

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILE 8672
1603 SCOMM 60. HOUSING FINANCE TASK FORCE, 1989

8. References

8. References

Several references to Ernst & Young's recent housing finance and real estate work follow. We urge you to contact these references to assure yourselves of the quality of our performance, and that the value of our consulting and advisory services is held in high esteem by our clients.

- **Mr. Karney Hodge, Director**
California Housing Finance Agency
Director, National Council of State Housing Agencies
1121 "L" Street, 7th Floor
Sacramento, CA 95814
Phone: (916) 324-4638
- **Paul Isaki, Special Assistant for Policy**
Office of the Governor, State of Washington
3rd Floor, Insurance Building
Olympia, WA 98504
(206) 586-0820
- **The Honorable Emilio Cantu, Senator**
Ways and Means Committee
Washington State Senate
Olympia, WA 98504
(206) 786-7680
- **Kanellos J. Astor, President/CEO**
Washington State Convention and Trade Center
720 Olive Way, Suite 1515
Seattle, WA 98101
(206) 464-5414
- **Brent Donaldson, President**
Liquidity Fund Investment Corporation
1900 Powell Street, Suite 730
Emeryville, CA 94608-1831
(415) 652-1462
- **Richard Wollock, President**
Johnstown/Consolidated Institutional Advisors, Inc.
2000 Powell Street
Emeryville, CA 94608-1831
(415) 652-7171

- **Tom Lackman, Chief Financial Officer**
Storek & Storek
484 Ninth Street
Oakland, CA 94607
(415) 444-3300
- **Jim Cote, President**
Grubb & Ellis Securities Corporation
One Montgomery Street, 32nd Floor
Crocker Center - West Tower
San Francisco, CA 94104
(415) 956-1990

9. Project Team Member Resumes

FIRM POSITION

Mr. Hill is the Director of Government Consulting for the Northern half of our West Region. Mr. Hill has twenty-five years of operational and consulting experience in the government and private sectors.

EDUCATION AND PROFESSIONAL ACHIEVEMENTS

- He was educated at St. Mary's College and John F. Kennedy University, majoring in Public Administration.
- He has also taken specialized legal courses at the Golden Gate Law School.

RELEVANT EXPERIENCE

- **California Department of Real Estate** - Partner-in-Charge on a study of licensee interaction with respect to the marketing of real estate owned/foreclosed properties (REO). This study arose primarily from concern about the increasing inventory of commercial and residential properties acquired by lenders as a result of record loan foreclosures in 1986/87. The goal of this study was to assess and evaluate new techniques and methods for marketing and disposing of REO properties through improved lender/owner and licensee interaction. A broad range of ideas and recommendations were made for improving licensee interaction in the REO marketing and disposal process.
- **California Office of Statewide Health Planning and Development** - The California Health Facility Mortgage Insurance Program has over \$1.5 billion (1987) in outstanding insurance contracts for health facility construction loans. The objective of this study was to review and analyze all federal, state, and industry regulations, policies, procedures, practices, and market conditions concerning life care facilities which impact solvency of the program. The study evaluated financial risk and exposure to the program which life care contract facilities represent, and made recommendations concerning financial operation of the program.
- **California Debt Advisory Commission** - Partner-in-Charge on an engagement to develop and implement a state and local debt issue data base. The project included report definition, specifications and data base design, resulting in screen, query language, data standards, dictionary, and performance

recommendations. DBMS vendor evaluations resulted in an Informix DBMS operating under UNIX.

- **Solano County** - Partner-in-Charge of a project to analyze and structure financing of eighteen capital facility projects. The objective of this project was to structure specific financing instruments which the County could use to fund a variety of new construction and remodeling building projects. The study included the following tasks: (1) review and preparation of projected year-by-year costs for each capital outlay project, (2) development of projected case inflows from County sources which could be used to fund the building projects, (3) analysis of a wide range of municipal financing instruments, and (4) preparation of specific financing instruments for each building project, including issue size, financing costs, and project drawdown schedules.
- **Land Developer** - Partner-in-Charge on a study to determine the feasibility of converting apartment property to a parking lot development. The engagement included income and cash flow analyses for different joint ownership structures.
- **City of Fremont, California** - Partner-in-Charge of a project to develop a comprehensive Capital Improvement Program (CIP) for the City. The study included an analysis of revenue, alternatives, development impact charges, and debt financing alternative, as well as the development of specific capital improvement policies and plans. An automated CIP model was developed, and multi-year cashflow projections were prepared.
- **California Department of Real Estate** - Project Manager to conduct a study of home equity lending by mortgage loan brokers. The principal goal of this study was to develop information on mortgage loan broker home equity lending practices and borrower and lender problems experienced as a result of these practices. A major mail survey of California mortgage loan brokers was conducted. The study provided recommendations for regulations to address problems with home equity lending by mortgage loan brokers in California.
- **California Department of Real Estate** - Lead Consultant to examine mortgage financing services in California. The objective of the study was to examine current practices and probably future developments in the use of computers and telecommunications technology in delivering mortgage financing services. The study includes determination of systems employed, transaction types, service providers, contractual relationships formed, general costs and benefits, and consumer experiences with applications of the technology. The final report will address changes in the industry and in consumer attitudes resulting from the use of automation.

FIRM POSITION

Dr. Gibson is a Director in our West Region Management Consulting Group, with a specialty in economic and financial consulting. Dr. Gibson has successfully directed, managed, and participated in over 170 individual client engagements during the course of his consulting career. He has eighteen years of experience in applied financial, economic, and market analysis and has been with Ernst & Young for eleven years.

EDUCATION AND PROFESSIONAL ACHIEVEMENTS

- Advanced Training in Economics, Graduate School of Industrial Administration, Carnegie Mellon University, 1988
- Ph.D. in Resource Economics, Iowa State University, 1976
- Nominated to Phi Kappa Phi National Honor Society at I.S.U.
- Attended I.S.U. on a Full Research Scholarship
- Nominated for the National Science Foundation Graduate Fellowship, University of California, Davis, 1971
- B.S. in Applied Economics with High Honors, University of California, Davis, 1971
- Received U.C. Davis Department of Agricultural Economics Citation for outstanding Graduating Senior.
- National Association of Business Economists
- National Economists Club
- American Economics Association
- Western Economics Association
- National Association of Forensic Economists
- American Agricultural Economics Association
- Phi Kappa Phi National Honor Society
- Gamma Sigma Delta Honor Society of Agriculture
- Sacramento Economics Roundtable

RELEVANT EXPERIENCE

- **California Department of Real Estate - Project Director on an engagement to conduct an analysis of the escrow industry as it affects real estate licenses. The study examined and compared different regulatory constraints confronting alternative providers of escrow services, and identified and explained the regional variations in escrow business practices between northern and southern California. A major component of this study involved conducting a statewide survey of 2,500 industry-related professionals for the purpose of determining the effects of differing escrow industry business practices on the consumer and the real estate industry.**
- **California Department of Real Estate - Project Director on an engagement to study the past performance and future outlook of the real estate appraisal industry. Major study tasks included: (1) conduct of interviews with relevant federal regulatory and legislative officials, real estate appraisal industry trade associations, mortgage lending and insurance institutions, and realty companies, (2) development, administration, compilation, and analysis of 1,500 surveys distributed to relevant industry-related professionals, and (3) development of viable alternative recommendations regarding the appraisal industry.**
- **California Department of Real Estate - Project Director on a study to assess the (1) business practices, and (2) borrower, lender, and loan purchaser problems associated with home equity loans made or arranged by mortgage loan brokers (MLBs) in California. The study involved telephone interviews with these principals of home equity loan transactions in order to develop recommendations regarding the business practices of mortgage loan brokers. A major mail survey was made of over 500 MLBs in order to solicit comments on the proposed recommendations.**
- **California Department of Real Estate - Project Director to study licensee interaction with respect to the marketing of real estate owned/foreclosed properties (REO). This study arose primarily from concern about the increasing inventory of commercial and residential properties acquired by lenders as a result of record loan foreclosures in the early 1980s. The goal of this study was to assess and evaluate new techniques and methods for marketing and disposing of REO properties through improved lender/owner and licensee interaction. Recommendations were developed for improving licensee interaction in the REO marketing and disposal process.**
- **California Department of Real Estate - Project Director to review California's continuing education program, including testing requirements. Study tasks included: (1) obtaining broad-based public input regarding the continuing education programs for real estate licensees in other states, and (3) preparing**

recommendations concerning the California real estate license continuing education program.

- **California Department of Real Estate - Project Director** to conduct an actuarial study of the real estate recovery account. This study included providing short- and long-term projection of recovery account activities, such as cash flows and State of California real estate license activity. The projections were based on statistical and econometric analysis. A detailed cash forecast model and a microcomputer on which to run the model were delivered to the Department at the conclusion of the study.
- **California Department of Real Estate - Project Manager** on a study to evaluate the Continuing Education Program for the real estate industry. The objective of this engagement was to evaluate the real estate continuing education program for real estate licensees. The evaluation included an estimation of approximately thirty million dollars in costs incurred by licensees and identification and estimation of the private and social benefits derived from the program. The study also assessed the adequacy of policies, procedures, and practices, used by the Department in its administration of the program.
- **California Department of Real Estate - Staff Advisor to the Commissioner.** Developed a master work plan and schedule for reform of the statewide real estate subdivision process.
- **California Department of Real Estate - Project Manager** to develop, through research, data required by the client for establishing minimum criteria for all real estate license preparatory courses. The study involved the formulation and application of a major mail survey. The detailed survey was designed to systematically sample from a population of over 300,000 licensees in order to allow statistical inferences.
- **Solano County - Project Director** to provide financial services for funding of County facilities. The goal of this project was to identify funding sources for construction and capital improvements of approximately \$42 million of County facilities. Potential financing scenarios were developed which considered and evaluated feasible combinations of public and private financing and ownership. The recommended funding approach included sized, lease-purchase financings, using certificates of participation. An implementation plan was prepared for obtaining funds necessary to meet assumed capital project costs.

OTHER QUALIFICATIONS

Dr. James Gibson joined Ernst & Young in 1978 after serving two years as a Principal Resource Economist for Harza Engineering Company, Chicago, Illinois. In this capacity, he was responsible for performing economic, environmental, and social analyses of major international projects in the field of energy development.

land and water development, agricultural development, regional development, and environmental quality.

Dr. Gibson's previous experience also included employment as an Instructor and Research Associate in Economics at Iowa State University. He taught economic courses in natural resources and was involved in applied research on land and water resource allocation problems, including the economic evaluation of multi-purpose reservoir projects, pesticides, energy, environmental policies, and agricultural land uses.

PUBLICATIONS

- Gibson, James A. and Timmons, John F., "Land Use Inventory and Projection Model with Application to Iowa and its Subregions." Center for Agricultural and Rural Development Report 82, Iowa State University, October 1978, 351 pages.
- Gibson, James A., "On the Allocation of Prime Agricultural Land." Journal of Soil and Water Conservation, Vol. 32, No. 6, November-December 1977, pp. 271-275.
- Gibson, James A., "A Review of Recent Extensions of Linear Economic Models to Regional Environmental Quality Analysis." Journal of Environmental Systems, Vol. VI, No. 2, 1976-1977, pp. 147-172.
- Gibson, James A. and Timmons, John F., "Information Needs and Models for Land Use Planning." American Journal of Agricultural Economics, Vol. 58, No. 5, December 1976, pp. 902-908.
- Gibson, James A., "Possible Impacts of United States' Domestic Environmental Policies on Less-Developed Countries' Trade, Investment, and Foreign Aid." Journal of Environmental Affairs, Vol. III, No. 1, Spring 1974, pp. 109-127.

In addition to the above referred professional journal papers, Dr. Gibson has published numerous general audience articles on a broad range of economic and finance topics.

FIRM POSITION

Mr. Harlow is Chairman of Ernst & Young's Seattle Real Estate Group. The Real Estate Group, including ten professionals from audit, tax, and management consulting, assists Ernst & Young clients in all aspects of real estate activity.

Mr. Harlow recently returned to Seattle from Arthur Young Hong Kong, where he was Executive Director, Arthur Young Management Consultants Ltd. He was heavily involved in commercial real estate development in Hong Kong and in the People's Republic of China.

EDUCATION AND PROFESSIONAL ACHIEVEMENTS

- BA, Finance (with Honors), California State University
- MBA, California State University
- Financial Management Honor Society
- Author of articles on China investment (Puget Sound Business Journal) and on China's electronics industry (Journal of the American Chamber of Commerce)
- Expert testimony on facility ownership and financing, Legislature of the State of Washington
- Lecturer on Financial Feasibility and Investment Criteria in Seattle, Juneau, Denver, Hong Kong, and in the PRC (Guangzhou, Fuzhou, Dalian)

RELEVANT EXPERIENCE

While in Hong Kong, Mr. Harlow developed a set of client services known as "Project Development Services", provided to developers, construction companies, and financial institutions. These services included:

- Performance of financial feasibility studies;
- Coordination with architects and quantity surveyors in detailed project definition, costing, and space allocation;
- Provision of negotiating support with respect to public sector involvement (primarily in the PRC, where development projects are usually public/private joint ventures); and
- Development of financing packages and financing cooperation arrangements.

Mr. Harlow managed professional service teams in one or more of the above areas with respect to several major projects, including:

- Central Plaza (Tianjin) Hotel (PRC, US\$36 million)
- Guangzhou World Trade Center (PRC, US\$176 million)
- Zhaoqing Star Lake Resort Hotel (PRC, US\$20 million)
- Repulse Bay residential development (Hong Kong & Shanghai Hotels project, US\$30 million).

Other development-related projects included pure demand studies and feasibility studies for manufacturing facilities.

Since his return to Seattle, Mr. Harlow has been working closely with Ernst & Young's Hong Kong office to connect Far East construction companies and financial institutions with local developers and others in North American commercial project development.

He has also managed several real estate-related engagements for Ernst & Young clients, including:

- A multi-firm consulting project to determine the feasibility of a 1,500 acre planned community near Bayallup, Washington.
- A study of the financial impacts of various redevelopment alternatives for the Union Station site in Tacoma.
- A facility siting and life-cycle cost analysis for the University of Washington.
- A detailed analysis of the potential fiscal impacts on the State of expanding and assuming full ownership of the Washington State Convention and Trade Center.
- Development of a cost accounting system and other services for the Washington State Convention and Trade Center.
- Financial analyses supporting a UDAG grant/loan application for a major retail complex.
- Reconnaissance of a proposed 400-acre industrial park in Pennsylvania for a local interested investor.
- Feasibility study for an 80-unit vacation condominium project in Anchorage.
- Financial projections for a major real estate holding company in Seattle.
- Project development services for a \$3 million manufacturing facility in Seattle.
- Financing alternatives study for a proposed 500,000 square foot State office facility.
- Due diligence for a proposed purchase of a major class-A office building in downtown Seattle.
- Demand study for a proposed major class-A office building in downtown Seattle.

Prior to transferring to Hong Kong, Mr. Harlow was practice manager for financial planning and control for Arthur Young Seattle. In this capacity, he performed a number of feasibility studies and other engagements for both public and private clients in the Northwest.

FIRM POSITION

Mr. Morris is a senior staff consultant in Ernst & Young's Seattle-based Real Estate consulting group. His primary responsibilities include market research and financial modeling/analysis on both public and private ventures with emphasis on real estate and tourism-related projects.

EDUCATION AND PROFESSIONAL ACHIEVEMENTS

- BA, Accounting, Western Washington University
- Member American Society of Travel Agents (ASTA)
- Member Pacific Area Travel Association (PATA)
- Member National Association of Industrial Office Parks (NAIOP)

RELEVANT EXPERIENCE

- Performed market research and analysis to support the development of international marketing strategies for a one billion dollar proposed Washington State ski resort. The analysis, with emphasis on Europe, Canada and the Pacific Rim, included developing a profile of the target consumer groups and their preferred product mix and set of amenities. The market research was also used to support a five year forecast of the level of inbound travel to the Pacific Northwest of these international visitors.
- Developed a financial model and conducted primary and secondary market research to support a feasibility study for a restaurant to be located in a major Colorado State destination ski resort. Analyses included study of competition, study of potential demand, and overall assessment of the project characteristics. The assignment also involved projecting future revenues and expenses for this restaurant.
- Performed research and analysis for a major Caribbean economic and marketing study sponsored by the U.S. Agency for International Development. The objective of this study was to determine the feasibility of a regional Caribbean campaign targeting North America.

- Performed research and analysis on critical assumptions and developed a financial model to support economic and operational analyses and business plans for a start-up cruise line.
- Performed research on critical assumptions to support financial analysis of a multi-million dollar start-up "hotel alternative" venture in the State of Alaska. Analyses included study of hotel occupancy and rental rate sensitivities and their impact on the hotel pro formas.
- Performed detailed financial analysis of the potential fiscal impacts on the State of Washington expanding and assuming full ownership of the Washington State Convention and Trade Center. Structured and performed market research and directed a nationwide telephone survey and data collection study of the major convention centers throughout the United States.
- Performed a due diligence study in support of an acquisition by a foreign buyer of a 450,000 square foot, \$100 million, Class "A" commercial office building in Seattle, Washington. The study included an analysis of historical, current and projected operating revenues and expenses.
- Performed research on critical assumptions to support a market demand and pricing study for a 300,000 square foot Class "A" commercial office building to be located in a major U.S. metropolitan city on the West coast. Analyses included study of historical absorption, vacancy and rental rates for comparable office space. This analyses was then used to estimate and project future demand and rental rates for this project.
- Conducted detailed financial analysis, developed financial models, and conducted research on critical assumptions to support a life-cycle cost analysis and a decision by the State of Washington to construct/own or lease a \$110 million office building.
- Directed market research and land valuation study for a financial feasibility analysis of a \$88 million 1,500 acre real estate project in South Puget Sound. Research model included interviews with real estate professionals, government officials and prominent business people.
- Performed "sensitive information" market research and analysis for a major foreign raw materials production facility planning to establish facilities in the United States. The research model included extensive interviews with corporate executives.
- Developed financial models and conducted primary market research to support the economic and operational analyses, strategic and business plans of a \$15 million fisheries project in the Bering sea.

- Extensive auditing and systems analysis experience with automated accounting information systems for public and private enterprise. Auditing was performed in accordance with Generally Accepted Accounting Principles.

FIRM POSITION

Mr. Kaempf is a Principal in our West Region Management Consulting Practice where he currently serves as Director of our Northern California Analysis Services Group. He has twelve years of quantitative analysis experience and has managed over thirty separate engagements for California State Government agencies and departments. He joined Ernst & Young nine years ago as an EDP specialist after several years experience as a systems analyst.

EDUCATION

- B. S. in Computer Science, University of Oregon, 1974
- B. S. in General Science, University of Oregon, 1975
- M.B.A. in Operations Research, University of Oregon, 1979

RELEVANT EXPERIENCE

- **California Department of Real Estate - Project Manager** of a study to assess the (1) business practices, and (2) borrower, lender, and loan purchaser problems associated with home equity loans made or arranged by mortgage loan brokers (MLBs) in California. The study involved telephone and personal interviews with these principals of home equity loan transactions in order to develop recommendations regarding the business practices of mortgage loan brokers. A major mail survey was made of over 500 MLBs in order to solicit comments on the proposed recommendations.
- **California Department of Real Estate - Project Manager** to conduct an actuarial study of the Real Estate Recovery Account. This study included providing short- and long-term projections of recovery account activities, such as cash flows and State of California real estate license activity. The detailed projections were based on advanced statistical and econometric analyses.
- **California Department of Real Estate - Project Director** to design and implement a microcomputer data base system to monitor legal claims made against the Real Estate Recovery Account. Major tasks performed included identifying needs of Department attorneys which manage the claims, designing data input and query screens, and writing a series of dBASE III programs.

- **California State Department of Education, Office of Food Distribution - Project Manager** of a detailed cost analysis of California's statewide surplus commodity distribution program. Among other activities, the study included:
 - Development of a detailed survey questionnaire administered to more than 2,000 participating local agencies in California and conduct of on-site interviews at 50 selected agencies.
 - Development of detailed costs for OFD services, including all state pro rata and departmental indirect charges and comparison of OFD costs and services with those of private sector food distribution firms and with programs in four other states.
 - Analysis of the cost and other trade-offs of contracted versus in-house warehousing and distribution and evaluation of a three-county pilot project in the Fresno area that utilized contracted services in lieu of state services.
- **State of Missouri, Environmental Improvement and Energy Resource Authority (EIARA) - Project Manager** on an engagement to conduct a comprehensive Statewide Resource Recovery Feasibility and Planning Study. The overall mission of this study was to determine the amount of solid waste produced, identify existing disposal practices, determine markets for secondary materials, and evaluate alternative technologies. Major study tasks included the following:
 - Performed a statistically-valid analysis of the solid waste stream in Missouri, and estimated the composition of solid waste by twenty-six categories (e.g., newspaper, corrugated paper, leaves and grass clippings, and aluminum beverage containers)
 - Conducted a comprehensive survey of all 157 refuse disposal facilities in the State, and prepared detailed findings on: (1) tipping fees required to cover the costs of operation, (2) amount of refuse received at the facility and its source, (3) remaining capacity at Missouri sanitary landfills, (4) plans for new or expanded facilities, and (5) amount and type of materials recovered at the facilities
 - Conducted a survey of all markets for secondary (recyclable) materials in Missouri and eight surrounding states, and markets for energy recovered from solid waste in Missouri
 - Evaluated the available and emerging technologies for resource recovery, and determined the economics of alternative technologies.

- **Diepenbrock, Wulff, Plant & Hannegan** - Project Manager on a litigation project involving a major retailer. There were three separate phases . First, an independent random sample was designed and conducted to determine the proportion of sale items which were marked at a price higher than the advertised sale price. Then an analysis of the District Attorney's own survey of sale item price marking was performed. Finally, a review and detailed analysis of present price marking procedures were conducted.

FIRM POSITION

Mr. Micheltmore is a Senior Manager in our West Region Management Consulting Group. He has over eight years of auditing and financial analysis experience with government, non-profit, and private sector clients. Mr. Micheltmore specializes in residential housing issues, both single-family and multi-family projects.

EDUCATION

- Certified Public Accountant
- B. S. in Accounting, California State University, Chico

RELEVANT EXPERIENCE

- **California Housing Finance Agency** - Project Director of the firm's annual financial audit of the Agency. The Agency's portfolio consists of \$2.5 billion in loans to single-family homeowners and \$500 million in loans to multi-family property owners.
- **California Housing Finance Agency** - Project Director of several engagements to issue comfort letters associated with the Agency's bonds.
- **California Housing Finance Agency** - Project Director of our annual single compliance audit of the Agency in regards to requirements of the Department of Housing and Urban Development. This work involves various procedures to determine compliance with various HUD requirements including tenant qualifications, political activities, civil rights, cash management, internal control, Davis-Bacon Act, schedules for receipts and disbursements, relocation assistance, and allocation of indirect costs.
- **Various Housing Construction Subcontractors** - Project Director of annual financial reviews of subcontractors to various housing General Contractors.
- **Real Estate Construction and Development Firm** - Project Director of our annual financial audit of one of Sacramento's largest home builders.
- **Savings and Loan** - Managed the real estate portion, including evaluation of REOs, for a large Sacramento-based savings and loan.
- **Real Estate Investment Firm** - Coordinated the review and client assistance for a large real estate advisory and property management firm. This included

development of a system to generate reports for the State of California Public Employee Retirement System, for whom this private firm managed all real estate investments.

- **Coordinator** - tax compliance and planning opportunities for several companies in the real estate industry.
- **Project Director** - in charge of a project designed to establish ownership of properties and allocation of property value amongst members of an affiliated group.

FIRM POSITION

Ms. Harris is the Manager of our Northwest Government Operations practice, specializing in services to state and local governments and non-profit organizations. She has over 15 years of both public and private sector management experience. Her expertise is in long-range strategic planning, management reviews and audits, organizational development, and public policy analysis.

EDUCATION

- Bachelor of Science, University of Michigan, School of Natural Resources, Ann Arbor, Michigan

RELEVANT EXPERIENCE

- City of Seattle. Department of Community Development—Ernst & Young is currently assisting the Department of Community Development in its efforts to define new homeownership strategies for residents of the Interstate 90 corridor. A twelve-member Homeownership Committee comprised largely of neighborhood residents is working with the Department to develop a plan to enable local renters to purchase state-owned homes they now occupy. E&Y is facilitating the community process for insuring neighborhood involvement in the preparation of City and State homeownership plans.
- Project Manager, Seattle Center Strategic Plan, Seattle, Washington. At present, developing a five-year strategic plan with the City Council, management, and employees of this 74-acre park, entertainment and cultural facility. Entails a comprehensive, participatory process to clarify the overall mission and purpose of this City of Seattle Department by developing of goals, objectives, strategies, and action plans. Emphasis on implementation of the strategic plan through the budget and ongoing operating plans.
- Project Manager, Seattle Housing Authority Strategic Plan, Seattle, Washington. Developed a five-year strategic plan with the Board of Commissioners and management team of the Seattle Housing Authority. Clarified and reinforced priority roles and opportunities for the Authority through the development of a shared vision, mission statement, goals, and objectives for the organization. Approach emphasized development of action plans and management tools to integrate agency budget and departmental

- operating plans with strategic plan implementation. Included public meetings and other extensive opportunities for employee and community participation.
- Senior Management Consultant hired to conduct a series of management audits for the City of Bellevue, Washington. First audit analyzed purpose, structure, organization, and operation of the Property Services Division of the Public Works Department. Identified key issues and developed recommendations to maintain and improve service delivery and functions of the Division.
 - Project Manager for a Relocation Study for the Fred Hutchinson Cancer Research Center, Seattle, Washington. Analyzed the necessary requirements for relocating the Administrative and Development Divisions of the Research Center. Approach included interviews, information gathering and analysis of space and work requirements. Developed recommendations to preserve communications and enhance operations during a period of transition to a new location.
 - Co-Manager of project to conduct a comprehensive management audit of the Bremerton Fire Department, Bremerton, Washington. Included analysis of organization structure, efficiency and response times, budget matters and revenue sources, as well as personnel issues. Identified opportunities for improving delivery of services and enhancing Department operations.
 - Joint Project Manager for the development of a Housing Needs Report for the City of Seattle and King County, Washington. Commissioned by the Local Initiative Support Corporation, the Report identified housing types along a continuum, from emergency shelters to independent housing alternatives. The gap between available housing units and need for such housing was identified. Emphasis was placed on the specific needs of special population groups.
 - Consultant, Management Review of Personnel and Fiscal Office, Oregon Research Institute, Eugene, Oregon. Analyzed structure, operations, and personnel classifications of the fiscal office of a large not-for-profit behavioral research organization. Included personal interviews with organization management and Board members, analysis of findings, and development of recommended alternatives.
 - Research Assistant, Management Audits of Fire Department, Police Department, Planning Department, and Mechanical System operations, City of Bellevue, Washington. Collected and analyzed comparative data through interviews, surveys, and literature review. Analyzed functions, organizational structure, number of personnel, and budget allocations for these city agencies. Compiled and analyzed data for reports.

- Coordinator, User Fee Seminar, Portland, Oregon. Conducted seminar on User Fees for local government officials, focusing on alternate ways for city and county governments to recover costs of local services. Included presentation of research findings concerning fee options for specialized services.
- Senior Advisor to member of City Council, Portland, Oregon. Management responsibilities for priority projects in community and economic development, energy conservation, parks and recreation, and public works. Researched, formulated, and implemented city policies, developed recommendations, and presented findings to City Council. Reviewed and prepared city ordinances and state legislation, coordinated press conferences and community workshops, and wrote major speeches. Responsible for long-range staff planning and strategy sessions. Investigated City Council teambuilding opportunities. Served as liaison to city bureaus, community organizations, and businesses. Resolved citizen and constituent concerns.
- Program Manager, Energy Conservation Act, Portland, Oregon. Secured over \$2.5 million for the City of Portland as payment for energy conservation programs and accomplishments under the Northwest Regional Power Planning and Conservation Act. Saved city taxpayers upwards of 50% on associated energy costs.
- Project Manager, Public Involvement Strategy for the Northwest Power Planning Council, Portland, Oregon. Designed and implemented public information campaign concerning the development of the Region's first energy conservation plan strategy. Publicized and coordinated public meeting and workshop series, conducted individual interviews and facilitated community work sessions. Analyzed public opinions and prepared written comment summaries for inclusion in the final plan.
- Project Manager, Waterfront Development, Portland, Oregon. Prepared and implemented a detailed workplan for the revitalization of Portland's downtown riverfront, including major park property development and waterfront tourist attractions. Completed groundwork for the construction of an esplanade park, and a major stream-powered tour boat. Coordinated related policy and land-use decisions, and enlisted private business and community support.
- Project Manager, Methane Gas Pipeline, Portland, Oregon. Initiated public-private partnership resulting in profits to the city from the sale of surplus methane gas. Secured buyer to purchase the gas, a usable by-product of sewage treatment. Led negotiations with all parties, prepared contractual agreements, obtained financing and tax credits, prepared press materials, and monitored project construction. Project received distinguished Governor's Energy Conservation Award.

- **Project Manager, Steam Plant Closure, Portland, Oregon.** Facilitated the orderly closure of a local utility's downtown steamplant operation. Developed the strategy and planned the stages for over 700 customer conversions to new heating systems. Designed a low-interest loan program to assist low-income people and non-profit organizations.
- **Liaison to Central City Plan, Portland, Oregon.** Represented member of City Council during development of comprehensive plan for Portland's central core area. Included participation in steering committee meetings and public workshops. Contributed to development of written policy, goals and objectives to guide future housing, recreation, transportation, natural resources and other facets of urban growth.
- **Facilitator, City of Portland Energy Office, Portland, Oregon.** Designed and facilitated two planning sessions for the staff of the City of Portland Energy Office. Included preparatory interviews and discussions with meeting attendees, agenda setting, and group facilitation. Determined work plan priorities, projects and schedules in the context of meeting local energy policy goals and objectives.
- **Consultant, Portland Energy Conservation, Inc., Portland, Oregon.** Designed and facilitated planning retreat for newly-established, non-profit energy conservation organization. Conducted individual interviews with staff and designed planning agenda. Designed system for ranking work priorities and developed corresponding work plans and schedules.
- **Outreach Services Director, Western Solar Utilization Network, Portland, Oregon.** Responsible for preparation, management, and implementation of annual operating plan for 13-state regional solar energy commercialization program. Facilitated planning sessions for 22-person staff to design innovative strategies for achieving solar energy goals. Allocated \$2.5 million annual budget to priority projects. Included monitoring and evaluation of program effectiveness using work plans and quarterly reports. Represented organization during federal and regional policy, planning and budget discussions.
- **Conservation Program Supervisor, Oregon Department of Energy, Salem, Oregon.** Responsible for preparation, management and implementation of annual state energy conservation plan. Included development of statewide strategies to achieve federal conservation goals. Designed and facilitated strategy sessions for conservation staff to determine program and budget priorities. Included development of work plans and quarterly reporting systems. Designed two strategic planning retreats for all department managers, and coordinated preparation and follow-up with management consultant and facilitator.

- Project Director, Public Information Campaign, Oregon Department of Energy, Salem, Oregon. Identified constituency impacted by the passage of seven new energy laws and designed statewide outreach and marketing program. Designed and facilitated small group workshops and two statewide conferences geared toward public acceptance and participation in new incentive programs.

FIRM POSITION

Ms. Hoe is a Manager in our West Region Management Consulting Group. She has extensive experience in developing financial projections using computer modeling techniques. She also brings direct experience in working with housing issues and related public policy.

EDUCATION AND PROFESSIONAL ACHIEVEMENTS

- Bachelor of Arts Degree with honors from the University of Hawaii
- Master of Business Administration Degree from Kansas State University

RELEVANT EXPERIENCE

- Project Manager in an engagement to assist in reorganizing the Hawaii Housing Authority (HHA) into two separate entities: HHA, and the Housing Finance and Development Corporation. Assistance included assessing the existing operations and organization, developing reorganization alternatives, preparing detailed position organization charts and cost estimates, preparing revised functional statements and the formal memorandum requesting reorganization approval from the Governor, and suggesting changes to job classifications for selected positions.
- Other engagements for the Hawaii Housing Authority (HHA) and the Housing Finance and Development Corporation (HFDC) include:
 - Project Manager on a project with the Hawaii Housing Authority (HHA) to recommend an organizational structure and staffing for housing financing programs designated to fund single family mortgages.
 - Project Manager to conduct a comprehensive management review of the Hula Mae Loan Program. The objective of the review was to provide the Board of Commissioners and HHA management with an assessment relating to the implementation and administration of the Hula Mae Program. During this engagement, we identified several areas requiring

attention, developed key questions relating to monitoring and internal control, and reviewed management and lender reporting systems.

- Project Manager for the detailed management review of the Land Reform Branch of the HHA. The objective of this engagement was to determine how well the program's objectives were being met as well as a general operating and performance review of the Land Reform Branch. Our review subsequently led to another engagement which focused on the development of a procedural guide which documented operational procedures followed in all aspects of the various programs conducted by the Land Reform Branch.
- Project Manager for an engagement involving conducting a performance review of the Development Branch. The objectives of this project were to determine how well the branch was performing and to identify and make recommendations to improve the management and control of development projects, including a review of existing systems.
- Project Manager for an engagement to update the Accounting Manual for the Finance and Accounting Office of the HHA. This project included a review of existing accounting systems documentation, identification of areas requiring updating and documentation of policies and procedures for those areas to reflect current tasks and functions performed.
- Lead Consultant to assist a local real estate developer in the review of the feasibility of the first large-scale mixed use complex to break ground in the Kakaakosection of Honolulu. The first phase of this \$100 million development resulted in construction of seven low-rise buildings totaling over 510,000 square feet for office and commercial use. As part of our engagement, we reviewed projections of cash flow, tax benefits and profit and loss from operations for eight years.
- Consultant on our engagement with the Hawaii High Technology Development Corporation and the County of Hawaii to develop a marketing strategy and plan for the proposed Hawaii Ocean Science and Technology Park. The project involved identification of potential tenants, determination of demand, price strategies, as well as development of an overall strategy for marketing the Park.
- Project Consultant to conduct an evaluation and analysis of the State of Hawaii's organization/reorganization review processing system for the Department of Budget and Finance (B&F). The project involved: reviewing statutes and administrative directives governing organizational change; conducting interviews with all State executive departments to discuss their internal procedures and experiences with B&F's review process and the requirements of the Department of Personnel Services for implementing organizational changes; analysis of B&F internal records of organizational change reviews conducted; identification of improvements to the existing system; development of

a new administrative directive, proposal documentation and procedures guide for use internally and by executive departments.

In a separate follow-up engagement, we are providing assistance to the Division in developing specific classification specifications and position job descriptions for new classes/positions in order to implement the reorganization of the Division.

- Project Manager for a project for the Department of Human Services to provide assistance in developing alternatives for an overall reorganization of the Department including all programs on Oahu and the neighbor islands and all staff office. We conducted interviews with management throughout the Department and on the neighbor islands, developed an explicit set of reorganization criteria, and developed alternative conceptual organization structures. Following selection of a conceptual design by the Department, we developed preliminary position organization charts and developed estimates of the impact on the Department's budget.
- Project Consultant for a project to provide assistance to a local real estate trading company in the design and implementation of a property management information system to manage their portfolio of properties.
- Project Consultant on a City and County of Honolulu project to conduct a feasibility study for contracting out public services to private companies. The scope of work included a review of all services performed by City personnel and a joint selection of five specific services identified as having the potential for being contracted out. Then, a detailed analysis of the five services was performed from which statement of work, quality assurance plans and cost comparisons were prepared.

**STATE OF ALASKA
LEGISLATURE**

**HOUSING FINANCE
TASK FORCE**

**Evaluation of Policy Options
Concerning the Future of the
Alaska Housing Finance
Corporation**

January 12, 1990

Ernst & Young

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Sacramento, California 95814
Telephone (916) 443-6756
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January 12, 1990

Representative C. E. Swackhammer
Chair, Housing Finance Task Force
Alaska State Legislature
Room 521, Capitol
P. O. Box V
Juneau, Alaska 99811

Dear Representative Swackhammer:

Ernst & Young is pleased to present this Draft Final Report on our analysis of the Alaska Housing Finance Corporation's future role in providing financing for Alaskan homebuyers. An Executive Summary is presented in this report which summarizes the background for this study, and highlights our findings.

We wish to thank both you and your Legislative Assistant, Mr. Carl Nickel, for not only your own continued support throughout this study but for the help you provided us in identifying and obtaining assistance from individuals throughout State Government. We owe Mr. Nickel a special thanks, as he was especially helpful in our research efforts and coordinating many requests for information.

Members of the Housing Finance Task Force, including Vice Chair Senator Patrick Rodey and Representative Randy Phillips, also provided us advice during the study. We wish to thank the members.

During this study we have enjoyed the full cooperation of AHFC's Board Chairman, Mr. Robert Mintz, and AHFC's Chief Executive Officer, Mr. Thomas Behan. We also wish to express appreciation to the many AHFC management and staff for their help, advice, and cooperative spirit during this study. This especially includes Mr. Mark Cameron and Mr. Paul Kapansky. Without their availability during this study's compressed time schedule, completing this project would have been impossible.

This study's schedule required we complete the final report within 42 working days of project startup. Although the schedule was abbreviated, we are confident that our analysis of policy options focuses on all the important issues raised during the study.

Representative Swackhammer
January 12, 1990
Page 2

We look forward to presenting our findings to the Task Force in person. Our Project Director, Dr. James A. Gibson, members of the project team (Messrs. Edward R. Kaempf, John Michelmore, and Vere Harlow), and our legal subcontractor (Delaney, Wiles, Hayes, Reitman & Brubaker, Inc.) are all prepared to address any comments or questions which the Task Force, AHFC, or the interested public may have concerning this report.

Very truly yours,

cc: Senator Patrick Rodey, Vice Chair
Senator Rick Halford, Member
Representative George Jacko, Jr., Member
Representative Randy Phillips, Member
Senator Mike Szymanski, Member

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EXECUTIVE SUMMARY

Ernst & Young

EXECUTIVE SUMMARY

The State of Alaska Legislature established the Housing Finance Task Force in 1989 to review and recommend changes in publicly-assisted residential finance programs, including those loan programs managed by the Alaska Housing Finance Corporation (AHFC). This study was commissioned to provide information regarding potential changes in AHFC programs, and included addressing the following concerns of the Task Force:

- Availability of a return on the State's \$1 billion investment in AHFC, without impairing AHFC's financial condition
- Affect on AHFC's financial standing from a change in the subsidy policy
- Impact on AHFC's financial position and on the State's housing market, due to changes in the AHFC subsidy and/or a return of AHFC to its original legislative intent
- Feasibility of "privatizing" AHFC.

The results of our analysis are summarized in following subsections of this Executive Summary:

- *AHFC Present Activities*
- *AHFC Financial Position and Availability of Funds*
- *Policy Option to Change AHFC Subsidy*
- *Policy Option to Return AHFC to Original Legislative Intent*
- *Policy Option to Change Ownership of AHFC*
- *Conceptualization of an Idealized AHFC.*

A. AHFC PRESENT ACTIVITIES

The Legislature created AHFC in 1971 to provide housing for low-income Alaskans. Since that time, the Legislature has progressively expanded AHFC's role, where the Corporation now provides financing for the varying housing needs of all

qualified Alaskan homebuyers. AHFC's core activities are selling bonds and purchasing home loans originated by Alaskan lending institutions.

During fiscal year 1988/89, AHFC purchased 2,740 new loans. One half of these new loans were purchased under the tax-exempt, first-time homebuyers program. In addition to purchases of new loans, AHFC also refinanced 6,316 existing AHFC loans in the same fiscal year. In total, AHFC purchased approximately 9,000 loans totalling almost \$900 million.

Over the past five years AHFC's purchases of new loans have dramatically declined while refinancings have significantly increased. In total, AHFC loan purchase activity has increased slightly in the past five years.

B. AHFC FINANCIAL POSITION AND AVAILABILITY OF FUNDS

In June of 1980, legislation was passed which allowed the State to subsidize interest rates on mortgage loans purchased by AHFC. In connection with the legislation, the State contributed monies to AHFC to provide for the overcollateralization of these loans so that qualified residents could obtain interest rates on mortgages below market rates.

Through fiscal year 1983/84, just over \$1 billion was contributed by the State to AHFC. Of this amount, \$808 million was contributed for the overcollateralization purposes described above. The remaining \$225 million was provided for various other specifically identified purposes. The Corporation has not required a direct State capital infusion since 1984.

The Corporation's ability to operate as a going concern depends on both its liquidity and solvency. The concept of liquidity includes AHFC's ability to meet necessary cash flow payments. Currently, the Corporation is experiencing liquidity problems as reflected in the most recent year's net loss of income. The concept of solvency includes AHFC's equity strength and general credit worthiness. The financial community still generally views the Corporation as financially stable because of the solvency of its balance sheet.

However, further extraction of Corporation assets, in any form, may have a serious impact on Corporate financial health.

Under the current AHFC practice of using general obligation financing, if funds were appropriated from the Corporation, a precedent would be set and the bond programs would likely be less solvent and credit worthy. Additionally, if funds were withdrawn, the State could conceivably run the risk of being held responsible for any resultant future losses in the bond programs.

AHFC had retained earnings of over \$300 million as of June 30, 1989. However, these cumulative earnings were principally a result of interest earned on State contributions, and that without prior State contributions the Corporation would reflect a deficit to-date.

As of June 30, 1989, AHFC had \$519 million of net Corporate assets not pledged as collateral for specific bond indentures. The \$519 million equity balance is only as strong as the Corporation's assets. Based upon our review, it appears that a fairly significant portion of these assets may not be liquid, if collectible or realizable at all. In addition, a significant portion of the mortgage loans maintained in the Corporate Operating and General accounts were either already pooled, or scheduled for pooling, to be subsequently pledged to a bond issue. Although these receivable balances (pooled loans) represent valid and collectible assets, the principal intent is to place these balances into a bond issue. Finally, AHFC's short-term borrowing agreements require minimum equity balances be maintained, which AHFC has met.

Therefore, after deducting from the \$519 million equity balance those assets considered non-liquid, and adjusting for current borrowing arrangements, we estimated AHFC had only \$10 million in unrestricted net liquid assets as of June 30, 1989. Virtually all of AHFC's \$519 million equity balance is thus restricted.

C. POLICY OPTION TO CHANGE AHFC SUBSIDY

For virtually all AHFC loan programs, a subsidy is provided to the borrower if the cost of AHFC's funds used to purchase a loan is greater than ten percent (nine percent to veterans). By law, this subsidy cannot exceed three percent. With the current level of

market interest rates, there is no subsidy on tax-exempt programs, an approximate 0.75 percent subsidy on the taxable program, and an estimated two percent subsidy on the Home Owners' Assistance Program.

We believe the subsidy program is presently not desirable because it presents a major drain on increasingly scarce AHFC assets and it prevents the re-entry of outside capital into the Alaska market. The cessation of the subsidy will not only make possible some long-term future return on prior State appropriations, it also will provide a great stride towards long-term fiscal responsibility for the Corporation.

Furthermore, a unique window of opportunity exists now to eliminate the subsidy because AHFC's cost of funds is generally below the ten percent threshold rates (although some slight subsidy is in effect for the taxable program), demand for mortgages is low as compared to the last couple of years, the price of housing appears to be at or near the bottom, and market interest rates are expected to remain stable in the short-term.

However, we wish to emphasize that elimination of the subsidy as of a set date (June 30, 1990) is only appropriate under the conditions noted above. A significant time delay in implementation could result in changed market and economic circumstances. Therefore, as a possible backstop, a ratchet mechanism may be wise to consider. That is, eliminate the subsidy through revised legislation as of a set date (again June 30, 1990 seems to be appropriate), but provide for the ability to extend this date if conditions are not actually favorable at that time.

We addressed the impact of changing the subsidy as to its effect on the housing market, AHFC, and the State (appropriated funds). Below is a summary of what we determined to be the impacts:

Market: We addressed the impact to the housing market under three separate circumstances, and determined that only in a worse case scenario (interest rates increasing significantly during the transition period) would any negative effects likely to occur. In this event, some form of ratcheting (such as extending the effective date of eliminating the subsidy until conditions were more favorable or phasing-out the subsidy over time)

would eliminate this problem. However, based on projected interest rates, we do not currently believe this to be the likely scenario.

AHFC: Either the elimination or phase-out of the interest rate subsidy will provide for a financially stronger Corporation and no negative effects to Corporation bond or loan covenants, or bond ratings from credit agencies. Without the interest rate subsidy for the taxable programs, the Corporation will lose much of its competitive market advantages over the private sector. In the long-term, this could lead to a healthier competitive capital market environment.

Without any future changes to the subsidy, and no further State capital injections, we have projected that the Corporation will have a major decrease in its unrestricted net liquid assets over the next five-year period. Because of the immaterial amount of total unrestricted net liquid assets available as of June 30, 1989 (only \$10 million), any substantial decrease in unrestricted assets will have the following two important negative impacts on the Corporation's short-term borrowing arrangements:

- If minimum unrestricted net liquid asset balances are not maintained, the Corporation may be in a default position on its working capital debt
- If net losses resulting from bond programs continue in the future, the critical short-term Corporation borrowing arrangements necessary for day-to-day operations may be severely jeopardized.

State Appropriations: Because elimination of the subsidy will provide for a more financially solvent AHFC, this may be one of the few ways for the State to ever receive a return on their substantial contributed capital. This is assuming the AHFC has to reach at least break-even operations in order to be able to return a dividend from operations to the State.

The net effect over a five-year period of eliminating the subsidy may range from \$43 million to \$91 million, depending on market conditions. In summary, elimination of the subsidy will reduce costs, either to the State or to the Corporation, by these substantial amounts.

D. POLICY OPTION TO RETURN AHFC TO ORIGINAL LEGISLATIVE INTENT

The original legislative intent was for AHFC to provide housing for low- to moderate-income individuals. Based on this interpretation of intent, we made a determination that the taxable program and the second mortgage program did not meet original legislative intent. Because the magnitude of the second mortgage program is negligible, we then estimated the impact of phasing-out the taxable program on Alaska's housing market and on the financial position of AHFC and the State.

The effect of phasing-out the taxable program on AHFC's financial position is measured by the change in unrestricted net liquid assets. The potential change in these assets arises from two sources:

- First, to the extent that loans under the taxable program are subsidized, terminating this program means that further subsidies are unnecessary and these assets, therefore, should increase
- Second, because bond issues supporting the program are overcollateralized as a credit enhancement measure, terminating this program frees up assets which would otherwise be pledged as collateral.

The additive effect (over and above elimination of the subsidy) of eliminating the taxable program as of June 30, 1990, would be to reduce by \$45 million the level of unrestricted net liquid assets otherwise required over the five-year period of fiscal years 1990 through 1994.

Due to the generally perceived role of AHFC, its long-term institutional relationships with other secondary market purchasers, and the continuing importance of the taxable program to the Corporation's REO sales, any phase-out of the program should proceed carefully and take place over an extended period of time. A careful implementation of the phase-out will avoid market disruption because if any disruption does become evident, mechanisms will then be in place to slow the phase-out and stabilize the situation.

In summary, AHFC programs supported by taxable bonds compete directly with private sector sources of financing. The AHFC, in absence of the subsidy, adds no unique value to these taxable mortgage programs, over and above the private sector. In addition, AHFC is not serving primarily low- to moderate-income persons with its taxable programs. However, it should be clarified that even though AHFC programs supported by taxable bonds appear to be presently expendable, we are not suggesting that this occur. These taxable programs must remain accessible to AHFC, but only on an "as needed" basis.

E. POLICY OPTION TO CHANGE OWNERSHIP OF AHFC

The legislature requested an evaluation of the potential for "privatizing" all or a portion of AHFC. Typically, privatization has been an arrangement in which the private sector supplies goods, facilities, and services that have been traditionally provided by the public sector. However, in the case of the Housing Finance Task Force request, this policy option actually extends to selling all, or a portion, of the Corporation's assets and related liabilities to a third party.

The sale of AHFC assets is probably not feasible for several reasons:

- There is little or no interest in the purchase
- The price paid could be far below State investment in AHFC
- Legal problems may exist with respect to the Alaska constitution and various bond covenants.

However, contracting out of the REO disposition process may be a viable option, and could offer cost-savings to AHFC. The REO functions performed are commercially available, non-governmental in nature, somewhat routine, and easily defined in terms of workload. A private firm(s) could avoid many government restrictions which presently hamper the AHFC REO disposition process, such as civil service requirements, procurement restrictions, and difficulty in authorizing needed additional staff positions. Competitive bidding for providing the services could lower the cost of disposing of REO properties. If AHFC used the private sector, rather than its own employees, to deliver the REO service, it would not have to give up its responsibility to provide the service.

F. CONCEPTUALIZATION OF AN IDEALIZED AHFC

We recommend the Legislature consider a new formal mandate for AHFC in order to redefine its role in the years ahead. We believe that the role of AHFC, as described below, makes good public policy sense and serves to stabilize Alaska's cyclical housing market, both in good times and bad.

The net effects of the proposed legislative mandate would be positive to the State, AHFC, and the Alaska real estate market, and would make AHFC a more effective organization in carrying out public policy. We recommend, therefore, that the Legislature consider the following long-term mandates:

- Focus AHFC'S role on low- and moderate-income housing, but retain AHFC in a "backstop role" to provide taxable mortgage financing, as required. This will help stabilize the Alaska housing market in the long-term
- Restructure AHFC's financing mechanisms to concentrate on tax-exempt revenue bonds. This will be consistent with its focus on low- and moderate-income housing and holds the long-term potential of freeing up part of AHFC's capital base
- Enable AHFC (through elimination of the subsidy and by operations improvements) to operate on a break-even or profitable basis. This will provide funding for the housing backstop role and provide the potential to pay dividends from operations to the State
- Make AHFC more independent of close legislative control. This will promote both efficiency of operations and the ability to respond to market conditions based on long-term legislative policy
- Require AHFC to pay operating dividends to the State. This is a reasonable condition considering the large investment already made by the State
- Protect AHFC's capital base and avoid new capital infusions by the State. This will protect AHFC's financial integrity. Also, because AHFC will be breaking even or making a project, no new capital will be required.

SECTION I

**OBJECTIVES AND SCOPE
OF EVALUATION**

Ernst & Young

I. OBJECTIVES AND SCOPE OF EVALUATION

The State of Alaska Legislature established the Housing Finance Task Force (Task Force) in 1989 to review and recommend changes in publicly-assisted residential finance programs, including those loan programs managed by the Alaska Housing Finance Corporation (AHFC). The Task Force issued a Request for Proposals to assist in the analysis and evaluation of the financial condition of the AHFC as it pertains to the Corporation's loan programs. Ernst & Young's response to the RFP was presented in its proposal dated October 20, 1989. A contract with Ernst & Young to perform the study was approved November 9, 1989.

The remainder of this introductory section is organized under the following headings:

- *Background of State of Alaska Housing Finance Task Force*
- *Objectives of Evaluation*
- *Scope of Evaluation*
- *Study Tasks and Schedule.*

Subsequent sections of the report are organized as follows:

- **Section II Background of Alaska Housing Finance Corporation**
- **Section III Present Financial Position of AHFC**
- **Section IV Present Economics of Alaska Housing Market**
- **Section V Description of Policy Options and Evaluation Methodology**
- **Section VI Policy Option to Change AHFC Subsidy**
- **Section VII Policy Option to Return AHFC to Original Legislative Intent**
- **Section VIII Policy Option to Change Ownership of AHFC**

- **Section IX Conceptualization of an Idealized
 AHFC**

Following Section IX are five appendices:

- **Appendix A Selected AHFC Operational Concerns**
- **Appendix B Projections of AHFC Unrestricted Net
 Liquid Assets**
- **Appendix C Survey of the Alaska Real Estate Market**
- **Appendix D Evaluation of Housing Assistance Fund
 Mortgage Loan Purchase by AHFC**
- **Appendix E Legal Review by Delaney, Wiles, Hayes,
 Reitman, & Brubaker, Inc.**

**A. BACKGROUND OF STATE OF ALASKA
HOUSING FINANCE TASK FORCE**

The Alaska State Legislature has provided for a substantial public financing system to assist homebuyers. Through the Alaska Housing Finance Corporation, the Legislature has provided more than \$1 billion of capital, as well as bonding authority, to initiate and sustain a large variety of residential loan programs.

Concerned over the future of the State's significant investment in AHFC, particularly in light of recent economic hardship in the State, the 1989 Legislature created the Housing Finance Task Force through Legislative Resolution Number 54. The charge of the Task Force was to review and evaluate the financial condition of AHFC's residential loan programs. Specifically, the Legislature requested the Task Force to:

- Summarize the financial condition of AHFC's residential loan programs, guidelines governing the loan programs, and the status and condition of any bonds sold to capitalize these loans
- Evaluate options and implications for restructuring, reducing the size of, privatizing, or phasing out AHFC, and to evaluate the potential return on the capital invested in AHFC by the State
- Review a proposal which would require AHFC to purchase mortgage loans from the Housing Assistance Loan Fund, and determine whether the purchase should be at par value or market value.

The Housing Finance Task Force was comprised of six members of the State Legislature, including three members of the Senate and three members of the House of Representatives. The Task Force had an advisory group composed of the Director of the Rural Development Division of the Department of Community and Regional Affairs, and the Executive Directors of AHFC, the Alaska State Housing Authority, and the Alaska Housing Market Council. The Housing Finance Task Force was to dissolve when the Task Force submitted its report to the Legislature.

B. OBJECTIVES OF EVALUATION

The primary goal of this study was to provide information and assistance to the Task Force, the State administration, and AHFC board and management in their determination of AHFC's future role in providing financing for Alaskan homebuyers. This included addressing the following concerns of the Task Force:

- Availability of a return on the State's \$1 billion investment in AHFC, without impairing AHFC's financial condition.
- The affect on AHFC's financial standing from a change of the subsidy program
- The impact on the State's housing market due to changes in the AHFC subsidy and/or AHFC programs.

In meeting the needs of the Task Force, the following were established as specific goals of the study:

- Determine the status of AHFC programs, including number of participants, target population, current status of loans outstanding, and financial condition
- Determine status of bond programs capitalizing the loan programs
- Assess restrictions on the State's original \$1 billion investment in AHFC
- Evaluate the history and present economics of the State's housing market, and AHFC's role in the housing market
- Evaluate the impact on the State's housing market, AHFC financial position, and State funds from implementation of various options which change existing AHFC programs and ownership
- Determine the feasibility and impact of a proposal to purchase mortgage loans administered by the Housing Assistance Division (HAD) of the Department of Community and Regional Affairs.

C. SCOPE OF EVALUATION

The primary focus of this study was an analysis of three basic policy options regarding the long-term role of AHFC in providing financing for homebuyers, and a determination of the implications of these options on the State's housing market and financial condition of AHFC. The policy options originally were outlined by the Legislature in its formation of the Task Force. Working with the Task Force, Ernst & Young then refined these alternatives to the following three basic policy options:

- Terminating the subsidy now available to Alaska homebuyers, either by a one-time elimination or gradual phase-out
- Returning AHFC to its original charge of primarily providing residential housing financing for low- to moderate-income Alaskans
- Changing the ownership of AHFC, which could involve the selling of some or all Corporation assets.

In addition to addressing the above three basic policy options concerning the future of AHFC, Ernst & Young also spent a considerable amount of effort addressing the legislative question of the present availability of, and amount of, AHFC net unrestricted assets which could be returned to the State.

This study impartially evaluated future policy options for the AHFC. The evaluation primarily considered financial impacts on AHFC and economic impacts to the Alaskan housing market. Minor emphasis was placed on social or welfare considerations as it was assumed that these issues would be debated in the legislative process. The findings in this report are presented independent of AHFC management and Task Force member positions. However, we did obtain considerable input from both AHFC management and Task Force members during the course of the study.

The scope of this study did not focus on review of day-to-day AHFC operations or cash management and financial systems. However, during the course of this policy review areas of concern were noted which are briefly commented on in Chapter II, "Background of AHFC."

The analysis of each policy option required an examination of its impact on the State's housing market, considering the significant role AHFC now plays in residential housing. The analysis also examined the impact of each policy option on AHFC's financial position, specifically the expected change in the Corporation's unrestricted assets over the next five years. Finally, the analysis determined what impact each option would have on the State's General Fund, whether a return on capital originally invested by the State was possible, or if additional State funds would be needed by AHFC as a result of the policy change.

In addition to an economic and financial analysis of each policy option, the study also obtained selected legal advice regarding the implementation of each option. Legal questions addressed included the following:

- What is the legal definition and structure of AHFC?
- What legal steps must be taken to modify the subsidy?
- Can the State legally expropriate funds from AHFC? Is AHFC required to provide a return on the State's capital investment in AHFC?
- Will an expropriation of Corporation funds by the State create an obligation of the State of Alaska for ultimate repayment of AHFC bonded indebtedness?
- Are there any significant legal issues which constrain AHFC from selling any, or a portion of, its assets?
- Are there any legal constraints to establishing a new agency to provide for low- to moderate-income housing as originally intended by the legislature? Can specific bond programs be eliminated?
- Can AHFC issue revenue bonds?

Ernst & Young retained as a subcontractor the Anchorage law firm of Delaney, Wiles, Hayes, Reitman & Brubaker, Inc. to perform this legal review. Their letter report addressing these legal issues is presented as **Appendix E** to this report.

The analysis in this report was based on an internal review of AHFC programs, and an external review of the present housing market in Alaska. Numerous interviews were conducted with AHFC staff, management, and board; Task Force members; Alaska State Government representatives; banks and other financial institutions both within and outside Alaska; selected financial intermediaries (Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, etc.); real estate brokers and developers, title companies, rating agencies and mortgage insurers; Alaska Housing Market Council; and University of Alaska and Alaska House and Senate researchers. The analysis included a detailed review of the financial position of AHFC, including requirements of bond covenants and short-term borrowing agreements.

This study did not involve construction of detailed econometric or financial models to complete the analysis. Rather, the analysis was kept at a macro level, and modelled only significant factors influencing AHFC liquidity and the State's housing market. These factors included general demand for home loans in Alaska, interest rates, and over-collateralization needed for the subsidy and for maintaining AHFC bond credit rating.

D. STUDY TASKS AND SCHEDULE

This project began November 9, 1989 with a kickoff meeting with the Task Force in Anchorage. With the due date for a final report already established by the Legislature, the study had just forty-two (42) working days to complete this report. Therefore, study emphasis was placed on an internal analysis of AHFC liquid assets and an external, macro-economic analysis of the State's housing market. On December 6th, Ernst & Young conducted a status meeting for the Task Force in Anchorage, providing findings to-date regarding AHFC financial position and recent trends of the Alaska housing market.

Other specific tasks which were completed in this study included the following:

- Initiate and Administer Project
- Assess Current Status of AHFC Financing Programs
- Determine Financial Requirements of Bond Covenants
- Evaluate Present Financial Position of AHFC
- Assess Historical and Existing State Housing Market
- Interview Industry Representatives
- Define Policy Options Regarding the Future Role of AHFC in Providing Housing in Alaska
- Develop Evaluation Methodology and Criteria
- Assess Policy Option Impact on AHFC Financial Position
- Assess Policy Option Impact on Housing Market
- Assess Policy Option Impact on State Funds
- Assess Legal Issues Which Impede or Facilitate Each Policy Option
- Evaluate Proposal Requiring AHFC to Purchase Housing Assistance Division (HAD) Mortgage Loans
- Summarize Findings
- Prepare Draft and Final Report
- Present Results of Study to the Housing Finance Task Force.

SECTION II

**BACKGROUND OF ALASKA
HOUSING FINANCE CORPORATION**

Ernst & Young

II. BACKGROUND OF ALASKA HOUSING FINANCE CORPORATION

In this section we provide a historical review of the Alaska Housing Finance Corporation, as well as a description of each housing program now administered by the Corporation. This background information is organized in the following subsections:

- *AHFC Enabling Legislation*
- *Evolution of AHFC*
- *Existing AHFC Financing Activities*
- *Existing AHFC Programs.*

During the course of performing our study of AHFC programs, we noted several issues and possible concerns which we summarize in **Appendix A** to this report.

A. AHFC ENABLING LEGISLATION

The Alaska Housing Finance Corporation was created by the State Legislature in 1971 as a public corporation within the Department of Commerce¹ but having a legal existence independent of and separate from the State. The Legislature determined that the private sector and existing federal government programs were inadequate in meeting the housing needs of low-income individuals. The AHFC was created to provide affordable housing for low-income residents, and was given the authority to issue bonds to carry out its programs.

The newly created AHFC was given a broad range of powers to provide low-income housing, including the following:

- Make or participate in construction loans to sponsors, developers, and builders
- Make or participate in the making of mortgage loans to sponsors, developers, and builders
- Purchase mortgage loans on the secondary market
- Make partial rental or mortgage interest payments
- Make loans from the Housing Development Fund (created by the enabling legislation)
- Issue bonds as a means of financing programs.

The Corporation eventually selected the actual scope of its activities, limiting its initial activities to the purchase of federally-insured² mortgages (secondary market purchases) originated and serviced by private lending institutions. Construction and direct mortgage lending were viewed as being in direct competition with the private sector. In addition, the AHFC decided not to provide rental subsidies because the Alaska State Housing Authority already had a rental subsidy program.

¹ The name of the Department of Commerce was later changed to the Department of Revenue.

² Most loans purchased by the AHFC from 1972 to 1975 were loans insured by the Federal Housing Administration or the Veterans Administration.

The purchase of loans through the secondary market would be financed by the sale of tax-exempt bonds, which provided for a mortgage loan interest rate that was below market rates. The enabling legislation did not appropriate any State funds to AHFC for financing the housing programs.

B. EVOLUTION OF AHFC

Since 1971, there have been several significant changes to AHFC, most of which have generally expanded the market which the Corporation serves, while leaving unchanged its core activities of selling bonds and purchasing mortgage loans. Legislative actions removed income limits, increased loan limits, and created a special interest rate subsidy so many Alaskans could afford to buy their own home. Additional programs allowed for more loans for rural and mobile homeowners, provided additional subsidies to low-income borrowers, and allowed AHFC mortgage holders to refinance their loans in order to lower payments and avoid delinquencies.

In the subsections which follow, we briefly summarize milestones in the evolution of AHFC.

1. Changes From 1972 Through 1979

In May, 1972, prior to the first bond issue in October, 1972, the legislature expanded AHFC's programs to include moderate-income individuals, as well as persons living in remote, underdeveloped, or blighted areas. The criteria qualifying such individuals was left to AHFC, although all individuals still had to have incomes sufficient to qualify for federal government mortgage insurance or guarantees because AHFC was only purchasing federally-insured mortgages.

In 1975, the Legislature created the State Mortgage Insurance Fund which allowed the Corporation to purchase loans which were not federally-insured. This allowed purchase of conventional loans (i.e., not FHA or VA insured), which was the majority of new home loans. While income limits and maximum loan amounts remained unchanged, the number of eligible borrowers in the state increased. Mortgages held by AHFC went from 2,161 at fiscal year end 1974 to 4,965 at FY year end 1977. The insurance fund lessened the risk to bondholders and improved the marketability of the insured mortgage bonds sold to finance purchase of mortgage loans.

During 1978 and 1979 the Legislature created a rural housing program to be administered by AHFC. Although AHFC's insured mortgage program already authorized loan purchases in rural areas, relatively few loans were purchased. The Legislature requested AHFC make a special effort in making mortgage loans in rural areas, and appropriated \$13 million to fund the program. The AHFC operated two rural programs from 1979 until 1982, when the programs were transferred to the State Department of Community and Regional Affairs.³

Beginning in 1979, AHFC developed a mobile home loan program at the request of the Legislature. Mobile homes were less expensive than other housing types, and were viewed as needed during a period of higher population growth and general housing price inflation. However, financial institutions treated mobile homes as personal, not real, property. Loan terms for mobile homes resembled consumer loans, with higher interest rates and shorter terms than real estate loans. This caused problems for low- and moderate-income buyers, a potentially large segment of the population. This new program was initially funded by State appropriations.

2. Changes In 1980

During 1980, State and Federal legislation resulted in significant changes to AHFC programs and operations. The legislation expanded AHFC's housing programs to all owner-occupying purchasers (not just low- to moderate-income individuals) and increased the State costs of these programs. These changes are summarized below:

- *State Legislation*

- Subsidized interest rates were established at ten percent on the first \$90,000 of all loans (nine percent for veterans), regardless of AHFC's cost of funds

³ One rural program provided for State funded mortgage title insurance and mortgage hazard insurance accounts, enabling AHFC to provide financing in those areas where title to the land may still be subject to conveyance under the Native Claims Settlement Act or where commercial hazard insurance is effectively unavailable due to cost. The second rural program provided for financing of rental housing in rural areas, by not requiring owner occupancy of the property.

- Borrower income limits were removed, opening up AHFC programs essentially to all Alaskans
- Loan limits were increased
- The Home Ownership Fund (HOF) was established which reduces the monthly mortgage payment a borrower is required to pay. The loan is written at the current interest rate but the borrower was required to pay a maximum of 25 percent of their annual income, with the AHFC paying the difference⁴. Because of the additional subsidy, AHFC subsequently developed qualifying criteria including the amount of total assets based on family size, and sales price limits
- Refinancing loans for home improvement were allowed
- A program for financing mobile homes in trailer parks was funded, providing for 20 year (or less) loan terms
- A rural housing program was funded
- For the first time, AHFC's operating budget was to be subject to the Executive Budget Act for fiscal years beginning June 30, 1982. This provision required that AHFC's budget be approved by both the Legislature and the Governor, meaning more direct control over the level of AHFC activities.

- *Federal Legislation*

- The Mortgage Subsidy Bond Tax Act of 1980 was enacted, restricting the use of tax-exempt bonds to first-time home buyers and limiting the amount of tax-exempt mortgage revenue bonds which could be sold in the State of Alaska to \$200 million per year. This limited the issuance of AHFC Home Mortgage Bonds, also known as AHFC's first-time home buyer bonds.

In order to implement the new programs, the Legislature appropriated to AHFC more than \$500 million in cash and residential mortgage loans held by the State General Fund. Earnings on the appropriated mortgage loans and a portion of the cash were utilized

⁴ The HOF program has changed since 1980, where the amount of the subsidy is now based on a borrower's income in an amount that would reduce the monthly payment to 28 percent of their monthly income or a six percent interest rate loan, whichever is greater. The amount of the computed monthly payment not paid by the borrower is paid directly by AHFC each month to the seller/servicer.

to subsidize the difference between the legislatively mandated interest rate and the Corporation's cost of funds.

The Corporation also implemented the Pledged Account Mortgage (PAM) program in 1980 as a means of offering a type of graduated payment mortgage plan. With a PAM, the borrower places a portion of the down payment in an interest-bearing savings account which is pledged as additional security. Money is drawn out of the account each month to pay a portion of the mortgage payment in the early years of the loan. Because the borrower is qualifying on a lower first-year payment, borrowers can purchase a larger home in anticipation of their income increasing.

3. Changes From 1981 Through 1985

The AHFC's volume increased sharply in 1981 as a result of changes made through 1980. According to AHFC, by 1981 the Corporation was purchasing eighty-five percent of all mortgage loans made in the State. In FY 1979/80, AHFC held 15,879 mortgages in its portfolio. In FY 1981/82, after all changes were implemented, AHFC held 29,037 mortgage loans.

The original structure of the interest rate subsidy, provided for ten percent loans to the majority of applicants. As a result, AHFC was subsidizing many loans purchased in 1980 and early 1981 at up to six percent below the Corporation's cost of borrowing money. Recognizing this uncapped subsidy, the Legislature in 1981 changed the subsidy program, limiting the subsidy to a maximum of three percent (four percent for veterans) below AHFC's cost of borrowing.

In 1981, AHFC issued taxable bonds (the first public agency to do so) in order to meet the growing demand for AHFC funded home loans. With the federal cap on tax-exempt debt, the AHFC had to develop other sources of financing the increased loan demand. The taxable debt increased the Corporation's overall costs of borrowing. The cost of the taxable State Assisted Mortgage (SAM) Bonds reached 18.8 percent (SAM Series D and E).

Also in 1981, the Legislature required a "due on sale" provision for all loans; in effect, AHFC loans were not assumable. This was established partly so that new buyers would have to pay current interest rates rather than the more heavily subsidized earlier rates. In 1986, loans became assumable.

In 1982, legislation transferred AHFC's rural programs to the Department of Community and Regional Affairs. In addition, two new programs were implemented in fiscal year 1982:

- Second Mortgage Loan Program, which allows a borrower to: (1) obtain a second for home improvement while maintaining their existing interest rate, or (2) assume an older first mortgage to maintain a lower interest rate
- Tax-Exempt Mortgage Loan Program for first-time home buyers, which are those who have not owned a home in the previous three years and who meet federal requirements, including purchase price limits.

In response to increased interest rates, AHFC on June 1, 1982, implemented the Alaska Building Equity (ABE) mortgage. These graduated payment loans are structured to pay off within 16 to 18 years. The AHFC could then issue shorter-term bonds which generally had lower interest rates than longer-term bonds. The ABE structured loans applied to all AHFC programs, with the exception of the Mobile Home Loan program and the Second Mortgage Loan program. Loans purchased under the tax-exempt, veterans, and taxable bond programs from June, 1982 through 1986 have the ABE loan structure.⁵

In fiscal year 1982/83, two new programs were implemented:

- The Veterans Mortgage Program was approved by Alaska voters. This allowed issuance of tax-exempt bonds guaranteed by the state for use in purchasing qualified veterans mortgage loans⁶

⁵ In 1987, AHFC signed an agreement with FHLMC ("Freddie Mac") which, among other provisions, required all loans to be written for 30 years.

⁶ Veterans who cannot qualify for the Veterans Mortgage program still can get the "veterans preference" of one percentage point below the current interest rates from AHFC on the first \$90,000 of AHFC loans. Veterans under any AHFC program also can qualify for VA loan guarantees, allowing them to take out loans with no down payment.

- The Triplex/Four-Plex Program was developed in response to concerns about the shortage of rental units throughout the State.

In FY 1984/85, the Legislature transferred authority for making non-conforming loans in urban areas from the Department of Community and Regional Affairs (DCRA) to AHFC. The program is intended for purchasers of houses that do not meet typical structural or other standards of private mortgage lenders. In remote areas of Alaska there are a number of houses that are not of standard construction, and it is difficult for borrowers to obtain conventional financing. The DCRA administers state financed loans geared towards rural areas.

From fiscal year 1980/81 through fiscal year 1983/84, the Legislature appropriated approximately \$1 billion to AHFC. A large portion of these funds, plus earnings on mortgage loans, was used to subsidize the difference between the interest rates offered to borrowers and the Corporation's cost of borrowing.

Through fiscal year 1984/85, the AHFC issued three types of bonds to finance loan purchases: tax-exempt, tax-exempt veterans, and taxable bonds. In fiscal year 1983/84, AHFC signed an agreement with the Federal National Mortgage Association (FNMA, also referred to as "Fannie Mae"), to swap Alaskan mortgages for Mortgage Backed Securities, achieving "AAA" bond rating on taxable issues for the first time and eliminating the need for mortgage pool and special hazard insurance through FNMA's guarantee of timely payment of mortgages. Also, the State Guaranteed Veterans Mortgage bonds were restructured to extend bond maturities to 30 or 35 years, and to allow AHFC to use loan prepayments to purchase new loans. This ability to "recycle" funds provided AHFC with continued access to a pool of funds at a known tax-exempt rate, hedging against a rise in interest rates or a loss federal tax-exemption on future issues.

In fiscal year 1984/85, the AHFC became an issuer of Government National Mortgage Association ("Ginnie Mae") mortgage certificates as a means of securitizing VA guaranteed loans. Also, AHFC signed another agreement with FNMA allowing the Corporation to swap mortgages financed with tax-exempt funds and extending the "AAA" rating to the tax-exempt Home Mortgage (first-time home buyers) and Veterans Mortgage bonds.

4. Changes from 1986 Through 1989

The price of oil started a dramatic decline in December, 1985, slowing overall economic activity and reducing State revenues. Also, the Tax Reform Act of 1986 changed the way mortgages could be financed. The Act substituted a ceiling on annual issuance of qualified private activity bonds at a level of \$250 million for the remainder of 1986, \$250 million for 1987, and \$150 million per year thereafter. This ceiling encompasses not only qualified mortgage revenue bonds but also student loan bonds and some of the bonds which are issued by other Alaska State agencies. The Governor allocated half of the new ceiling to AHFC and the other half to the Alaska Industrial Development and Export Authority.

Changes made by AHFC and the Legislature in fiscal year 1985/86 were in response to economic and tax reform changes, and included three new programs and two other changes:

- A refinance program was begun in March, 1986, allowing any AHFC borrower to refinance their existing loan, generally to obtain a lower monthly payment. This program also reduced AHFC's cost of the subsidy because older (higher interest rate) bonds could be retired with the refinancing of the older loans
- A rental program was initiated with the sale of two, \$25 million note issues with five year maturities. The program allows a borrower to refinance a property for the purpose of renting. This was popular with borrowers with the means to "move up" but who were unable to sell their current home, as well as with borrowers who have moved out of state but have been unable to sell their homes
- AHFC began purchasing loans secured by properties for which typical financing cannot be obtained. These properties have non-conforming features such as low ceilings or lack of utilities. Single family homes, duplexes, and mobile homes on lots are eligible. In fiscal year 1985/86, AHFC purchased 27 such loans
- Regulations were adopted which made all AHFC loans assumable to qualified borrowers, providing the seller and buyer more flexibility and lower costs

- The ABE graduated loan structure was approved by the Federal Housing Administration (FHA), qualifying AHFC loans for FHA insurance. Moderate income borrowers who cannot meet AHFC down payment requirements may now make an FHA loan instead of a FNMA loan.

In 1988, the Home Owners' Assistance Program (HOAP) was implemented. Under the original program design, borrowers which were experiencing some hardship were allowed to refinance an existing AHFC loan in order to lower the interest rate, eliminate scheduled increases in principal and interest (from the ABE graduated payment loan structure), or provide funds to bring the loan current (if delinquent). In 1989, HOAP II was implemented which was open to any AHFC borrower. In 1990, HOAP III will be added which is different in two respects. The subsidy cannot be greater than two percent below AHFC's cost of borrowing, and the borrower cannot keep their old interest rate but must instead take the interest rate currently offered by AHFC.

Most of AHFC's loan activity in fiscal year 1988/89 involved refinancings. The AHFC purchased 9,081 loans made in fiscal year 1988/89, of which 6,316 were refinancings of existing loans under HOAP. In the prior fiscal year 1987/88, AHFC purchased just 363 HOAP loans. **Exhibit II-1**, on the following page, provides a summary of AHFC program activity in fiscal year 1989.

In the fall of 1989, AHFC initiated the Condominium Stabilization program which has three components:

- Retail Sales Financing Program will provide low interest rate (7.5 percent) financing for AHFC owned condominiums and planned unit developments. The program, referred to in public advertisements as the "Yes You Can" program, is funded from accumulated prepayments from the tax-exempt insured mortgaged bond program. The AHFC has estimated that this program is not subsidized because of accumulated excess earnings in the insured mortgage program
- Association Loan Program will provide loans to homeowners' associations for common area improvements necessary for the health and safety of the residents (essentially to make the property more marketable)

**AHFC Programs and Level of Activity
Fiscal Year 1988/89**

Program	Loans Purchased in FY 1988/89	
	Number	Dollar Amount (\$ Millions)
<i>New Loans</i>		
Tax-exempt	1,371	\$100.9
Tax-exempt veterans	254	29.8
Taxable	892	78.8
MGIC special financing	161	6.6
Mobile home	18	0.3
Home Ownership Assistance (HOF)	26	1.9
Non-conforming	16	1.2
Pledged account mortgage	<u>2</u>	<u>0.2</u>
Total new loans	2,740	\$219.7
<i>Refinancings and Seconds</i>		
HOAP refinancings	6,316	\$647.5
HOAP seconds	23	1.0
Refinance -- taxable and rental	<u>2</u>	<u>0.2</u>
Total refinancings and seconds	6,187	\$648.7
Total loans purchased	9,081	\$868.4

Source: AHFC 1989 Statistical Abstract

- Exchange Program will allow condo owners in projects with high foreclosures ("donor" project) to exchange their property for a condo of greater value owned by AHFC ("receptor" project). The AHFC then would return the vacated condo development to some other use (such as low-income housing).

In the past two years, AHFC has expanded its staff to handle the disposition of foreclosed properties. The number of delinquencies, foreclosures, and real estate owned (REO) properties increased significantly in the last few years. In 1986, AHFC had 360 REOs. Today, AHFC holds over 4,000 foreclosed properties. The AHFC expanded its activities and staff to handle the increased workload and to manage the disposition of REOs. A REO broker program was instituted which employs private real estate firms across the state to market and sell AHFC foreclosed properties.

In 1989, AHFC established the REO Financing program, providing financing of AHFC REO properties or MGIC (Mortgage Guarantee Insurance Corporation) pool insured properties which do not meet property requirements of other AHFC programs. The properties can be owner-occupied, second home loans, or non-owner occupied. Condominiums and mobile homes are not eligible under this program. The AHFC estimates that there are 300 properties which would fit under this program.

In addition to the mortgage programs, AHFC was requested by the Legislature in fiscal year 1985/86 to purchase \$70 million in mortgage loans from the Alaska Department of Community and Regional Affairs, Housing Assistance Division (HAD). The AHFC used its own funds to purchase the loans in November, 1986. One year later, AHFC combined the \$70 million in HAD loans plus an additional \$9.5 million in other AHFC loans, and used the \$79.5 million loan pool as collateral for a \$62 million bond issue. In effect, bond holders paid for approximately \$62 million of the HAD loans.

In fiscal year 1988/89, the legislature requested that AHFC purchase an additional \$80 million of HAD loans. An evaluation of this second purchase is provided later in Section IX of this report.

C. EXISTING AHFC FINANCING ACTIVITIES

The AHFC does not lend mortgage money directly to home buyers but rather supplies the funds indirectly, purchasing mortgage loans originated by banks and other lending institutions. Both the bank originating the loan and AHFC review and must approve all new loans and refinancings, which includes a review of the borrower's eligibility and the property's appraisal documents. Payments by borrowers are made to the lending institution which then transfers accumulated payments to AHFC. The banks charge a fee for servicing the loan⁷ and also charge an additional fee for originating the loan. Banks reduce their risks by not owning these long-term loans, and free up their own capital for other commercial and personal loans.

1. Source of AHFC Funds

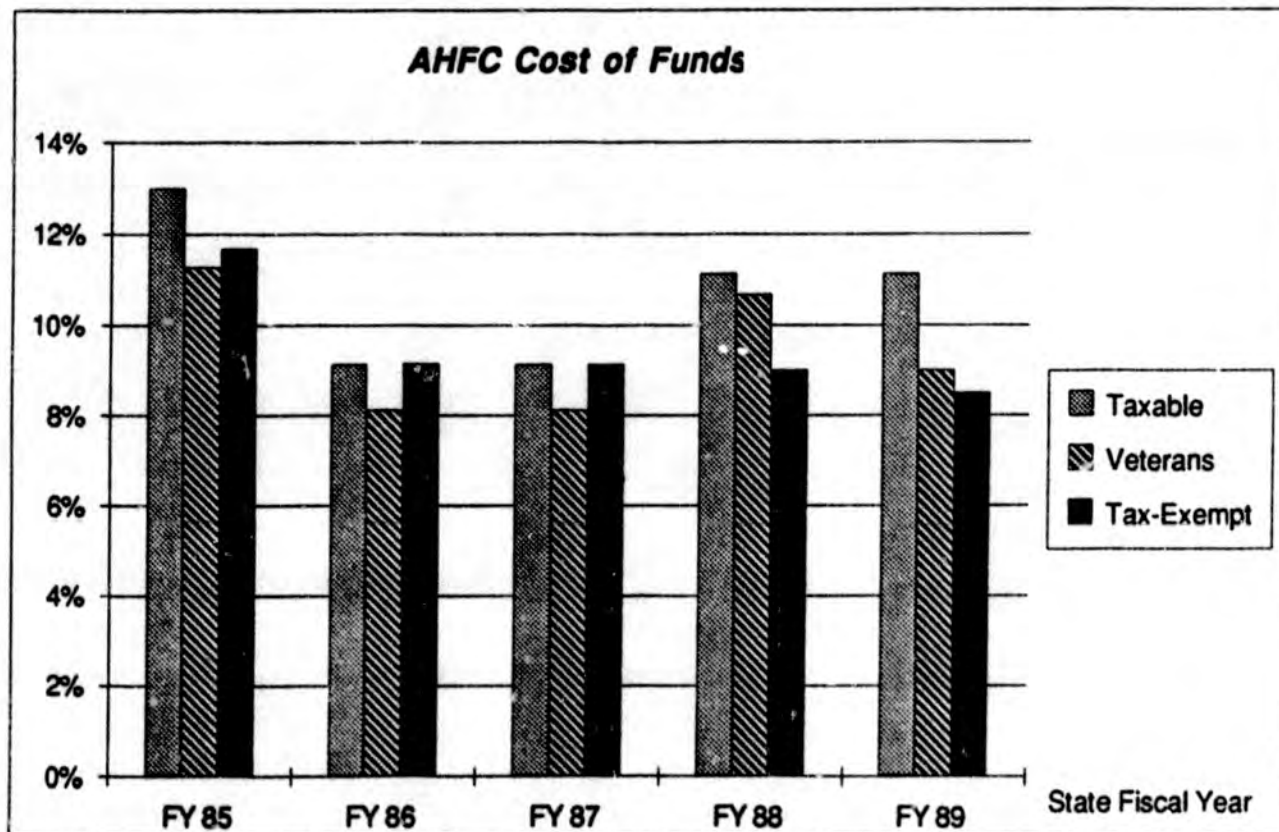
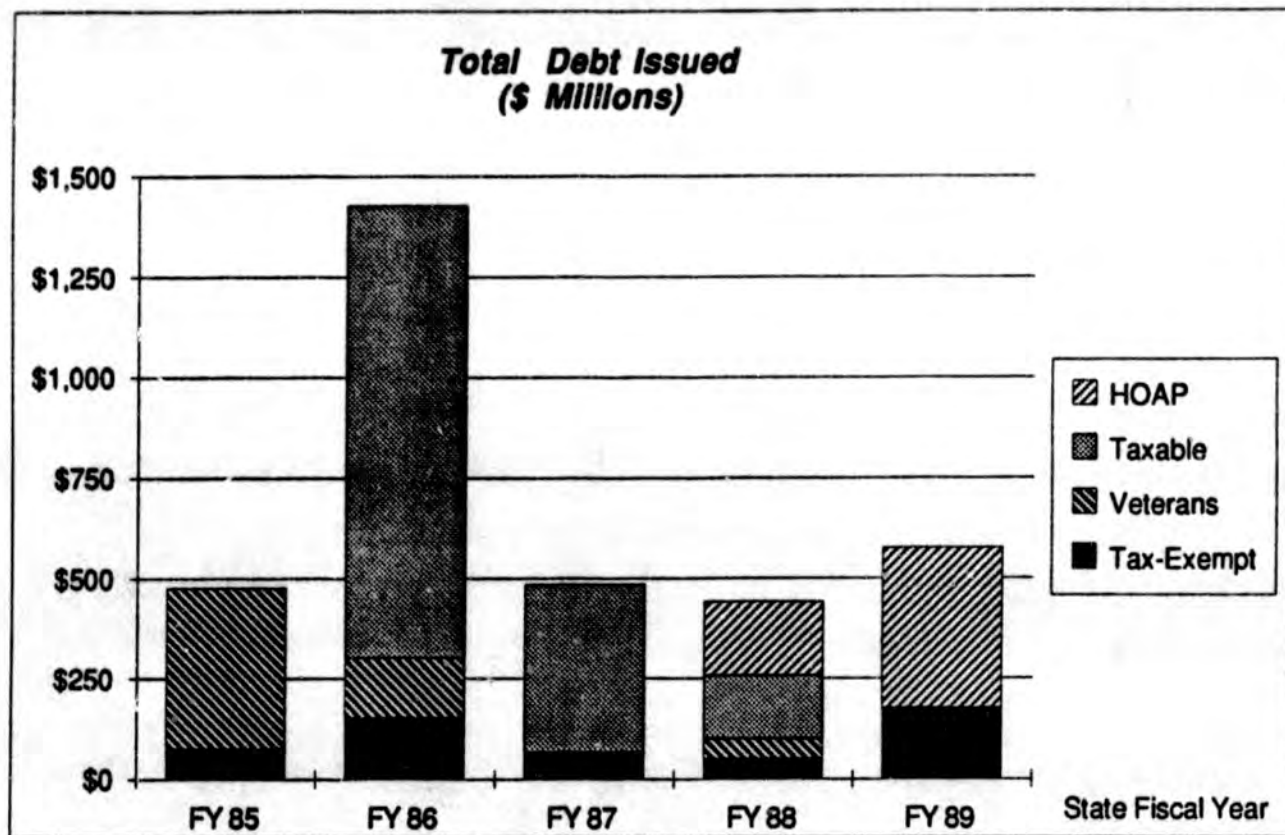
Funds for purchasing the loans come from two sources: State appropriations and bond sales. State appropriations totalled approximately \$1 billion through fiscal year 1983/84, the last year AHFC received State funds. The second source of funds is through the sale of bonds and notes of the Corporation. Through 1989 fiscal year-end, AHFC had cumulatively issued \$6.7 billion in bonds and notes, of which \$3.6 billion remain outstanding.

Exhibit II-2, on the following page, shows total bond issuance by type of debt over the last five years. The type of debt issued includes the following:

- Tax-exempt debt used by first-time homebuyers
- Tax-exempt veterans bonds
- Taxable debt used by borrowers who cannot qualify for tax-exempt funds which are restricted to use by first-time homebuyers and veterans
- Home Owner's Assistance Program (HOAP) debt used by borrowers who want to refinance an existing AHFC loan.

⁷ The monthly charge for servicing the loan is at an annual rate of generally 3/8 of 1 percent of the unpaid principal due on the mortgage loan.

AHFC Debt Issued and Cost of Funds Fiscal Years 1985-1989



2. Security for AHFC Debt

Except for the tax-exempt veterans mortgage bonds which are unconditionally guaranteed by the State of Alaska, all bonds and notes issued by AHFC are general obligations of the Corporation. Security for the bonds and notes issued by AHFC are the revenues generated from a pool of mortgage securities. Mortgage loans purchased by AHFC are combined into loan pools which then are exchanged for a class of mortgage backed securities, depending on the type of loans purchased:

- Federal National Mortgage Association Mortgage Backed Securities (Fannie Mae MBSs) in the case of conventional mortgage loans
- Federal Home Loan Mortgage Corporation (FHLMC) Participation Certificates (Freddie Mac PCs), again for conventional mortgage loans⁸
- Government National Mortgage Association (Ginnie Mae) Certificates for those loans which are insured by the Federal Housing Administration or guaranteed by the Veterans Administration.

Each mortgage backed security (or certificate) represents an undivided interest in the pool of mortgage loans created by AHFC. Timely payment of both principal and interest of the MBS is guaranteed by FNMA, FHLMC, and GNMA, whether or not the mortgage holder makes payment. This loan pooling and swap program was designed to obtain the highest possible rating for AHFC debt issued. Additional security for specific bond issues may be provided by a letter of credit purchased by AHFC.

3. Collateralization of AHFC Debt

Bonds and notes issued by AHFC generally are collateralized by mortgage backed securities of FHLMC, FNMA, or GNMA. Repayment of the bonds is dependent on the cash flow from these securities, which is essentially a pass-through of principal and interest

⁸ In connection with the agreement AHFC signed with Freddie Mac, AHFC in FY 1988 switched to a 30-year, level payment mortgage, dropping the Alaska Building Equity graduated payment structure.

from the underlying mortgages. The structure and number of mortgage backed securities which are pledged to an individual bond issue is designed to accommodate the following:

- Expected lags in the payment of principal and interest (i.e., delinquencies), as well as expected prepayments of the outstanding mortgage loans. Additional loans will be pledged to a bond or note series to obtain the maximum rating possible on the debt
- The interest rate subsidy provided borrowers. If the cost of the debt (including additional AHFC costs of borrowing) is greater than ten percent, there must be a sufficient number of underlying loans purchased at ten percent to generate the cash flow to repay the bonds. In simplest terms, to pay for the subsidy, more loans are needed than the size of the bond issue. The Corporation has estimated that for each one percent subsidy on a \$100 million bond issue, an additional \$7 million in mortgage loans must be pledged to meet the subsidy.

The cost of the subsidy, therefore, is reflected in the original over-collateralization of a bond issue (the aggregate principal balance of the underlying loans exceeds the aggregate principal balance of the bonds). Sufficient AHFC funds, plus mortgage loans pooled and swapped for mortgage backed securities, are pledged to a specific bond issue to generate the cash flow needed to service the debt and pay for the subsidy.

The over-collateralization of mortgage loans is estimated by AHFC to actually range from 105 percent to 120 percent of any particular bond issue. After a bond is fully redeemed (paid off), any remaining investment or loan pledged to the bond is freed-up and becomes available for use by AHFC for pledging to other new bond issues. The overcollateralized bond issues are:

- State Assisted Mortgage bonds (taxable)
- Home Mortgage bonds (tax-exempt)
- Second and Third Series of Insured Mortgage bonds (tax-exempt) issued in 1980 after the subsidy became effective
- Home Owner's Assistance Program (HOAP) bonds
- Collateralized FNMA and medium term notes.

4. AHFC's Cost of Borrowing

The cost to AHFC of the subsidy program is directly related to the Corporation's costs of funds. By statute, the current subsidy on the first \$90,000 of a loan is up to three percent less than AHFC's costs of borrowing (four percent for veterans), if AHFC's costs of funds is greater than ten percent. If AHFC's costs of borrowing is less than ten percent (nine percent for veterans), then loans are made at AHFC's cost of borrowing, and there is no subsidy. The interest rate on the balance of a loan greater than \$90,000 is at the Corporation's cost of funds.

The cost of funds is tied directly to the cost of borrowing money from investors through bond sales, plus additional costs of issuance, credit enhancement, the originating mortgage lender's fees for servicing loans, and AHFC overhead. Because of a general decline in interest rates nationwide, and because of specific financing actions of AHFC, the cost of funds in fiscal years 1985/86 and 1986/87 were lower than the ten percent threshold established for the AHFC subsidy. Essentially, AHFC was lending money at its cost of funds. Since fiscal year 1986/87, AHFC's cost of funds has increased to just over the threshold level of ten percent (nine percent for veterans), so that there was a subsidy of approximately one percent or less. Exhibit II-2 summarizes AHFC cost of funds since fiscal year 1984/1985. Because AHFC's cost of funds were at times lower than ten percent, there were periods when there was no subsidy.

The interest costs of just bond sales since July 1, 1989, are shown in Table 1, on the following page. Assuming other costs of borrowing add 0.8 percent to the actual bond debt costs, we make the following observation regarding the subsidy program:

- **Tax-exempt** No subsidy currently, because the costs of funds are now about 7 percent. This may increase after the short term, floating rate bonds are converted to fixed-rate bonds in 1990. The floating rate changes weekly, and was 6.2 percent in early December
- **Veterans** No subsidy currently. Estimated cost of funds for the \$45 million issue is less than 9 percent

• Taxable

A subsidy of between 0.5 to 0.8 percent may exist for the most recent \$70 million HOAP bond issue and two, \$75 million taxable issues.

Table 1
AHFC Interest Costs of Bonds Sold Since July 1, 1989

Program	Size (\$ Millions)	Bond Interest Cost
<i>Tax-Exempt</i>		
Home Mortgage Bonds	\$148	Floating
Veterans	45	7.5%
<i>Taxable</i>		
HOAP	70	9.7%
Other:		
CMO Series 1989-2	75	10.0%
CMO Series 1989-4	<u>75</u>	9.7%
Total	\$413	

D. EXISTING AHFC PROGRAMS

A summary of existing AHFC housing programs which had activity in fiscal year 1988/89 is provided in **Exhibit II-3**, following this page. It should be noted that approximately two-thirds of the loans purchased by AHFC under three bond financed programs (tax-exempt, tax-exempt veterans, and taxable), are guaranteed by the Federal Housing Administration (FHA). These FHA loans generally have more lenient down payment and qualifying guidelines. **Exhibit II-4**, following **Exhibit II-3**, summarizes general eligibility requirements, and shows the number of loans purchased in fiscal year 1988/89 for each program.

AHFC Housing Programs

Tax Exempt Program

Intended primarily for first-time homebuyers. Only those who have not owned homes in the previous three years and certain low-income residents qualify

Tax Exempt Veterans Mortgage Loan Program

Open to Alaskans who are military veterans and who meet specific service requirements

Taxable Program

Open to borrowers who do not qualify for the tax-exempt or veterans mortgage program

MGIC Special Financing Program

Provides low down payment financing of condominiums where MGIC previously provided pool insurance, and on certain properties owned by AHFC

Mobile Home Loan Program

Provides for loans on mobile homes in trailer parks with terms up to 20 years at the same rate as the taxable program

Non-Conforming Loan Program

Provides financing of properties which do not meet typical structural or other requirements of private, state, or federal mortgage programs

Home Ownership Assistance (HOF) Program

Provides loans for low- to moderate-income homeowners by subsidizing a portion of the borrower's monthly payment. Restrictions exist on purchase price and total assets.

Home Owner's Assistance Program (HOAP)

Provides for refinancing of any AHFC loan, including restructuring an ABE loan to a 30-year fixed payment loan and advances to bring a loan current

Second Mortgage Program

Provides financing for home improvement or for a second on the purchase of a property with an AHFC first

AHFC Housing Program Terms

Program	Number of Loans Purchased Fiscal Year 1988/89	Average Annual Income of Borrower (a)	Maximum Loan Amount				Down Payment	Income or Asset Ceiling
			Single Family Residence	Duplex	Triplex	Fourplex		
Tax Exempt	1,371	\$42,305	New \$108,180 Exist. \$86,850	\$97,793			10%	Yes
Tax Exempt Veterans	254	\$59,125	\$199,850	\$255,650	\$308,900	\$384,000	10% SFR/Duplex 20% Tri/Fourplex	No
Taxable	892	\$59,948	\$199,850	\$255,650	\$308,900	\$384,000	10% SFR/Duplex 20% Tri/Fourplex	No
MGIC Special Financing	161	\$36,507	\$199,850	\$255,650	\$308,900	\$384,000	5%	No
Mobile Home	18	\$33,018	I \$125,000 II \$75,000				10%	No
Non-Conforming Property	16	\$42,354	\$199,850	\$255,650			10%	No
HOF	26	\$25,431	\$72,000	(b)			10%	Yes
HOAP (refinancing)	6,339	\$56,158	(c)				N/A	No
Second Mortgage	2	\$79,368	\$99,900	\$99,900			N/A	No

(a) Averages for all loans purchased from July 1, 1986 through June 30, 1989.

(b) AHFC sets the maximum purchase price of the home being financed, depending on family size, with a maximum limit of \$100,000.

(c) Maximum loan amount for HOAP is 110% of the outstanding loan balance. Eligible properties include single family residences, duplexes, triplexes, fourplexes, and mobile homes.

SECTION III

**PRESENT FINANCIAL
POSITION OF AHFC**

Ernst & Young

III. PRESENT FINANCIAL POSITION OF AHFC

The purpose of this report section is to provide a discussion of the Corporation's financial position. We first define the term financial position as it is used in this report. Secondly, we present a brief history of the Corporation's financial position. Finally, we present the financial position of AHFC at June 30, 1989, with an emphasis placed on the various restrictions imposed on the Corporation's assets and equity.

This section is organized under the following headings:

- *Definition of Financial Position*
- *History of Financial Position*
- *Analysis of Present Financial Position*
- *Summary of AHFC Financial Position.*

A. DEFINITION OF FINANCIAL POSITION

In our analysis of the present financial position of AHFC, we considered both the concepts of solvency and liquidity in determining the overall ability of the Corporation to continue to operate as a going concern. The concept of solvency includes the Corporation's equity strength and general credit worthiness. The concept of liquidity includes AHFC's ability to meet necessary cash flow payments.

Both criteria are equally important. As can be seen later in this section, it is essential to understand not only what the net liquidity of the Corporation is at any point in time, but also whether or not all debt covenants and minimum balances are being met and that credit ratings are being maintained.

B. HISTORY OF FINANCIAL POSITION

To understand the evolution of the Corporation's financial position at June 30, 1989, we reviewed key historical data and discussed AHFC's history with members of its management and various outside interested parties (including representatives of its credit rating agencies, FNMA, FHLMC, and local financial institutions and real estate businesses). From this extensive review process, we learned the following significant items:

- Prior to June, 1980, the Corporation had issued only tax-exempt bonds with no subsidy of interest rates. These bonds were issued under the Housing Mortgage Bonds (HMB) and Insured Mortgage Bonds (IMB) programs. (Note that the last two issuances of IMB, totalling \$460 million, were sold after June, 1980, and were subject to the subsidy)
- In June of 1980, legislation was passed to allow for the State to subsidize interest rates on mortgage loans purchased by the Corporation. In connection with the legislation, the State contributed monies to the Corporation to provide for the overcollateralization of bonds sold to finance these loans so that qualified residents could obtain interest rates on mortgages below market rates
- During the fiscal years 1981 through 1984, a total of \$808 million was contributed by the State of Alaska to AHFC for the overcollateralization purposes described above. Additionally, another \$225 million was provided by through 1984 for various other specifically identified purposes. **Exhibit III-1**, following this page, summarizes these contributions, by year
- Of these total contributions, \$766 million had been subsequently transferred to the bond-financed programs as of June 30, 1989. **Exhibit III-2**, following **Exhibit III-1**, shows how the remaining \$267 million of contributed capital was allocated as of June 30, 1989.

History of State Appropriations to AHFC

(\$ Millions)

Year	- Revolving Fund -					Total State Funding
	General Purposes	Home Ownership Fund (HOF)	Rural Mortgage Purchase	Mobile Home Purchase	State Mortgage Insurance Fund	
FY 1979 and Prior			\$ 1		\$ 7	\$ 8
FY 1980					3	3
FY 1981	\$474	\$53	12	\$12	7	558
FY 1982	222	43				265
FY 1983	105	45				150
FY 1984	7	42				49
Total	\$808	\$183	\$13	\$12	\$17	\$1,033