avoid double-counting, those are included in AHFC's holdings and excluded from FHA's and VA's. In addition to those held by AHFC, there were nearly 8,500 FHA-insured loans and 8,600 VA-guaranteed loans in Alaska in 1987, with a combined unpaid balance of \$1.6 billion. FNMA and FHLMC were each carrying more than 5,000 mortgage loans with a combined balance of nearly \$900 million.

Table 1

Residential Mortgage Holdings of Major
Alaska Lenders, June 1987^a

	Number of Loans Outstanding	Unpaid Principal Balance (\$ millions)
AHFC		
Mobile Homes	4,760	\$ 151
AHFC/FNMA ^b	10,722	1,170
AHFC/Other	36,686	2,967
Total	52,168	\$4,288
FNMA^c	5,471	\$400
FHLMC^d	5,152	479
FHA-Insured ^e	8,437	844
VA-Guaranteed ^f	8,602	763
Alaska Dept. of CRA ^g	1,194	123
Farmers Home Admin. ^h	1,322	106
Alaska Permanent Fund	300	42
Alaska Pension Funds ⁱ	NA	NA
AIDA & Div. of Invest. ^j	1,565	68
Total	84,211	\$7,113

^aAs of June 1987, unless otherwise noted.

^bThese are loans financed with FNMA money from early 1984 through 1986; AHFC makes principal and interest payments to FNMA on collateralized notes. FNMA is, however, liable for any losses not covered by private mortgage insurance if borrowers default.

^cExcluding loans cited in note b; these are loans purchased from banks and other primary Alaska lenders.

^dFigures are for FHLMC loans serviced by Alaska

lenders as of June 1987; they may include some loans on homes outside the state but serviced by Alaska lenders and exclude some loans on Alaska homes that are serviced by lenders outside the state.

^eOutstanding loans as of December 31, 1986, excluding AHFC loans insured by FHA. The unpaid principal balance is an estimate, based on average size of outstanding loan. Although FHA is an insurer rather than a lender, FHA-insured loans are included here because most of those loans go to lenders other than those listed in this table. Most FHA-insured loans go into mortgage-backed securities (MBSs) issued by the Government National Mortgage Association (GNMA) and sold to various investors.

^fFigures as of March 31, 1987, excluding VA-guaranteed loans held by AHFC. A very large share of new VA-guaranteed loans in Alaska in the first half of the 1980s were purchased by AHFC. Most VA-guaranteed loans not purchased by AHFC go into MBSs issued by GNMA and sold to various investors.

^gAs of March 1987.

^hOutstanding loans as of May 1987. Unpaid principal balance is an estimate based on average size of outstanding loan.

Good estimates of cumulative Alaska residential mortgage holdings of the pension funds are not available because figures on such holdings are combined with figures on other mortgage holdings of the funds.

ⁱThese are mortgage loans made under a state veterans' loan program that no longer exists; it was replaced in the early 1980s by the state veterans' program administered by AHFC. Most of these loans are now held by the Alaska Industrial Development Authority (AIDA); the Division of Investments in the Alaska Department of Commerce and Economic Development holds a few and services those held by AIDA.

Source: *Alaska's Economy and Housing Market*, ISER Report, October 1987, Tables 3.1 and 3.3.

Mortgage Liabilities

The current recession has pushed thousands of Alaska homeowners into default and foreclosure. Before we look at 1987 figures on properties in foreclosure, we'll broadly outline liability on mortgage loans when borrowers default. When we say "mortgage liabilities," we mean just losses lenders and borrowers take when individual borrowers default. There are of course other kinds of liabilities—for instance, AHFC is liable for payment on the billions of dollars in bonds it sold to finance mortgage loans. We don't discuss that or other potential liabilities here.

Table 2 summarizes insurance requirements and liabilities of home buyers and major lenders. When agreeing to make a mortgage loan, lenders generally require two kinds of protection against default. The first step is requiring a down payment, generally 5 to 10 percent of the sales price. The chief exception is the Veterans Administration program, under which qualified veterans can borrow up to a specific amount with no money down.

Second, lenders typically require borrowers to carry private mortgage insurance (PMI) on loan amounts above 70 to 80 percent of the purchase price. If the borrower defaults, the private mortgage insurer pays the lender any losses on the insured portion of the loan. Loans in remote areas of Alaska generally don't carry private insurance because it usually isn't available in those areas. Loans held by the Alaska Department of Community and Regional Affairs and the Farmers Home Administration are uninsured. Also, some loans made before 1980 under various state loan programs are uninsured.

So what happens when a borrower defaults and his property goes into foreclosure? First, borrowers who default lose their down payments and any additional amount they've paid on the loan principal.

Another liability borrowers face is that lenders may institute what is known as a judicial foreclosure. If a lender believes that a borrower who defaulted could have continued to make his payments but chose not to, he may go to court to try to make the borrower liable for any losses when the property is re-sold. In a non-judicial foreclosure, the lender accepts that the borrower has neither the income nor the assets to meet his payments and does not press for any further liability. (Damage that defaulting does to a borrower's future credit is also certainly a loss, but a less measurable one.)

The losses that lenders and insurers face when properties go into foreclosure are complicated to calculate. The biggest factor is the condition of the housing market. If prices are rising, insurers and particularly lenders don't generally lose money—because they can expect to re-sell the relatively few

properties that go into foreclosure for enough to cover the outstanding mortgage and foreclosure costs. But when prices are falling—as they have been in Alaska over the past two years—it's a different story: there are thousands of foreclosed properties and they frequently sell for less than the outstanding mortgage, especially if the mortgage was written when prices were at their peak.

In Alaska's housing market today, insurers face the first losses when properties with private mortgage insurance go into foreclosure. They try of course to keep those losses to a minimum, and they have two broad choices. The insurer can take a foreclosed property and re-sell it, or the insurer can let the lender re-sell it and pay the lender a claim up to the maximum insured amount.

Say for example that a property with a \$100,000 outstanding mortgage goes into foreclosure, and that private mortgage insurance covers \$20,000 of that mortgage.³ Estimate the foreclosure costs at \$5,000. Suppose the insurer thinks the property will be hard to re-sell (which means that there will also be substantial interest and other holding costs) and that it might command only \$70,000 when it does sell. If the insurer took the property, held it, and re-sold it at a depressed price, his costs could easily exceed \$35,000. On the other hand, if the insurer let the lender take the property and simply paid the maximum insurance claim, he would limit his costs to \$20,000. Only in cases where the insurer thinks he can keep his costs below the maximum insurance claim will he be likely to try to re-sell it himself.

What about lenders? What losses do they take in foreclosures? Again, in a market where prices are rising, lenders who require down payments and mortgage insurance don't generally take any losses. But in the Alaska market today, values of many properties are so much lower than the outstanding mortgages that insurance doesn't cover all the losses. And on loans not covered by insurance, lenders take all the losses.

AHFC's liability on mortgage loans varies considerably among loans made at different times and under different programs, as Table 3 shows. But AHFC has better protection than most lenders on the majority of loans it made between 1981 and 1986. Most AHFC loans made during that period carry private mortgage insurance and additional features that limit AHFC's liability.

Most AHFC loans made between 1981 and early

³These figures are simplified to make the example straightforward. To show precisely how much private insurance covered of any given loan we would have to know original purchase price, size of down payment, subsequent payments on principal, and amount of insurance the lender required.

Table 2

Liability* in Home Foreclosures

Lender	Insurance Requirements	Liability of Borrowers in Foreclosure	Liability of Lenders in Foreclosure
FNMA/FHLMC	Borrowers required to carry private mortgage insurance (PMI) on loan amounts above 80% of the house price.		Lender liable for any losses not covered by PMI.
FHA-Insured Loans	Borrowers pay premium for government insurance, either in lump sum or as part of monthly payments.		FHA liable for all losses.
VA-Guaranteed Loans	The federal Veterans Administration guarantees up to \$27,500 on mortgage loans to veterans as a benefit of military service; this guarantee takes the place of private mortgage insurance.	<i>Borrowers in all cases lose their down payments, which can be as low as 0-5% but are generally 10% or more of the purchase price. Also forfeited is any amount subsequently paid on the loan principal. And, in some cases, lenders will undertake judicial foreclosures, in which they go to court to try to make borrowers who default liable for losses on resale of the properties.</i>	VA liable for losses up to \$27,500 on each loan; additional liability falls on primary or secondary lender.
Farmers Home Administration	This federal agency makes loans to low-income households in rural areas; no private mortgage insurance.		Farmers Home Administration liable for all losses.
State of Alaska			
AHFC	Most borrowers required to carry private mortgage insurance on loan amounts above 75% to 80% of the house price; on mobile home loans, borrowers must carry private credit insurance on 40% of the loan amount.		Varies substantially among different types of loans; see Table 3.
DCRA	Loans in rural areas; no private mortgage insurance required (because it is not available in many cases).		DCRA takes all losses.
Ak Permanent Fund	Borrowers required to carry private mortgage insurance on loan amounts over 70% of the house price.		Permanent Fund bears any losses not covered by PMI.
Division of Investments and AIDA	These loans were made to veterans before 1981 through the former Division of Veterans Affairs; no private mortgage insurance required.		Losses accrue either to Veterans' Revolving Loan Fund or AIDA.

*Includes just losses the various parties may be liable for when individual loans go into foreclosure; does not include AHFC's liability for repayment of bonds and notes financing the loans, or other kinds of liabilities.

1984 carry pool insurance—insurance that covers any losses not covered by private mortgage insurance. Mortgage Guarantee Insurance Company (MGIC) provided that pool insurance as a provision of bonds AHFC sold to finance loans during that period. So AHFC has virtually no liability when borrowers default on those particular loans.⁴

From 1984 through 1986, the national lender FNMA financed a large share of AHFC loans—and on those particular loans, FNMA rather than AHFC is liable for any losses not covered by private insurance. (AHFC is, of course, liable to re-pay principal and interest to FNMA on the notes that financed the loans.)

AHFC's liability on other loans varies, as Table 3 shows. Some loans it took over from earlier state loan programs carry no insurance. Mobile home loans made before 1983 carry no insurance; loans made

after that time carry private credit insurance on 40 percent of the value of the loan. AHFC takes losses beyond what private credit insurance covers.

Homes in Foreclosure

We've seen the mortgage holdings of major lenders and how the losses are divided up when borrowers default. Now we turn to the grim evidence of Alaska's battered housing market: properties in foreclosure.

Table 4 shows foreclosed properties held by the major lenders and insurers as of mid-1987. In June 1987, lenders and insurers were holding more than 4,200 foreclosed properties. During the preceding 18 months, they had sold an additional 1,600 properties that had been foreclosed on. Taken together, the foreclosed properties still in inventory and those re-sold during the preceding year and a half totaled nearly 5,900—or 7 percent of outstanding residential mortgages in Alaska in mid-1987. And there were doubtless other foreclosures not recorded on Table 4—properties held by individual banks and private mortgage insurers other than MGIC, for instance. Reliable figures on such foreclosures are hard to get.

Table 3

AHFC's Liability* in Foreclosures

All Loans Except Mobile Homes	AHFC Liability
Loans with private mortgage insurance and pool insurance; include most loans made from 1981 to early 1984.	None, until bonds carrying pool insurance provision are paid off; then AHFC liable for any losses not covered by PMI.
Loans with private mortgage insurance that were financed by FNMA, 1984-1986; include most loans made during that period.	None. FNMA is liable for any losses not covered by PMI on loans it financed for AHFC during this period.
Loans with just private mortgage insurance; include some loans made throughout AHFC history and almost all loans made since January 1987.	AHFC is liable for any losses not covered by PMI.
Loans with no insurance; include loans made under several special programs that no longer exist.	AHFC liable for all losses.
Loans with federal government insurance or guarantee; include loans made throughout most of AHFC's history.	FHA takes all losses on FHA-insured loans. VA takes liability only up to \$27,500 on each VA-guaranteed loan; AHFC liable for additional losses.
Mobile Home Loans	
Loans before 1983 with no insurance.	AHFC liable for all losses.
Loans since 1983 with private credit insurance.	AHFC liable for losses not covered by PCI.

*Includes just losses AHFC is liable for when individual borrowers default.

It's no surprise that AHFC held about 65 percent of foreclosed properties in mid-1987. AHFC bought most of the new mortgages written in Alaska in the 1980s and in particular most of those written when prices were at their peak. Also, from 1980 on,

Table 4

Inventory of Foreclosed Properties Held by^a Major Alaska Lenders and Insurers, June 1987

	Held in Inventory June 1987	Foreclosed Properties Sold 1986-June 1987
AHFC		
Mobile Home	965	143
Other	1,793	1,075
Total	2,758	1,218
FNMA	394	160 ^e
FHLMC ^b	78	—
FHA-Insured	385	87
VA-Guaranteed ^c	366	80
MGIC	105	25 ^f
Alaska Dept. of CRA	40	1
Farmers Home Admin.	100	30
Alaska Permanent Fund	23	11
AIDA and Div. of Invest.	5	6
Others ^d	NA	NA
Total	4,254	1,618

^aProperties "held by" each lender or insurer include just those to which each already held title or was in the process of acquiring title as of June 1987.

^bIncludes both completed and nearly completed foreclosures.

^cIncludes both properties the VA had already acquired title to and pending title acquisitions. Excluded are properties that the VA paid claims on but did not take possession of. Most such properties probably went into AHFC's inventory of foreclosed properties; some ended up in the hands of mortgage companies, banks, or other primary lenders.

^dSome foreclosed properties are held by a wide range of Alaska banks, other primary lenders, and private mortgage insurance companies other than MGIC. Figures on such holdings are extremely difficult to get, and the numbers are small compared with the holdings of the secondary lenders and largest insurers.

^eProperties sold 1986–May 1, 1987.

^fEstimated sales from November 1986–June 1987.

Sources: See Sources, Table 3.1, *Alaska's Economy and Housing Market*.

AHFC bought almost all the mortgage loans on mobile homes—which have seen tremendous losses in value during the recession.

FNMA, FHA, and VA were also holding several hundred properties each in the middle of the year. Other lenders held fewer. The 100 properties that the insurer MGIC was holding at that time were just properties it had actually taken title to; remember that MGIC carries substantial liability on properties that are in AHFC's inventory.

We don't have foreclosure figures more recent than mid-1987 for most individual lenders, but we do have them for AHFC through the end of 1987. We know that, like AHFC, other lenders continued to add to their inventory of foreclosures in the second half of the year.

Table 5 and Figure 5 document the relentless climb in AHFC's inventory of foreclosures from 1984—before the start of the recession—through 1987. At year-end in 1984, AHFC held just 129 properties. By the end of 1985 that had grown to more than 500, and in 1986 to more than 1,600. At the end of 1987 AHFC held 3,700 properties. If we compare those figures with the mid-1987 figures in Table 4, we see that at the end of 1987 AHFC held 1,000 more properties than it had six months earlier.

Table 6 shows a more detailed breakdown of properties in AHFC's inventory as of the end of 1987: 1,325 single-family houses and duplexes, 1,171 condominiums and townhouses; 1,192 mobile homes; and 13 triplexes and fourplexes.

It's easy to see why the problems in the condominium and mobile home markets are more severe than in the market for single-family houses: there are a great many more single-family houses in Alaska

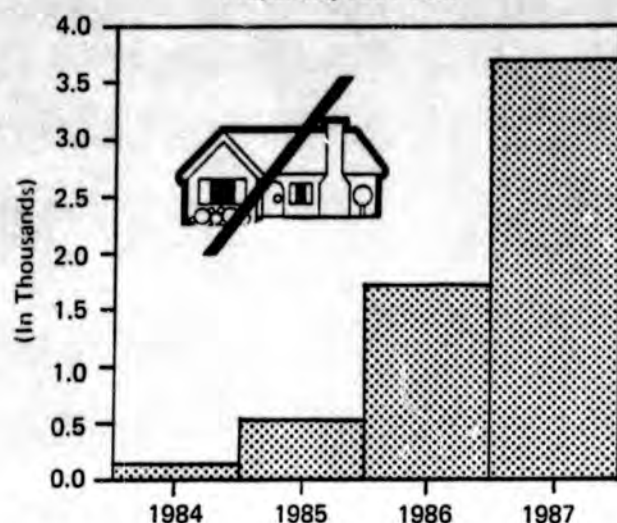
Table 5

AHFC Cumulative Inventory* of Foreclosed Properties, Year-End, 1984-1987

	1984	1985	1986	1987	% of 1987 Total
Mobile Homes	38	186	610	1,192	32%
Other	91	322	1,061	2,509	68%
All	129	508	1,671	3,701	100%

*The year-end inventories are total properties foreclosed on minus those resold. These figures are AHFC's state-wide inventory.

Figure 5. AHFC Year-End Inventory of Foreclosed Properties, 1984-1987



than there are either condominiums or mobile homes, but there are just about as many mobile homes and condominiums in foreclosure as there are single-family houses.

As the last column of the table shows, houses and duplexes made up more than 75 percent of active AHFC loans in 1987, but just 36 percent of foreclosures. By comparison, condominiums and townhouses made up 15 percent of total loans but 32 percent of foreclosures. Mobile homes, while making up just 7 percent of active AHFC loans, accounted for 32 percent of foreclosures.

Table 6

AHFC Inventory of Foreclosed Properties, Year-End 1987

	Number of Foreclosures	Percent of Total Foreclosures	Active AHFC Loans by Type
Single-Family Houses & Duplexes	1,325	36%	77%
Condominiums & Townhouses	1,171	32	15
Mobile Homes	1,192	32	7
Triplexes & Fourplexes*	13	1	1
Total	3,701	100%	100%

Source: AHFC.

*Although AHFC loans by type give us a good idea of the composition of housing stock in general, this is not true of triplexes and fourplexes, of which AHFC finances few. Most are financed by other lenders.

POLICY OPTIONS

Future economic conditions will be the biggest force in the recovery of the Alaska housing market. But the next biggest force will be the mortgage lenders and insurers with big inventories of foreclosed properties. They can help stabilize the market by selling their holdings at a moderate pace rather than selling large numbers quickly—which would further depress prices and put more homeowners at risk of default.

What is the Problem?

The problem in the Alaska housing market today is that we have more housing than we have households: too many condominiums, mobile homes, houses, and apartments. Having too big a supply and too little demand has created an unstable market, where prices have already fallen dramatically and there is great anxiety about the future.

Thousands of homeowners have defaulted on their mortgages over the past two years. Some lost their jobs and were unable to keep up the payments; some had to move and were unable to sell the houses for what they still owed on them. Still others simply walked away from their properties because they had lost value. Many thousands more Alaskans are still making their payments but have negative equity—that is, their homes are worth less than their outstanding mortgages.

The big lenders and insurers are holding depressingly large inventories of foreclosed properties. They have already taken tens of millions of dollars in losses.

The worst thing for the housing market right now would be panic. If the big lenders decided to dump their inventories of housing on the market at a low price in an attempt to cut their losses, they could create panic among homeowners with negative equity. Large numbers of homeowners might simply walk away from basically sound properties that will appreciate in value in the future. The result of such panic would be a continuing downward spiral of prices and many more foreclosures.

What would help the housing market most is a move toward stability: a leveling-off of prices and a reduction in defaults. Such a move toward stability would boost confidence among homeowners, and make them more likely to try to stay in their homes. Fewer defaults would ease the pressure on the lenders. Stability would help buy time toward solutions of the housing problems and eventual recovery of the market.

We are not saying that lower prices are bad for everyone and that higher prices are universally good.

Lower prices are obviously good for some Alaskans who might not have been able to buy houses a few years ago. What we are saying is that a *stabilization* of prices would be good. If prices became stable, the stage would be set for the recovery of the market and Alaskans could become more confident that housing is a good investment.

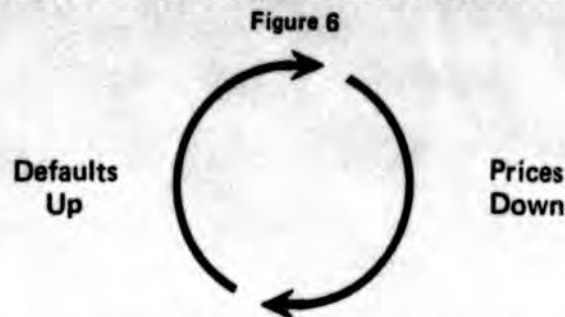
If, on the other hand, prices continue to fall and defaults persist in such disheartening numbers, investors will be reluctant to put money into the Alaska housing market in the future. That reluctance will translate into more expensive mortgage money for Alaskans. AHFC's ability to sell bonds could be hampered. Mortgage insurers might pull out of the Alaska market entirely, or charge much higher premiums for staying in.

So how can the market be stabilized? The biggest factor in the recovery of the housing market will of course be economic conditions. ISER projects that if—a crucial qualifier—oil prices remain stable in the \$16-to-\$20-per-barrel range, the state economy should bottom out in 1988 and begin a gradual recovery. This is our medium-case projection, and we consider it the most likely, if oil prices stay in that range. The economic recovery would be faster over the next several years if oil prices suddenly rose to around \$25 a barrel (our high-case projection) and stayed that high. At the other extreme, if oil prices dropped to \$15 a barrel or less and stayed that low for many months, the economy could continue to decline into 1989 and we would see very little growth over the next few years (the low-case projection).⁵

The next biggest factor in stability of the housing market will be—for reasons we describe below—sales of foreclosed properties. In the following pages we assess how rates of foreclosure sales and other factors could affect the Anchorage housing market between now and 1992.⁶ We don't have enough information to make such assessments for housing markets in other areas of the state, but movements in the Anchorage market will reflect general trends in housing markets throughout Alaska—with some obvious regional differences.

An important point to keep in mind is that we cannot forecast what is going to happen in the Anchorage housing market. To do that we would have to know how many foreclosed units the institutional sellers are going to put on the market and at what rate. What we can show are effects on the market of various rates of sale.

Sliding Prices and Rising Defaults: A Vicious Circle



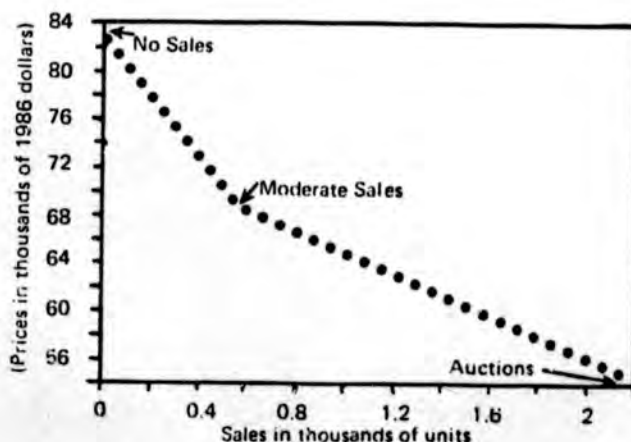
The faster AHFC and other big lenders and insurers put foreclosed properties on the market—at the extreme, through large auctions without bid floors—the more prices will be depressed and defaults persist, as illustrated by Figure 6. More defaults will mean the lenders will end up with even more foreclosed properties.

Flooding the market with housing pushes prices down. As prices go down, more and more homeowners find themselves with negative equity—that is, their mortgages are larger than the market prices of their properties. If owners with negative equity are forced to sell, many will likely default because they are unable or unwilling to make up what can be a very substantial difference between what they owe and what the properties will sell for.

Also, a continuing downward spiral of prices erodes confidence among would-be buyers and existing homeowners. Alaskans who might be attracted by lower housing prices won't buy if they think prices could go much lower. Demand for housing could dry up. Existing owners with negative equity become more likely to walk away from their properties if the value continues to drop and they can see no turnaround in sight.

Figure 7 illustrates how prices of Anchorage condominiums are related to the number of fore-

Figure 7. Relationship Between Real Prices and Sales of Foreclosed Anchorage Condominiums, 1988



⁵Those economic projections appear in "Alaska's Economy: What's Ahead?" *Alaska Review of Social and Economic Conditions*, Vol. XXIV, No. 2, December 1987.

⁶Anticipating what may happen is of course complicated by the fact that each lending institution has its own interests in and constraints on holding foreclosed inventory.

closed units on the market. The prices shown on the vertical axis of the figure are for a particular kind of unit and are *not* intended to represent average prices of all condominiums on the Anchorage market. (We know that in recent months condominiums in Anchorage have sold for as little as \$25,000 and as much as \$100,000.) What we are showing here is how different rates of sale could affect the price of the same condominium. So it is more important to look at the difference in the prices at various rates of sale than at the dollar figures.

As the figure shows, if all foreclosed condominiums were kept off the market—a very unrealistic scenario—condominium prices could be nearly 50 percent higher than if the market were flooded with condominiums through large auctions. At more moderate rates of sale, prices would be about 25 percent higher than if large auctions were held.

Holding properties off the market is of course very expensive for lenders and insurers: they pay in the neighborhood of \$18 to \$30 a day for each unit, depending on the size of the outstanding mortgage and the interest rate. We are not suggesting that lenders and insurers should hold onto all their foreclosed units: that simply is not feasible. We are pointing out that lenders should consider the future costs they might face if their selling policies contribute to more defaults.

Sliding property values and rising defaults have already cost Alaska lenders, insurers, and borrowers tens of millions of dollars. The foreclosure process itself is expensive. Costs of judicial foreclosures—under which the lender goes to court to try to make borrowers liable for any losses when the property is re-sold—are particularly high. And falling property values also have other social costs. For example, some homeowners who could find better jobs elsewhere don't move because they can't sell their houses for what they owe on them, and they don't want to default.

What Can Be Done?

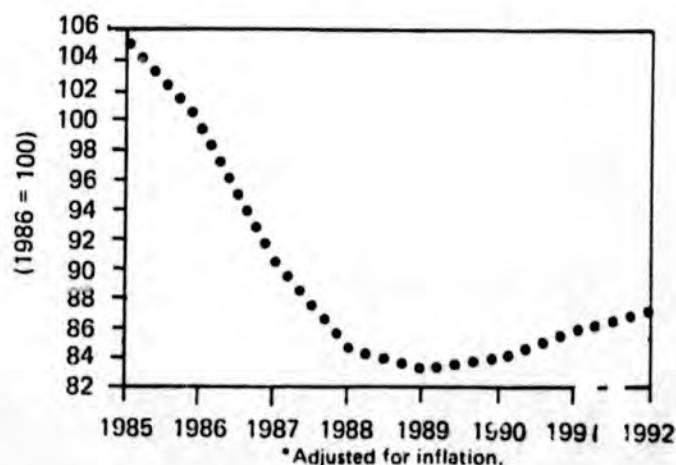
We examined a number of policies AHFC and other lenders might try to increase demand, reduce supply, stabilize prices, and reduce defaults. Those include loosening down payment and other loan requirements; easing restrictions on owner-occupancy in AHFC-financed condominium complexes; subsidizing interest rates; removing housing stock; and limiting or transferring mortgage liability in some circumstances.

We made our analysis with a complex computer model that simulates the Anchorage housing market and incorporates ISER's medium-case economic projections. Our findings about how various policies might affect the Anchorage housing market are de-

tailed in ISER's recent report, *Alaska's Economy and Housing Market*. Below we summarize our main findings:

- How the big lenders manage their large inventories of foreclosed properties will be far more important than anything else they do to try to stabilize the market. If they sell those properties very quickly—at the extreme, through big auctions without bid floors—and push prices further down, the housing market will continue to be unstable and defaults will persist.
- The market for single-family houses will recover more quickly than the market for condominiums. Most buyers prefer houses when they can afford them—and today's lower prices mean houses are within the reach of more buyers. Once the economy turns around, the market should be able to absorb the inventory of foreclosed single-family houses relatively quickly. And there will be some construction of single-family houses in Anchorage over the next several years—but the total number of new houses built between now and 1992 will likely be smaller than the number built during the peak construction year of 1983.
- Very few condominiums or apartments will be built in Anchorage between now and 1992, if our medium-case economic projections prove correct. The existing supply will be more than ample to meet demand. Under that same case, real rents—rents adjusted for inflation—in Anchorage in 1992 will still be below 1985 and 1986 levels (see Figure 8).
- Because such a large proportion of Anchorage condominiums are in foreclosure, it will likely take several years beyond 1992 to sell the inventory of

Figure 8. Projected Anchorage Real* Rent Index



foreclosed condominiums without further depressing prices.

- For some Alaskans there is a silver lining in the real estate cloud: lower prices will mean that they can move into better-quality housing than they could afford before. But a big barrier for those who already own homes is that many now owe more on their houses than the houses will sell for. Lenders may want to consider a policy that allows those who want to buy better houses in Alaska to transfer a portion of their current mortgage liability to new homes.

Faster or Slower Economic Recovery

We consider our medium-case economic projections most likely, if oil prices stay in the range of \$16- to \$20- per barrel. The findings outlined above are based on those medium projections. But it's always possible that the economy could grow faster or slower than we expect: the Alaska economy is often surprising. If oil prices were significantly higher or lower than we assume in the medium case, the housing market would of course be affected. Figures 9 and 10 illustrate the possible range of change in two housing market variables under the low, medium, and high economic cases.

Figure 9 shows how real—adjusted for inflation—prices of Anchorage condominiums would be different under the high, medium, and low economic projections. All three cases assume the same moderate rate of sales of foreclosed properties. If more or fewer foreclosed properties were sold, the projections would change.

In the medium and the high cases, average real prices for a standard condominium would bottom out in 1988 and in the low case in 1989. Prices would then begin a very gradual recovery. But even under the most optimistic case, 1992 average condominium prices when adjusted for inflation would still be far below their 1985 peak of around \$100,000.

Real prices of single-family houses should rebound faster, and—unlike the case for condominiums—a number of new houses will likely be built in Anchorage in the next few years. Figure 10 shows projected cumulative numbers of building permits for new single-family houses in Anchorage from 1987 through 1992 under high, medium, and low economic projections. Under any of the cases total construction over the next few years would be much less as compared with the frenzied building of the early 1980s: under the medium case, a total of fewer than 3,000 new houses would be built in Anchorage between now and 1992. By contrast, in 1983 alone 3,500 new houses were built in Anchorage.

Figure 9. Real Prices, Anchorage Condominiums Under Three Cases, 1985-1992

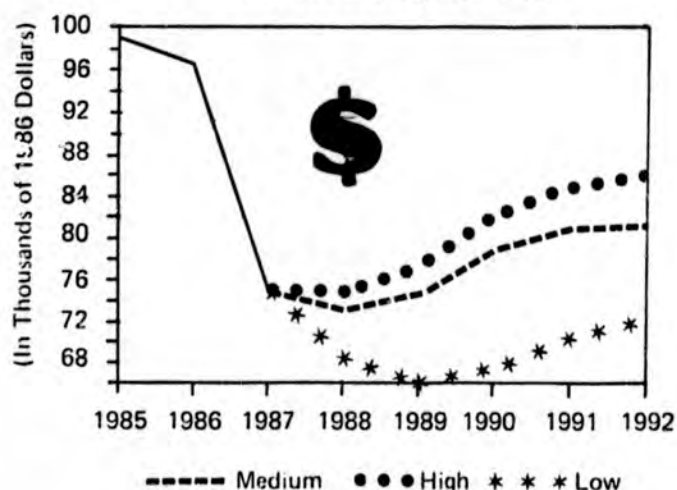
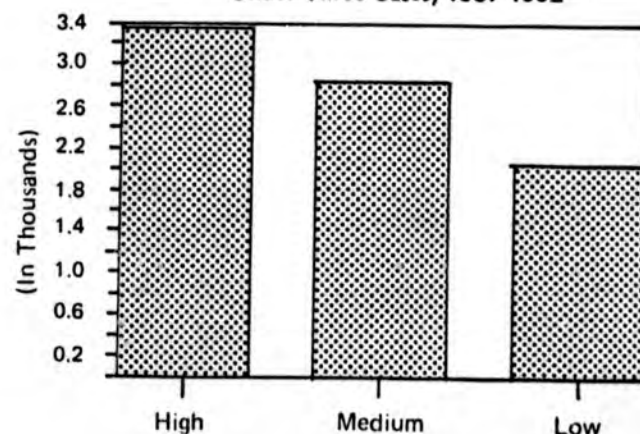


Figure 10. Projected Cumulative Building Permits for Anchorage Single-Family Houses, Under Three Cases, 1987-1992



Proposals
(Bridge Bank)

Peter McDowell

STRATEGIC DEVELOPMENT SERVICES

A DEVELOPMENT VENTURE COMPANY
AN APPROPRIATE FINANCIAL INSTITUTION FOR ALASKA

Background

Rural Alaska (Alaska excluding the boroughs of Anchorage, Fairbanks, Juneau, the Kenai Peninsula, Ketchikan, and Mat-Su) is the source of much of Alaska's economic wealth (60-80 percent depending on the export value of crude oil). It only contains about 10-15 percent of Alaska's population and about 12-15 percent of the nonseasonal jobs. Those people and jobs, however, produce most of the wealth enjoyed by the other 85-90 percent who live and work in urban Alaska. With the exception of Kenai and Ketchikan, most urban Alaskans do not live near any basic economic activity other than tourism and national defense installations at Anchorage and Fairbanks. Future expansion and diversification of the Alaskan economy's basic sectors will also take place in rural areas, because much of it will depend on the locational, fish, timber, subsurface and scenic and recreational resource values which are concentrated there.

Moreover, any vision of the future of Alaska's economic growth should be solidly grounded in "fundamental economics", i.e., that economic activity in a specific geographic place will be limited to subsistence unless exports to nations, regions, and states outside its boundaries are produced. This also means that a secondary (service) economy cannot exist in the absence of a primary (export) economy. Since contact with the Russians, Alaska has always been an exporter - furs, whalebone, whale oil, gold, salmon, walrus ivory, other minerals, oil and gas, other fish, crab and forest products. Alaska also exports geopolitical location (to the U.S. military), public domain (to federal civilian agencies) and scenic and recreational resource values (to tourists). Alaskan exports of manufactured goods are principally LNG and urea from the Kenai, and pulp, cants, and heavy timbers from Southeast. The fundamental insight is no basic, no secondary.

The concentration of basic economic activity does not appear to have led to any concentration of financial assets or services in rural Alaska. In fact, the opposite seems to be true. Most financial assets and services are in urban areas, particularly Anchorage. Rural financial services appear to consist mainly of gathering deposits, some of which are in turn used to create financial assets (loans, leases and securities) in urban places.

Most Alaskan economic activity controlled by residents is secondary (service) by nature. That is also the principal kind of economic activity financed by Alaskan financial institutions, particularly those which have failed, or are in danger of failing in 1987. It is likely that the successful Alaskan financial institutions of the future will not specialize in the financing of speculative secondary (service) businesses. They will probably specialize in either:

- investing deposits gathered from Alaska in a blend of Federal government and other investment-grade securities, and loans to conservatively-managed Alaskan businesses in urban places, or
- facilitating the development and/or expansion of export-based economic development projects in rural Alaskan places that involve the export of one or more of Alaska's natural resource values:
 - fish products
 - timber products
 - hard rock minerals
 - coal
 - geopolitical location
 - public domain
 - oil and gas
 - scenic tourism
 - recreational tourism

This function is currently carried out principally by investment groups and private corporations from Canada, Japan, and the United States and some ANCSA corporations, for both resident and nonresident businesses engaged in basic (export) sector activities. There is also some involvement of Canadian, Japanese, and U.S. banks and investment banks.

An Appropriate Financial Institution

Central to any "Alaskan economic strategy" is a vision of Alaska's economic future where a vital, market-driven basic export sector provides opportunity for individuals and businesses to take risks and to use their imagination, knowledge, skills, energy, capital and technology - the basic stocks of wealth-creating capability - to create new products or services that markets want, or improve on those already being provided. In other words, to compete. One potential State economic strategy might be to: Go forth and do the right thing - create jobs by building private businesses.

There is an investment opportunity to seize the lead role in development of the kind of private financial institution appropriate to the strategies inherent in this vision. The development of an appropriate financial institution to help enhance the wealth-creating capability of Alaskan businesses is a compelling necessity, not a redundant luxury.

Such an institution would need to be substantially different from all existing Alaskan financial services agencies, if it were to concentrate its efforts on expansion of basic export sector economic activities. It could be structured as a blend of the venture capital fund model successfully operating elsewhere in North America, and the "development finance company" model successfully implemented in other countries by the International Finance Corporation, the private sector affiliate of the World Bank. This blend could be called a "development venture company" (DVC). The key factors for success of a DVC include, in priority order:

1. A viable expanding market for its services, consisting of individuals and entities with entrepreneurial will, financial capital, and export resources.

2. Personnel with the training and temperament to add value by nurturing and counseling those persons who are willing to engage in rural, export sector entrepreneurship, including the ability to:
 - identify business opportunities,
 - assess entrepreneurial skills and commitment,
 - develop pragmatic business plans with adequate data about critical success factors including skills, markets, equity, and other financing,
 - evaluate economic development project viability, and
 - restructure or reject nonviable proposals early.
3. A financial capital structure based on a high proportion of equity and stable, low-cost, long-term debt.

This model includes several features which are distinctly unlike any existing Alaskan financial institutions, including:

- Close linkage with State government agencies and programs that have a mandate to help promote and develop export base industries - e.g., the Alaska Industrial Development and Export Authority (AIDEA), as recently strengthened, Trade Alaska, and the Departments of Commerce and Economic Development and Community and Regional Affairs.
- Predominant emphasis on active lending and investment in development projects, i.e., asset management, rather than the current liability management (deposit-gathering) emphasis of most Alaskan financial institutions.
- Provision of regular and substantial management assistance to borrowers/investees, much like the nurturing activities of venture capitalists and investment bankers.
- Unprecedented use of technology in computing and communications. All day-to-day communications between project locations and the financial institution must be conducted with maximum facility and power. This is only obtainable through leveraging human resources with communication and information technology.
- Strategic alliances with customers, federal, State and local governments and other leading economic institutions involved with export base industries.
- Strategic alliances with Japanese and other foreign private financial institutions with the wherewithal to participate in the financing of, and technical assistance to, basic export sector economic development projects.

- Recruitment, and investment, of a pool of financial capital from a variety of sources depending on the organizational form selected.
- Profits from fees for services and risk-sharing, dividends, interest, and capital gains.
- Employment of personnel distinctly different from the typical Alaskan bank management staff of the 1980s. The new personnel need to be recruited and trained to emphasize:
 - ° Advocacy for the ideas and business plans of their customers,
 - ° Export base development project design and technical assistance skills,
 - ° Shared Alaskan values - the "corporate culture" of our state,
 - ° Rural Alaskan factors for success, and
 - ° Alaska Native background, with special emphasis on ANCSA corporations.
 - ° Service and management assistance skills in:
 - Application of technology
 - Export financing
 - Foreign financial markets and institutions
 - Acquisitions, mergers, and divestitures
 - Seafood harvesting and processing
 - Timber harvesting and processing
 - Mineral exploration, extraction, and processing
 - Tourism attractions, accommodations and access
 - Rural construction
 - Rural real estate development
 - Rural governance
 - Energy
 - Transportation
 - Other infrastructure

This people component represents a commitment to strive for modernization and would open a clear opportunity for Alaskans to grow into the present and future business world of knowledge-based employment and technology-driven services that are already reshaping Alaska's economic opportunities.

Financial Structure

The contemplated institution must have extreme stability of equity and debt capital. It should rely on:

- Equity capital from investors.

- Long-term bond debt - perhaps issued by AIDEA - to help capitalize the institution in as stable a fashion as possible.
- Core deposits from rural areas (at present only six or seven percent of total Alaskan bank deposits), depending on the entity selected.
- Core deposits from urban places, to the extent available (likely to be limited to public funds), depending on the entity selected.

The Market for Regional Services

A principal mission of such a financial institution would be regional services - development project services including financing and management assistance which add value - to regional and village ANCSA corporations and other entrepreneurs who are actively developing resource export projects in rural places. The institution could, for example, specialize in regional services for companies that do business in rural Alaska - whether the Interior, North Slope, Northwest Arctic, Bering Sea, Southwest, Gulf Coast, or Southeast regions. Regional service functions would consist primarily of:

- Information and education about rural, state, and worldwide economics, markets and technology.
- Management assistance for designing the financial infrastructure of development projects.
- Recruitment of equity and long-term debt capital sources.
- Provision of debt for exploration, development, working capital for operations, and other shorter-term purposes.

These services can, and must, be rendered with quality and excellence as the foremost values of the institution and its people.

Leveraging Existing Financial Institutions

As stated, there are no private Alaskan financial institutions currently operating on the development venture company model. In the public sector, AIDEA now has statutory authority to assist in this field, but limited prior experience.

Certain banks do operate (principally as deposit-gatherers) in rural Alaskan places. These include UBA, UBASE, NBA, FNBA, First Bank and B.M. Behrends. It is possible to conceive that an existing bank could form the core of an export-oriented rural Alaskan DVC. They would, however, require major management, skill, and technology transfusions to become successful in development project finance activities.

Beyond these, there do not appear to be any existing domestic financial institutions designed for, or in pursuit of, Alaskan development project finance activities. There do, however, appear to be numerous offshore institutions that are so engaged.

These offshore institutions may represent an opportunity for reverse leverage, by capitalizing on their interest in expansion of their DVC activities in association with Alaskan partners. Such partnerships could represent significant access to the human, financial, and technological resources necessary to this proposed expansion of the domestic Alaskan financial infrastructure.

Alternative Entity Forms

An Alaskan "development venture company" could be structured in several ways - from a unit within an existing company, a subsidiary thereof, a joint venture corporation, an investment bank, to a State-chartered commercial bank. Each organizational form has advantages and disadvantages. These include control, economies of scale, financial risk, capital requirements, complexity, and government regulation as shown below:

<u>Entity</u>	<u>Corporation Unit</u>	<u>Corporation Subsidiary</u>	<u>Joint Venture</u>	<u>Investment Bank</u>	<u>Commercial Bank</u>
Control	Most				Least
Economies of Scale	Least				Greatest
Financial Risk - Spreading	Least				Greatest
Capital Requirements	Low				High
Complexity and Cost of Implementation	Least				Most
Degree of Government Regulation	Least				Greatest

Peter McDowell
June 1987

RBY

FACT SHEET **SOUTHWEST PLAN**

OBJECTIVE: Achieve viability of Texas thrifts through consolidation. Reduce cost of funds in Texas and ultimately nationwide.

STRATEGY: Consolidate 143 ailing (104 insolvent) out of 281 thrifts currently operating in Texas, so that surviving viable institutions number between 160 and 180. Approximately 70 percent of troubled institutions have signed consent-to-merge agreements.

Reduce number of branches from more than 1800 to nearly 1400.

Divide Texas into 14 thrift regions and ensure that each region has appropriate service to meet needs of its people.

RESULTS: Potential size of surviving thrifts

Local.....Up to \$800 million
Regional.....\$800 million to \$2.5 billion
Multi-regional.....More than \$2.5 billion
Statewide.....None

Estimated Size of all Texas thrifts before and after consolidation

	<u>Pre-plan</u>	<u>Post-plan</u>
0-\$100 million	45%	53%
\$100-\$500 million	39%	29%
\$500 million-\$1 billion	8%	6%
More than \$1 billion	8%	12%

Eliminate 1987 loss of \$2.2 billion of all Texas thrifts at end of first year of consolidation.

COST TO FSLIC: Estimated for implementation of strategy, \$6 to \$7 billion, with funds derived from FSLIC recapitalization program, assessments of the thrift industry and other sources.

FSLIC will conserve cash and extend impact of its funds by issuing FSLIC notes and using assets as collateral. FSLIC expects to recoup part of its investment in troubled thrifts by sharing in profits of consolidated institutions and/or holding an equity position in them. FSLIC's equity position will not be used to control an institution.

OTHER CAPITAL: \$1 billion in new capital could be available from potential acquirers and/or institutions that could participate in consolidations. Additional capital will be available as the plan moves forward.

FEDERAL HOME LOAN BANK BOARD**Resolution No.****Dated:**

- Whereas** The Federal Home Loan Bank Board ("Board") is engaged in the development of a plan for solving the multibillion dollar problem of thrift institutions in the Board's Ninth District, comprised of the states of Texas, Mississippi, Louisiana, Arkansas and New Mexico, called the "Southwest Plan";
- Whereas** Representatives of the thrift industry in the Southwest, together with their trade associations, have urged consolidation as a means of reducing excessive operating costs and expenses;
- Whereas** The Board has placed a major priority on resolving thrift problems in Texas in recognition of the fact that thrift troubles in that state constitute a major fraction of all thrift problems nationwide;
- Whereas** The Board believes that a solution of the Texas problem will aid the Board's efforts to solve thrift problems throughout the nation and aid in the reduction of the cost of funds to all institutions;
- Whereas** Consolidation of the Federal Savings and Loan Insurance Corporation's ("FSLIC's") insolvent institutions together with some combination of healthy institutions and capital infusions to produce viable thrifts would achieve various benefits, including:
- Significant savings in operating expenses;
 - Management teams capable of providing the leadership and controls necessary to achieve viability;
 - The ability to permit higher cost deposits to be reduced by cash flow from investments supported by lower cost deposits;

- Merging within one institution complex financial investments that currently are located in several institutions, with attendant unnecessary costs;
- Attract capital to a market that currently has too many inefficiencies to produce a reasonable return on new capital;

Whereas The Board initiated an analysis of possible means to reduce operating and deposit costs in support of the Southwest Plan, thereby enhancing confidence in the thrift industry, with the following directions:

- Retain a competitive environment within the district, preserving the basic nature of its thrift industry, while delivering financial service to customers efficiently and effectively;
- Reduce or eliminate duplications and redundancies in the financial services industry, which currently are adding to operating costs;
- Identify the most capable management to implement the plan;
- Provide a mechanism for reducing the expenses and controlling losses in troubled assets;
- The efficient use of FSLIC resources in resolving problems;
- Shares of the future profits of assisted institutions for FSLIC;

Whereas The analysis has reported, in pertinent part, that:

- Consolidation would provide for an integrated approach to the existing insolvencies rather than resolving cases less effectively on a case-by-case basis;
- Fourteen geographical regions can be identified in Texas; consolidation should occur within the framework of those geographical market areas, some of which are local, some regional, and some multiregional (but not statewide);

- Consolidation could significantly reduce the number of savings and loans and deposit-gathering offices within those markets;
- Consolidation should provide immediate operational savings, exclusive of conversion costs, of several hundred million dollars per year;
- Additional, even greater, savings may be achieved through resulting reductions in the cost of funds to insured institutions throughout the Ninth District;
- Further savings are possible through the consolidation of shared complex financial assets in a single institution, eliminating or simplifying management costs and litigation;
- The key to these savings, as well as to reducing the long-run cost to the FSLIC, is the identification and selection of strong management;
- By retaining an interest in the future profits of assisted institutions and their assets, the FSLIC stands to share in the savings that result from the plan; and

Whereas The Board concludes that the resources of the FSLIC are sufficient to support a strategy of consolidation if pursued in accordance with the analysis considered by the Board.

Now therefore be it resolved that:

The strategy of consolidation should be pursued as part of the Board's Southwest Plan and its overall efforts to restore the financial health of the thrift industry and preserve the financial health of the FSLIC;

The FSLIC, in consultation with the Board's Office of Regulatory Policy, Oversight and Supervision, the Federal Home Loan Bank of Dallas, and other appropriate state and federal regulatory agencies shall:

- Within the limits of the Board's authority, identify and foster the retention of the most capable management in the consolidated institutions, with a view toward both satisfying the institutions' immediate needs for capable management and minimizing the long term costs of the FSLIC;
- Develop such a strategy that will consider the multiregional nature of the Ninth District in general and the State of Texas more specifically;
- Provide a procedure that will permit new capital to be introduced into consolidated local, regional, and multiregional institutions within Texas on a cost-effective basis;
- Promote fairness by providing potential investors and managers the opportunity to compete for the right to participate in the plan on an equitable basis, to the ultimate benefit of the FSLIC fund;
- Foster the consolidation of complex financial assets in which conflicts among participants are raising costs;
- Provide necessary procedures and staffing for continuing a strategy of consolidation; and
- Proceed with implementation in as expeditious a manner as possible.

By the Federal Home Loan Bank Board

KEY PARAMETERS

- **Preserve basic structure and competition of thrift industry.**
- **Eliminate duplication and over-branching**

GUIDELINES USED IN DEVELOPING SOUTHWEST PLAN

- Retain competitive environment within district, preserving basic nature of thrift industry, while delivering financial service to customers efficiently and effectively.
- Reduce or eliminate duplications and redundancies in financial services industry, which currently are adding to operating costs.
- Identify most capable management to implement plan.
- Provide mechanism for reducing expenses and controlling losses in troubled assets.
- Minimize use of cash in resolving problems.
- Gain future share of profits from assisted institutions for FSLIC

POTENTIAL RESULTING THRIFTS (ASSETS)

LOCAL	UP TO \$800 MILLION
REGIONAL	\$800 MILLION - \$2.5 BILLION
MULTI-REGIONAL	MORE THAN \$2.5 BILLION
STATEWIDE	NONE

SIZE OF THRIFTS

	<u>PRE-PLAN</u>	<u>POST-PLAN</u>
0 - \$100 MILLION	45%	53%
\$100 - \$500 MILION	39%	29%
\$500 MILLION - \$1 BILLION	8%	6%
OVER \$1 BILLION	8%	12%

TEXAS MAJOR METRO AREAS IN PROPOSED REGIONS



	MSA	IN REGION
A	ABILENE	14
B	AMARILLO	12
C	AUSTIN	8, 10
D	BEAUMONT- PORT ARTHUR	4, 5, 6
E	BROWNSVILLE- McALLEN	9, 11
F	CORPUS CHRISTIE	4, 7, 8, 9
G	DALLAS/ FORT WORTH	1, 2, 3 2, 3, 14
H	EL PASO	11
I	HOUSTON- GALVESTON	4, 5
J	KILLEEN-TEMPE	8
K	LAREDO	9, 11
L	LUBBOCK	12
M	MIDLAND- ODESSA	13
N	SAN ANGELO	13
O	SAN ANTONIO	8, 10
P	SHERMAN-DENTON	3
Q	TEXARKANA	3
R	TYLER- LONGVIEW	3
S	WACO	8, 14
T	WICHITA FALLS	14

TEXAS MAJOR METRO AREAS IN PROPOSED REGIONS

<u>REGION</u>	<u>ANCHOR AREA</u>	<u>GEOGRAPHIC DESCRIPTION</u>
1	DALLAS	DALLAS ONLY
2	DALLAS/FORT WORTH	THE METROPLEX
3	DALLAS TO TEXARKANA INCLUDING FT. WORTH, TYLER, LONGVIEW, SHERMAN DENTON, ETC.	(NORTH AND EAST TEXAS)
4	HOUSTON, GALVESTON, BEAUMONT, ORANGE, CORPUS CHRISTI	(TEXAS COAST)
5	HOUSTON, GALVESTON	(TEXAS COAST)
6	BEAUMONT, ORANGE	(TEXAS COAST)
7	CORPUS CHRISTI	(TEXAS COAST)
8	SAN ANTONIO, AUSTIN, CORPUS CHRISTI, KILLEEN, BRADY, WACO	(CENTRAL TEXAS AND THE HILL COUNTRY)
9	CORPUS CHRISTI, RIO GRANDE VALLEY, LAREDO	(SOUTHERN TIP OF TEXAS)
10	SAN ANTONIO, AUSTIN	(CENTRAL TEXAS)
11	EL PASO TO BROWNSVILLE	(ENTIRE RIO GRANDE BORDER)
12	LUBBOCK, AMARILLO	(PANHANDLE AND PLAINS)
13	MIDLAND, ODESSA, SAN ANGELO	(WEST TEXAS)
14	ABILENE, WICHITA FALLS, FT. WORTH, WACO	(NORTH AND WEST CENTRAL TEXAS)

**Non-viable thrifts should be
“*packaged*” with creative FSLIC
financial and regulatory assistance
to create marketable entities.**

CONCLUSION

- Consolidation Works
- FSLIC Can Afford
- Thrift Benefit Nationwide

REQUESTS FOR STATEMENTS OF INTEREST

The Federal Savings and Loan Insurance Corporation ("FSLIC"), an agency of the Federal Home Loan Bank Board, is considering a plan of action for the Southwest regional restructuring of savings institutions. The FSLIC may provide economic and non-economic assistance where it deems appropriate to assist in the restructuring of involved institutions. The purpose of the Southwest regional restructuring is to realize economies of scale, reduce operating expenses and eliminate redundancies in office locations while preserving adequate services, competition and basic structure in each locale.

The FSLIC is requesting statements of interest from parties desirous of participating in the Southwest regional restructuring. The FSLIC will consider responses from principals only. A Request for Proposal ("R.F.P.") may be requested from:

Coordinator
Southwest Regional Development
FSLIC
1700 G Street, N.W.
Washington, D.C. 20006

Indications of interest should clearly state the following:

1. The asset size of the savings institution(s) you are contemplating to acquire.
2. Preliminary estimates of the amount, type and source of capital you are willing to infuse into the acquired entity or entities.
3. The region(s) or local area(s) in which you may be interested, unless the party has no geographic constraints.
4. The general characteristics of the types of institutions in which you are most interested.

The FSLIC is seeking interest for three types of acquisitions:

1. Local institutions limiting service to their local communities and having an asset base of up to \$800 million.
2. Regional institutions serving the area of the state in which they are located and having assets of \$800 million to \$2.5 billion.
3. Multi-regionals serving more than one region and having assets in excess of \$2.5 billion.

Interested parties will be required to submit confidential biographical and financial information in order to be pre-screened to receive additional information regarding institutions that may be

involved in the restructuring. The required information for the pre-screening process will be provided to those who have indicated an interest.

The FSLIC, in consultation with the Office of Regulatory, Policy, Oversight and Supervision and the Federal Home Loan Bank of Dallas, will determine the acceptability of those seeking to be pre-screened. Such determinations will consider:

- o The financial strength, ability, amount and type of capital that the interested party will provide when pursuing consolidation within the targeted area;
- o The strength of proposed management;
- o Applications for acquisitions with the Southwest submitted within the last 12 months to either the Dallas Bank or FSLIC;
- o A key consideration in any of FSLIC negotiations for assisted acquisitions or mergers will be the preservation of as much of the basic structure and preservation of competition in each locale while restructuring these institutions to realize economies of scale, reduce operating expenses and eliminate redundancies in office locations.

FSLIC will provide to any interested party guidelines for equity sharing by FSLIC. Such guidelines will be subject to change without notice.

If requested, the R.F.P. will offer, on a confidential basis, financial summaries and projections of combinations available within market areas. Such information will also offer preliminary projections of potential branch closures, operating expenses reductions,...

Institutions not under a Consent to Merge Agreement will be notified if a proposal has been made affecting them. If they decline to be considered as a part of an approved plan of consolidation their Directors will be so notified by FSLIC, together with an estimate of increased costs to the plan and to their own operation.

FSLIC will approach some institutions that are not under a Consent to Merger Agreement and that appear to be good candidates and encourage them to submit proposals.

Questions regarding the R.F.P. should be directed to the coordinator listed above or to _____ at the Federal Home Loan Bank of Dallas.

Statements of interest should be submitted at your earliest convenience but no later than _____.

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ADDENDUM

PRE-SCREENING REQUIREMENTS

The following information must be submitted in order to ascertain the identity and legal form of a potential acquirer and to develop a basis for a preliminary financial evaluation:

FINANCIAL INSTITUTIONS

Financial Institutions that wish to be included on the National Marketing List are required to submit the following information:

On the institution's letterhead, a statement indicating their interest to be placed on the National Marketing List;

A statement detailing geographic and asset preferences; plus

Name, address and telephone number of the contact person to whom marketing information should be addressed.

Submission of this information will allow for inclusion on the FSLIC's National Marketing List. However, invitation(s) to submit a proposal is subject to supervisory clearance from an institution's primary regulator. The general parameter used to determine those financial institutions to be invited is twice the asset size of the target institution. Exceptions to the general parameter must be coordinated with the institution's primary regulator and the FSLIC.

INDIVIDUAL INVESTORS

A completed copy of the Investor's Information Form and the Confidential Biographical and Financial Report (FHLBB Form 1393) or a signed personal financial statement with supporting schedules detailing assets and liabilities.

Executed Affidavit that the information supplied is true and accurate.

Executed Certification regarding criminal and civil litigation.

A statement indicating business/financial background and/or management resources that will be made available for the acquired institution.

Additional information may be required in the course of the pre-screening process.

ADDENDUM: Page 2

COMPANIES (CORPORATIONS, PARTNERSHIPS, ETC.)

A copy of the company's annual report to shareholders for the last two years and the most recent quarterly statement (consolidated when appropriate).

1934 Act Reporting Corporations must also provide Forms 10-K, plus the recent 10-Q and proxy statements.

A statement that the financial information supplied is true and accurate.

A statement indicating the company's business/financial capabilities and management resources that will be made available for the acquired institution.

In addition, principals of non-publicly traded corporations must submit those items listed under the Individual Investors section for each principal involved in the transaction.

Note: All prospective acquirors are subject to credit and background checks. Once the pre-screening has been completed, you will be notified by the Marketing Section of the Mergers and Acquisitions Division/FSLIC.

REQUIREMENTS FOR CORPORATE AND PRIVATE INVESTORS TENDERING A PROPOSAL

In order for the FSLIC to proceed with an evaluation of a proposal tendered by a private or corporate investor, the offeror is required to submit the following additional information:

- 1) Statement as to the amount and source of capital to be provided.
- 2) Adequate evidence that the capital is available, e.g., letter of credit, commitment letter, subscription agreements, escrow verification, etc.

For those parties seeking to infuse non-cash capital, especially where no readily discernible market exists, please provide detailed information regarding the type of assets, the fair market value and the method of valuation used. Additional information may be required.

This information must be submitted no later than the submission deadline for receipt of proposals on this institution.

ADDENDUM: Page 3

The FHLBB/FSLIC reserves the right to reject an offeror's proposal based upon on inadequate demonstration of financial capability, inadequate management experience/depth or other factors which would impair the restoration of the savings institution to viability.

please direct Client Clearance Pre-Screening questions and information to:

Mr. Thomas L. Batties
Marketing Director
Mergers and Acquisitions Division
1700 G Street, N.W.
Washington, D.C. 20552
(202) 254-2593

ALASKA INVESTMENT BANK & TRUST

A Real Estate Holding Company
for the people of Alaska

Proposal by:

John M. Bashaw, Jr.

12746 Reata Drive
Anchorage, AK 99516
office 278-4556
home 345-3212

CORRECTED COPY FEBRUARY 15, 1988

OVERVIEW

We have, at this moment in time, one of the greatest opportunities for all citizens of the State of Alaska to participate in an investment that should help to provide stability in our economy and, in turn, a profit to themselves.

Most people realize we have an increasing loss of demand and an escalating overabundance of supply of real estate. There is not much that can be done in the near future to move the demand curve to a more favorable position. One that will have a dynamic impact on our economy (\$40/barrel oil excepted). This is not true; however, of the supply side.

Simply put - we now have the opportunity to buy low, deposit in savings, and (hopefully) sell at a profit in the near future - as with any investor. Also, I might add, I think we can safely say that we may never see this opportunity again.

Essentially, I see the current situation in three distinct categories.

1. The individual investor who is now buying properties and loans on the open market and from institutional owners such as FDIC. This is ideally where the market should remain, however, it does have enough positive impact on the current economy.
2. Institutional and strong individual investors who have been, and are continuing, to look for bulk purchases at large discounts. These buyers speculate (for cash) that these properties and loans can be "worked" until the economy improves and the assets sold at a profit. Simply said - high risk, cash intensive, with potentially large losses or gains. Please note, when we speak of assets we are talking about

two separate types. One is the buying of the actual real estate and the other is the purchase of loans and mortgages. The latter generates fair interest from potential buyers, however, I am not aware of any investors who are seriously interested in buying Alaska real estate in bulk.

3. The third approach, which seems to be the most touted and certainly the one getting the most attention, is the exclusive use of public funds or public debt to purchase speculative and selective real estate. We should strongly oppose any such plan!

JURY APPROACH

This plan of attack is simple, easy, and just takes one key participant or agency to coordinate the initial effort.

Lets get any and all ideas out on the table and come up with one recommended course of action that has a reasonable probability of being acceptable to the people first, and in turn public representatives and private industry. At the present time we have a number of proposed solutions and recommendations in various degrees of quality and territorial imperatives. Now is the time to draw all these efforts into one cohesive plan.

JURY SELECTION...The Department of Commerce recommends, and the Governor invites key participants to a conference to develop a workable economic plan. The jury will consist of one representative from the following areas and agencies with consideration to be on a statewide basis.*

- Native Corporations
- Private Industry
- Legal Profession
- Corporation Taxation
- University of Alaska
- Banking Industry
- Legislature
- Department of Commerce
- Permanent Fund
- AIDA
- AHFC
- Real Estate Industry
- Local Government

*Names available upon request.

These representatives are to be invited with only a few rules to the game.

1. Only the final plan will be made public. Any ideas expressed or explored during the conference are to be totally confidential and will not be discussed outside of the "jury" room.
2. Nothing is sacred. Any and all sources of funding, participation, and structure will be looked at and there will be no dumb ideas. Of course, some ideas may be rejected sooner than others.

3. There is no designed final plan, up to and possibly a final recommendation to do nothing.
4. All attendees must be willing to participate full time and continue until a majority agrees on a published plan or disband as a "hung jury".
5. All attendees must be willing to accept input from the public. This includes related professionals, as the "jury" has been limited to insure a workable number of participants.

EVERYONE CAN PARTICIPATE

As Dr. Hayden Green pointed out the other day - "Everyone wants to go down in history as the slayer of the economic dragon."

Question? Is there a way we can turn our current economic situation into an investment opportunity that will:

1. Not increase public debt.
2. Minimize the use of public funds.
3. Spread any use of public funds over a number of sources (risk management).
4. Cultivate and attract private capital to the maximum extent possible.
5. Establish a profit motivated entity that will benefit all participants and investors.
6. Assist in stabilizing our economy and stop or slow the erosion of property values.
7. Cease operation when no longer required.

YES!

Before I continue, I'd like to give credit to some of the clear thinkers on this issue. Thank you for your thoughts and ideas.

Dave Rose

Buz Hoffman

Hayden Green.

Ken Gain

Establish a holding bank with the clear purpose of buying foreclosed real estate at discount prices, moth balling the real estate, and liquidating these assets, at a profit, in the near future.

Seed money for development to be obtained by grants from

1. Municipality of Anchorage
2. State of Alaska
3. Federal funds (grant application)
4. Railbelt Energy Fund

The holding bank is to be profit motivated and structured.

The institution is to be chartered for no more than a 10 year life.

The Bank & Trust is to be (initially) equity financed with three basic stock issues.

1. Preferred stock (cumulative, first out, non voting) to be made available to any and all private investors, large or small, institutional* or individual. Issue to be at a \$1 par and, (as an additional incentive to attract private capital) for each share of preferred the stock holder automatically receives one share of Class A common stock.
2. Class A common stock (second out, voting) to be issued at a \$10 par and to be purchased with public funds from all of the following (spread the risk):

AHFC

AIDA

Permanent Fund earnings

Railbelt Energy Fund

Legislative appropriation from:

operating budget

capital budget

ASBA

3. Class B common stock, (last out, non voting) at a \$100 par to be purchased through an exchange of real estate at discounted values. These purchases (exchange of real estate for stock) are to be limited to real estate owned by institutional investors (lenders or mortgage insurance agencies) such as:

Banks

FNMA

HUD

AIDA

AHFC

MGIC

FDIC (may require cash only)

* examples: Native Corporations, Alaska Railroad, Banks, Alascom, ARCO, North Slope Borough, Municipality of Anchorage, Alaska Airlines.

It is important to stop and point out that these proposed numbers have not been fine tuned to computer accuracy and are only conceptual in nature. For example: if the holding company purchases a piece of real estate currently appraised for \$100,000 and expects to hold that property for ten years and sell it for \$100,000, then, at a 7% desired annual return on invested dollars the holding company should pay \$50,000 (actual \$49,759.63) less anticipated holding costs. Of course, if the property can be sold earlier at the same price, then the yield to the investors increases accordingly. Also, before I receive a rash of "bcy is that a good deal for someone" then let me also point out that "someone" is anyone who is willing to put their dollars down and take the corresponding risk for a possible profit - someday. Also, this concept addresses the supply side only and I leave the demand side solutions to other experts.

All plans must have some game rules, so let me throw some of these on the consideration table.

1. The Commission of Banking and Securities contract an external consulting firm to create the financing and accounting functions.
2. The Commission of Banking and Securities contract an external annual audit (published).
3. Purchases to be negotiated at a best buy price with significant discounts for bulk buys. No seller would be forced to sell and may certainly elect to keep their inventory (FDIC included).
4. Establish a moratorium on issue of Class B stock (real estate exchange) - say three years.
5. Establish guidelines (not limitations) on liquidation of assets, at less than face or appraised values, - example:

year 1	0%
2	5%
3	10%
4	15%
5	20%
6 - 10	as market dictates
6. Do not purchase loans or mortgages. These investments should be owned and operated from the private sector only.
7. Defer profits until liquidation.

8. The Governor appoints the chairman of the board and the legislature confirms the board members who will come from the following investment areas:

AHFC	Department of Commerce
AIDA	Appraiser
Real Estate Broker	Banker
Public at large	

9. The president and CEO plus all other employees to be private sector type hires with salary commensurate with the limited employment period, complexity, trust responsibilities and lack of retirement opportunities.
10. Earnings are not to be reinvested in anything other than a sinking trust fund and liquidation of equity position.
11. Asset liquidation to be accomplished through the real estate industry on a open listing type basis similar to HUD's current operation - selling commission only.
12. Place all acquired assets on the market at face or appraised value to allow the market to catch up with the price.
13. Establish a watch dog procedure to monitor appraisals, building permits, foreclosures, bankruptcies, etc. so that assets can be sold in the most favorable market conditions and at the earliest opportunity.
14. Do not close on property that is occupied. The selling agency must relocate all tenants, hopefully to other properties they own, prior to closing. The Bank and Trust should function as a holding company, not a competitor for property management.
15. Pursue unique markets such as sale of condos to the University of Alaska for use as dorms and the bulk sale of condos to Pacific Rim countries (at discount prices) for use as cultural exchange homes.
16. Yes, it might be necessary to obtain additional funds through debt financing. If so, then consideration should be given to bonds (not convertible) that could be raised on the strengths of the corporation alone. If that is not possible, then consider loans from either the public and/or private sectors. However, lest we forget, the creditor is now the first out and the equity owners take second position in case of forced liquidation.

EXTERNAL COMMITMENTS

No entity can operate in a vacuum or in isolation from its surrounding economic influences. Therefore, it is important that in developing this holding bank we also obtain written commitments to:

1. Demolish marginal and unsafe properties whenever possible.
2. Place a moratorium on any rezoning that results in a higher density.
3. Place a moratorium on expansion of utilities, at least until there is a better utilization of highest and best use of our present land.
4. Mothball or export all excess mobile homes.

CONCLUSION

I doubt that my plan, which is really a conglomerate of my ideas and other proposals, will slay the economic dragon (wounded - maybe). However, after a stop, look and listen posture for the last three years, I am now convinced that the time is right to bring together some of the best talent in the state who will, in turn, analyze the problem, evaluate alternative courses of action, and develop a proposal that WILL WORK!

If there is a problem in our economy, and that problem is an excess in the supply of real estate and we have decided that something must be done - then let's do it right!

1. a combined effort from the private and public sectors.
2. put our money down and accept the risk and profit.
3. spread the risk.
4. and most importantly do not debt finance with public funds. Let's treat this problem as an investment opportunity not a bail out program.

P.S. If we are going to moth ball real estate, let's start with the PAC! It's a little silly to walk around town in a mink coat and no shoes.

Alliance Bank

March 19, 1988

Mr. Gumbiner has asked us to transmit the enclosed updated "PROPOSAL FOR THE ESTABLISHMENT OF THE HALLWOOD ALASKAN REAL ESTATE STABILIZATION TRUST" to you in an effort to keep you informed.

Should you have questions or comments, they could be directed to him through my office.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Fred H. Burrow', is written over a circular stamp or seal.

Fred H. Burrow
President

Enclosure

**PROPOSAL FOR THE ESTABLISHMENT OF THE HALLWOOD ALASKAN
REAL ESTATE STABILIZATION TRUST**

A liquidating trust formed to liquidate on an orderly basis at stable appraised prices in the best interests of the Beneficiary Institutions, the supply of distressed real estate properties and loans currently overhanging the Alaskan market.

Background

As a result of the current severe recession in the Alaskan economy which followed a period of strong economic growth in the commercial and residential real estate market, Alaskan lending institutions and certain state and government agencies who have assumed the obligations of failed institutions, are today burdened with an unprecedented holding of "bad" real estate loans, some of which have been foreclosed and all of which are at least partially non-performing. Real estate values have been declining monthly. Although the decline in real estate values has been slow and the recession is seen to be bottoming out, the recovery is extremely fragile and prices could be precipitously collapsed if the overhanging real estate were offered back into the market at distressed prices for forced sale.

Alliance Bancorporation ("Alliance") was recently formed by the merger of Alaska Mutual Bank, United Bank Alaska and United Bank Alaska Southeastern and was recently recapitalized by the Hallwood Group Incorporated ("Hallwood") and the FDIC. Alliance currently holds some \$300 million of bad real estate loans of which about \$80 million has already been foreclosed and the balance being in the form of classified and non and partly performing real estate loans. The FDIC, as Receiver of the failed First Interstate Bank of the North, holds about \$200 million of "bad" loans of which at least half are property related. Additionally, Fannie Mae, the Federal Home Loan Bank Board, Alaska Housing Finance, MGIC, New York Life and other Alaskan lending institutions all hold similar "bad" loan portfolios.

If any of the above institutions were to "dump" their real estate holdings into the local market they would collapse the fragile price structure and ensure the continuation of the current recession to the detriment of not only themselves individually and as a group, but all Alaskan citizens and property owners.

The objective of "The Hallwood Alaskan Real Estate Stabilization Trust" is to prevent a further decline in real estate values by allowing the Trustee of the Trust to manage the liquidation of the trust assets so as to prevent an oversupply of property in the local marketplace such as would cause further declines in the price of residential or commercial properties.

The Proposal

In order to maintain a stable market and to encourage a recovery, Hallwood proposes the establishment of "The Hallwood Alaskan Real Estate Stabilization Trust" (the "Trust") to be formed as a liquidating trust with the purpose of liquidating trust property by sale or other disposition as promptly as shall be economically feasible in the best interests of the Beneficiary Institutions and to distribute the distributable proceeds to the Facilitating Beneficiary Institutions solely and exclusively in accordance with the provisions of a Distribution Agreement.

The Board of Alliance Bank has already agreed to subscribe its distressed portfolio of real estate assets to the Trust and we intend to invite the FDIC and the other concerned institutions mentioned above to become subscribers to the Trust prior to its formation date of March 31, 1988. Following subscription of assets to the Trust, beneficiary institutions will own an undivided interest in the Trust.

We anticipate that the transferred assets will consist of single family homes, condominium projects, apartment buildings, a few

office buildings and other commercial structures, shopping centers and parcels of raw and improved land. We also anticipate receiving non-performing or partly performing mortgage loans secured by real estate.

It is our intention that all transferred assets will be recorded in the Trust's books at fair market value as of March 31, 1988. The fair market value of real estate properties will be based upon current independent appraisals except for those assets where a sale was pending and subsequently closed. In those cases, the proposed selling price will be considered as a more accurate indication of fair market value. Fair market value of real estate loans will be based upon current independent appraisals. All appraisals will be carried out in accordance with accepted appraisal methods by a qualified independent appraiser who is a member of the American Institute of Real Estate Appraisers and who regularly performs appraisal services for major financial institutions. Credit will be given in the appraisal process for any income flowing from any transferred asset.

It is intended that Hallwood will act as the Trustee for the Trust which would be established for a ten-year period expiring in March 1998. If all of the Trust assets have not been sold off by this time, then the Trust will come to an end unless a new five-year liquidating trust is established by the Beneficiary Institutions.

It is intended that a Procedures Agreement would be drafted to establish a minimum sales price for each of the Transferred Assets. Minimum sales prices will be based upon appraised values. The Procedures Agreement will also establish restrictions on financing by the Trust although it is intended that the Trust will offer financing to purchasers to assist in the sell-out (see "Marketing"). The requirement of the Procedures Agreement will assure the Beneficiary Institutions

that no asset will be sold for less than a certain fixed amount and that the deferred portion of any sales price will be properly secured and payable over a limited period of time. The Trustee's powers and duties would be governed by a Trust Agreement which will generally authorize the Trustee to preserve and manage but not to develop the Trust assets.^d Accordingly the Trustee has discretion, for the purpose of marketing, to obtain necessary appraisals, feasibility studies, engineering studies or marketing surveys. The Trust cannot undertake to develop unimproved properties to the extent of commencement of any sort of major construction.

Generally the Trustee will limit expenses to any necessary management costs such as taxes, insurance and maintenance and to its own office budget and outside professional fees. Additionally, the Trust may expend sums necessary to preserve its properties or prevent the enforcement of liens superior to the Trust's mortgage loan assets.

As to borrowing funds, the Trust Agreement will provide that borrowings shall not exceed an aggregate of 10% of total Trust assets at appraised value and further that borrowings may only be made from the State of Alaska, secured on any future profit which may be realized from future sales of Trust Assets. Under such borrowings we would expect the State to roll over interest payments to the extent that such payments were not available out of Trust cash flow. It is not anticipated that the Trust will need to avail itself of this borrowing facility and it is anticipated that the cash flow from the prospective sale of Trust assets together with the \$15 million cash contribution which will be contributed by the State of Alaska (see "Assistance from the State of Alaska") will be sufficient to fund all ongoing operations of the Trust.

Under the terms of the Distribution Agreement, the Trustee will

first satisfy itself that sufficient working capital is available to the Trustee to operate the Trust and will then distribute

- a) To the Beneficiary Institutions such sum as represents a proportional return of appraised value and any profit achieved thereon unless some drawdown shall have been made by the Trustee under the standby credit facility from the State of Alaska more particularly mentioned hereafter.
- b) If such drawdown shall have been made, then any such profit shall first be applied to repay with interest any advance made by the State.

The Trustee will be empowered to sell off blocks of property to other trusts or corporations dedicated to a long term holding period such as that currently proposed by the Commissioner for the Department of Commerce and Economic Development for the State of Alaska and Sealaska Corporation.

As to the tax consequences of the Trust to the Beneficiary Institutions, the Trust will be treated as a "Grantor Trust" for federal income tax purposes and, as such, all tax trust consequences flow through the Trust to its beneficiaries in accordance with their respective interests. The Trust beneficiaries are fully insulated, on the other hand, from any liability which might arise out of the various Trust Assets.

To ensure that the Trust will distribute all distributable proceeds in a timely manner and in accordance with the proper percentages to the Beneficiary Institutions, the Trust Agreement will require that the Trust's financial statements will be examined by a firm of independent certified public accountants. Following each examination, the accountants will issue a letter to the Beneficiary Institutions stating whether all distributions have been made in accordance with the Trust Agreement and the Distribution Agreement.

The Trust Agreement will also require the Trustee to furnish the following reports to beneficiary banks:

- a) A monthly statement of cash receipts and cash disbursements with a detailed description of all sales or dispositions of trust property and of any modifications, amendments or extensions of obligations owing the Trust.
- b) A quarterly unaudited balance sheet, income statement, statement of Trust principal, statement of changes in financial position and a schedule of all distributions made during such quarter.
- c) A semi-annual summary of the status of each Transferred Asset and a description of any negotiations then in progress concerning the sale or other disposition of such Transferred Assets.
- d) An annual audited balance sheet, income statement, statement of Trust principal, statement of changes in financial position and a schedule of all dispositions made during the year.
- e) In connection with the examination of the annual reports and financial statements, the independent certified public accountants must issue letters stating:
 - 1. that the sales and distributions made during the preceding year were in accordance with the terms of the Trust Agreement, Procedures Agreement and Distribution Agreement, and,

- ii. with respect to the internal financial controls and practices of the Trust, setting forth such recommendations as the independent certified public accountants may consider appropriate.

Assistance from the State of Alaska

In order to ensure that the Trust is funded with sufficient working capital, we shall request the State of Alaska, through one or more of its agencies, to appropriate and subscribe the sum of \$15 million in cash to the Trust for which the State shall receive a beneficial interest in the Trust, in proportion to its subscription.

We anticipate that this \$15 million plus the proceeds of sale of Trust Assets will be sufficient to ensure the continuity of the Trust and the payment of all marketing and general and administrative costs and expenses of the Trustee, for at least one year. At the end of the year if the Trust requires further funding from the State, we shall report our then position and request a further sum of up to \$15 million for the next current year in the form of a loan from the State to be secured by a first lien on any profit that may be realized by the Trustee from future sales of Trust Assets, such loan to bear interest at current market rates. The Trust shall have the power to roll over interest payments until sufficient cash flow becomes available from profits generated from Trust operations to make

settlement. Repayment of interest and principal upon such loans drawn down during the life of the Trust shall have priority to any distributions of any profit which shall be made to Beneficiary Institutions.

Marketing

Immediately following the establishment of the Trust, the Trustee shall prepare a cash flow projection to determine how quickly the Beneficiary Institutions can reasonably expect the transferred assets to be sold and to what extent their interests could be converted into cash. At the outset the Trustee will review all of the non-performing real estate loans and real estate owned to identify essential problem areas. Problems involving construction, design, budgets, cash flow, management location, competition, marketing techniques and various other factors must be analyzed to determine the causes of non-performance or under-performance for each specific asset. Independent appraisals will have to be obtained to arrive at a minimum selling price for each real estate property and further, an initial status report must be prepared for the real estate unit for each asset containing the description of the asset, the loan history, net book value, current status, pending litigation.

For real estate owned, professional quality sales packages will need to be prepared for each real estate property. Each package will contain a full description of the property site and

improvements, income and expense information, lease abstracts, information on available utilities, zoning, taxes, etc.

Regarding loan workouts, the Trustee will evaluate the financial condition of the debtor and the prospect for recovery and will evaluate existing collateral and the prospect for obtaining additional collateral in addition to various types of loan modification, intervention in management or leasing, increased monitoring and control of collateral and possible turnaround methods may also be considered.

Both real estate owned and real estate loans deemed appropriate for foreclosure, i.e., future real estate owned, will be marketed for sale although particular care will be taken with regard to the amount and pricing of real estate offered for sale in the local Alaskan marketplace. The major marketing effort will be made to foreign, i.e., non-American, prospective purchasers through Hallwood's international network around the world.

Hallwood is a public company listed on the New York and London Stock Exchange, specializing in the financial services industry and owned by approximately 35,000 shareholders and institutional investors. Prominent amongst these are the Fidelity Group of Boston, one of the largest fund managers in the United States, with offices in London, Hong Kong, Singapore, and various other countries. Fidelity owns approximately 11.2% of Hallwood's

equity. Another major shareholder is M&G, one of the largest fund managers in the United Kingdom, controlled by Kleinwort Benson, an international merchant bank with a major presence around the world. Hallwood has considerable expertise in the liquidation and management of distressed real estate. In 1979, Hallwood restructured First Pennsylvania Mortgage Trust, a New York Stock Exchange listed real estate investment trust, owning a major portfolio of distressed real estate and mortgage loans located throughout the United States.

In 1981 Hallwood restructured the Umet Trust, a New York Stock Exchange listed real estate investment trust formed by Union Bank of California, again holding a major portfolio of distressed real estate and real estate loans.

In 1983 Hallwood restructured the Institutional Investors Trust, yet another New York Stock Exchange listed real estate investment trust, this time formed by Donaldson, Lufkin, Jenrette, the New York investment bank, again holding a portfolio of poor quality distressed real estate. Finally, in 1984, Hallwood acquired the assets of The Twenty Seven Trust which was formed to liquidate the assets of the bankrupt Chase Manhattan Mortgage and Realty Trust for the beneficiaries of 26 creditor banks and the FDIC. This current proposal is based upon the arrangements entered into by the creditor banks and the FDIC for the liquidation of The Twenty Seven Trust's assets.