ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

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reservoirs that we are just completing now are roughly on the order of 750,000 dollars. We are spending presently about 1-1/2 to 2 million dollars a year on capital improvements on our own system. Those are funds that are derived from our cash flow, but largely, probably two-thirds to three-fourths of those funds are coming from developers as a cost of development of a subdivision and that has certain benefits. They are providing the financing in those particular areas, however, they are only interested and capable of providing the facilities directly within their subdivisions. It does not accomplish such things as building reservoirs. It also puts quite a burden on the developer. As you all know, the cost of lots in the Anchorage area is at a ridiculous level at the present time. 20 to 23,000 dollars for a subdivision lot. Largely because of the cost of development. We also have individual home owners or people within a neighborhood that are existent but need the service but flat can't afford it and we can't afford to finance it for them. We have had to establish, since we are not in the lending business, for those few cases that absolutely had to have it and could not come up with the money, provided a 3-year financing program at an extremely high rate of interest, about 14.5, 5 percent. Simply because we had to be in the position of enabling them to get the service and there was no other way to do it. We would rather not be in the financing business. The same, conversely, if we have the long term financing available and it can be established that an extension, for example into a new area will accomplish a great deal of good and a return over a period of time, I think it is a good investment. It would also then enable you gentlemen to finance that improvement and let the people take advantage of the long term financing as opposed to a two and three year program as we have now. It is an extreme hardship in many cases.

MR. WOHLFORTH: That was a very eloquent presentation, sir, and we appreciate your coming forward.

MR. SMITH: We appreciate the opportunity to be heard. I would like just to part on one final shot. The money is, again, to be spent entirely within Alaskan industry and the service that we provide is entirely to Alaska.

MR. CRAWFORD: What is the breakdown as far as water utilities and electrical utilities as compared to REA?

MR. SMITH: I can't honestly say. I believe we only have one REA in the group. All of the regulated utilities are not members of the Association. We have opened the membership and invited membership of all the regulated utilities. Of the 143 that are regulated, I believe 18 are actual operating members. Many of them are extremely small. Some of them are REA's and they haven't expressed any particular interest nor have the municipals. I believe we have two municipals. It is also a new organization. We are just putting it together. Essentially, we started this thing with the idea of generating support for this loan program. So, primarily, those utilities that were interested in the loan program itself immediately joined and have been active in it.

MR. CRAWFORD: This is primarily electricity.

MR. SMITH: We have extended membership to everybody that is a regulated utility. Our membership even includes a couple of TV operators.

DR. LOGSDON: Did I understand you to say there were 143 utilities?

MR. SMITH: By our count from the PUC list there are 143 regulated utilities.

DR. LOGSDON: Did I understand you to say 10 million dollars?

MR. SMITH: Well, we picked a figure that we felt was reasonable based on our queries of the various utilities and what they felt their needs might be. We picked a figure of 10 million dollars. A level of 10 million dollars to be available during any given year with no utility receiving more than a million dollars at a throw.

MR. EDENSO: One question I have is, what is the average or the normal turnover rate for long term debt in Alaska utilities? In other words, how long is the average long term debt kept on the books?

MR. SMITH: Do you mean the term of the various programs? There are some that have been reported to us -- I don't have a real reading on it. Just the few reports that we have had. We did get a response from one utility that had a 30-year loan. We, ourselves, happen to have an SBA loan, it was a disaster loan, which was a 30-year loan. The balance of our funding has been 5 to 7 years that we have been able to get on the open market.

MR. EDENSO: I understand that. But on the average for the utilities in Alaska, you don't have long term debt.

MR. SMITH: Except in extreme or unusual cases, long term debt has not been available for the utilities.

MR. EDENSO: What I am getting at is, would 10 million dollars be adequate if you have an average life of your long term debt of 30 years?

MR. SMITH: Well, there are a number of factors that are going to govern this. One is the rate of expansion of a given utility for a particular area. In our specific case, we're going 10 to 15 percent a year so our needs are greater. A million dollars a year essentially would satisfy our need. So trying to use that as a criteria, we're trying to make a projection without having all the facts available and maybe 10 million dollars would be light. I don't know. I honestly don't know. Chances are, if the fund was once established and put into use, and the utilities aware of its use and methods of operation, then 10 million wouldn't be sufficient. But we are trying to start -- to put a parameter on the thing, we are trying to start with a figure.

MR. EDENSO: Do you know what the total asset dollar value is for the utilities in the State?

MR. SMITH: No, I honestly don't.

MR. EDENSO: In excess of 300 million dollars?

MR. SMITH: Yes, I would say that is very easily true. In our case, we're roughly a 20 million dollar operation and this is water only.

MR. EDENSO: Do you have a feeling that the demand for expansion and demand for utilities in the State, has there been any kind of information of that nature available to you?

MR. SMITH: No, there hasn't.

MR. EDENSO: 10 to 15 percent is your growth rate.

MR. SMITH: That has been our pattern of growth, that is correct.

MR. LOVE: Could we receive some of that information from the Public Utilities Commission?

MR. WOHLFORTH: That occurred to me that is where all the figures are.

MR. SMITH: That is the one clearing house source of information. Every utility is required to file an annual report to the Commission. The Commission is aware, incidentally, our our presentation and did support us in this presentation to the Commerce Committee.

MR. WOHLFORTH: Thank you again, sir. Any more questions?

MS. FLEISCHER: Are you talking about two different kinds of financing programs, one for the utilities. But also a separate financing for individuals who may need ---

MR. SMITH: No. I feel that, if such long term financing was available to the utilities themselves, then they would be able to provide that service to their customers. Thank you very much.

MR. WOHLFORTH: Two gentlemen from the Home Federal Savings & Loan have been sitting very patiently. The chairman of the board and the president.

MR. BOWDEN: I am Dwight Bowden, chairman of the board of the Home Federal Savings & Loan Association. I am also a real estate broker and primarily interested in residential housing.

Our interest here this morning as members of the savings & loan community, having known about this for a very short time, we have had a limited amount of time to discuss the Permanent Fund with the other members of the savings and loan community. However, we feel that our views will only differ by degree with the other savings and loans.

Paul Kapansky is here as president of Home Federal Savings & Loan.

We feel one of the excellent uses of the Permanent Fund would be as a secondary market for residential home loans or possibly as multi family housing loans in the State of Alaska.

Alaska has always been a capital-short state and the banks and the savings and loans have traditionally only been able to make loans if they were able to sell them to some Outside investors. Outside investors always look at Alaska and considered Alaska as a capital-short state and automatically our rates go up a point or two over if they were buying a loan in their own neighborhood. We feel that the Permanent Fund could well be used as a competitive market and possibly at rates that would allow Alaskans to own their own home, or keep housing costs down.

Of course, another big factor in the cost of housing in Alaska is all the fees that are charged to the developer at the time that he takes out a loan because of high risk and the fact that Alaska is a capital-short state. In order to compensate for that risk, the Outside investor wants very substantial fees. But we do feel this is an area the Permanent Fund could get into at fairly low risk and provide much needed housing for Alaskans who can't afford it.

MR. KAPANSKY: I think that we also feel that not only to compete with some of the existing secondary markets but perhaps create a secondary market where there is none, primarily residential lending. There does not seem to be any problem in finding a secondary market for some of our housing with a loan up to 68.750. Anything above that with the exception of the state gets more difficult. As you are probably aware, many of our homes up here sell for considerably more than 68,750. And this have a tendency to put a crimp on some of the sales of these homes. Our primary secondary markets and I speak specifically for Home Federal on that and not necessarily for the S & L industry up here, the Federal Home Loan Mortgage Company. Although they do purchase mortgages, if they follow within certain criteria up to 68,750, they also have criteria for certain areas which they will not purchase the mortgages in. It doesn't necessarily mean that these areas are a more risky area, it's just that they have come up with certain criteria that says we will not purchase these. They do not live in the area and are not all that familiar with it. I don't think the loans are any riskier, and perhaps the Permanent Fund could be used to supplement that also.

When we get involved in commercial projects, it has been my experience, as I think Mr. Bowden has indicated, it is an extremely capital-short state. The S & L's, the financial institutions Outside realize this. When you attempt to put together a project or a package, and although it may be a very strong package, when you go to peddle it down there and deal with them, they realize you don't have too many alternatives and perhaps in order to put the package together you have to pay their points and you perhaps have to pay a higher rate as opposed to if we had something within the State of Alaska which perhaps we would not have to charge the buyer or the builder as much.

MR. MOTLEY: Do you sell any of your loans to the Alaska Housing Finance Corporation?

MR. KAPANSKY: Yes, we do.

MR. MOTLEY: Is their rate more competitive than the Freddie Mack?

MR. KAPANSKY: I think their rate is -- they are normally lower because it is for a qualified buyer. I think it allows people who would not ordinarily be able to purchase a house to purchase one.

MR. MOTLEY: Are their geographical restrictions a lot more liberal? You talked about restraints that Freddie Mack had and you meant geographical?

MR. KAPANSKY: That is right.

MR. MOTLEY: Those don't appear in the Alaska Housing Finance Corporation, is that correct? In other words, there are no geographical restrictions.

MR. KAPANSKY: I don't believe there are.

MR. MOTLEY: So that settles that aspect of what you are talking about.

MR. KAPANSKY: Not necessarily. Alaska Housing Finance, to my understanding, is set up on a per family per income basis. In other words, if you make over "X" dollar amount and only have two children.

MR. MOTLEY: We are talking about geographical now. Not income limitations. I would assume that you don't sell more to them because there isn't that much Alaska Housing Finance Corporation money available. Is that a fair statement or not?

MR. KAPANSKY: The reason we don't sell more to them is you once again get into the income limitations.

MR. MOTLEY: Income limitation is the problem.

MR. KAPANSKY: Yes.

MR. MOTLEY: The reason I bring it out is because I think what you are saying is a very valid point in regard to the difficulty of finding a secondary market. Alaska Housing Finance Corporation has attempted to fill that to a certain extent, but there is such a big market. I think it might be a useful thing to explore. The vehicle is there if it had more dough, would you agree to that?

MR. LOVE: I believe you were talking about redlining when you were talking about certain areas. I mean there are certain areas of the state ---

MR. KAPANSKY: Certain areas of the state secondary markets do not care to invest in.

MS. FLEISCHER: Such as?

MR.KAPANSKY: I couldn't tell you specifically off the top of my head.

MR. LOVE: Are there any areas in Anchorage that are redlined?

MR. KAPANSKY: Probably areas in Mountain View, and they call that a transitionary area, going from single family to multi family.

MR. LOVE: We are not just talking about Dillingham and Barrow?

MR. KAPANSKY: No, we're talking about here in Anchorage.

MR. BOWDEN: For instance, they won't normally purchase a loan on a single family home zoned for a higher use. Anything that is in a transition area. Possibly an older residential area that is in transition to a commercial use.

MS. FLEISCHER: Who makes the decision as to whether it is in transition?

MR. KAPANSKY: The secondary -- they have representatives who come up here on occasion and they also have their own appraiser who checks out the areas also.

MR. LOVE: You are suggesting we start government loan programs for homes over the 70,000 dollar bracket to 80,000, 90,000. It seems odd to me that the government would want to provide government loan programs for people who can afford to buy an 80,000 dollar home.

MR. WOHLFORTH: We are talking about the secondary market.

MR. KAPANSKY: The secondary market. Because that is extremely limited. As you are aware, this is a capital-short state so you can only make so many home loan mortgages.

MR. LOVE: My question is whether or not that should be a priority ---

MR. KAPANSKY: I think essentially what you are saying is because a person can afford a 70,000 or 80,000 dollar house and many banks up here cannot afford to portfolio those, so therefore that person should not be afforded the opportunity to purchase one of those homes.

MR. LOVE: It seems odd to me, a government effort at a social loan program ---

MR. KAPANSKY: You are saying he should purchase it but where is he going to get the financing.

MR. LOVE: That's his problem.

MR. BOWDEN: He's saying there aren't funds available and you're saying that's tough.

MR. MOTLEY: I think you have missed the whole point of the secondary mortgage.

MR. LOVE: I don't think I did. I think I understood exactly what he is saying. I have a couple of other questions here.

MR. WOHLFORTH: Are they questions?

MR. LOVE: Yes, they are questions. Do you think we look more towards being involved in the house market whether it is multi or single family homes because of the increasing cost of the single family home. How realistic do you think it is over the long run to really think in terms of providing single family homes?

MR. BOWDEN: I would say multi family housing is going to be priced in the range that more people can afford than a single family home on its own lot because of the high cost of land and the high cost of developing that land. I would say any developer or builder in the Anchorage area would be quite happy if he could develop and build a home to sell for 60,000 dollars or less. But it is a virtual impossibility because the economics just aren't there.

MR. KAFANSKY: We haven't gotten that involved.

MR. BOWDEN: We're very small.

MR. LOVE: Rehabilitation loans for houses. Is that an area where the current money markets aren't serving those needs?

MR. KAPANSKY: You're talking about home improvement loans? I can't speak for all the S & L's but I know we are quite active in it. And once again, something because of our size, which we have to look at, we can only tie so much in portfolio because in our business -- once again, because we are young and haven't established a good servicing market, what I mean by that is selling houses on the secondary market, most of the mortgages which we look at as a matter of survival have to be salable markets and that is dictated by the secondary market.

MR. LOVE: There is going to be, I think, a big move to have the Permanent Fund get involved in housing. A number of the legislators made that part of their campaign. Housing is a real tough item here and I think it important that we get comments from the banks and savings and loan industry. In just exactly what areas are needs in terms of financing. The secondary market is not buying these second deeds or not buying home improvement loans. I would be interested in the future in hearing more.

What would you think if the Permanent Fund Committee or whatever said, we won't put dough into the savings and loans that utilize the proxies? Would that be objectionable to your institution?

MR. BOWDEN: What would be the objective of such a regulation?

MR. LOVE: Well, just to give the people that put the money in the bank a more democratic control over the system, like the system was supposed to be when it was originally set up. In most banks there is not very much respect for control by depositors ---

MR. KAPANSKY: Once again, I think you're dealing with the nature of the animal, if they chose to have a voice which I am not assuming they want. And then from a practical standpoint, as you are aware now, perhaps a municipality, on occasion they put funds up for bid. One of the restrictions is that we cannot collateralize deposits. So, therefore, we, in most instances, can only bid on 100,000 dollars in increments. So if you are talking about putting funds into permanent funds which come from one source. But if you chose not to have it collateralized, yes, it might be helpful.

MR. LOVE: I'm talking about the secondary money market.

MR. KAPANSKY: What you are saying is that because we are controlled by proxy, therefore, you shouldn't purchase our --- We contribute to the economy and we put 15 million in loans into the economy.

MR. LOVE: What do you think of that idea?

MR. KAPANSKY: To me it doesn't make sense.

MR. GALLAGHER: As you are aware, the Department of Revenue put out of the pension fund large quantities of money into housing. Is that program a successful program?

MR. KAPANSKY: I can't speak for the whole industry. But at Home Federal we have utilized every nickel that we have been able to get our hands on.

MR. GALLAGHER: Has it satisfied that market, or is that market quite a bit bigger than ---

MR. KAPANSKY: It's quite a lot bigger than you have funds to utilize. As a matter of volume, I can't put it into -- whether it's 68.750 or whatever. The S & L industry approximately made about 199 loans last year. So we do contribute quite a bit to the economy. For instance teachers retirement, I think there is more in need that you have funds.

MS. FLEISCHER: I just wondered what the income limitation is. For Alaska housing the problem was, you said, income limitation.

MR. KAPANSKY: I couldn't say specifically but I think the formula they use is it varies on the size of your family. A person may make 24,000 dollars a year and have no dependents and are not qualified. But a person making 24,000 dollars a year and having three dependents would qualify. So it goes in various increments and stages.

MS. FLEISCHER: So, basically, it is for low income people.

MR. KAPANSKY: Essentially.

MS. FLEISCHER: My question was, knowing the housing market here, are there houses available for people if they are really low income?

MR. KAPANSKY: The average home up here is about between 60 and 70,000 dollars. When you look at it in mortgage payments of existing rates of 9 or 9-1/2, you're looking at a monthly payment of 650 or 750 dollars. And generally the rule of thumb that we use and the secondary market uses, because we have to sell our loans through the secondary market, we're tied into that. They look to an income ratio of about, their monthly payment to their gross monthly income of about 25 percent. So at a 650 dollar monthly payment, you're looking at an income of 30,000 dollars a year.

MS. FLEISCHER: But you're saying that if there were, if the State would provide that secondary market, then possibly the State could meet its own needs.

MR. BOWDEN: Set your own criteria.

MR. KAPANKY: Set your own criteria and I think you would open up the housing market a little bit more to people which now can't afford it.

MR. WOHLFORTH: Are there any other questions? If not, we thank you very much, gentlemen.

MR. FLEETWOOD: I'm Al Fleetwood, and I am appearing here today in my capacity of Secretary-Treasurer of the Alaska Bankers Association. My presentation is in behalf of the Alaska Bankers Association.

In particular, the Alaska Banks Association is pleased to support the creation of a Permanent Fund, and congratulates the Legislature on its foresight in giving the voters of Alaska the opportunity to approve this concept.

You have invited us to submit suggestions concerning the use and policies governing the Permanent Fund. We appreciate this opportunity to participate and certainly pledge our fullest support and cooperation and assistance in your efforts to establish the policies for the best possible use of the fund.

The fund can be used as an economic stabilizer. It is our position that it should be structred and maintained as a Trust for the lasting benefit of the citizens of the State of

Alaska.

As such, all objectives, investment policies and guidelines should be established within the context of the "reasonable or prudent-man" investment principle.

So managed, we feel that the Permanent Fund can be a tremendous asset for our State in terms of both a capital source for future development and a cushion for a possible period of inadequate State revenues. It should be treated as a trust fund for the Alaskans of the future.

At this time, we are actually not prepared to make definitive suggestions as to how to best achieve what we are sure would be our mutual goals. We are hopeful that we may have sufficient time to develop specific suggestions for your consideration, believing that a little more time at this time will be worthwhile for such a far-reaching function. It is hoped that we can have meaningful recommendations in your hands in about 45 days.

Again, I thank you for this opportunity and look forward to our next meeting. That's about it.

MR. WOHLFORTH: Any questions to Mr. Fleetwood?

MR KERTTULA: That is a good presentation.

MR. FLEETWOOD: Well, we mean to establish an eager foot in the door.

MR. LOVE: One suggestion, will the Association try and come back with some specific suggestions for how to deal with some of the problems which have been brought up, some of the ways or protecting the interest of the State from political maniuplation and also bank participation. We're not going to be stuck with bad loans. I would like it if I could just see some specific proposals presented to us from the Association that we can look at in terms of amounts of bank participation.

MR. FLEETWOOD: Let me give you a little bit of background of our meeting. I wish the Permanent Fund could be invested in something in the Post Office to make its system more efficient, but we got out our mailing list and most of them had just one day in order to come to the meeting and all but one bank in the whole area was represented at that meeting. It's difficult to get all the banks together, but they are committed to come up with some composite position. And I think you're going to get this. I am interested to see what will come out of it also but I think it will be very, very meaningful to your Committee.

MR. KERTTULA: You think you can stretch across the State banking and mutuals and the whole works.

MR. FLEETWOOD: Yes. They are all members with the exception of the S & L's. But if we can't come up with a composite position on all points, we just don't address those points.

MR. KERTTULA: The medical fraternity did that and their composite position put the public right straight in the middle. I hope yours doesn't.

MR. FLEETWOOD: I hope it doesn't too.

MS. FLEISCHER: I just wanted to ask, when you're saying a composite position, on the goals of the Fund as well as well as the structure?

MR. FLEETWOOD: Yes.

MR. KERTTULA: The only thing you could ever get together on before, Al, was raising the interest rates.

MR. WOHLFORTH: Any questions? If not, we thank you very much.

(RECESS AT 12:00 NOON AND RECONVENED AT 2:00 O'CLOCK)

MR. WOHLFORTH: The afternoon session of the Investment Advisory Committee considering the Permanent Fund. We do have scheduled a report from Mr. Ken Butler of White Weld on leverage financing, however, I was told that he is not here, is that correct?

MR. FUHRMANN: Yes.

MR. WOHLFORTH: We are fortunate to have two other representatives of that firm and, if they will introduce themselves to the audience, they can proceed with their comments.

MR. FUHRMANN: I am Charles Fuhrmann and with me is Ted Swick. We are from our New York office.

We were asked to comment in an introductory fashion today on the use of leverage in the Permanent Fund, or the possibilities of such use. It is our feeling that it is premature for a detailed discussion of leverage because the goals and objectives of the fund, which are an integral part to any decisions about the use of leverage and its appropriatness have not been established. Nor has there been a decision taken as ) whether or not leverage is appropriate for the Fund. We agree that it is appropriate for Committee members to be aware of the possibilities of leverage so that they can focus on those decisions.

The Fund itself is going to have a pool of funds and a future cash flow. The cash flow being by statute at least 25 percent of various revenues which can be projected by analyists government officials and the financial community. And leverage should be a means magnifying the influence and maximizing the economic impact of the Fund. And there are various ways of doing that. One is by direct borrowing of the Fund, either tax exempt borrowings, if the funds to be borrowed are going to be used in certain fashions. That possibility exists and Ted will discuss that in greater detail in a moment. Or straight debt issues in either the public or private capital markets where the Fund was the borrower.

Among the various development banks and other funds in the world, many have used borrowings on their own assets either from their governments or from the public or private market. Some of the other funds are actually the borrowing entities for their public agencies and for other purposes, and so there are all kinds of possibilities with respect to borrowing. You can borrow long, you can borrow longer, you can borrow longest. And, as I say, they are either the public or private market and you can be issuing either tax exempt or straight securities.

Another means of leverage and one that has been discussed briefly here this morning is the use of guarantees, which allow you to have a multiple effect in the use of your assets rather than being limited to the assets themselves, you could extend guarantees of other people's securities to an extent much greater than the assets you have. And the value of the guarantee would be based on the amount of leverage you created and the form of the collateral behind the guarantee. Whether you have created a pool of cash or a pool of investments against which the guarantees are issued, or whether you were guaranteeing strictly against the future cash flows anticipated by the Fund. Some people have used guarantee limits of 10 times assets, 5 times assets, 20 times assets. And the value of that guarantee is dependent upon the amount of assets or earning power or future cash flow behind the entity issuing the guarantee. These guarantees could be extended to public -- other public financings, from Alaska authorities, or to private credits.

In addition, there are several forms of Federal borrowing entities or programs that provide guarantees which depend upon and given to people on the basis of the equity behind the issue. I refer, for example, to Title 11 financing, which is available at the Federal level for the building of a merchant marine operation, ships, or vessels or any kind. And the U. S. Government extends guarantees up to 87-1/2 percent, vessels built using the Title 11 program. And they expect those vessels to have a 12-1/2 percent equity interest in them. And their willingness to give those guarantees is often dependent upon the strength of that equity. And there are also possibilities there for guaranteeing the equity and not just the debt of other entities in order to get them to qualify for programs that already exist on the Federal level. Sometimes guarantees can take the form of guarantee of performance beyond the principal and interest payments on debt then. They can also be related to equity performance.

A third means of leveraging the Fund or at least maximizing the economic impact, is the form of the participation or financial participation you take in a project's financial structure. As opposed to being the lender on a senior basis to a project, any consideration on the part of the Fund to take subordinate positions, either equity or subordinated debt securities. Encourage and facilitate the participation of private capital, because they come from behind that capital and create a sense of security and minimize the risk to that capital. And, in this way, you have the means of expanding the size of the projects you can participate in without having to be the total lender.

Discussed this morning was participation -- participating only with private capital and that may be an attractive alternative but oftentimes you will find with some of the projects you may wish to consider, that private capital will not be available unless somebody is going to step in with subordinated capital to give some security to it.

Again, in the area of participation loans, by being a central force of a principal lender to a transaction, you can often encourage money from the banks and other lending institutions, many of which deal in longer term financing than banks do. So your means of creating leverage are borrowing yourselves to create a larger pool of funds readily available to you through the future cash flow generated by the resource revenues. Guaranteeing loans or equity. Providing subordinate capital, either debt or equity to transactions. Or being only willing to participate in loans which would encourage external capital to also be participating with you. Those are the four principal ones.

An unusual element here is the ability to use tax exempt market to borrow some of the funds, should you wish to do so, and I think that Ted is better informed in that area than I am and can better deal with it.

MR. SWICK: I think we ought to take a few minutes to talk about tax exemption. In discussions, sometimes it isn't clear exactly what it means. It certainly means something in the capital market but what it means in terms of government and that side of the thing. As far as the ability of Alaska through its Permanent Fund to participate in tax exempt activities is inherent in its very existence as a local government. The assets of the Fund itself and the source from which they come has no bearing at all on whether or not your activities can be tax exempt. The only restriction that I see, and our experience shows and the law says, based on Federal statutes, that if you were using the proceeds of a bond issue issued by the Fund or an appropriate underlying entity that might be created, that those bond proceeds from that specific tax exempt issue could not be used for the benefit of a private person. I think is the language they use, which would include either individuals or corporations.

Those funds that come directly from the principal source of your money in the Fund are not a deterent to being -- having access to the tax exempt field at all. There is no restriction on that whatsoever.

The various financing alternatives that relate to leverage have been used and are available in the tax exempt market. You wouldn't be breaking any new ground. Demonstrations and exhibits of these activities can be easily brought to you. The general existence of the people who have used them are already in your files in regard to some of the funds that exist in the Lower 48 that you are already familiar with and have background material on. The material you have, I don't believe up to this time shows you the details and the mechanics of exactly the way it works. It is certainly implied in the summary of those entities.

I don't know whether there has been any decision on this tax exempt subject. Perhaps I could clear it up a little bit. The financing possibilities and the use of the Fund, whether to commit principal in some way or commit earnings only. As Charles has already said there are things that can be examined at that point in your life when you decide really what do you want to do and then the financing mechanisms are either copied, if you will, or developed for your needs. Or, in certain circumstances it is not beyond possibility that new configurations can be created with some work and some thought. And, hopefully, at that stage is where we would make a more specific recommendation. It is our judgment that the possibilities of extent to which the assets of the Fund can be expanded, if you will, into a fairly sizable activity. Your alternatives and your choices are very broad. And I think the economic impact can be very pleasing to what you are trying to accomplish.

Charles and I would be glad to elaborate, if you have any questions. We believe that it is too early to get into these things, you know, who pays what, and how does this dollar get to there, and all that until we collectively have a feeling of what about this or what about that, and which way should we go.

MR. FUHRMANN: I might add that I have suitcase that is lost between here and New York and it is probably sitting in Seattle with Ken Butler in a fogged-in airport. In that suitcase is a study of how some of these other funds have used leverage. And the requirements of the lending agencies in terms of covenants and extent of leverage in order to maintain AAA credit rating for either the guarantee or the borrowing. That will ultimately get here. If not in the next 24 hours, I will see that the bag gets delivered to somebody on the Committee before it gets returned to me in New York. So you can look at that. I think that will be helpful to you.

Also, off the subject for a second, in the same bag is a bibliography that was requested at the last meeting on what people might be reading about development funds and various programs around the world and how people have used them and it lists books on the subject and articles on the subject. And to the extent that those are not available to you, we will be happy to get copies of anything on that bibliography for you. In addition, there are two additional studies to go with our original study on international and domestic development funds, to include the industrial estates in Newfoundland and Quebec development banks. Those will be available to you.

MR. SWICK: We have here -- just a 2-page introduction to the subject. I might even describe it as superficial perhaps. I will leave copies here with you.

MR. GALLAGHER: Could you elaborate on whether the limits -- when you talk about public purpose in tax exempt financing, just what are the limits of public purpose? It seems to be the industrial development authorities are just about the limit of where a public purpose might be and sometimes they reach over what public purpose might be. Could you elaborate on just what the current thinking is on limits of what public purpose is in the United States?

MR. SWICK: Well, sir, as you implied and Eric is probably closer to some of this. But the definition, I guess has been stretched in some people's minds beyond reason, particularly when you talk about industrial aid and lending of credit to private persons. There is still a very broad body of opinion and the United States Congress may act to restrict it even further. They may adjust it so that it presumably has some impact on smaller businesses or smaller activities where the restrictions are now directed pretty much. As far as pollution control is concerned, it created a volume in the tax exempt market which has been dealt with, I think, well, the market has performed well. There is some fear in the minds of the Federal Congress that it is overburdening the market but I'm not sure that can be really measured accurately.

I think every state, in effect, rolled over and have industrial aid and industrial development and economic development, with the exception of the State of Washington. I don't have an answer to your question other than as I remarked earlier, the place they go and the place they come down in local government for financing economic development is when you use bond proceeds. The clearest demonstration of the other technique is what has been done in Pennsylvania where they've used other assets for industrial loans. One recent development which is maybe only two years old shows that on the other hand the IRS will take a view of what a public purpose is when they declared the handling of garbage or refuse as now a public purpose. Subparagraph 3 in the 1968 Act relates to industrial development. I would think though that the attitude generally in the Federal Congress would be that the public purpose is stretched about as far as it should be and it should be brought back a little to the more traditional activities of government.

I think it is possible for this Fund and the source of its assets, as I have already said, to be not restricted in the activities you can engage in with that money. If they do go into the borrowing market on an entity of their own and expand their capital base in that manner, the Fund does, I think it is very easily done with legal documents to have that money segregated and just trace it through so it doesn't end up in an industrial private person's hands.

MR. FUHRMANN: It needn't be fundable in the sense it contaminates the whole fund.

MR. LOVE: Would you say that housing and public utilities, even investor-owned utilities, are those the more traditional areas?

MR. SWICK: Investor-owned utilities, the answer is no. They have entered into the tax exempt field as I am sure you are well aware in the area of pollution control in very significant amounts. It has been a much more reasonable source of their raising capital for non-productive expenses that they have to do to comply with our environmental protection laws. Traditionally, really the services you come to expect from your town, county, borough, or State, schools, roads, sewers, water.

MR. LOVE: Housing is.

MR. SWICK: Housing is.

MR. LOVE: Let me see if I understand this. You've got a million dollars in principal and you either commit that into safe securities and use the principal as your reserve fund basically, or you use, say, the earnings off your million dollars which might be, say, 60,000 dollars a year or something like that as a committee of one. And after you've got this amount that's committed, how much bonds can you sell and maintain a AAA rating, how much reserve to get a AAA rating?

MR. SWICK: You go to the credit matter which is important because it has a direct relationship on the cost of money. Levels of credit by our traditional ratings, AAA is the best credit and on down to AA, BAA and then it begins to drop out of what is called investment quality. The cost of money directly relates to those investments. If you want to have a AAA bond issue, we would want to make something up, say a new high school ---

MR. LOVE: Let's just say housing.

MR. SWICK: Then to insure yourself of a AAA rating on the securities that were sold in the tax market to build the house units ---

MR. LOVE: Buy the mortgage.

MR. SWICK: You would probably have to take an equal amount of the Fund's assets.

MR. LOVE: 100 percent.

MR. SWICK: One to one. What the investor in the tax exempt bond issue then sees is that he has a government security. And the market for that bond is probably going to be maybe 5 percent and pledged assets invested in U. S. government are earning 7.

MR. GALLAGHER: You might enlighten further that it is only because of the State's credit rating itself that the State agencies don't have a higher rating. It is traditional in the market that the agencies don't have a higher rating, I don't care how strong you make the credit, it's not going to be higher than the State itself.

MR. FURHMANN: This isn't completely true.

MR. GALLAGHER: It's substantially true.

MR. SWICK: A housing bond issue -- I'm making all this up -- and pledged to it were assets of the Fund invested in a like amount of U. S. government, you really don't get into that problem of it being an agency of the State and having to have the same rate. They'll go right to the ---

MR. WOHLFORTH: That would be of such a high quality that it would be unique almost. I am wondering, would it have to be quite such a tough pledge. This was suggested back in '69 by some of the investment bankers who came up and they said what about a State public improvement corporation which would be a bond issuing autonomous public authority. The pledge that they envisioned was a pledge of income from the Fund up to 1.3, 1.4 times debt service annually. To the extent that interest was met, those funds were then free for expenditure at the end of the year. Since it was a test kind of thing, during the year the pledge is effective in favor of bondholders' debt service. At the end of the year, it fell over and became free and things started up again. That was one of the thoughts they gave us.

MR. SWICK: You're right, I was starting at the top.

MR. FUHRMANN: Guaranteeing the AAA.

MR. SWICK: Bring it down. Any choice as to what you would actually put toward that particular indebtedness. Whatever you do will determine what it costs in the market.

MR. FUHRMANN: A lot of this, you should also be aware that the rate agencies are prepared to negotiate and discuss with you in advance of any issue what they really require. You participate, you don't just send it in and pray. And you also go with some pretty good advice. But there is nothing to say that you have to be invested in Treasury. You could be invested in fisheries, public utilities, vessels, timber lands, food packaging and all the rest with various invested securities. You have as your assets a series of investments, bonds and certificates. And those may have just horrible credit, or they may have very good credit, or a mixed bag of credit behind them. That could be set aside too or the earning power and future principal could be set aside but then the demands would obviously be greater than they would be in terms -- if you wanted to preserve the credit and they would be if your investment was solely in U. S. government. But this is not to restrict what you do with your Fund to maintain credit and value in the credit that you put into the market.

MR. LOVE: I guess you could go down quite a bit though from 100 percent. You could down to about 20 percent reserve and, if so, what type of interest rate? Can you give me some ballpark figures?

MR. FUHRMANN: The credit agency is concerned about the last dollar as they are the first dollar. It would not be correct to tell you that, if you only guaranteed 80 percent of the issue ---

MR. LOVE: How about 20?

MR. FUHRMANN: You just wouldn't work that way. You would have to guarantee the whole issue.

MR. GALLAGHER: He is asking the size of the reserve fund necessary to get there.

MR. FUHRMANN: It depends on what you've got in the fund. That is what we are trying to say. If it's all governments there probably is a break, and it depends on how the Permanent Fund is structured. The credit agency may be able to look to the future cash flow of the fund as well as security here.

MR. LOVE: It seems a couple of weeks ago somebody was taking about 10 to 1 leverage in the Fund. Are you saying you're not going to leverage 10 to 1 in the tax exempt market, that you have to go to different markets?

MR. GALLAGHER: What he is saying that you go to 10 to 20 and you may not gain that much.

MR. FUHRMANN: You may not be AAA when you're finished, but you can probably go that far as some people have indicated. We haven't. Some funds have gone as high as 20 to 1 but most of those have the taxing power behind them of the nation. The Permanent Fund doesn't.

MR. LOVE: Say we were to get some estimates on, you know, hypothetical situation, you might be able to get this type of a rating for this type of -- let's say bonds for mortgage or something like that. If you were leveraging say 6 to 1 or 5 to 1 or something like that --- To make the whole thing more tangible, I would like to see -- this may not be appropriate right now but it is just really too early to do this type of thing, but ---

MR. SWICK: It could be done but I would warn you that it would probably be such an academic discussion, how it would ever relate to the market place would be anybody's guess. A credit analysis on the municipal side, there are really only two things that you get down to. What is the willingness of the issuer to make the thing work piled on top of the need for it in the first place as a governmental service. Not to get too far afield, you are talking about housing on several occasions. You may be familiar with Section 8 deal setup in the Housing Act and what a basic disaster it has been. The problem simply is that the lender of money doesn't find any comfort in any bonds that are based on the Section 8 program. Housing units of that part of the Act which have been created have been a failure.

MR. FUHRMANN: Jamie, if I were to tell you that the interest rate you pay for a loan is based on the terms of the loan, the structure of it, whether it is 1 year, 2 years, 10 years, 15 years, and the credit behind the loan, whether it's AAA of AA or A, or whatever. And if I told you the credit rating somewhat depended upon the extent of the leverage, you can go as you want but at some point the market will tell you that they won't accept you as a credit at all. But the Fund itself, to simplify the whole thing and ignore tax exempt from it, the Fund has a pool of funds, some of which may be invested as assets, cash, it will be investments in debt and equity securities perhaps, it has the potential to earn money on its investments. And has a dedication by statute of future cash flows coming from oil revenues. So the credit institution -- if the Fund itself were to issue straight bonds, not tax exempt, and they are the issuer and they are not creating any pool or anything else, they are not setting it aside to be issued against anything, it is not a collateralized bond of any kind, the credit agency and the market place would be looking at what their perception of what the oil revenues will be in the future, earning power of the assets you have already invested in other things, how good an asset those are, to determine what you are going to pay for that and what maturity they are prepared to let you have. Now, if you take away credit from me, if you stick over something in a pool, if you just put the worst loans over there, I can tell you you're going to have trouble getting a long maturity, you're going to have trouble getting a low interest rate, you're going to have trouble selling it at all.

MR. LOVE: I'm not talking about the worst loans.

MR. FUHRMANN: If you put the best ones over there, you're going to have to get a longer maturity rate -- maturity, you're goinq to get a lower interest rate. It will be a breeze selling the loan. And you will be able to have greater leverage on it. Because the earning power will be better and it will be perceived better without damaging your credit standing.

MR. LOVE: I think I understand the process.

MR. WOHLFORTH: Other questions?

MR. WALDOCK: Jim, when these studies on the leverage that White Weld comes up, would you see that we all get a copy of that. I would appreciate that.

MR. WOHLFORTH: We've had some limited experience with the leverage concept, although very limited experience, in terms of loans from the General Fund to support a Capital Reserve Fund. One new agency which is starting up, the Alaska Municipal Bond Bank Authority. And we have seen some credit recognition to it. Certainly not what we had hoped for but it never is what we hope for. The Bond Bank Authority has an actual hard dollar legislative appropriation. As a reserve fund it happens to be put on a 10 to 1 basis. And I think it has achieved, in part at least, a rating based on that. I am sure some of the Committee will want to be thinking about the same kind of leveraging principle in terms of municipal loans. Some way of translating the State's credit, which I feel will improve dramatically probably within the next year and certainly within the next two years, ways of translating that credit to the local government who will have continuing borrowing needs. We have a small example of how that can be done. The Legislature has taken a step in that direction and we are seeing some signs of success. I am certain the local governments will feel that very keenly if the State is able to borrow at a AA or AAA rating, and they are barely able to achieve an investment grade rating and they can see interest rates that they are paying substantially more than the State itself. So it is something that has to be thought about as this whole process develops, from my point of view.

MR. FUHRMANN: I might point out in that line an experience we had. We represent Nationale Prinensierra (phonetic) which is the Mexican development bank, for all intents and purposes. No. 1, politics in Mexico is rather intense between the people that run the Treasury Department and the people that run Nationale Prinensierra, is just one example. But the Nationale Prinensierra has essentially been used as a vehicle for which everything goes to the market in Mexico, except the Mexican government itself. All the agencies go through it and everything else. And the Mexican government issues bonds. Nothing in Mexico is really rated because they don't want to be rated anything less than single A and, therefore, they have chosen not to be rated at all and run the risk of being rated less than that. But we were in a position to offer Nationale Prinensierra a security that was going to sell better and be perceived in the market places as better credit than the Federal government's direct paper. And, in that case, the Federal government was fearful that this would influence their sinking fund retirement programs and their ability to issue direct paper in the future and everything else and people would be insisting that -- Nationale Prinensierra not only represented the agency but also represented the government itself in the market place. So they rewrote the charter of Nationale Prinensierra to remove the advantage that Nationale Prinensierrra was going to be able to have, that was going to help them in the market place. So, if there is a sense of competition, you may find that happening here too. There is certainly within this Fund the ability to create a AAA security. So keep that in mind.

MR. WALDOCK: I wonder if you would address the possibility of using an insurance program on some of our loans, i.e., the Alaska State Housing Development people just put out some bonds here within the last month, and it is a fully insured program. Would there be any possibility of using this type of an insurance on various types of loans that we might be able to utilize through the Permanent Fund?

MR. SWICK: Well, when you're talking loan insurance you are talking about bond issues of local communities?

MR. WALDOCK: Yes.

MR. SWICK: Yes, I think very quickly to answer you the technique that is used in the Housing Finance Agency, State Bond Bank that Eric referred to, are techniques that can be applied right to this corporation money.

MR. FUHRMANN: I am not sure there is much difference between a guarantee and an insurance program. You understand with a guarantee program the Fund could look to -- could get a fee for providing the guarantee. And to the extent that they are putting assets aside to collateralize the guarantee, those assets will not be idle, will be invested. And the combination of the guarantee fee and the earnings on the put-aside assets may be considered an attractive investment alternative for you.

MR. WOHLFORTH: The insurance program Dennis referred to -- the current program of this corporation is to purchase conventional mortgages which are either 80 percent loan to value or insured through PMI, Private Mortgage Insurance. A 2 percent fund has been created, essentially take care of the uninsured portion, or the perceived portion which needs coverage. It is, again, just another financial device that may well be proven.

MR. GALLAGHER: It also has an additional reserve fund that insures the whole bond issue and not the credits themselves.

MR. WOHLFORTH: Yes.

MR. SWICK: I think the point is the assets of the Fund would be positioned in the same way that the corporations have done.

MR. WALDOCK: Does any development corporation use this principle?

MR. SWICK: I can't come up with one. South Carolina was gatting at it and the legislation failed on the floor and it never got to a test. The private mortgages were interviewed and had meetings and had associations meet to get themselves into this thing, but it never got together.

DR. LOGSDON: What was that, we couldn't hear that down here.

MR. FUHRMANN: Were there any other funds using the insurance concept.

MR. LOVE: Are you prepared now to give us more tangible ideas if we went into the tax exempt market the traditional type of loans we might make other than housing?

MR. FUHRMANN: We indicated, Jamie, we have talked about things like power transmission and distribution, housing, schools, roads and highways, recreational facilities, airports, ports, hospitals, water and sewer systems, transportation facilities and so forth.

MR. LOVE: These development corporations they are basically in developing structures and facilities, they are not like research development or something like that?

MR. WOHLFORTH: He may be asking about the IBB test, what is the test for an industrial development bond with security interest ---

MR. FUHRMANN: It's the ratio in dollar amounts and they you start qualifying for all kinds of things.

MR. LOVE: How about if it was like for a public resource development company or something like that, a public insurance company. Say the State went into the medical malpractice field or the workmen's comp. field or auto insurance, the State got involved in resource development, would that become eligible for tax exempt borrowing? If it was actually publicly owned.

MR. SWICK: I don't know why not.

MR. LOVE: It is not the nature of the activity, it is who the ultimate borrower is, right? But home owners would qualify ---

MR. FUHRMANN: Someone is going to track the dollars that you have raised to make sure that you have not abused the privilege of tax exempt financing.

MR. LOVE: But a homeowner would probably qualify. But a guy with a 100 or 200 apartment complex, he probably wouldn't qualify.

MR. WOHLFORTH: It is all very meticulously set out Section 103 of the Code.

MR. SWICK: You understand that those restrictions -- those restrictions only exist to the extent that you use the proceeds of the tax exempt bond issue. Don't confuse that with the fund.

MR. CRAWFORD: What is the point spread between tax exempt and non-tax exempt bonds?

MR. SWICK: It would be easier for me to say it fluctuates. I guess traditionally we're talking about 1-3/4's, 2 percent over a period of years. You get disruptions in the market based on technical things that are of a temporary nature. The tax exempt market is the full product of the money market and the whole interest rate structure. The demands for capital on the public and private side change that. It's substantial.

MR. FUHRMANN: Changes with maturity.

MR. WOHLFORTH: Some commentators in talking about the Permanent Fund and opposing it specifically, this was printed in the Lt.-Governor's material submitted to the voters, said that instead we should retire our general obligation debt and finance all our improvements directly from recurring revenues in the future. What would be your reaction to that?

MR. SWICK: My quick reaction is, why do that, just keep doing -- you've got your governmental function and your regular sources of income for your governmental services. Those activities continue and I'm sure you don't want to lose sight of the fact that there is going to be additional income from the General Fund, this 25 percent or whatever that is going into the Permanent Fund, which would be used for these special things that go beyond the everyday expectations of your General Fund creditors.

I don't envision the existence of the Permanent Fund making it unnecessary for the State of Alaska to go into the General Obligation bond. The same idea that has been inherent in all your discussions, there is no sense in paying cash for a facility or an activity that is going to benefit Alaska now and down the road. That is the whole theory behind municipal finance, to build a facility that has a 25, 30 or 40 year life, you, in effect, have the fellow who is going to use it 30 years from now also paying.

MR. LOVE: I think some of that was coming from fiscal conservatives who want to see the State budget limited and expenditures cut back.

MR. SWICK: There is nothing criminal about being in debt, is there?

MR. FUHRMANN: You are doing a lending by taking this money out of the General Fund and putting it into a Permanent Fund.

MR. WOHLFORTH: Are there other questions? Before you leave, there is a point that I think maybe we need to have some expert advice on, later on, from perhaps the Attorney General's office as we look at some of these questions. The phrase, income-producing investments which is virtually the only qualification in the amendment, what can they invest it in. As we consider intrastructure investments, I'd say, if they are to be direct. And we talk about schools, roads. Obviously some public investments fall into the income producing category and others do not. We talk about the concept of leveraging. It may be that the Legislature considers that we will continue to borrow for public improvements and have the Fund, indeed, provide a substantial reserve against the amount that is borrowed.

I think we ought to consider early whether or not, if we use a reserve fund concept for public borrowing, if we can do other than a borrowing for so-called income producing investments, which a school, obviously, doesn't qualify for. Does the fact that ultimately that the monies may be paid back to the reserve fund as a loan, does that qualify it as an income producing investment. I am not clear at all in my own mind whether that is the case.

MR. SWICK: You have already said that this idea of providing what we loosely call front-end money, having it returned and it will begin to return at a later date and still qualify.

MR. FUHRMANN: We talked about that at lunchtime after some of the comments that were made this morning by the bankers, Chamber of Commerce people, I believe.

Ted asked me, he said, "What happens if the Fund wants to get into research and development or front-end money to something that would lead to an income producing situation" and my answer was that if the Fund is, indeed, income producing that another form of leverage that we really haven't talked about here, it's not really leverage but it is in a sense of multiplying your economic impact and your ability to pledge future funds that will be coming into the Fund as opposed to current funds, was that you can provide a long-term takeout to a bank so the bank is actually putting up the start-out or front-end money and is assured of a takeout from you when the project becomes operational. So, in that sense, you have the ability right away to encourage R & D and projects getting off the ground that are not initially income producing. The other alternative, of course, is having interest holidays until the project gets going. But that may not be consistent with the income producing concept.

One way you can work with banks is being there to provide the long-term takeout and let banks do what banks do and you do what most development funds do which is long term financing and not short term financing or working capital.

Take that concept. No one has decided yet whether you're going to be development oriented or capital preservation oriented, or to what extent you want to be both or either. Back to Lanie's goals and objectives.

MR. SWICK: You can do other things.

MR. FUHRMANN: You let us know what it is, and we'll tell you what kind of leverage.

MR. WOHLFORTH: Next on the program is Bob Richards from the Alaska Banking System

MR. RICHARDS: The comment on the discussion that we were just having that the insurance that is available to municipalities in Alaska, the Housing Finance Corporation, that is limited to to 20 million dollars, may or may not have some application to the Permanent Fund, but one thing that is interesting, one of the positive elements of the Permanent Fund is your judgment that there is an opportunity for a AAA rating. That is pretty exciting and, of course, that would preclude any real need for additional insurance.

The specific inquiry that you made at our last session is being researched and that activity was preempted by the request that we go in the direction that we are going into today. At any rate, those questions will be answered and will be submitted to you in writing.

Mr. Rhode and Mr. Edenso requested that I prepare some observations on the interface of the Alaska Permanent Fund with the Alaska Banking System. And I have done that, and about all I have is just that, observation as distinguished from comprehensive analysis of this matter.

The discussion today will really have two parts. The first part will be kind of institutional in nature, that is, comments on describing the Alaska Banking System. And the other part, and the longer part, the more significant part, is the relationship -- initital observations on the relationship between the Permanent Fund and the Alaska Banking System. I have some tables here that underlie some comments I will be making. If you don't mind, I'll use the same format I used last time. I will lay this out and then we can discuss it.

I think that relative to consumers in other states, Alaskans enjoy access to a broad banking system. Now, we all know that on any per capita contest, Alaska wins hands down. Just by the mathematics of the issue. But, be ng that what it may, the statistical fact remains that on a per capita basis there are more separate banking institutions -- this is not number of offices -- there are more separate banking institutions in Alaska than in all of the other western states. By the way, I don't know relative to the rest of the country. This is an analysis I have performed -- I arbitrarily compared Alaska to the other western states, which reduced the research effort. Further, as exhibited in Exhibit B, for communities of 10,000 and over, people in Alaska have twice as many banks as the U. S. average. Exhibit C is just coming at this item in a little different way. That the Alaska commercial banks service some pretty darn'd small entities, by any measure --- By the way, as an aside, I have shown this Exhibit C to various of our correspondent banks from Outside who are utterly aghast at the proposition of building a bank to service such small population. Finally, Exhibit D is a map, which I think indicates a fairly broad geographical dispersion of Alaska's commercial banking system. But, as you can see, quite clearly the Alaska banking system falls right in line with the Alaska economy is related directly to the present day economic complexion of the State. And, finally, Exhibit E is just for your files, your background, it is simply a list of all of the Alaska -- I indicated Alaska financial institutions. Included are commercial banks, savings banks and savings and loan associations. I will have to confess to you a typographical error in here and that is Behrends, that is Hoonah not Hootnah. And another quite surprising -- when you put this together -- I was informed that the total was 110 commercial banking offices in the State, I found out it was a somewhat surprising total, clearly in excess of what I had intuitively imagined. So I think the information on these exhibits -- although, again, like the statistics I presented to you before, an intrinsic nature of the statistics that I will always present to you, and I think an intrinsic nature of any statistics anywhere at any time, they are imperfect But perhaps some sort of general conclusion that might be drawn here is that the Alaska consumer, in terms of convenience, has access to -- is not hurting in terms of access to financial institutions. I will put that, the Alaskan consumer functioning within the cash economy.

Now, the information that I have presented to you is primarily just for your background. The main element that we wanted to get to today was some comments on the Alaska banking system and the Permanent Fund. I think the most important element of the Alaska banking system, in terms of the Permanent Fund, is the role which Alaska banks -- and I am going to use the term banks and you can broaden that term as appropriate. The role which Alaska banks have played as a conduit for channeling funds from large, long-term investors to Alaska's families and businesses. I'll repeat that, I think the most important element of the Alaska banking system in terms of the Permanent Fund is the role which Alaska banks have played and are playing as conduits for channeling funds from large, long term investors to Alaska's families and businesses. I will give you some examples. Over 80 percent of the money which finances the purchase of homes in Alaska does not come from Alaska bank deposits. It comes from large institutional purchasers of mortgages. And these institutional investors are comprised, at the present time, basically of one Federal agency, Fannie Mae and Freddie Mack. (2) Outside savings institutions. (3) Union pension plans. The local banks originate the mortgages, that is, they take the application from the borrower and do all the paperwork, et cetera. Then the banks sell the mortgages to these large investors and service the mortgages for a fee. By that I mean collecting the payments, making the tax and insurance payments. And, in fact, the borrower deals solely with the bank and is not even aware of the institutional investor who purchased his mortgage.

Now, another way in which the Alaska banks serve as the conduits for the flow of funds into the Alaska economy is through loan participation with Outside banks. This situation normally arises when a customer comes into his bank in Alaska and requests a loan that exceeds the lending authority of the particular

Alaska bank, or which has a characteristic such that, for some reason or another, the Alaska bank wants the participation by a large Outside bank. The Alaska bank then presents the loan to an Outside bank with which it has a correspondent relationship for consideration by the Outside bank to lend the amount of money which exceeds the Alaska bank's authority. This is a very, very common practice and it goes on every day. And Exhibit G --- I'm sorry, I meant to give Exhibit F to you earlier. Exhibit F is still descriptive institutional material and it simply -- note that I entitled this the partial list. This list simply came forth by my checking the yellow pages of the telephone book and my sitting back and using -- inquiring of other people, and this is just to give you some sort of a representation of the variety and magnitude of the financial institutions which are channeling funds into the Alaska economy. Well, at any rate, back to Exhibit G now. As I indicated to you, another way in which Alaska banks channel funds, serve as a conduit for channeling funds into the economy is through loan participation with Outside banks. And Exhibit G is just -- and financial institutions. And Exhibit G, again, is just a representative list of financial institutions that I know of which have purchased or which participate in Alaska loans.

Probably the most significant investor which injects funds into the Alaska economy through the Alaska banks is the State of Alaska. The State General Fund, the public employees retirement fund and the teachers retirement fund currently hold over 100 million dollars in loans and mortgages which were purchased from Alaska banks. Additionally, at the Federal level, the Small Business Administration has been a substantial purchaser of Alaska loans.

So the relevancy of all of this, everything I have talked about so far has led to one point and that is: The Alaska banking system is structured and has operating procedures established for serving as an effective conduit for the flow of funds from large investing agencies to Alaska's families and businesses. The Alaska banking system has a considerable amount of experience in this procedure and the bankers of Alaska perceive this, I think, as one of their important roles. The investing agency benefits from this system by receiving the knowledge, the skill, the manpower, indeed, the entire mechanism of, I think, an extremely efficient group of institutions set up to perform this very function. The large institutional investor pays a fee for this service, which, obviously, the institutional investors, to date, have felt was more economical than setting up their own organizations to take loan applications and process the paperwork and et cetera. Or else they are making irrational decisions, one of the two.

The conclusion then, it seems to me, is that if a portion of the Permanent Fund is allocated toward loans to consumers, families and Alaska businesses and organizations -- and

I don't mean to imply that it should be -- I don't mean to imply that it should be. I don't mean to imply that it shouldn't be. But, if it is, if a portion of the Permanent Fund is allocated toward loans to consumers, families or Alaska businesses and organizations, it appears to me to make sense to do this through an efficient system of financial institutions already set up to perform this function. As I say, this is the conclusion that a number of large institutional investors have already come to themselves.

Further, however, I think that, if the managers of the Permanent Fund, whoever they may be, should give consideration toward allowing Alaska banks to participate in the large economic development type loan. Now, some Alaska banks already participate in major financing in the State which was actually originated between the corporate headquarters of a national firm and a large lender , a large bank in the Lower 48, who then bring in, so to speak, the Alaska bank. The advantage of having the participation of the Alaska bank is two-fold. One, often the Alaska bank brings an understanding of the environment within which the loan is being made. And, No. 2, the Alaska ban.. provides a certain amount of local supervision of the loan by maintaining surveillance over the activity which the loan is financed.

Now, I think that most bankers in Alaska are quite enthusiastic over the Permanent Fund. This was evidenced in the statement which they made to you this morning. Because, frankly, they are aware of the tremendous good that can be forthcoming from this vehicle. And they certainly do not perceive it as a threat, at least the bankers with whom I have discussed it. It should be kept in mind that commercial banks are in business to make short term commercial loans. Hence, their name. The Permanent Fund, on the other hand, as indicated in my very first working paper I presented to you, should have long range orientation. It's very name implies this. And it is my opinion that the Alaska voters had this in mind when they approved it. So, operated as I think they ought to, the Permanent Fund and the Alaska Banking System are certainly not in a competitive posture and are certainly in a complimentary posture. As an added service to the Permanent Fund, however, the Alaska Banking System does offer an efficient conduit through which the Permanent Fund could channel certain of its investments.

Those are my observations at this point on the Permanent Fund and the Alaska Banking System. Again, to summarize, I think they are complimentary systems.

MR. WOHLFORTH: I would be my suggestion we all take a little break and a leg stretch before we launch into Mr. Richards with questions. Let's try and hold it down to about five minutes.

OFF THE RECORD

ON THE RECORD

MR. WOHLFORTH: We are back into session now, if you will take your seats. Bob Richards has concluded his prepared remarks and now it is questioning time. Who would like to be first?

MR. GALLAGHER: I want to make one institutional observations and then I want to talk about institutional problems. I see a need for an institutional change. These numbers on banks in the size of towns are good numbers. There are even a number of smaller communities in Alaska. I see the need for us to change the Banking Code to make mobile branches or branches that don't have to be open five days a week and 8 hours a day, which is under the current law. It could make the banking system even more responsive than it presently is for rural Alaska.

MR. RICHARDS: I share the same feeling.

MR. GALLAGHER: The institutional problem that I would like to get at and it really relates to rural Alaska is that it is the tendency of the commercial banks in the State to send out the relatively young and inexperienced managers out to these small rural branches. Since they are young and inexperienced, they seem to be unwilling to take risks or do any new sort of program. I was wondering just what sort of institutional change or what sort of emphasis could be accomplished in order to make them more responsive to that problem.

MR. RICHARDS: Two reactions. No. 1, I don't necessarily concur with your thesis. No. 2, it would be helpful to me to know what sort of tack we're going to take over the questioning period. Are we just going to discuss the Alaska Banking System? Are we going to discuss the Permanent Fund and the structuring of the Permanent Fund? Are we going to be discussing the relationship between the two?

MR. WOHLFORTH: Unfortunately, Mr. Richards, I have been able to exercise very little control over the questioning and the direct relevancy of the questions to the Permanent Fund. So I would just have to say that it is going to have to be fielder's choice to some extent. I guess the agenda item, Alaska Banking System, has probably an indirect relationship because any State loan program that is conceived to come from the Permanent Fund must interface with the system as you have already indicated. So I would hope that we would try and keep our questions in that general context, but certainly I can't insist that they be. Did you have any more response to Commissioner Gallagher's comment or question?

MR. RICHARDS: Well, as I say, I don't think there is sufficient -- I haven't seen a sufficient amount of data to lead me to that conclusion. There are young inexperienced people in all enterprises in Alaska. And, as you know, I was once an employee of the National Bank of Alaska and I could perceive no -- either policy or behavior on their part that substantiated the thesis expressed.

MR. GALLAGHER: I happened to have to go to visit several rural towns and I just happened to gc visit the branch manager in each town and quizzed them on what State loan program monies were getting down to their level and were they aware of certain State loan programs. And the answer was universally no, they were not aware and, no, they had not participated.

MR. RICHARDS: Have you visited branch managers in Anchorage?

MR. GALLAGHER: No, I haven't. But under the State loan programs -- that worl through the banking system, we are getting substantial loans our of Anchorage banks and Fairbanks. But it is in the rural areas that we are not getting that sort of applications.

MR. RICHARDS: I respect your raising the thesis. It is one that I do not necessarily concur with its validity. No. 2, I don't feel qualified to respond to it.

MR.WOHLFORTH: Maybe we are talking in general the whole communications problem which has been such a problem in Alaska. We are challenged all the time to figure out ways of getting the message across, even what is happening at these meetings. And media devices, I don't think there is a state -- I don't think any of us have really fulfilled our responsibility of how to get events that are happening across. We are doing a lot now with task forces and groups and committees, but there are a whole lot of people who aren't clued in yet. It's a universal problem.

MS. FLEISCHER: It's just that I don't really know anything about this. For one thing, this is kind of a small point in a way but I note the census data here is 1970. I know that the towns aren't this small.

MR. RICHARDS: I agree with you. I think you are raising a trivial point.

MS. FLEISCHER: Well, what I was wondering was, are you saying that towns as small as 150 people can have a bank now. Did they have a bank when there were only 163 people there?

MR. RICHARDS: That is a very important question or point that you raise, Lanie. And I don't think you can draw that conclusion necessarily. It depends upon the role of that town in the region in which it is located. It depends upon the relationship of that town to the other towns served by the branch system of which that branch is a part.

MS. FLEISCHER: In other words, the town itself may be small but they may be serving ---

MR. RICHARDS: Right.

MS. FLEISCHER: What I was wondering, what is the need for banks in smaller villages, unless there is a need, if people need to be served.

MR. GALLAGHER: One of the institutional problems I was referring to, FDIC requires them to be open five days a week and I think six hours a day if they're open. And so there is an institutional problem. If the State allows a State bank to do it, then automatically the Federal banks are also allowed to do it under Federal regulations. So it is a matter of changing the State banking code to be more responsive in that area.

MS. FLEISCHER: That is something that could be done regardless of what happens to the Permanent Fund.

MR. RICHARDS: I think most bankers, or at least I would concur with some sort of mobile system or parttime system, or some sort of device to make remote banking efficient.

MR. LOVE: The Permanent Fund, a lot of people think it is to provide loans to Alaska residents. I think what would be helpful to the Committee is some indication of the areas where the Permanent Fund might fill gaps that are not otherwise met, either by the bank's own portfolios or secondary money market. And I feel like right now I don't feel we are working with very objective data. We've never really had the banks tell us where those unmet needs are.

MR. RICHARDS: We would be happy to.

MR. LOVE: Secondly, I think at some point and you may or may not be the proper person to draw on for information, I would like to know a little bit better how we can interface with S & L's credit unions. I know there are some that say, S & L, we're going to have different types of problems -- the impact of the Permanent Fund on savings and loans some people say is going to be different than the impact on commercial banks. I would like to know how the difference. And also a little bit more about the credit unions. You may prefer to defer to other consultants on this matter, I'm not sure.

Also, Senator Kerttula earlier got into a dialogue with Frank Murkowski about some of the problems in the past, the Development Loan Corporation or something like that, and some of the areas where he thought the banks had taken advantage of the State. The State had made money available to the banks to make loans. And we told him , Frank Murkowski, that we would like some specific proposals submitted to us that would outline how they think that we ought to balance -- safeguarding the public's interest. This is obviously public funds being invested by the bank. That in itself would present a problem if the bank didn't have to take the loss. What I am saying, the members of the Committee, we're going to come up with some recommendation. The State's interests have to be safeguarded in these types of investments, and I have a vague notion that has to be done somehow. I am not sure of the best system and I would like you to provide us with a recommendation.

Also, another area and this has to do with just some dollar figures. We sort of know that the banks are not providing money in the secondary market. I would like some figures at some time over what the total dollar amount is made annually in mortgages. Roughly, how much of this is by Federal agencies, how much by Unions. So we kind of know the dollar amounts currently we are dealing with so we can understand a little bit more about how the Permanent Fund relative to its size fits into all these overall pictures. Secondly, besides mortgages and things like that, the amount of consumer loans that are being made, the different kinds of Alaskan loans so we've got of a detailed picture of just how all these investments -- how these markets are being served. We are asking each person to give us some figures, the utilities, the fisheries said they didn't know yet how much they wanted. But before we start making a lot of grandiose plans for the Permanent Fund, we have to know what the needs are in the State to what we're looking at in terms of this money. Then we can look at decisions about whether or not we want to get into leverage and make direct loans and things like that. These are the types of things I would like to see provided relative to how the banks fit in with the Permanent Fund.

MR. RICHARDS: I feel confident that I can respond adequately to the first three. To your fourth there is a data problem in terms of -- we can estimate, we can come up with some sort of rough estimate I think, but ---

MR. GALLAGHER: That information may be available in the semi-annual report we send to FDIC. You tell them in one of those reports just what loans you make and which ones you sell.

MR. RICHARDS: That's true, but whether or not FDIC is going to ---

MR. GALLAGHER: Or are you going to go to the State Banking Commission.

MR. LOVE: You say you think the State should move into the long term money market -- just overall ideas about the total amount of money to commit to the long term investments or that we could commit -- that the market probably wouldn't be over saturated with, whether it's mortgages, take out loans on various resources or something else.

MR. WOHLFORTH: Are there other questions.

MR. WALDOCK: Bob, would you mind exploring a little bit more in depth in regard to your -- second to your last paragraph in your presentation today in regard to the competition of the Permanent Fund and the banking system. I understand from what I read here that you are implying that you think we ought to concentrate as Committee members toward larger sums of money and longer term structure for these monies rather than to participate in the shorter term type vehicles.

MR. RICHARDS: For two reasons. One, I'm no political scientist, I'm just another guy off the street when it comes to this observation. But it seems to me that the Alaska, the very nature of this thing that Alaska voters approved, the Permanent Fund, and all the talk that I have ever heard about this subject has some sort of connotation of long range permanency. It's my guess as just another guy off the street that was what the Alaska voters intended.

The second reason is all the other paragraphs that led up to the last paragraph, there is, in my opinion, existing a very efficient mechanism for handling the short term credits. And I think it is more efficient than any other mechanism that could be established. This is not to preclude the Permanent Fund from investing in some short term credits, but I think they should do it more in the way of purchasing, participation with local financial institutions. It's more efficient.

MR. GALLAGHER: One comment I have made here from time to time, I see the banking structure in Alaska resembles a rural economy with small short term deposits, or very little long term deposits and quite a bit of short term deposits. Is there any data available to show the legion of financial institutions that go together in a mature economy, let's say like in California you'll have insurance companies. Is there financial data available that shows all those assets per state and how they make up?

MR. RICHARDS: I am not aware of any in a meaningful way because, you see, those -- the State data is a reflection of the headquarters of those various firms and they could be investing in loans all ---

MR. GALLAGHER: The reality of the matter is quite often they use the investment within 50 miles of headquarters though. Loan officers intend to loan to things that they are familiar with. If the home office is in San Francisco, they tend to lend in the San Francisco area.

MR. RICHARDS: Yes, but I just don't know what portion the Bank of America -- maybe they're a bad choice but certainly others, Security and UCB and Union bank. I may be able to draw some inferences from this but that would be --- I concur with your original thesis that the deposit mix in the Alaska bank tends to reflect a rural economy and there is not the mature deposit, so to speak.

MR. GALLAGHER: Is there any data that you might be aware of that could prove my thesis?

MR. RICHARDS: No, but I'll look for it.

MR. WALDOCK: Bob, would you mind clarifying for me what is the length of a short term loan and what is the length of your long term loans? What I am trying to say is, I would like to know what you mean by a short term loan, i.e., what the commercial banks are doing versus what you think the Permanent Fund should be doing in regards to length of time.

MR. RICHARDS: I think more than maturity is -- I could give you a textbook answer to that question but it would be meaningless in terms of Alaska. I think rather than the maturity is the implied market. I think that Alaska banks are well set up to take care of credits that originate from Alaska families and businesses. I am not asserting that there are not some gaps, as suggested by Jamie. I think there are some gaps. How large they are, how significant they are, I don't know. But I think the Alaska banking system, at least is set up to take care of credits generated by local Alaska businesses and families.

But to give you another kind of response to your question. They make consumer loans that are as long as ten years. The textbook answer is a commercial bank makes loans to businesses for less than a year and they are paid off within that period. That's a nonsensical definition in terms of Alaska and many other areas as well. It's kind of more the market perceived by the enterprise. The Permanent Fund, as I have suggested really from the outset, should be oriented more toward the larger -- oh, for lack of a better word, economic development types of loans. In terms of what its organization does, I'm not saying they should just invest in those kinds of loans. If they invest in local loans or loans of families and locally owned businesses, so to speak, I think that can best be done through the Alaska banking system on simply the basis of efficiency.

MR. WOHLFORTH: I can remember, if I may, the time of the lease sale in '69 the banks were anxious and properly so to be considered for State deposits and, indeed, substantial amounts were deposited with the banking system and some money, I think 25 million was put up on a 10 to 14 year basis. The colloquy of the bankers at that time reflected an underlying fear that even though the deposits were made on a long term basis that, in fact, they might not be. And at least one had a perception, one couldn't prove it, that their ability to really use these deposits in a meaningful short term commercial loan was inhibited by the perception that the deposits were vulnerable. Do you think that deposits from a Permanent Fund, in quotes, would carry that same kind of banking apprehension or not. Do you think that deposits would be more meaningful did they come from a fund of this nature rather than the General Fund?

MR. RICHARDS: Yes, I definitely think so. I definitely think so. I'm glad you raised that because there are way in which the Fund can influence indirectly the type of lending activity of Alaska banks. And if you place long term -- except for this apprehension -- if you place long term funds with bankers that don't have that apprehension, the bankers will feel more inclined to make longer term loans. Getting back to perhaps some assertions that Senator Kerttula made this morning -- I wasn't here. But just because I'm saying -- suggesting one thing you might do is buy the loans from commercial banks. I am not implying this be done willy-nilly, but you can tie all sorts constraints around this or criteria. If the manager of the Permanent Fund concludes that certain loans, certain types of loans ought to be made in certain places, they can say, we will buy these types of loans made in these types of places.

But to repeat my answer to your inquiry, I think the attitude on the part of Alaska bankers is such that long term CD's, let's say for example, purchased by the Permanent Fund would be perceived as stable long term deposits and, therefore, would find their way into those kinds of loans.

MR. GALLAGHER: In talking about vis a vis making a loan direct and putting deposits, when FDIC looks at its financial institutions they usually require certain asset mixes and capital structure bases. By putting in deposits are you not creating a cost to the bank to have a certain capital structure that may not be reflected in its natural capital asset structure?

MR. RICHARDS: You are absolutely right. The response is inquiry, it implies within the bounds of prudent asset management, you bet, or liability management.

MR. GALLAGHER: I think Alaska banks are more in the liability management than the asset management.

MR. LOVE: All these things you are saying about banks could be equally applied to credit unions.

MR. RICHARDS: I don't think I am particularly qualified to respond to the matter of credit unions. They are under a whole different set of laws with which I am not familiar.

MR. LOVE: My suggestion to the Committee would be, if we are going to pursue this idea of having banks making a certain number of loans, we also ought to analyze equally the possibilities of doing the same thing with savings and loans and credit unions.

MR. GALLAGHER: The credit unions aren't in that business. There's no institutional thing that is against it but they have never been in that business. S & L's are very much in that business.

There is one difference between S & L's, credit unions and banks under their financial charters. S & L's and credits unions cannot collateralize deposits. That has been a thorn in the Department of Revenue's side when we put out deposits. One has to collateralize it 100 percent, and the other ones by the FDIC regulations, or FLIC, and those other institutions cannot pledge assets. Public trust and having some connotation of public trust and security. Those two institutions because of their nature and because of those restrictions do not have as much security.

MR. LOVE: Would that be the same thing on mutual savings banks?

MR. GALLAGHER: No. Under FDIC regulations.

MR. CRAWFORD: Bob, is there a substantial demand that is not being satisfied? Is that true?

MR. RICHARDS: Well, I have to respond to that question as an economist. As you know supply and demand always clear at the market price. And I don't know whether the demand for toothpaste in Alaska is being satisfied or the demand for -- pick any product you want. In economics, demand is always

-- supply and demand always equal. So the implication that demand is not being satisfied definitely implies some sort of value judgment being made on the part of the asserter.

I don't mean to be begging the question at all. But too often this assertion -- frankly, I think it is a naive assertion and to give a naive assertion a sophisticated response, it just cannot --- Naive in the rigors of economic analysis, not naive necessarily in the understanding of the world, this sort of thing. I know that from time to time comments are made on the street by people that the banks aren't loaning enough money. That is like somebody saying on the street John Stepp isn't selling enough Fords or Larry Carr isn't selling enough groceries. The banks are in business to loan money. And banks want to loan money. And every bank that I know of in Alaska is loaning just as much money as it can consistent with its judgment regarding the credit worthiness of applicants and liquidity considerations.

MR. CRAWFORD: Is money tight now?

MR. RICHARDS: Well, putting on my economist's hat, no.

MR. GALLAGHER: You earlier though spoke of institutional sort of problems. You referred to commercial banks lending short. If the need in the State is long lending then there may be an unfilled need.

MR. RICHARDS: That could very well be. You're right, there very well may be a demand for more Jeeps, but that is no criticism of John Stepp. I assume -- are commercial banks doing enough of what they are supposed to do.

MR. LOVE: Can you get a home improvement loan for 5,000 dollars from most banks?

MR. RICHARDS: Sure.

MR. LOVE: That is not what I've been told by people that work in mortgage banks. They say they can't make enough money on them, they don't like to process the paperwork. They tell me opposite. This gets back to, are there areas that aren't being serviced. Maybe that is an area for the Permanent Fund to look at.

MR. CRAWFORD: That wasn't the basis of the question. With the documentation we have been presented and the analysis for the western states. The purpose of the question, I guess is there are substantial demands now which are not being met, which I think you answered.

MR. WOHLFORTH: I think that in any what we call -- have to really call an offshore problems like Alaska with a relatively young banking system, a young and volatile economy, there's going to be a lot of basic dissatisfaction with the banking services, real or perceived, it's the nature of the thing. The banks represent to a lot of people, you know, a kind of money center which they don't like.

I would like the discussion, if we can, to get off a little bit of examination of the adequacy of the banking system because I don't think we can hope to resolve that in an objective sense, but into a little more of the details. Some of the observations that Bob Richards has made. He stated, and I don't think you have to be taxed with it as having been stated as an absolute certainty, that the larger loan, the longer term loan, and Murkowski said the same thing this morning, were probably a thing that the Permanent Fund should be looking at and not disrupt the credit mechanism of the banking system which is to some extent satisfying and servicing the shorter term smaller amount of loan catagory. I think, however, that is something we are just beginning to approach in this Committee. That assumption needs a very rigorous testing. The consultants from White Weld and others are aware of development corporations in some of the Canadian provinces that have made some very serious mistakes in large loan situations.

MR. FLEETWOOD: A short term loan is 5 years or less. (inaudible) Their policies, what they do with their funds is based on where their capital comes from. Principally, they are involved in making loans and investments and their loans are of the short intermediate variety and their investments usually cover securities. They are prohibited by law from making equity investments. I don't know the local policy with respect to banks and whether they do reach out for longer loans. Funds in development banks have a completely different capital structure.

80 or 90 percent of their capital is either equities and long term and the other 10 to 20 percent is perhaps short term in nature. So these funds in development banks. (All the rest of this inaudible)

MR. WOHLFORTH: To me your comments are helpful, maybe bringing us back on the track a little bit. Is there a demand for long term credit? Is there a real demand for long term credit? What does real mean? Does that mean there are projects which should be financed now and which are not because of lack of long term capital.

MS. FLEISCHER: Do we have the answer to that question?

MR. WOHLFORTH: I said two meetings ago I think it is probably one of the central questions to the whole concept of a development loan bank in the State. We don't want to set up a credit mechanism which is inappropriate to the economic scene and climate of the State. Everyone in his own mind's eye has perceived the capital needs for Alaska but nobody, it seems to me, has a real grasp on what they are, are they being unmet now for lack of capital.

MR. BARNES: I think Bob alluded to the difference in the Alaska banking system to the United States banking system and is very substantially different. And I think it illustrates that the Alaska banking system a mortgage banking system plus we are filling a gap and that gap is real estate monies. That's where the real need is. We have to now write our mortgages to the underwriting standards of Outside lenders. Someone sitting down in Washington tells us the criteria we have to use if we're going to sell them loans. And those, in many cases, are not realistic Alaska criteria. They will say we won't take anything that doesn't have streets, gutters and sewers. That eliminates half of Anchorage and certainly the rural areas. So, why don't banks make more mortgage loans on the Kenai Peninsula, we can't sell them. They don't meet lenders' criteria. If the State had a program in which these criteria were eliminated, that I think would serve a real purpose.

MR. CRAWFORD: I notice on the agenda tomorrow we get into the structure. We still haven't decided what our goals are. I think we continue to put the cart before the horse. I think we should decide what the objectives of the Fund and in what direction we want to go.

MR. WOHLFORTH: Do the members feel we are making any progress in our thinking? In the discussions we have had, are the areas sharpened in your minds, the issues that the Legislature has to face and I see them facing it this year and perhaps next year in determining the goals and the areas where this Fund can be effective.

MR. LOVE: I think some of the most important things we can do now, I don't think this Committee can commit the State towards goals in different directions. I think the best thing that we can do is that, if you embark on certain goals, these might be some of the structures which you might want to look at, if we want to get into development banking. I'm not so sure that it is going to be too fruitful for us to presume that we can set goals, social goals for the Fund. I think what we can do is getting some good background in terms of types of vehicles and the structure that is necessary. I think we should get some facts before us. So when the public begins to deal with these decisions about goals, that they have better information and understanding of the program and they also have before them a bunch of different alternatives and choices so that they are making their decisions based upon the best educated and most sophisticated understanding of the whole thing.

MR. CRAWFORD: We have heard comments from various people about public utilities, secondary mortgages, and fisheries and several others. One of the bases for decisions is how big a pie there is to split up, which we don't have. Can we get projections as to what is going to be in the Fund.

MR. GALLAGHER: I think Bob Barnes' point was well taken. I think under that context is what tomorrow's session is about.

MR. WOHLFORTH: I think it is frustrating for any group to be thrust with any job of finding the goals. And it is possible you can only get to it through a process of discussion, if you will, of segments of lending activities or capital needs in the State. Then the goals could conceivably begin to emerge as the understanding of what we are dealing with is developed. I, for one, like the question, What Went Wrong. That is to say at least we can be aware of some of the positive things that have happened elsewhere that we want to avoid and we can transmit that to the Legislature. That seems like a valuable effort. I honestly think it is completely unrealistic to say we'll sit down at 9:00 o'clock tomorrow and determine our goals. That is my own private view.

MR. EDENSO: Mr. Chairman, I don't think anyone intends tomorrow to try to identify the goals or objectives, or for that matter, what you will do with the income once you have earned it. I think that will take a public process, public participation process that will include several months and a great deal of effort by a legislative body plus a whole number of dollars which we don't have. However, we do have a task before us and one of the easier portions of that task is to address what kind of structure and organization we may have. I think if you take it in the context that we do want to provide some kind of social service or social good or if you do want to provide some economic development activity or if you do want to provide some community development activity than you can begin to talk about structure and organization and management. I think that we are very seriously remiss in our thinking if we can assume that we can go along between now and January, meeting every month, every two or three weeks at the company's expense without coming up with a product.

I fully intend to see that this Committee has some kind of product before the legislative body in January. That may mean taking each one of us out behind the barn and settling our differences, or it may not mean that. I am hopeful we will get a lot of cooperation. This is a constructive effort, we are trying to construct something. We are trying to construct a Permanent Fund. We have hired some very expensive, very talented consultants to do that for us. We've got them here, we've had them here several times. We have spent a considerable amount of money. You have listened for literally hours on end to them describe different kinds of organizations, different kinds of funds and I think it is about time we started taking a cut at it. You know, at least a significant portion of our task. To divide the task up into three major catagories, one is what are the goals and objectives. I don't believe we can answer that. I don't believe we have either the time or the money available to us between now and January to do that. A second is, what kind of organization, what kind of structure, how does that relate to the general public, how does it relate to the legislative body and how does it relate to the administration. I think we can address that. I think we can take some real significant cuts at it and come up with very sound, very well based ideas. And, finally, you do have a problem of what do you do with the income of the Permanent Fund. How you distribute that, how you directly benefit Alaska. I think, again, we are talking about a large amount of time and a very large effort on the part of this committee and on the part of a number of other people. We don't have that time. We do have a committee and we may be able to talk about it. There have been ideas kicked around such as Alaska, Incorporated, such as tax benefits or tax rebates. The only thing that is lacking in that is our imagination and how to address the problem. So, again, I think we do have a task. I'll really put it before the Committee. I think the Committee ought to begin to sit down and look at it. One of the reasonable things we can do is talk about structure and organization. And I think one start at that is what went wrong with other efforts. What kind of mistakes have been made. And then from there just get into a general working session and say, "Look, maybe we want a dual board system or maybe we don't". There are all kinds of questions that that could raise. With that I would ---

MR. GALLAGHER: With the basic assumption that you do want to look at this sort of management structure given this sort of goals and objectives.

(MEETING RECESSED AT 4:50 P.M. AND TO RESUME AT 9:00 O"CLOCK, NOVEMBER 6, 1976)

(CHAIRMAN WOHLFORTH CALLED THE MEETING TO ORDER AT 9:00 A.M., NOVEMBER 6, 1976)

MR. REGIS: This is the second report of Price, Waterhouse. If you recall, the former report was given by Pete McDowell. That first report was a comprehensive look at matters affecting the security and protection of any prospective fund to be established with the proceeds associated with the Alaska Permanent Fund issue. By contrast, this is a specific issue oriented question which was given to us through Jim Edenso and Jim Rhode.

We were presented with three specific questions which this report attempts to address. The first was, what development banks had gotten into trouble and why. Secondly, from our experience with development banks, what are our preliminary views as to an appropriate policy level and operating structure for the Permanent Fund. And, lastly, and this was primarily in response to a question which was posed in the prior presentation, what are some of the specific criteria by which the success of development banks -- development bank efforts are measured.

First, let's take a look at the problems associated with development banks. The only notorious and widely-known case of a development bank failure or what can be called very close to a development bank failure, occurred with the development bank of Ethiopia. This also happened to be the very first development finance company which was funded by the World Bank. A development finance company, you may recall from McDowell's prior presentation, is in reality just a smaller version of an international developmert company. And the primary distinction is that its concentration is in one geographic area and tends to concentrate on smaller dollarsize issues as opposed to the large things associated with an international finance company.

In this particular instance -- let me step back for a minute, I said that this is the only widely-known case of a close to failure. There are some specific reasons for that which I will go into a little bit later. But for the moment, concentrating on the Ethiopian bank. The problems probably began as a result of a split between the agricultural and industrial sections of their charter. Originally, it was a multi-faceted institution. And subsequently the agriculture was retained and the industrial section was put off in a separate development bank. Now, from what we have been able to determine the causes for the problems subsequent thereto were essentially four. First of all, the only thing left with this bank was the agricultural area. There was too much concentration in that particular sector of the economy. Crop failure or whatever, there was not adequate diversification to protect that portfolio as a whole. Secondly, the key issue, the loans were much too small. Too small to be adequately supervised, to small to be processed efficiently. And, in turn, by their size alone, as one would guess, they were to mostly unsophisticated borrowers who did not properly use the proceeds to expand production and as a result were unable to repay many of them. Management, and this again is a key issue, management was simply not adequate to the task. And, finally, the control systems which were devised for a multi-faceted bank and which were set up to handle a larger volume, or larger single value portfolio, were not probably revised when they went to a small organization.

These problems were recognized with the Ethiopian bank and it was remerged into the industrial bank and, at the present time, it appears to be operating successfully.

At the outset, I said that there were no known failures and very few notorious examples of problem banks. That requires a bit of comment. For the most part, development finance companies, which are the most risky of all ventures, can be shored up by the local government so they are understandably reluctant to wash their dirty laundry in public, and it is very difficult to find case by case information. Our discussions with World Bank and other associated with them on a no-name basis and trying to concentrate on issues as opposed to specifics gave us a laundry list, if you will, of common reasons why some of the other banks had gotten into unpublicized trouble. And the reasons, again, are pretty much the same as the Ethiopian bank with some diversification but essentially they are: Incompetent management, unusual or undue political influence, and lack of a clear operating mandate. And in some [illegible]es, there is also one final one and that was too ambitious a program.

A summary of lessons which could be learned from these experiences would be first of all that the operating management must be very capable as must the Board. The appointment power must be removed generally from the political influence so that operating management can and does indeed exercise prudent decisions. The charter of the institution must clearly define the objectives. Impossible objectives should not be set. If you wish to loan a certain dollar value of money, it isn't any trouble to throw it away. And, finally, government influence must be reasonably controlled so as not to dilute the independence of the institution.

The second issue had to deal with organizational structure. Perhaps I will save that for the last in order because it probably will elicit the greatest comments and questions.

Perhaps we will move on to page 6 of this report about measurement techniques. This question primarily arose from a -- one of the Committee members asked, what criteria other than simple ability to repay were used in determining whether or not a program was successful for a development bank. First of all, most of the organizations we presented to you in the prior report were World Bank or World Bank-affiliated, or somehow associated with receiving funds or whatever. The World Bank has a section called Operations Evaluating Department, or some words very equivalent to that. The function of that particular organization is solely to evaluate the results of particular programs which are undertaken. At the completion of every project, there is a very detailed project completion report submitted by the various sections involved in making the loan. And this is reviewed by the OER Department. From time to time, the OER Department also specifically audits some of these programs and looks to the report to see that it is indeed factual. The thrust of the evaluation process in the World Bank and its affiliates is that it is both inward and external. I use the word inward intentionally as opposed to internal-external. Inward meaning that they use both the borrower, borrower's consultants, other third parties, to measure the success of the project as well as their own internal staff. The purpose obviously being to avoid the prospect of the bank considering its own beauty in the mirror.

Evaluation is really a 3-fold process. The primary thrust is a comparison of actual to plan as it was originally proposed when the project was brought to World Bank or World Bank actually sought it out.

There are a whole series of specific things which are compared in this actual plan which include implementation, just how quickly it was done, if it was done in the same time as proposed, has a serious impact of a host of the benefits intended. Compliance, did the borrower and the government associated meet the loan covenants and so forth. Did the consumer perform as expected. Questions relating to that. What is the financial performance of the borrower. That is the obvious one. What is the economic impact to the extent that it can be measured. Regretably this is probably the most nebulous area and perhaps one of the prime objectives. Unfortunately, it would take a number of years to really assess it in many cases. And, finally, a question of efficiency. Efficiency on the part, primarily, of the lending institution. Could or should other projects of this like be offered and can it be done in a more expeditious manner.

The second thrust is a macro view of the impact on the economy of the country or the area, whatever was intended and this would be cumulative as opposed to individual. Annually within World Bank there is a report by the Evaluation Section which measures the cumulative impact of all the projects. And this macro view is designed to see whether you help employment, income redistribution, whatever else was intended in that particular country, has the standard of living increased, whatever.

And, finally, is the suggestion at the outset that the thrust is inward. Can we do a better job? Was the performance of the bank actually appropriate to the circumstances presented to it? Was the diagnosis of the borrower's needs appropriate?

Was the definition of the objectives of the project correct at the outset, understood, whatever. Were there unintended effects, either good or bad? Poor or good environmental impacts? Was the bank participation effective or was it detrimental. The purpose of all this is to restructure activities in the future -- future efforts.

Let's move back to page 3. It starts on the end of page 3, Organizational Structure. This is the first, I guess, question for the most part asked of us in terms entirely judgmental call. So far, I think most of our input has been in terms of comparison with other associations with the possible Permanent Fund. For input only this would probably be the first conclusion. This is a very tentative one and there are a number of factors yet to be decided.

The question essentially is, what is the appropriate organizational structure at the policy level for the Permanent Fund institution assuming that development financing is a significant part of the activities. The objectives that we were trying to achieve when we set up this -- our conclusion is essentially it should be a dual board structure. I'll get into that in more detail. The objectives that we were trying to achieve with this dual board structure. First, we wanted to avoid undue political influence while being yet responsive to the political system. We wanted to provide for public input. We wanted to make sure that the organization allowed the selection of the most capable people. And, finally, we wanted to make sure that the organization preserve the operating management's prerogatives ordinarily associated with management exercise.

The dual board structure is composed -- our suggested dual board structure would be composed of first a board of citizens and secondly a board of directors. The board of citizens, the primary purpose, in our view, in this board of citizens is to react and to act and suggest changes in the charter. Secondarily, it's purpose would be to represent, if you will, the citizens of the State of Alaska and voice their views with respect to the operation of the Fund. I should not say secondarily, it is equally primarily. But that second objective would be accomplished through an annual meeting very comparable to that which is held for normal corporations. This board of citizens could be composed of two -- and that is only a suggestion -- two members from each Senatorial District. We used that since that would be the easiest in terms of trying to preserve one man, one vote at this point. It is suggested the board be composed of two members, elected by popular vote from each Senatorial District, to a term of either two to four years. But to coincide with the election of the State representatives, or the election of the governor or members of the Legislature. The purpose, of course, to get the maximum amount of input into these races.