

SCOMM

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April 18, 1977

Hon. Clark Gruening, Chairman

Commissioner of Revenue, Sterling Gallagher

Members of the Joint Legislature
Committee on the Permanent Fund

Sirs:

I am very sorry that I cannot attend your hearings scheduled for April 20 and 21, on the Permanent Fund. I would like, nevertheless, to set down for your consideration a precis of my views.

The special State Investment Advisory Committee Hearings held last year were an immensely valuable start of consideration of uses of the permanent fund. Advisors were used intelligently and were made to work hard to educate the Committee on development loan and permanent fund systems in place elsewhere. Not the least important lesson of the hearings was the fact that public education as to the parameters of the issues is at least as important as pure public input. In light of this, I feel that you should consider compiling a readable digest of this expert testimony, and that otherwise available to you, as to what has happened elsewhere both with permanent funds created with non-renewable resource revenues and with public development banking. I further suggest that the digest be made broadly available in Alaska before embarking on broad scale public hearings. Hearings conducted in this context would seem to me to be very much more valuable than those conducted in a public vacuum of knowledge of what has happened elsewhere. Ideally the digest would contain a readable summary of the history of state loan programs to date.

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If I may presume to advise you further on procedure, I commend to your consideration the hearing-seminar procedure of the type conducted by the Brookings Institute in 1970 after the North Slope lease sale. The considerations of possible use of the permanent fund have major implications for Alaska's governmental structure as well as its economic future. I cannot emphasize too strongly the importance of the selection of the correct method of securing public input.

As to substantive matters, I have two observations. First, the preliminary pass at the development loan banking issue which I chaired in Juneau in 1971 elicited the firm recommendation of the representative of the World Bank that structuring of a development loan program be preceded first by intensive investigation of development banking opportunities. We were told then, and I have heard since, that a one year initial effort to ascertain the scope and magnitude of investment opportunities be first undertaken before a developmental banking structure is legislated. The initial committee should be comprised of Alaska businessmen, entrepreneurs and investors in various sectors of our economy and should have adequate support help.

Our situation in this regard is better advanced than in 1971 for now we have developing case histories of successes and failures in Native Corporate investment in the State. We should take advantage of this body of knowledge in configuring any Development Loan structure.

Secondly, I feel that Permanent Fund monies devoted to the public sector should be used on a "leveraged" basis. I feel that establishment of reserve funds to support local government borrowing or State agency

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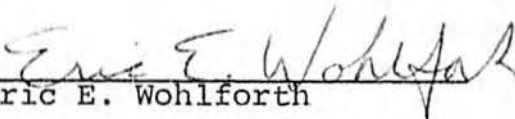
borrowing for this purpose is preferable to direct loans to municipalities. The reason for this view is the fact that local government bonds are tax exempt. Loans between tax exempt entities are not economically efficient if the debtor entity can borrow publically at tax exempt rates. Satisfactory precedent for this procedure now exists with both the Alaska Municipal Bond Bank Authority and the Alaska Housing Finance Corporation.

Thank you for the opportunity to comment. I wish again I could attend the meeting and hearings. Extra copies are enclosed for the Committee's use.

Very truly yours,

WOHLFORTH & FLINT

By


Eric E. Wohlforth

EEW:vf

Enclosures: as stated.

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M E M O R A N D U M

TO: Hon. Sterling J. Gallagher
Commissioner of Revenue

Hon. Clark Gruening, Chairman
Special Committee on the Alaska
Permanent Fund

FROM: Eric E. Wohlforth *Eric E. Wohlforth*

DATE: February 1, 1978

SUBJECT: Brief Comments on House Bill 595 Relating to
Income of the Alaska Permanent Fund, House Bill
596 Relating to Non-renewable Resources, and
House Bill 682 Relating to Non-renewable Resources.

Section 1 of HB 596 provides for an investment oversight committee apparently with the purpose of overseeing the activities of all agencies of the State performing lending, borrowing or investment functions, including the corporations established by the bill itself.

Section 3 of the bill establishes, by adding a new chapter to AS 37, the Alaska Permanent Fund from which is allocated 5/6 of mineral rents and royalties to the Alaska Permanent Fund Corporation. AS 37.13.020 contains legislative findings with respect to the Alaska Permanent Fund Corporation and its primary goal which is to maximize total return while maintaining safety of principal and states that it is a savings device to allow the maximum use of disposable income as needed for the purposes as provided by law. Under 37.13.130 the prudent man rule is established to govern the investment activities of the corporation with the provision that assets may be used only for income producing investments and that the board maintain reasonable diversification. Subsection (g) of Section 130 limits investments to direct obligations of the United States, mortgage loans and stock and "corporate obligations freely marketable under the Securities Act of 1933". It is submitted that the limitation to direct obligations to the United States may be too limiting now and that investment permission should be extended to government agencies and instrumentalities currently the subject of investment of monies in the State general fund.

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The Alaska Enterprise Investment Corporation is created by Section 4 and is funded with an allocation from the Permanent Fund of one-sixth of all of the receipts thereof up to \$100,000,000. The corporation is permitted to invest its capital in loans or stock of projects, with stock investment limited to 25% of the capital stock of a project and loans up to 90% of cost except where additional amounts are necessary to protect the interest of the fund.

AS 44.55.125 imposes a prudent man rule on the investment policy of the corporation requiring at least 150% of all guarantees by the corporation to be invested in investment grade securities with not more than 50% invested in "financing the establishment, improvement, and expansion of productive private enterprise which will benefit Alaskans, and for which sufficient capital is not available from other sources or unreasonable terms" in the form of equity, debt or guarantees and 50% "for financing the longer-term investment capital needs for financially sound small and medium scale community development projects of municipalities and public corporate entities and private dwellings for which sufficient financing is not available from other sources or unreasonable terms". The right to guarantee obligations in addition to the right to invest in the stock or purchase the debt of a corporation is referred to in AS 44.55.080 and AS 44.55.120 and provides that the corporation has power to guarantee obligations of another corporation or legal entity to facilitate their sale. In general, guarantees are made in connection with corporate financings by a parent of a subsidiary in which there is already an investment. There would be some question as to whether a guarantee of debt not incident to an investment of monies would qualify under the constitutional limitation that money to the Permanent Fund may only be invested in an income producing securities.

AS 44.55.130 establishes a capital reserve account to secure obligations of the corporation. Monies in the capital reserve account are to be used to pay principal, interest and redemption premium on obligations of the corporation. The capital reserve account is funded with the income of the corporation until that is equal to 25% of its

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outstanding obligations. Under AS 44.55.120(4) the corporation is permitted to borrow amounts up to its paid-in capital. If the corporation is conceived as a borrowing vehicle to provide money for investments or loans and there should be additional provisions establishing its rights to enter into covenants and agreements with bondholders, provisions providing that the indebtedness of the corporation is not a debt of the State and otherwise as necessary for a public bond financing. The above is not in the nature of a policy observation since it is readily perceived that the primary thrust of the fund is an investment or lending vehicle rather than a borrowing vehicle.

HB 595 provides that income from investment of the Permanent Fund, becomes part of the Permanent Fund and may be used to provide for guarantees of indebtedness issued by governmental agencies of the State for power projects. This is a worthy and sensible goal for the use of Permanent Fund income in my opinion. However, I feel that the efficacy of a guarantee of debt of public authorities, municipalities or agencies issued for power projects may well be subject to the legislature's appropriating income to the fund for this purpose on an annual basis. Further, the requirement that the fund itself be invested in income producing investments may not be satisfied by a guarantee or indebtedness of another body. When AS 37.13.200 provides for the guarantee of indebtedness issued for power projects of monies transferred to the Permanent Fund from its income, the actual obligation which is entered into by the board of trustees of the Alaska Permanent Fund Corporation may amount only to an annual direction to use income for the purpose stated rather than a long term obligation requiring the corporation to devote the income to that purpose without further act. As I have stated before, I may well be wrong in my reading of the power and permission to devote Permanent Fund income on a long term basis without further appropriation of the legislature, but I think there is at least a substantial question whether an effective guarantee can be entered into under HB 595 of such income to secure indebtedness of another party.

As to HB 682 creating an Alaska Renewable Resources Corporation, the primary purposes appear to be research and development in renewable resource industries and investment

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in projects related to research and development. The investment permission in AS 37.12.170 is limited in size (\$1,500,000) and in percentage of a project (25%) unless a greater amount or percentage is fixed by concurrent legislative resolution. Under AS 37.12.050, the corporation is allocated 5% of mineral lease bonuses and rentals, half of which are to be placed in the fund. Under AS 37.12.150(11) the corporation "may make financial assistance available in the form of grants, loans, loan guarantees or other appropriate forms to public research and development groups in the state in order to facilitate investment" and in (13) may further make grants. The power to make grants seems to run counter to the constitutional requirement that the Permanent Fund may only be invested in income producing investments. As to guarantees, please see my comments above.

EEW:jx



BANK OF AMERICA

October 19, 1971

BANK INVESTMENT SECURITIES DIVISION

Mr. Eric E. Wohlforth, Commissioner
Department of Revenue
State of Alaska
Pouch S
Alaska Office Building
Juneau, Alaska 99801

Dear Commissioner Wohlforth,

The objective of forming an Alaska Industrial Development Corporation is certainly commendable, from a theoretical standpoint. Yet given the variety of structural and operational alternatives relative to such formation, the small step from concept-in-theory to implementation-in-practice imposes on the executive several large and hard questions which demand resolution. It was obvious, from our conversation last Friday, that you and your staff are well aware of the organizational problems and pitfalls. What you might be less familiar with - insofar as research materials are concerned, is: 1) the latest literature on industrial-aid financing and the IRS; 2) prospectively, the increased ease and attractiveness of using tax-exempt bonds issued by the state or a state agency, as the primary financing vehicle for raising seed capital to lure new industry to Alaska.

Recent efforts by the Investment Bankers Association and other interested groups have concentrated upon:

the desired exclusion from present IRS industrial-aid bond limits of all state and local general obligation bond issues, regardless of purpose

expansion of the straight industrial-aid limit to \$15 million per issue, as proposed by Chairman Wilbur Mills of the House Ways and Means Committee.

Favorable action in either of these areas should promote renewed consideration by Alaska of tax-free industrial-aid bonds as a financing alternative to subsidize or support statewide industrial development. The cheapest method of financing would clearly be to issue voted bonds backed by the state's guarantee or its full faith and credit. Reasonable rates could also be obtained by using a state agency as issuer, provided that: 1) a debt-service reserve fund were established from bond proceeds equal per issue to maximum annual principal and interest; 2) annual access to the state's general fund were statutorily permitted, to compensate for any drawdown of the reserve fund to meet debt-service payments. In the case of

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Commissioner

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either direct state or state agency financing, support for industrial-aid issues would presumably be derived not from state-tax moneys, but rather from loan repayments by the benefited industries. As such, from a municipal analyst's viewpoint, the bonds in due course would be treated as self-liquidating obligations deductible from the state's gross debt - thus reducing, to small or no measure, potential impairment of the state's general credit.

The success of an industrial development corporation in Alaska is keyed as much to its structure and planning as to the method selected for financing its operations. It would be an error, in my view, to staff and administer the corporation as a unique, state-level entity responsible only to the executive and a governing board, and responsive by its nature largely to the corporate stature, potential profitability, and market prospects of applicant industries on a case-by-case basis. In order to ensure a better, more even-handed result, I would strongly recommend - before the corporation is formed, that a joint study be undertaken: by the state and selected local governments or chambers of commerce, to determine the number, type, size, and optimum location of the industries that such a corporation would seek to draw to Alaska. By inviting local participation in the planning process, the corporation would additionally benefit from a broader political base of support, as well as a greater prospective commitment from the private local sector in financing a share of the corporation's activities. Then, too, while there is an evident need for an executive director and professional staff on the state-corporation level, there would seem to be an equally pressing need for local representation on the governing board-which would presumably include leading spokesmen from the public, business, financial, and academic communities.

Much stress in this analysis has been given to the necessity for intergovernmental cooperation in planning, organizing, and administering an Alaska Industrial Development Corporation. This relationship could additionally be extended, on the public level, to the financing aspect as well. Where the siting of a corporation-assisted enterprise could reasonably be expected to stimulate ancillary developments, the local government in the area may strongly be induced to underwrite certain infrastructural costs associated with servicing an industrial complex. To the extent that such participation could be courted, the capital costs of a corporation-assisted enterprise would be reduced, and the free-resource funds of the corporation enlarged accordingly.

I welcome this opportunity to share these views with you, Mr. Wohlforth, and hope that the enclosed materials on industrial-aid

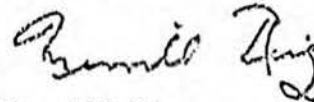
Mr. Eric E. Wohlforth
Commissioner

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financing will prove of value. If I can be of any further assistance,
please be in touch.

Sincerely,



Merrill Ring
Senior Research Officer

Enclosures

MR/vs
622-2530(415)

cc: Mr. Leland S. Prussia, Jr.
Mr. William D. Shaw, Jr.