

ALASKA LEGISLATURE COMMITTEE FILES 1993-1994 8672

8402 SENATE LABOR & COMMERCE

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Cook
4/27/94

CS FOR SENATE BILL NO. 24(L&C)
IN THE LEGISLATURE OF THE STATE OF ALASKA
EIGHTEENTH LEGISLATURE - SECOND SESSION

BY THE SENATE LABOR AND COMMERCE COMMITTEE

Offered:
Referred:

**Sponsor(s): SENATE RULES COMMITTEE BY REQUEST OF THE LEGISLATIVE BUDGET AND
AUDIT COMMITTEE**

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to equity investments of the permanent fund; and providing for
2 an effective date."

3 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

4 * Section 1. AS 37.13.120(g) is amended by adding a new paragraph to read:

5 (21) notwithstanding (i) of this section, equity investments may
6 comprise more than five percent of the stock of a corporation if the investments in
7 excess of five percent consist of an interest in a nonrecourse partnership or ownership
8 in a nonrecourse collective investment vehicle, and only under the following
9 conditions:

10 (A) the fund may not own more than a 60 percent interest in a
11 partnership or collective investment vehicle;

12 (B) the aggregate investment of the fund under this paragraph
13 may not exceed five percent of the total investments of the fund;

14 (C) at no time may the fund own, directly or indirectly, through

1 a corporation, partnership, or collective investment vehicle, more than five
2 percent of any entity that has substantial oil and gas operations in the state;

3 (D) appropriate policies and procedures for investments under
4 this paragraph shall be reviewed and approved at least annually by the board.

5 * Sec. 2. This Act takes effect immediately under AS 01.10.070(c).

SENATE COMMITTEE REPORT

DATE: 4/14/94

FURTHER: Judiciary
Finance

DATE TURNED INTO OFFICE: 5/3/94

L&C Committee considered SENATE BILL NO. 244

"An Act relating to investments of the permanent fund in certain limited partnerships each of whose principal purpose is investment in securities of public or private companies; and providing for an effective date."

and recommends:

replace with _____ CS SB 244 (L&C)
 or adopt previous _____ CS _____
 attaches amendment(s)

same title
 new title
 technical title change (HB only)

adopts _____ Letter of Intent

further referral to the _____

do pass

do not pass

no recommendation

individual recommendations

NEW FISCAL NOTES

Department	Date	Zero	Fiscal

PREVIOUS FISCAL NOTES

Department	Date	Zero	Fiscal
CS			
CS	DOR	1/12/94	✓

Appropriation No Fiscal Note

DO PASS:

OTHER RECOMMENDATIONS:

Ti Kelly - Do Pass No Rec

Chair: Signature and Recommendation

A M E N D M E N T

OFFERED IN THE SENATE

TO: CSSB 244(STA)

Page 1, line 7:

After "interest in a":

Insert "nonrecourse"

After "ownership in a":

Insert "nonrecourse"

A M E N D M E N T

OFFERED IN THE SENATE

TO: CSSB 244(STA)

Page 2, line 3, after "approved":

Insert "at least"

COPY

FISCAL NOTE

STATE OF ALASKA
1994 LEGISLATIVE SESSION

BILL NO. Senate Bill No. 244

Revision Date:

Dept. Affected: Department of Revenue

Title: "An Act relating to investments of the permanent fund in certain limited partnerships each of whose principal purpose is investment in securities of public or private companies; and providing for an effective date."

BRU: APFC

Component: APFC

Sponsor: Senate Rules Committee by Request.

Requestor: Senate State Affairs.

COMPONENT SERIAL NO. 109

Expenditures/Revenues:

OPERATING	FY95	Dollars)		
		FY98	FY99	FY00
PERSONAL SERVICES				
TRAVEL				
CONTRACTUAL	200.0	223.0	-232.0	240.0
SUPPLIES				
EQUIPMENT				
LAND & STRUCTURES				
GRANTS, CLAIMS				
MISCELLANEOUS				
TOTAL OPERATING	200.0	223.0	232.0	240.0

CAPITAL						
---------	--	--	--	--	--	--

REVENUE FUND SOURCE:						
----------------------	--	--	--	--	--	--

FUNDING:

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other (Corporation Receipts - 1022)	200.0	206.0	215.0	223.0	232.0	240.0
TOTAL	200.0	206.0	215.0	223.0	232.0	240.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year (FY94) Impact: \$ -0-

ANALYSIS: (Attach a separate page if necessary) The Corporation intends to begin expending money for due diligence relating to these investments on July 1, 1994. These costs will include a "gatekeeper" fee similar to current real estate advisory fees; and will increase annually at the 3.75% inflation rate.

Prepared by: William H. Scott, Executive Director
 Division: Alaska Permanent Fund Corporation
 Approved by: Darrel J. Rexwinkel, Commissioner
 Commissioner: Department of Revenue
 Agency:

Phone: (907) 465-2047
 Date: April 12, 1994
 Date: _____

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SB

245

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ALASKA PERMANENT
FUND CORPORATION

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PAUL H. SAYLOR

November 9, 1993

Mr. Pete Jeans
Investment Officer
The Alaska Permanent Fund Corporation
801 West Tenth Street
Suite 302
Juneau, AK 99801

RE: Proposed Legislation

Dear Pete:

You have asked that I give a few thoughts why I am in favor of a legislative change to allow you to take up to a 100% interest in an investment.

1) *Control*

Although co-investment documentation is evolving to the point where a minority investor will not necessarily be disadvantaged as to influence or control, there is no such thing as a 40% gorilla. In other words, it would be preferable for the APFC to invest on a basis that would allow it to control major investment, management and divestment decisions in its own best economic interests, rather than be influenced by one or more investors which may, at least over time, have differing objectives.

While I believe the APFC has been advantaged by retaining discretion over major investment, management and divestment issues, it is currently required to be totally aligned with one or more partners in order for activities which best serve it to occur. Examples include the inability to close recent transactions because of (what I consider) minor differences with a 60% partner, and your lack of influence in matters associated with Boston Real Estate Counsel assets in a situation where at least one of your partners was lethargic and bureaucratically hamstrung from acting in all partners' best interests.

2) *Maximum New Opportunities*

As property markets turn back in favor of sellers, the APFC will receive

— LETTER FROM
SAYLOR PROPERTY CAPITAL, INC.

increasingly fewer high quality investment opportunities, as investment managers will be less in need of the APFC's capital and wish to conclude transactions with either one investor or a commingled format over which they have discretion. Currently, it is relatively complicated for a transaction originator to identify an asset for the APFC with the condition the APFC will only pursue due diligence or the consummation of a transaction once a compatible investment partner has been identified. Recently, transactions have gone elsewhere to avoid this process.

Additionally, there are increasing concerns regarding potential incompatibility of APFC requirements with those of certain other active investors. Although the multi-asset co-investment opportunity which we have collectively pursued for the last several months will go a long way to establish levels of overall compatibility among several investors and standardized processes, sellers or transaction originators generally attempt to avoid the unknowns associated with due diligence and documentation requirements of multiple investors.

3) *Management Changes*

Since the APFC appropriately exercises rights of management oversight, it is more likely to recognize management program weaknesses and to move to correct them than most other institutional investors. Existing assets and portfolios need to be intensively managed in order to improve their performance and occasionally to position assets for sale. Managers who are ineffective should be replaced, and manager replacement is most difficult to accomplish for the APFC as a minority investor especially since most partners of the APFC are required to live with an "approved list" of investment managers.

I do not at all advocate that the APFC should only pursue acquisition of full interests in individual assets and portfolios, but I believe a change of legislation to allow you to do so is most important. It is my view that the immediate effect of such change will not be termination of your co-investment programs, but rather a gearing up of the process contemplated by your co-investor conference this past April. Your ability to be a major partner, rather than (always) a minor partner is most important to the achievement of your objectives set forth for the asset class of real estate and to your competitiveness in the marketplace.

Yours very truly,



Paul H. Saylor

CC: Llewellyn Lutchansky

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November 16, 1993

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(415) 677-7048

VIA FACSIMILE

Mr. Pete Jeans
Real Estate Investment Officer
Alaska Permanent Fund Corporation
P.O. Box 25500
Juneau, Alaska 99802-5500

Dear Pete:

You have asked us to review the proposed legislative amendments to Section 37.13.120(g) of the Alaska Statutes in the context of our experience as investment counsel for the Alaska Permanent Fund Corporation (the "APFC"). We understand that the legislative amendment to be reviewed by the Board would modify subsection (g)(16) of Section 37.13.120 to provide:

(g) Subject to the limitations contained in this section, the board may invest fund assets at the competitive national market rates or prices that are applicable to each investment only in

(16) Equity interests in, and debt obligations secured by mortgages granted a first lien on, real estate located in the United States.

We believe that this proposed amendment would be beneficial in carrying out the investment policies of the APFC for several reasons. First, it would allow the APFC to effect real estate investments that fulfill its investment objectives without imposing legal constraints that may not be relevant to ensuring that the investments are prudent. Second, the existing provisions of Section 37.13.120 that would remain unchanged by this legislative proposal ensure that sufficient fiduciary safeguards are present in connection with the acquisition of real estate by the APFC. Third, and perhaps most significantly, the proposed

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~~_____~~
- LTR FROM RACHEL MARKUM
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Pete Jeans
November 16, 1993
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amendment would allow the APFC to invest in real estate on terms that are comparable to the terms available to ERISA-regulated corporate and Taft-Hartley (union) retirement plans and a majority of governmental retirement systems. By adopting the standards utilized by most tax-exempt institutional investors, the APFC will be poised to compete more effectively with such investors for real estate opportunities and to exert the degree of control that many of such investors have viewed as conducive to maximizing return and minimizing risk in their real estate portfolio investments.

The current provisions of Section 37.13.120(g)(16) include specific limitations that mandate, among other requirements, that the APFC not hold greater than a 40 percent beneficial ownership interest in a real estate investment at the time of acquisition, that the real estate investment is improved by completed buildings and that such buildings are substantially leased. These types of restrictions are typically referred to as "legal list" statutes and were commonly used in state statutes applicable to public and private retirement plan investments prior to 1974.

The enactment of the federal ERISA statute in 1974 eliminated the applicability of these legal list statutes to private corporate and union retirement plans. ERISA imposed general fiduciary standards applicable to all types of investments. The foundation of these fiduciary standards is the prudence and diversification rules of Section 404 of ERISA. These rules are incorporated into Sections 37.13.120(a) and (c) of the Alaska Statutes and are fully applicable to the APFC's real estate investments.

The drafters of ERISA abandoned the legal list statutes in favor of general rules of prudence and diversification for two reasons. First, to the extent that a restriction found in a legal list is a restriction appropriate to effecting a prudent and diversified investment, the legal list restriction is merely duplicative with the general fiduciary standards. Moreover, to the extent that the restriction was unnecessary to ensuring that appropriate fiduciary caution was exercised in effecting an investment, the legal list restriction was viewed as impeding the plan's ability to pursue prudent acquisition opportunities.

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Pete Jeans
November 16, 1993
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Since the enactment of ERISA, a majority of public retirement systems have adopted legislative changes that substitute general fiduciary standards for legal list statutory restrictions. The rationale underlying these changes has been similar to the legislative intent of Congress in enacting ERISA, that the legal list restrictions are either duplicative with the general standards of prudence and diversification, are obsolete interpretations of such standards or are general examples of such standards that may not be appropriate in specialized investment contexts.

It would be beneficial to the APFC to pursue investment opportunities in real estate under standards similar to the fiduciary standards applicable to the majority of institutional investors competing for these investment opportunities. Because the APFC will be fully obligated to pursue real estate investments that satisfy the prudence, diversification and other standards applicable under Section 37.13.120, to the extent that the legal list restrictions of current subsection (g)(16) are appropriate to ensure prudence or diversification, these restrictions will still apply to real estate investments of the APFC. Thus, for example, if a purchase of more than forty percent of the beneficial ownership of a particular real estate investment would not be consistent with the standard of maintaining a reasonable diversification among investments, the "forty percent rule" would continue to apply. If, however, it was not only prudent and consistent with diversification standards to invest in a larger percentage of a particular real estate investment, but would allow greater controls with respect to operating budgets, leasing decisions and other control features determined relevant to enhance the APFC's investment return, the forty percent rule would operate to limit potential investment returns in the APFC real estate portfolio.

In summary, the legal list restrictions of subsection (g)(16) are generally redundant with the prudence and diversification standards of sections (a) and (c) of Section 37.13.120. In those instances where these restrictions do not duplicate the general standards, but provide more onerous restrictions, it is difficult to justify rules that do not further the standards of prudent real estate acquisitions or may impede such acquisitions.

It is widely recognized that the current real estate acquisitions market demands a greater scrutiny of

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November 16, 1993
Page Four

current income opportunities than was the case in years where capital appreciation in real estate could be more easily projected. It is significant to note that the APFC's ability to control decisions that are economically relevant to both income and potential capital appreciation is limited by its current inability to acquire a majority interest in its real estate investments. By allowing the board and, to the extent delegated by the board, the APFC staff, the ability to balance the economic benefits of control against the costs of such a percentage acquisition, the APFC will be able to maximize its investment objectives in a context relevant to each particular investment opportunity it reviews for potential acquisition.

Please contact me if we can be of further assistance in this matter.

Very truly yours,

Rachel Markun, pmd

Rachel Markun

RM:pmd

Alaska Permanent Fund Corporation

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

(907) 465-2047

MEMORANDUM

DATE: November 18, 1993

TO: Board of Trustees
Alaska Permanent Fund Corporation

FROM: Pete Jeans *PJ*
Real Estate Investment Officer

THROUGH: William H. Scott
Executive Director

SUBJECT: Recommended Legislative Changes, Real Estate

I am recommending a change to Title 37, Chapter 13, Section 37.13.120, the Alaska statute that authorizes the Fund's investments in real estate. The reference to real estate investment responsibilities of the Board of Trustees will be changed to read:

(g)(16) equity interest in, and debt obligations secured by mortgages granting a first lien on, real estate located in the United States.

(16)(A) deleted

(16)(B) deleted

(16)(B)(i) deleted

(16)(B)(ii) deleted

(16)(B)(iii) deleted

This change removes the 40% restriction on real estate acquisitions. The real estate "investment list" is stricken from the Statute and transfers to the Board of Trustees, the responsibility for establishing prudent investment standards and guidelines through the annual real estate resolution.

In order to justify this recommendation it is necessary to give a brief description of the Fund's real estate experience over the past ten years, along with my views on the changes that are taking place in the industry.

In 1983, the year the Alaska Permanent Fund Corporation made its first investment in real property, the Board of Trustees had allocated 6% of the \$3 billion Fund to real estate. The Board of Trustees hired a real estate consultant to assist

in selecting three real estate advisors. From 1983 through 1987, the Fund took a passive role in real estate investing and relied almost exclusively on the recommendations of the consultant and advisors. Additionally, the 40% co-investment requirement created a high comfort level for the Trustees. By co-investing with larger, more sophisticated pension funds and endowments, the Permanent Fund took advantage of their expertise and leadership in real estate investing. During this period, control and involvement in property decisions were not priorities for the APFC.

In the later part of the 80's, there was a turnover in Permanent Fund real estate staff. Soon after, the Fund employed new real estate consultants and attorneys, all of which resulted in a more directive approach to real estate investing. The Fund has become more involved in the real estate investment process, from requiring certain controls and buy-sell arrangements on each real estate transaction to initiating disposition activities. Even as a 40% player, the Fund has been able to negotiate either equal or favorable terms and receive coequal treatment from larger investors.

Historically, market conditions played an important role in negotiations for favorable terms. During the recent market decline in the industry, many pension funds sat on the side lines, offering little competition for deals. Now that the market has shown signs of recovery, pension funds are re-entering the markets. Like the APFC, our institutional partners are gaining knowledge and confidence in their abilities to control investments and they no longer allow us to participate as an equal partner in a 40/60 deal. The only way to secure the same level of control that the Fund historically obtained with past investments is to acquire an equal or majority interest.

~~Control is by far the greatest benefit of holding a majority position in an investment.~~ Timing of major capital events, such as a property sale or the funding of a mall redevelopment designed to head off new competition, is often crucial to enhancing returns on a property. The inertia of some institutional partners has caused numerous missed opportunities for the Permanent Fund in the past.

~~Other advantages also exist.~~ The real estate asset allocation set by the Board of Trustees ~~will be more easily attainable.~~ Unless a single deal is exceptionally large, the acquisition of a single property will not materially affect the diversification strategy. Through resolution, the Board of Trustees will continue to maintain control over the diversification goals.

~~Legal costs will be reduced substantially by eliminating or decreasing the negotiations over control issues in partnership agreements.~~ Complications in replacing investment advisors are directly correlated with the number of partners in a deal. The replacement process is simplified in a 50/50 to 100% investment.

Board of Trustees
November 18, 1993
Page 3

~~By having the option~~ to take 100% of an investment, we anticipate an increase in ~~cash~~ flow. With only one or two investors involved, advisors will be more likely to propose acquisitions to us, particularly those with short closing time frames.

This proposed change to the Statute will give the Board of Trustees the flexibility to direct the real estate staff by board resolution. Attached is a letter from our legal counsel and real estate consultant recommending these changes.



Alaska Permanent Fund Corporation

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

(907) 465-2047

RESOLUTION OF THE BOARD OF TRUSTEES
OF THE ALASKA PERMANENT FUND CORPORATION
PERTAINING TO LEGISLATIVE CHANGES IN THE ALASKA STATUTES
RELATING TO REAL ESTATE INVESTMENTS BY THE
ALASKA PERMANENT FUND CORPORATION

RESOLUTION 93-11

WHEREAS, the Fund is limited in directing business decisions on real estate investments as a 40% participant; and

WHEREAS, the Alaska Permanent Fund Corporation is impaired in its ability to reach its targeted real estate asset allocation within current parameters; and

WHEREAS, the Alaska Permanent Fund Corporation has lost opportunities to acquire high return, low risk real estate investments;

NOW, THEREFORE, BE IT RESOLVED, THAT the Board of Trustees unanimously directs staff to seek legislative changes to provide for up to 100% ownership in real estate investments.

PASSED AND APPROVED by the Board of Trustees of the Alaska Permanent Fund Corporation, this 6th day of December, 1993.

Chairman, Board of Trustees
Alaska Permanent Fund Corporation

ATTEST:

Corporate Secretary

- PF CORP. RESOLUTION -

THE INSTITUTIONAL REAL ESTATE LETTER

The Information Source For Industry Insiders

Volume 5, Number 7

ISSN 1044-1662

July 1993

PROSPECTUS

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SECURITIZATION

by Steve Bergsman

REITs On a Tear

Déjà Vu—Have We Been Here Before?

Real estate investment trusts have been on a tear. For the first quarter of 1993, REITs posted returns of 19.1 percent, easily outdistancing the S&P 500 which only managed a 4.3 percent return. This was an even faster start than in 1992 when REITs

blistered the market for a 20.7 percent return, again showing up the S&P 500 which only notched a decent 7.7 percent return.

It's not just the market performance of REITs that has caught the eye of the investor—last year, the REIT market raised \$6.6 billion, nearly \$2 billion greater than the previous record year of \$4.8 billion. More than half of that \$6.6 billion was raised by existing REITs which were extremely active in the real estate market, acquiring \$2 billion worth of properties. REITs suddenly became the Japanese of the Nineties. The paradox is, after mugging the U.S. real estate market with a seemingly inexhaustible supply of capital, the Japanese have disappeared. Will the same thing happen

Continued, Page 5

CO-INVESTMENT

by Steve Bergsman

The Dark Side Co-Investment May Be Trendy, But It's Not All Wine and Roses

The concept of co-investing has been around for decades, but recently, it seems to have become the "in" thing to do.

Increasingly, over the past three years, investors and investment managers alike have been dressing their portfolios up with

co-investments—the institutional investment community's analog of the "grunge" look.

The "grunge look"—ripped jeans and flannel shirts—may be popular in some circles today, but it certainly isn't for everyone. Neither is co-investment. Even if co-investment is particularly well-suited to the needs of your fund, there are numerous issues which must be considered to make sure your beneficiaries don't end up in rags and tags.

Like the grunge look, the trendsetter for co-investment came out of the Pacific Northwest. Since the mid-1980s, the **Alaska Permanent Fund**—a \$15 billion endowment organized for the benefit for

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COVER STORY

Co-Investment

*Trendy, But It's Not All Wine and Roses**Continued from page 1*

all the citizens of Alaska and funded by taxes on mineral extraction revenues—has been the leader in the U.S. co-investment movement.

The reason? As always, necessity is the mother of invention. By statute, the maximum interest the Permanent Fund can hold in any single property is 40%. This means that, in order to make separate account investments work—and the Alaska Permanent Fund's Real Estate Investment Officer, **Pete Jeans**, very much wants his fund to be a separate account investor—the Fund has no choice but to co-invest (join with other tax-exempt funds to make a purchase).

As a result, for the last eight years, Jeans has made co-investment after co-investment, bringing into his real estate plays more than 100 pension fund investment partners. The approach has worked well for the Alaska Permanent Fund, and now Jeans has come south to spread his gospel throughout the "Lower 48." (More than 40 pension, foundation and endowment funds recently attended a private conference on co-investment in Dallas, sponsored by the Alaska Permanent Fund and its advisors.)

Obviously, Jeans is having some success spreading the word. He credits this success to the discontent so many pension plans have been feeling over the real estate investment programs in which they invested during the early to mid-1980s. During those formative years, Jeans explains, the institutional investor community enthusiastically embraced the concept of blind pool commingled fund investing. With this approach, a group of tax-exempt investors would invest their capital in a specified group trust, insurance company separate account or limited partnership organized and managed by an investment manager in order to enable those investors to acquire a diversified portfolio of real estate assets. The problem with these funds, says Jeans, is that investment decisions and management responsi-

bilities were left in the hands of a third party who had ultimate discretion over the funds—and who almost always had significant conflicts of interest. To make matters worse, when the real estate market collapsed, funds trying to escape the calamity discovered they were blocked by poorly-conceived exit strategies.

Today, pension plans, still tangled in the webs of commingled funds but anxious to get in on the buying opportunity of a lifetime, are looking for new paradigms—alternative forms of real estate investment that can offer greater control and liquidity. Of course, the ultimate control results when a pension fund acquires properties directly with no partners. Some funds are unable or disinclined to go that route, however, which, according to Jeans, is what makes co-investment so appealing today.

If one considers investment structures on a continuum, notes **Allen Andersen**, a Principal with the Dallas office of **Arthur Andersen Real Estate Service Group**, they will fall somewhere between sole ownership and commingled funds. Where on the continuum co-investment lies—especially in regards to the control issue—is still subject to debate. Andersen, for one, says he would place co-investment closer to commingled funds on the spectrum, rather than placing it squarely in the middle.

Of the many forms of co-investment, the least popular have been those which require advisors, operating partners or developers to put their own capital at risk alongside the investors. While some investors now require such arrangements, others shy away because of the obvious inherent conflicts of interest. (As **Bob Burke**, a Principal of **AMB Institutional Realty Advisors** likes to point

out, the investment management industry appears to have come full circle. The real estate investment management industry really took off, explains Burke, when the Employee Retirement Income Security Act of 1974 [remember ERISA?] mandated that pension funds interject a fiduciary between pension plan assets and deal promoters. Today, notes Burke, pension funds requiring their advisors to co-invest effectively are requiring them to become promoters—creating, once again, precisely the kinds of conflicts the provisions of ERISA sought to eliminate.)

An examination of many of these structures also will reveal that the advisor/developer/operator often stands to receive back in fees during the first few years of the investment, an amount equal to or exceeding the capital it generally committed to the partnership. In such cases, the pension fund's coinvestment "partner" may have little or no capital at risk after the first few years.

To make matters worse, warns **Allen Andersen**, when the other partner is not a tax-exempt fund there usually is a disproportionate level of investment. The tax-exempt investor typically funds something akin to 90-95% of the investment and the advisor, 5-10%. Those kinds of splits don't

Of the many forms of co-investment, the least popular have been those which require advisors, operating partners or developers to put their own capital at risk alongside the investors.

really do what the pension fund wants them to do.

When pension funds do require their investment managers to put their own capital at risk in the deal, adds **Jim Curtis**, a Principal with San Francisco-based workout specialist **The Bristol Group**, they typically are seeking to align the interests of their partners with their own. The hope, explains Curtis, is that, by having their capital at risk alongside the pension fund's capital, the operating partner will be more attentive to the management of the pension fund's investments. "That's the hope,"

Continued, Next Page

Continued from previous page

notes Curtis. "We've learned, however, that people can make equally as bad investment decisions with their own money as with somebody else's." Clearly, therefore, having capital at risk is no guarantee that things will go well.

Curtis also cautions that frequently the partner doesn't even have its own capital at risk. "They raise it from other sources or they borrow it. The problem is, when the capital contributed is non-recourse, the investment manager or promoter really isn't at risk at all. In such cases," warns Curtis, "all that these co-investment requirements really create is the *illusion* of comfort."

In addition, an incompatibility of incentives often exists in these types

involves more than one investor (the typical co-investment involved between three to five investors). Therein lies co-investment's strength—and its weakness.

For a smaller pension plan, co-investment offers the opportunity to participate in transactions larger than those the plan otherwise would be able to execute on its own. "Small funds may not be able to invest in large projects simply because their allocation is insufficient," explains **Terry Ahern**, a Principal with the Cleveland-based **Townsend Group**. It also enables a larger investor to achieve more diversification than otherwise would be possible by investing directly. According to its Chief Real Estate Investment Officer, Grayson Sanders, for example, the Ameritech

Pension Trust has assembled a roughly \$1.2 billion real estate portfolio over the past ten years. Sanders notes, however, that because it has acquired much of that

portfolio by co-investing with other tax-exempt funds, Ameritech's \$1.2 billion position is covered by a portfolio of more than \$14 billion in real estate assets.

Investors who have done co-investments often say they like being involved with other participants with similar goals because there is a comfort with being associated with other entities that have the same investment strategy. Or, as **Andy Smith**, President of **L&B Real Estate Counsel Inc.**, says, "There is a warm and cozy feeling about doing a large investment with others." Why? For one thing, there is a lot more due diligence, explains Smith. Each partner gets to scrutinize the deal; there are more checks and balances so it's less likely there will be any surprises.

Despite the lack of surprises, there also is going to be a lot more work—and fiduciary liability—for the co-investors. By co-investing rather than commingling, for example, tax-exempt investors not only have to review the potential investments, but also must participate in the decision to acquire. In addition, they must be

involved in decisions concerning the ongoing management of the property, and when and how eventually to divest. The problem is, without a third party fiduciary to share the risks, a pension fund subject to ERISA provisions must shoulder the fiduciary liability associated with making these decisions alone.

Despite the extra work and liabilities, however, this is precisely the kind of control that was lacking in the commingled funds, and precisely the kind of control that many tax-exempt investors now want. When investors were passively investing in commingled funds, advisors and managers made those decisions. When advisors became promoters, and began structuring funds as partnerships to avoid being subjected to fiduciary liability under ERISA, they still made the decisions, but investors no longer enjoyed any insulation from fiduciary liability. When investors realized they weren't going to receive any fiduciary insulation, they started questioning why they should give up control. This issue, and this issue alone, is the primary driving force behind the co-investment trend. "Investors were very concerned about the lack of control in commingled funds," explains Alaska's Pete Jeans. "They wanted to be part of the process. Co-investment gives the investor more control."

Or does it?

LESSONS LEARNED

The old axiom of real estate used to be "location, location, location." But, counters **Tim Getz**, Investment Officer with the **Ohio Public Employees Retirement System**, the axiom really should be "control, control, control. You're not going to get that control," warns Getz, "by sharing your decision-making power." Getz speaks from experience—his fund was a pioneer in both the early commingled fund and co-investment movements. "One of the lessons that we learned from commingled funds was that the investor didn't make portfolio decisions. The decisions were always being made by someone else. When things got difficult, it was impossible to achieve consensus." Getz warns that the problem is no different with co-investments, which he says are

... co-investments ... are nothing more than a commingled fund warmed over.

of investments, according to **Ron Karp** of the Summit, NJ-based consulting firm **Ronald A. Karp & Associates**. Karp notes that there is a mismatch in the long-term stability and financial staying power of the pension plan versus the investment advisor or operating partner. "If the investment gets into trouble, who is going to fund the losses? Obviously, it's going to be the pension plan. And that is going to create a problem when it comes to decision-making."

The most popular form of co-investment, however, is between similar investors with similar objectives and resources, such as two or more pension plans. Even here, however, there are variations and concerns. One type of co-investment, for example, relies on an advisor who brings together investors with a common investment strategy. The advisor then executes transactions accordingly. A second type of co-investment occurs when investors unite under their own initiative—when the co-investment is investor-driven, rather than manager-driven.

The principal feature of every co-investment, however, is that it in-

"nothing more than a commingled fund warmed over."

As noted before, one of the strengths of co-investment is the added layer of scrutiny. This also is a weakness, however, because it often can be difficult if not impossible to get multiple parties to come to a decision. And, since co-investors don't always have equal shares, by definition, someone is bound to end up with a minority interest. Obviously, that can be a real problem if the majority investors have a different point of view than the minority investors.

"Co-investment complicates every single aspect of a transaction," says **Susan Hudson-Wilson**, Director of Portfolio Strategy for Boston-based **Aldrich, Eastman and Walch**. "All of a sudden there are two or more parties—very interested parties—that need and ought to be satisfied on every single aspect of the investment." As Hudson-Wilson points out, however, a hot button for one co-investor may not be so hot for another. This can make it extremely difficult to structure a transaction.

Once a co-investment has been completed, however, there essentially are five decisions upon which co-investors have to agree: leasing; capital improvement; budget; sale; and an exit strategy. In a co-investment, the way for the investors to feel their way through those processes, says L&B's Smith (who has been putting together co-investment deals since the 1970s) is to make sure that one participant never has more than 50 percent of the vote. To make a co-investment program work, explains Smith, a reasonable level of democracy must be established.

Michael Evans, National Director with **Ernst & Young's** Real Estate Advisory Services in San Francisco, counters that co-investment adds another, unneeded level to problem solving over the life of the asset. "When there are decisions to be made by different investors who have changing objectives and strategies, there is always going to be the potential for conflicts of interest."

Hudson-Wilson concedes that co-investment may be a great way for a small pension plan to participate in larger investments, but reiterates that, "there is true lack of control when you need it most." At the point when you

most need and want to do something big—like invest more or reduce the size of your investment—you discover that your options aren't much different than if you had invested in a commingled fund.

A FORMULA FOR SUCCESS

Co-investors typically try to avoid the problem of potential conflicts of interest by finding other investors with similar investment objectives. "The big key to success in co-investment is picking your partners," admits Jeans. "It does little good to find a partner who wants to hold properties for the long term, if you want to sell after three years."

Cab Grayson, Managing Director of **CB Commercial Realty Advisors**, feels that establishing a pre-existing association for co-investment can greatly enhance the success of the co-investment. "These associations of like-minded investors agree in advance to a defined real estate investment strategy, acquisition process, standardized contracts covering the decision-making powers of investors and transferability of interests, and pre-negotiated investment management fees that are performance-based and aligned with the investors' interests. The associations and the predefined process allow the investment manager to move quickly and to better negotiate with the seller." CB completed its first co-investment in 1981 and has created an active co-investment association of like-minded investors. **Scott Tracy**, Grayson's partner at CB Commercial, adds that, "The association prompts the co-investors to address most of the issues beforehand, and minimizes the difficulties in gaining consensus. Investors agree that, once the initial acquisition decision has been made, the advisor is given a defined level of discretion on operating decisions, thereby reducing disputes.

"When constructing the co-investment, it is critical that the rights of the co-investors be stated clearly and definitively. "You must have a mechanism for resolving disputes among the participants," warns **Jim Snyder**, President of **Kennedy Associates Real Estate Counsel**, a Seattle-based advisor that has been putting together co-investments for the past 15 years.

Snyder explains that the problem-solving process among the co-investors should be formalized as a general part of the co-investment agreement. Sometimes the process could be as simple as a majority vote among the co-investors, but it also should include a way to allow an unhappy investor to exit the co-investment. As noted, liquidity is one reason why pension plans are looking at co-investment. Investors, therefore, need to be assured that there is an easy out if they want to leave.

"Our experience," says Jeans, "has been that, if we're having a problem or disagreement with a partner, we call a meeting and sit down together face-to-face. Ninety-nine percent of the time we can solve the problem. In those few instances where it absolutely doesn't work out, the partner can leave." According to Jeans, that usually means the other partners will buy out the disgruntled party.

The **New York State Teachers Retirement System** also has been involved in co-investment transactions in the past, but none recently. "We're not saying we won't do anymore, but when we have a choice, we prefer to invest on our own," notes **Jim Campbell**, Assistant Real Estate Officer at NYSTRS. The Fund wants to control its own destiny, Campbell explains, and it is tougher to do that when hooked into other investors. "It can be frustrating to be in a deal with an investor who has a shorter term horizon or is handicapped by political decision-making processes."

The bottom line is, co-investment is a little like "the Force"—that wonderful source of power that Luke Skywalker discovers in George Lucas' *Star Wars*. Like the Force, co-investment can be either of great benefit, or great harm to the user—depending on how you approach it. And, as with all sources of power, investors must not forget that co-investment has its dark side. ♦

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REGARDING: *Asset allocation study of the Permanent Fund*

ATTACHED TO THIS COVER PAGE, YOU SHOULD FIND 19 PAGES.

MESSAGE: *Attached is a copy of our report on the Permanent Fund.*



ASSET ALLOCATION STUDY
FOR
THE ALASKA PERMANENT FUND

Prepared by Ibbotson Associates, Inc.
January, 1994



Summary of Recommendations

Currently, the Alaska Permanent Fund is a well diversified portfolio that has enjoyed tremendous success in recent years. This success is mainly due to the Board's knowledge of the importance of asset allocation and its commitment to diversification. This has resulted in the Fund earning high rates of return at relatively conservative levels of risk. The Fund is well positioned to reap the benefits of diversification, having made investments in many different asset classes, both domestic and international. Also, the Fund appears to be efficiently managed, employing reputable and capable managers for both its equity and fixed income assets. The Fund has been able to manage its substantial fixed income portfolio entirely in-house, keeping administrative costs and outside management fees to a minimum. Several important issues must be addressed, however, in order to ensure the Fund's continued success.

Our analysis suggests the Permanent Fund should alter its asset allocation policy in order for the Fund to enjoy returns similar to those it has earned in recent years. Specifically, the Board should consider the following actions:

- ▶ Revise its current three-year target asset mix to include a larger allocation to domestic mid and small capitalization equities, European, Pacific Rim and emerging market equities, and mortgage-backed securities.
- ▶ Adopt a more aggressive investment style by allocating a larger percentage of Fund assets to equity assets and real estate.
- ▶ Revise its equity management plan by setting specific allocations for international and domestic mid and small capitalization equity managers.
- ▶ Set specific target allocations across fixed income sectors.

By implementing these changes, the Board can help ensure that the Permanent Fund will achieve the highest expected return for its chosen risk level. This will help the Board achieve its statutory goals of maximizing total Fund return and providing the maximum amount of disposable income to Alaska's citizens.

This report presents recommendations concerning the Alaska Permanent Fund. The first section provides background information on the procedures we used to perform the asset allocation study. The second section suggests improvements for those portfolios, and outlines a third portfolio suited to a more aggressive investment philosophy. The final section provides guidance on several important implementation issues.

I. Analyzing an Investment Portfolio

A first step in analyzing an investment portfolio is determining whether the portfolio adequately compensates the investor for taking risk. Ideally, the portfolio is *efficient* in providing return to the investor; i.e., the portfolio provides the most return possible for the amount of risk taken. In reality, however, few portfolios accomplish this objective.

Defining Asset Classes

In order to analyze the Fund's portfolio, we had to decide which assets to include in the Fund's investment universe. Currently, the Fund invests in 12 different asset classes that comprise six main categories. The benchmarks used to represent each asset class in our analysis are listed in Appendix A at the end of this report. The asset classes used in our study are as follows:

U.S. Equity Assets

Large Capitalization
Mid/Small Capitalization

Non-U.S. Equity Assets

Canada
Europe
Pacific
Emerging Markets

Other Assets

Real Estate

Non-U.S. Fixed Income Assets

Intermediate-Term Government/Corporate Bonds
Long-Term Government/Corporate Bonds
Mortgage-Backed Securities

Non-U.S. Fixed Income Assets

Non-U.S. Government Bonds

Cash

U.S. Treasury Bills



Forecasting Return

We also had to forecast three estimates for each asset class: expected return, expected risk (as measured by standard deviation), and expected return correlation between assets. Summary tables of our forecasts are provided in Appendix B. It is important to note that our return, risk, and correlation forecasts are *long-term* -- they apply to an investment horizon of 10 years or more. Our forecasts are passive in nature and, therefore, would not change dramatically if we were to recalculate them a year from now. Consequently, the portfolio allocations we recommend will remain stable over a very long time period, and will require few changes over a long-term investment horizon.


The basis for our equity return forecasts is the risk-free rate of return and the historical premium, called an equity risk premium, that is demanded by investors for holding risky assets. We use the historical premium because the amount by which common stocks have outperformed risk-free government bonds has been consistent over time. The long-term equity risk premium for large capitalization domestic equities over the period January 1926 to September 1993 was 7.25 percent. Also, many researchers have found that, as the risk of an investment increases, so does its expected return. For this reason, we forecast the expected return of other equity asset classes, such as domestic small capitalization equities and international equities, to have greater expected returns.

The basis of our fixed income return forecasts is the current risk-free rate of return, as proxied by the current yield on a risk-free government bond with a maturity matching the investment time horizon. Currently, this rate is 6.31 percent, the current yield on 20-year U.S. Treasury bond. To this rate, we add the appropriate maturity premium (additional return required by investors for relinquishing the use of their money for long time periods) and default premium (additional return that compensates investors for buying bonds that have default risk, such as corporate bonds) for each class of bonds for which we are forecasting returns.

For international fixed income assets, we forecast returns as if the assets were denominated in U.S. dollars. Since currency fluctuations are expected to average to zero over time, any short-term currency gains or losses will not affect the long-term return on international assets. Currency fluctuations do increase risk, however, and are accounted for in our risk forecasts of non-U.S. fixed income assets.

Forecasting Risk

When forecasting the risk of an asset, we typically assume that the future will equal the past. Therefore, we forecast risk by calculating the historical standard deviation using a long time period over which we have reliable data, and data that is representative of possible future scenarios. Although investment risk can be quantified in a number of



ways for asset allocation purposes, we believe that risk is best modeled as the annual volatility of returns, and standard deviation provides an estimate of how much actual returns may deviate from the average, expected return over time. We use shorter time periods only when we can identify a permanent and dramatic process shift in the behavior of an asset class, such as the late 1960s when bond market volatility increased noticeably from its observed volatility during the previous 40 years.

Forecasting Return Correlation


Return and risk are not the only factors that determine how a portfolio performs. The correlation between the returns of two assets also plays an important role in portfolio performance. Correlation measures how much the returns of two assets tend to move together or move separately. If the returns move together, the assets are positively correlated. If they move in opposite directions, the assets are negatively correlated. If no pattern can be detected in the way the assets' returns move, the assets have a return correlation of zero.

Portfolios comprised only of assets that have high, positive correlations with each other are not well diversified. This tends to exaggerate both upside and downside volatility, and the risk of the portfolio. On the other hand, portfolios with assets that have low or negative return correlations will provide more stable returns because, even though some assets may perform poorly, other portfolio assets will perform better, serving to reduce portfolio volatility. The benefits of diversification, therefore, are a direct result of relatively low return correlations among portfolio assets.

When forecasting return correlation, we again typically assume that the future will equal the past. The basis for our forecast of return correlation is, therefore, the historical correlation between assets, observed over the longest time period for which reliable data is available.

Determining the Fund's Current Allocation

The amount of the Fund currently allocated to each asset class was determined by using information in the Fund's 1993 Annual Report, with supplemental information provided by William L. Means, the Fund's Chief Investment Officer. Market values of all investments came from the Annual Report, while Mr. Means provided clarification regarding the amount currently invested in equities of domestic companies with capitalizations larger than \$1 billion (large capitalization equities), the amount currently invested in equities of companies with capitalizations of \$1 billion or less (mid and small capitalization equities), and the amount currently invested in domestic government and corporate bonds with maturities ranging from one to seven years (intermediate-term),



and more than seven years (long-term). The Fund's current allocation, and its expected return and standard deviation is given on page 5.

Determining the Fund's Three-Year Target Allocation

The Permanent Fund's investment manual provided information regarding the three-year target allocation, although some guidelines were too broad for our purposes. For example, the manual lists a 10 percent target allocation for international equities, but gives no country-specific allocations. In this case, we assumed the Fund would increase its international equity exposure to 10 percent, while maintaining the current proportion invested among sectors. Also, the target allocation constrains the amount invested in non-domestic fixed income assets to 10 percent or less, but provides no specific number. We assumed the amount invested in international debt would decrease in proportion to the total decrease in the amount allocated to all fixed income assets. The Fund's three-year target allocation, and its expected return and risk, is listed on the following page.

Current and Three-Year Target Portfolios

Asset Class	Current Allocation (%)	3-Year Target Allocation (%)
U.S. Large Capitalization Stocks	21.17	24.00
U.S. Mid/Small Capitalization Stocks	0.65	6.00
Canadian Stocks	0.03	0.04
European Stocks	2.54	4.28
Pacific Region Stocks	2.94	4.97
Emerging Market Stocks	0.42	0.72
Real Estate	6.69	10.00
Cash	4.64	0.00
Intermediate Govt/Corp Bonds	30.86	25.32
Long-Term Govt/Corp Bonds	25.27	20.74
Mortgage-Backed Securities	3.94	3.24
Non-U.S. Government Bonds	0.85	0.69
Expected Return (%)	8.53	9.93
Standard Deviation (%)	7.57	9.91



II. Asset Allocation Recommendations

The next step in our analysis was to improve the Fund's current and target portfolios by increasing their expected return while keeping expected risk at a constant level.

Allocation with Risk of the Current Portfolio

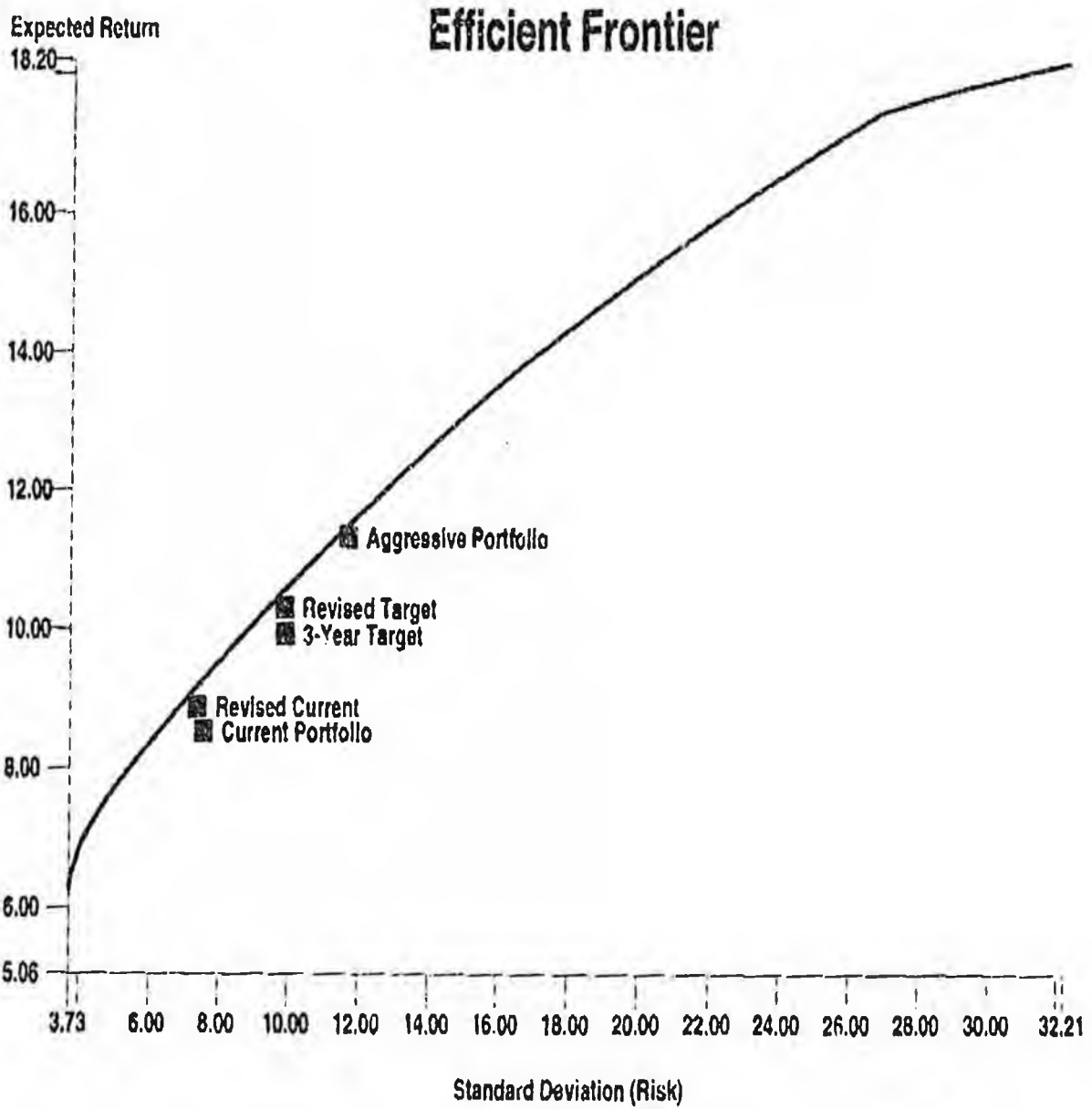
As shown in the graph on page 7, the Fund's current portfolio does not provide the maximum amount of expected return for the amount of risk taken. For example, the portfolio labeled "revised current" provides a higher expected return and slightly less risk than the current portfolio. (The graph is titled "Efficient Frontier" because the line in the graph represents those portfolios which are the most efficient in providing return to the investor; i.e., those portfolios provide the maximum return for a given level of risk.) The allocations for both the current and revised portfolios, as well as their expected returns and standard deviations, are shown on page 8.

The current portfolio need not be drastically changed in order to achieve a higher expected return. In fact, the percent of the portfolio invested in equities (approximately 35 percent, including real estate) and in fixed income assets (approximately 65 percent), is the same in both the current and revised portfolios. Rather, the composition of the equity and fixed income portions need only change. By shifting part of the equity portion from large capitalization stocks to mid and small capitalization and international stocks, and part of the fixed income portion from cash and long-term bonds to intermediate-term bonds and mortgage-backed securities, the Fund can achieve a higher expected return while taking less risk.

Although these changes represent shifts from safer assets to more risky ones, the overall risk of the portfolio actually decreases. This is because domestic mid and small stocks, mortgage-backed securities, and international stocks have low correlations with many of the other portfolio assets.

Allocation with Risk of the Target Portfolio

The graph on page 7 shows that the Fund's target portfolio also does not provide the highest possible expected return for the amount of risk taken. Although both the allocations of the target and revised target portfolios are equally divided between equity and fixed income assets, the revised target portfolio has a significantly higher expected return and less risk. The composition of both portfolios, along with their expected returns and standard deviations, is given on page 8.



**Current and Recommended
Portfolio Allocations**

Asset Classes	Allocations				
	Current Portfolio (%)	Revised Current (%)	3-Year Target (%)	Revised Target (%)	Aggressive Portfolio (%)
U.S. Large Cap Stocks	21.17	11.00	24.00	16.00	18.00
U.S. Mid/Small Cap Stocks	0.65	4.00	6.00	8.00	10.00
Canadian Stocks	0.03	0.00	0.04	0.00	0.00
European Stocks	2.54	3.50	4.28	6.00	7.50
Pacific Region Stocks	2.94	4.00	4.97	7.00	10.50
Emerging Market Stocks	0.42	2.50	0.72	3.00	4.00
Real Estate	6.69	10.00	10.00	10.00	10.00
Cash	4.64	1.00	0.00	1.00	1.00
Intermediate-Term Govt/Corp Bonds	30.86	40.00	25.32	30.00	18.00
Long-Term Govt/Corp Bonds	25.27	12.00	20.74	5.00	6.00
Mortgage-Backed Securities	3.94	12.00	3.24	14.00	15.00
Non-U.S. Govt Bonds	0.85	0.00	0.69	0.00	0.00
Expected Return	8.53	8.89	9.93	10.31	11.33
Standard Deviation	7.57	7.40	9.91	9.89	11.69

The superior tradeoff between risk and return of the revised target portfolio can be accomplished by shifting a larger portion of Fund assets into domestic mid and small capitalization stocks, international stocks, mortgage securities, and real estate. Again, these riskier assets have low correlations with many other portfolio assets, and therefore provide enhanced diversification benefits.

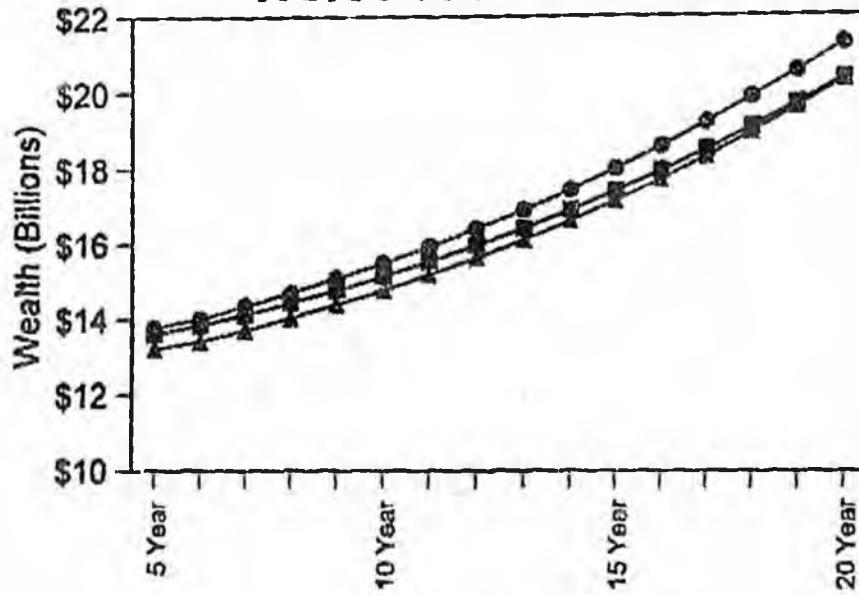
Allocation of a More Aggressive Portfolio

Although we have analyzed and suggested improvements to both the current and target portfolios, we have not yet commented on whether either portfolio is appropriate for the Fund. Ideally, a portfolio provides enough return to meet the goals of the investor while maintaining a level of risk that is comfortable for the investor. By setting a three-year target portfolio that has an increased allocation to equity assets, the Board has indicated that it is comfortable with a more aggressive investment philosophy. In our opinion, such an aggressive investing strategy is appropriate and necessary for achieving the Fund's statutory goals of maximizing total return and providing the maximum amount of disposable income to the citizens of Alaska. Consequently, we believe the Fund should consider the benefits of investing in the "aggressive portfolio," also shown in the graph on page 7.

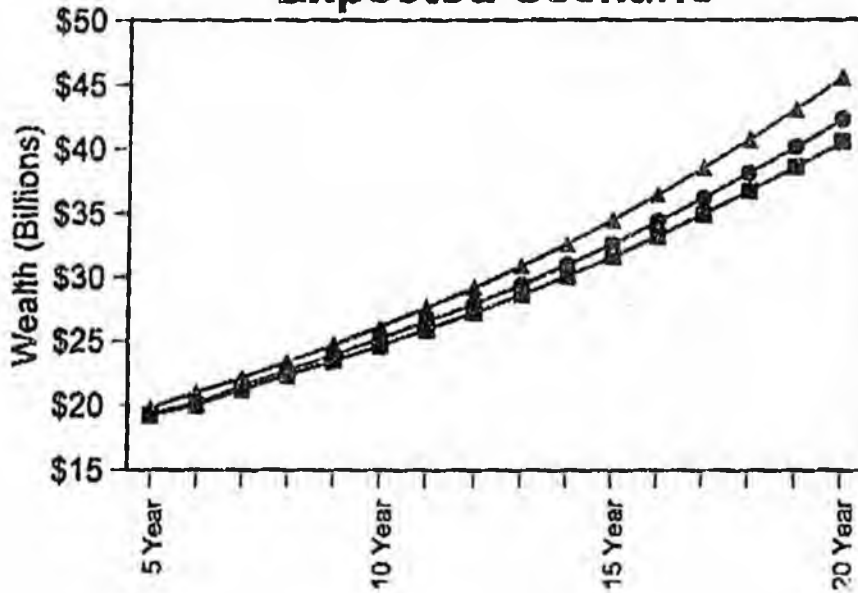
In recent years, the Fund has enjoyed relatively high returns, particularly on its fixed income investments. These high returns were due, in part, to rather unique market conditions, such as a dramatic decline in U.S. interest rates. These market conditions, however, are not expected to continue in the future, as evidenced by the returns expected on the current and target Fund portfolios. The potentially lower returns earned by both these portfolios are important factors to consider, because such low returns will inevitably lead to lower dividend payments to Alaskans. Our recommended aggressive portfolio, however, with its significant allocations to international equities and mortgage-backed securities, has an expected return in the range of the Fund's recent returns. The allocation of this aggressive portfolio, along with its expected return and standard deviation, is provided on page 8.

The graphs on the following page can help to compare the expected performance of each portfolio. The graphs show expected wealth values under the target, revised target, and aggressive portfolios for five-, ten-, and twenty-year investment horizons. Although the Board may consider the aggressive portfolio too risky, the graph shows that the majority of this portfolio's volatility is due to its broad range of possible high, *positive* returns, not negative ones. For all investment time horizons, the aggressive portfolio has a higher expected wealth value under the best- and expected-case scenarios. Only under the worst-case scenario does the aggressive portfolio underperform the target portfolio, while the revised target portfolio performs better than the target portfolio in *all* cases.

Worst Case Scenario

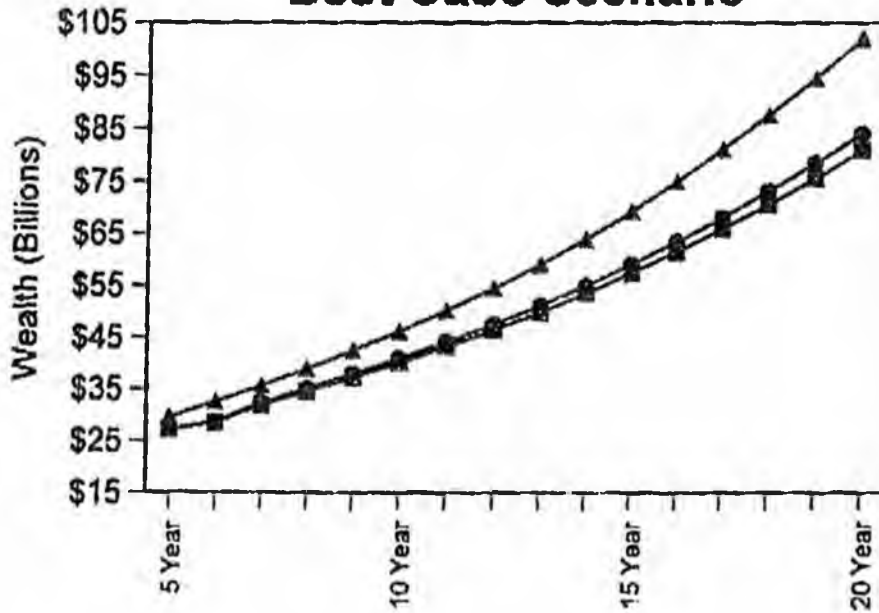


Expected Scenario



- 3-Year Target Portfolio
- Revised Portfolio
- ▲ Aggressive Portfolio

Best Case Scenario





Testing Our Recommended Portfolios

To ensure the validity of our recommended portfolios, we tested those portfolios and the Fund's current and target portfolios for *stability*. A stable portfolio is one that performs well under a variety of possible future market conditions; i.e., the portfolio provides adequate return for the amount of risk taken under conditions that differ from our forecasts. We tested the portfolios using "worst-case" scenarios where the return of one or more assets is lower than expected and the risk is higher than expected. The following scenarios were used, both individually and in combination, to test our recommended portfolios:

- U.S. equity risk premium decreases to 5 percent
- Mid and small capitalization equity return decreases to 15 percent
- Europe equity return decreases to 10 percent
- Europe equity standard deviation increases to 26 percent
- Pacific equity return decreases to 10 percent
- Pacific equity standard deviation increases to 34 percent
- Emerging market equity return decreases to 10 percent
- Return between long-term and intermediate-term bonds increases to 1 percent
- Intermediate-term bond standard deviation increases to 6 percent
- Mortgage-backed securities return decreases to 6 percent
- Mortgage-backed securities standard deviation increases to 11 percent
- Real estate standard deviation increases to 25 percent
- Correlation between U.S. stocks and U.S. bonds increases 30 percent
- Correlation between U.S. stocks and non-U.S. stocks increases 30 percent

Under these scenarios, our recommended portfolios provided higher returns with less risk than either the Fund's current or target portfolios. For example, the improved target portfolio had 10 basis points more return and less risk than the current target portfolio when tested under the assumption that all international markets had the lower returns and higher risks outlined above. This indicates that the revised portfolios will perform better over the long run, despite possible extreme underperformance of some markets.



III. Implementation Issues

Whichever portfolio the Board chooses, several issues must be addressed by the Board to ensure maximum Fund performance. The single most important issue is the degree of adherence to the chosen allocation. Research has suggested that the asset allocation decision accounts for over 90 percent of the variability of returns on a portfolio, and is the single largest determinant of portfolio performance.¹ Consequently, individual security selection and active security management, the two factors commonly assumed to contribute the most to the return of a portfolio, actually account for only a small amount of portfolio return variability. Therefore, adherence to the chosen allocation is *crucial* to the future performance of any investment portfolio, including the Permanent Fund. Accordingly, the Board must decide whether the current investment strategy of the Fund accommodates a strict adherence to the chosen allocation. We address this issue separately for equity and fixed income assets in the following two sections.

Equity Assets

As of April 1993, the Board decided to use active managers only for domestic mid/small capitalization stocks and all international equities. Since our recommended portfolios are based on passive benchmarks, we believe that the long-term performance we forecast can be achieved through the use of passive managers, although it is certainly possible for active managers to meet or exceed that performance. For this reason, we believe the Board's decision to retain active managers is appropriate, *as long as each manager is given only that portion of Fund assets that is recommended in the chosen allocation, and is required to invest those assets in the specific, recommended asset class.*

This stipulation is in direct contrast to the Board's new global investment strategy as outlined in the Fund's 1993 Annual Report. The new strategy allows active international equity managers to decide when and where to invest Fund assets, essentially shifting the asset allocation decision from the Board to the manager. As mentioned earlier, asset allocation, not security selection or active market timing, is the largest determinant of portfolio performance. Under the planned strategy, the Fund's equity allocation will shift continuously, violating the most crucial aspect of strategic asset allocation: maintaining a stable asset mix which was chosen based on long-term forecasts and needs of the fund. For this reason, we suggest a slightly modified strategy where the Board hires managers that have a specific style of investing. For example, under this modified strategy, the European equity allocation would be managed by a manager who specializes in European equities. This type of management strategy would allow the Board to retain control over the equity allocation of the Fund.

¹ Gary P. Brinson, Brian D. Singer, and Gilbert L. Beebower, "Determinants of portfolio performance II: An update," *Financial Analysts Journal*, May-June 1991.

The Fund's domestic equity managers also have similar control over the asset allocation decision. Currently, the performance of each domestic equity manager is evaluated by using a benchmark portfolio that consists of 80 percent large capitalization equities and 20 percent mid and small capitalization equities. The equity managers, however, are not specifically required to invest 80 percent of their Fund allocation in large capitalization stocks and 20 percent in mid and small capitalization stocks. A manager could alternate between large cap and mid and small cap stocks, and still *average* an 80 percent large cap and 20 percent mid and small cap investment. This manager could potentially be 100 percent invested in large cap stocks when the return in the mid and small cap market is high, and vice-versa. Again, this causes the overall equity allocation of the Fund to change continuously, and shifts control of the asset allocation decision to individual managers. Because the asset allocation decision is so important to the overall performance of the Fund, we feel the Board should set specific domestic equity allocations, and select managers who specialize in each asset class. This will ensure the maximum expected return for the Fund's equity investments.

Fixed Income Assets

Currently, the Fund's fixed income assets are passively managed in-house by the Fund's Chief Investment Officer, and are generally treated as a single asset class. Our analysis, however, treats the fixed income category as five distinct asset classes, because each contributes unique benefits to the overall portfolio. Treasury bills, for example, provide more liquidity than the other assets, and are, consequently, the least risky. Also, mortgage-backed securities perform differently from government or corporate bonds. For this reason, each fixed income asset class must be considered separately in the asset allocation decision.

Currently, the Board treats all fixed income assets as a single asset class and provides only a broad allocation directive. This essentially shifts the asset allocation decision to the fixed income manager. While the current allocation across fixed income assets may be appropriate when viewed in isolation, that same allocation may be inappropriate when viewed in the context of the overall portfolio. The Board has a comprehensive perspective on the Fund and, as such, should determine the Fund allocation to each asset class. For this reason, we suggest that the Board set specific target allocations for fixed income asset classes. In this way, the Board maintains control over the Fund's asset allocation and ensures maximum overall Fund performance.

Prior to beginning our study, several Board members and senators voiced concern over the Fund having only one manager for the entire fixed income portfolio. We feel that a single, capable manager, such as the current manager, can manage a large, passive fixed income portfolio with few problems, as long as that portfolio has only a small allocation to mortgage-backed securities. However, if a larger proportion of funds was invested in

mortgage-backed securities (as is our recommendation), it may be required to hire additional staff. This is because mortgage-backed securities are more complex to analyze, and the holders of mortgage securities continually receive principal and interest payments which must be accurately recorded. All our recommended portfolios contain substantial allocations to mortgage-backed securities. Consequently, we suggest that the Board hire an outside manager to manage the mortgage portfolio, or, at the very least, hire additional support staff.

Conclusion

Although the Permanent Fund has an excellent performance history, the Fund faces new and uncertain investment challenges in the coming years. The Board, realizing the importance of asset allocation to overall Fund performance, has created a target allocation to meet those challenges. However, as our analysis reveals, the Board can implement a better allocation for the Fund, one that has higher expected return and less risk than the Fund's target portfolio. Also, the Board can implement a new investing policy, one emphasizing an adherence to the chosen allocation. By doing so, the Board will help ensure the maximum expected performance of the Fund over the long-term investment horizon, thereby providing the highest possible income to the State's citizens and fulfilling its obligation to those citizens.

Appendix A: Benchmarks Used in Asset Allocation Study

<u>Asset Class</u>	<u>Benchmark Description</u>
U.S. Large Capitalization Equity	S&P 500: A market capitalization-weighted index of 500 of the largest stocks of companies domiciled in the United States.
U.S. Mid/Small Capitalization Equity	Russell 2000 Index: A market capitalization-weighted index of the stocks of the bottom two thirds of the largest 3,000 publicly traded companies domiciled in the United States.
Canada Equity	Morgan Stanley Capital International Canada Total Return Index: A market capitalization-weighted index of 81 large Canadian stocks.
Europe Equity	Morgan Stanley Capital International Europe Total Return Index: A market capitalization-weighted index of large stocks from Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Netherlands, Norway, Spain, Sweden, Switzerland, and the United Kingdom.
Pacific Equity	Morgan Stanley Capital International Pacific Total Return Index: A market capitalization-weighted index of large stocks from Australia, Hong Kong, Japan, Malaysia, New Zealand, and Singapore.
Emerging Markets Equity	IFC Emerging Market Composite Index: A broad-based, market capitalization-weighted index of stocks listed in countries with a per capita GDP below an annually-disclosed figure. Currently, 20 countries are represented in the Composite index.
Cash	U.S. 90-Day Treasury Bills: Published by Salomon Brothers in <i>International Bond and Money Market Performance</i> .

IT Govt/Corp Bonds

Lehman Brothers Intermediate-Term Government/Corporate Bond Total Return Index: A portfolio of U.S. government issues (>\$100 million par value) and investment grade corporate debt (>\$50 million par value) with an average maturity of 4.42 years as of November 29, 1993.

LT Govt/Corp Bonds

Lehman Brothers Government/Corporate Bond Total Return Index: A portfolio of U.S. government issues (>\$100 million par value) and investment grade corporate debt (>\$50 million par value) with an average maturity of 10.81 years as of November 29, 1993.

Mortgage-Backed Securities

Lehman Brothers Mortgage-Backed Securities Total Return Index: An index of all fixed-rate securities backed by mortgage pools of the Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), and the Federal National Mortgage Association (FNMA). The index has an average maturity of 6.89 years.

Non-U.S. Bonds

Salomon Brothers Non-U.S. 1+ Bond Index: A market capitalization-weighted index of bonds from Australia, Canada, Germany, Japan, Netherlands, Switzerland, and the United Kingdom with one year or more to maturity. The average maturity of bonds in the index is 6.95 years.

Real Estate

Wilshire Real Estate Securities Total Return Index: A market capitalization-weighted index of approximately 85 real estate investment trust and real estate operating companies.



Appendix B: Forecasts Used in Asset Allocation Study

Forecasts of Expected Return and Standard Deviation

Asset Class	Expected Return	Standard Deviation
U.S. Large Cap Stocks	13.56	20.61
U.S. Mid/Small Cap Stocks	18.03	32.95
Canada Stocks	13.73	24.64
Europe Stocks	13.98	22.69
Pacific Stocks	15.11	28.24
Emerging Market Stocks	21.38	47.00
Real Estate	9.90	13.63
Cash	4.61	2.73
IT Govt/Corp Bonds	5.89	4.10
LT Govt/Corp Bonds	6.37	7.22
Mortgage-Backed Securities	7.45	9.28
Non-U.S. Govt Bonds	6.01	14.75

SENATE COMMITTEE REPORT

DATE: 2/4/94

FURTHER: Judiciary
Finance

DATE TURNED INTO OFFICE: 3/16/94

L&C Committee considered SENATE BILL NO. 245

"An Act relating to investments of the permanent fund involving equity interests in and debt obligations secured by mortgages on real estate; and providing for an effective date."

and recommends:

replace with _____ CS SB 245 (24C)

or adopt previous _____ CS _____ (_____)

attaches amendment(s)

same title
 new title
 technical title change (HB only)

adopts _____ Letter of Intent

further referral to the _____

do pass

do not pass

no recommendation

individual recommendations

NEW FISCAL NOTES

	Department	Date	Zero	Fiscal
CS	Dept. of Rev.	1/31/94	✓	

PREVIOUS FISCAL NOTES

	Department	Date	Zero	Fiscal

Appropriation No Fiscal Note

DO PASS:

Steve Hein
Scott Berg

OTHER RECOMMENDATIONS:

Judith E. Salo

Tim Kelly - D. Parr

Chair: Signature and Recommendation

* fees of over \$1 B in Real Estate market value of fund = \$160 M

(14th largest lender in the U.S.)

do ~~the~~ Trustees have fiduciary responsibility? (not in statutes?)

CS FOR SENATE BILL NO. 245(STA)

IN THE LEGISLATURE OF THE STATE OF ALASKA
EIGHTEENTH LEGISLATURE - SECOND SESSION

BY THE SENATE STATE AFFAIRS COMMITTEE

Offered: 2/4/94
Referred: L&C, JUD, FIN

Sponsor(s): SENATE RULES COMMITTEE BY REQUEST OF THE LEGISLATIVE BUDGET AND AUDIT COMMITTEE

A BILL

FOR AN ACT ENTITLED

* amend 37.13.110 to add reference to fiduciary responsibility
Reger
* raise real esth % of portfolio to 25%

1 "An Act relating to investments of the permanent fund involving equity interests
2 in and debt obligations secured by mortgages on real estate; and providing for
3 an effective date."

* delete "and located in the U.S."

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

\$50 M

5 * Section 1. AS 37.13.120(g)(16) is amended to read:

* change to \$50 M

6 (16) equity interests in, and debt obligations secured by mortgages
7 granting a first lien on, real estate improved by completed and substantially rented
8 buildings and located in the United States [,] if the total value held by the fund in
9 each investment does not exceed \$50,000,000, and, if the total value held by the
10 fund in each investment exceeds \$50,000,000, these investments are made

11 (A) in a corporation, partnership, trust, or other entity in which,
12 at the conclusion of each investment transaction, at least 33 [60] percent of the
13 beneficial ownership interests are held by other institutional investors, and
14 which is organized and operated for the purpose of making real estate

1 investments by a bank, insurance company, or other manager of institutional
2 funds that has had at least five years of experience in the management of real
3 estate investments of institutional investors; or

4 (B) with corporations, partnerships, trusts, or entities in which,
5 at the conclusion of each investment transaction, at least 33 [60] percent of the
6 beneficial ownership interests in the co-investing entity or entities as a whole
7 are held by institutional investors, and if

8 (i) at the time of investment the fund has no more than
9 a 67 [40] percent beneficial ownership interest in the real estate
10 invested in as a whole;

11 (ii) the rights and obligations of the fund are
12 substantially similar to those of the other institutional investors, except
13 for the percentage interest in the property; and

14 (iii) the property is managed and operated by an entity
15 that has had at least five years of experience in the management of real
16 estate investments of institutional investors;

17 * Sec. 2. This Act takes effect immediately under AS 01.10.070(c).

SENATE BILL NO. 245

IN THE LEGISLATURE OF THE STATE OF ALASKA

EIGHTEENTH LEGISLATURE - SECOND SESSION

BY THE SENATE RULES COMMITTEE BY REQUEST OF THE LEGISLATIVE BUDGET AND
AUDIT COMMITTEE

Introduced: 1/14/94
Referred: STA, L&C, JUD, FIN

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to investments of the permanent fund involving equity interests
2 in and debt obligations secured by mortgages on real estate; and providing for
3 an effective date."

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

5 * Section 1. AS 37.13.120(g)(16) is amended to read:

6 (16) equity interests in, and debt obligations secured by mortgages
7 granting a first lien on, real estate improved by completed and substantially rented
8 buildings and located in the United States [IF THESE INVESTMENTS ARE MADE

9 (A) IN A CORPORATION, PARTNERSHIP, TRUST, OR
10 OTHER ENTITY IN WHICH, AT THE CONCLUSION OF EACH
11 INVESTMENT TRANSACTION, AT LEAST 60 PERCENT OF THE
12 BENEFICIAL OWNERSHIP INTERESTS ARE HELD BY OTHER
13 INSTITUTIONAL INVESTORS, AND WHICH IS ORGANIZED AND
14 OPERATED FOR THE PURPOSE OF MAKING REAL ESTATE

1 INVESTMENTS BY A BANK, INSURANCE COMPANY, OR OTHER
2 MANAGER OF INSTITUTIONAL FUNDS THAT HAS HAD AT LEAST
3 FIVE YEARS OF EXPERIENCE IN THE MANAGEMENT OF REAL
4 ESTATE INVESTMENTS OF INSTITUTIONAL INVESTORS; OR

5 (B) WITH CORPORATIONS, PARTNERSHIPS, TRUSTS, OR
6 ENTITIES IN WHICH, AT THE CONCLUSION OF EACH INVESTMENT
7 TRANSACTION, AT LEAST 60 PERCENT OF THE BENEFICIAL
8 OWNERSHIP INTERESTS IN THE CO-INVESTING ENTITY OR ENTITIES
9 AS A WHOLE ARE HELD BY INSTITUTIONAL INVESTORS, AND IF

10 (i) AT THE TIME OF INVESTMENT THE FUND
11 HAS NO MORE THAN A 40 PERCENT BENEFICIAL OWNERSHIP
12 INTEREST IN THE REAL ESTATE INVESTED IN AS A WHOLE;

13 (ii) THE RIGHTS AND OBLIGATIONS OF THE
14 FUND ARE SUBSTANTIALLY SIMILAR TO THOSE OF THE
15 OTHER INSTITUTIONAL INVESTORS, EXCEPT FOR THE
16 PERCENTAGE INTEREST IN THE PROPERTY; AND

17 (iii) THE PROPERTY IS MANAGED AND
18 OPERATED BY AN ENTITY THAT HAS HAD AT LEAST FIVE
19 YEARS OF EXPERIENCE IN THE MANAGEMENT OF REAL
20 ESTATE INVESTMENTS OF INSTITUTIONAL INVESTORS];

21 * Sec. 2. This Act takes effect immediately under AS 01.10.070(c).

FISCAL NOTE

b. . . version: SB 245
 (S) Publish Date: 2-4-94

**STATE OF ALASKA
 1994 LEGISLATIVE SESSION**

BII Dept. Affected: Department of Revenue
 BRU: APFC

Revision Date:
 Title: 'An Act relating to investments of the permanent fund involving equity interests in and debt obligations secured by mortgages on real estate; and providing for an effective date.'

Component: APFC

Sponsor: Senate Rules Committee by Request of the LB&A Committee

Requestor: Senate State Affairs

COMPONENT SERIAL NO. 109

Expenditures/Revenues:

(Thousands of Dollars)

OPERATING	FY95	FY96	FY97	FY98	FY99	FY00
PERSONAL SERVICES	-0-	-0-	-0-	-0-	-0-	-0-
TRAVEL	-0-	-0-	-0-	-0-	-0-	-0-
CONTRACTUAL	-0-	-0-	-0-	-0-	-0-	-0-
SUPPLIES	-0-	-0-	-0-	-0-	-0-	-0-
EQUIPMENT	-0-	-0-	-0-	-0-	-0-	-0-
LAND & STRUCTURES	-0-	-0-	-0-	-0-	-0-	-0-
GRANTS, CLAIMS	-0-	-0-	-0-	-0-	-0-	-0-
MISCELLANEOUS	-0-	-0-	-0-	-0-	-0-	-0-
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-

CAPITAL:	-0-	-0-	-0-	-0-	-0-	-0-
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REVENUE FUND SOURCE:	-0-	-0-	-0-	-0-	-0-	-0-
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FUNDING:

(Thousands of Dollars)

1002 Federal Receipts	-0-	-0-	-0-	-0-	-0-	-0-
1003 GF Match	-0-	-0-	-0-	-0-	-0-	-0-
1004 GF	-0-	-0-	-0-	-0-	-0-	-0-
1005 GF/Program Receipts	-0-	-0-	-0-	-0-	-0-	-0-
1006 GF/MHTIA	-0-	-0-	-0-	-0-	-0-	-0-
Other	-0-	-0-	-0-	-0-	-0-	-0-
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME	-0-	-0-	-0-	-0-	-0-	-0-
PART-TIME	-0-	-0-	-0-	-0-	-0-	-0-
TEMPORARY	-0-	-0-	-0-	-0-	-0-	-0-

Estimate of current year (FY94) Impact: \$ -0-

Changes in CSSB245 (STA) have no fiscal impact. This fiscal note is appropriate.

ANALYSIS: (Attach a separate page if necessary)

2/4/94 date [Signature] Comte Aide (Initial)

Prepared by: William H. Scott, Executive Director
 Division: Alaska Permanent Fund Corporation
 Approved by: Darrel J. Rexwinkel, Commissioner
 Commissioner:
 Agency: Department of Revenue

Phone: 465-2047
 Date: January 31, 1994
 Date: 1/31/94

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FISCAL NOTE

FISCAL NOTE

STATE OF ALASKA 1994 LEGISLATIVE SESSION

No. 1
 Version: SB 245
 (S) Publis' Date: 2-4-94

BII

Revision Date:

Dept. Affected: Department of Revenue

Title: "An Act relating to investments of the permanent fund involving equity interests in and debt obligations secured by mortgages on real estate; and providing for an effective date."

BF U: APFC

Sponsor: Senate Rules Committee by Request of the LB&A Committee

Component: APFC

Requestor: Senate State Affairs

COMPONENT SERIAL NO. 109

Expenditures/Revenues:

(Thousands of Dollars)

OPERATING	FY95	FY96	FY97	FY98	FY99	FY00
PERSONAL SERVICES	-0-	-0-	-0-	-0-	-0-	-0-
TRAVEL	-0-	-0-	-0-	-0-	-0-	-0-
CONTRACTUAL	-0-	-0-	-0-	-0-	-0-	-0-
SUPPLIES	-0-	-0-	-0-	-0-	-0-	-0-
EQUIPMENT	-0-	-0-	-0-	-0-	-0-	-0-
LAND & STRUCTURES	-0-	-0-	-0-	-0-	-0-	-0-
GRANTS, CLAIMS	-0-	-0-	-0-	-0-	-0-	-0-
MISCELLANEOUS	-0-	-0-	-0-	-0-	-0-	-0-
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-
CAPITAL:	-0-	-0-	-0-	-0-	-0-	-0-
REVENUE FUND SOURCE:	-0-	-0-	-0-	-0-	-0-	-0-

FUNDING:

(Thousands of Dollars)

1002 Federal Receipts	-0-	-0-	-0-	-0-	-0-	-0-
1003 GF Match	-0-	-0-	-0-	-0-	-0-	-0-
1004 GF	-0-	-0-	-0-	-0-	-0-	-0-
1005 GF/Program Receipts	-0-	-0-	-0-	-0-	-0-	-0-
1006 GF/MHTIA	-0-	-0-	-0-	-0-	-0-	-0-
Other	-0-	-0-	-0-	-0-	-0-	-0-
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME	-0-	-0-	-0-	-0-	-0-	-0-
PART-TIME	-0-	-0-	-0-	-0-	-0-	-0-
TEMPORARY	-0-	-0-	-0-	-0-	-0-	-0-

Estimate of current year (FY94) Impact: \$ -0-

Changes in CSSB 245 (STA) have no fiscal impact. This fiscal note is appropriate.

ANALYSIS: (Attach a separate page if necessary)

2/4/94 date [Signature] Comte Aide (Initial)

Prepared by: William H. Scott, Executive Director
 Division: Alaska Permanent Fund Corporation
 Approved by: Darrel J. Rexwinkel, Commissioner
 Commissioner:
 Agency: Department of Revenue

Phone: 465-2047
 Date: January 31, 1994
 Date: 1/31/94

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) Changes in CSSB 245 (L&O) have no fiscal impact. This fiscal note is appropriate.

3/15/94 date [Signature] Comte Aide (initial)

SB

251

**MEMORANDUM
DIVISION OF INVESTMENTS
ALASKA DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT**

To: Glenn Reed, Deputy Commissioner
From: Martin J. Richard, Director *CM*
Date: November 24, 1993 *for*
Subject: Assistant to Western Alaska

To aid in the economic recovery of Western Alaska, Bob Richardson, Loan Manager of the Division of Investments Anchorage Lending Branch, traveled to the Yukon/Kuskokwim area from November 15-18, 1993 to meet with area fishers. Mr Richardson was accompanied by Steve Street of the Alaska Business Development Center, Inc. (ABDC), which has a contract with the Division of Economic Development to provide small business assistance.

Mr. Richardson and Mr. Street met with residents of St. Mary's, Emmonak, Mt. Village, Alakanuk and Kotlik. They spoke to approximately 120 people in these villages about the Commercial Fishing loan program and its financial and eligibility requirements. Mr. Street assisted fishers with IRS problems. Mr. Richardson handed out 26 applications to fishers who could potentially qualify for new loans.

The following summarizes existing loans serviced by the Division in the Y/K area:

<u>AREA</u>	<u>COMMERCIAL FISHING LOANS /</u>		<u>OTHER DCED LOANS</u>	
	Number of Loans	Prln. Balance Outstanding	Number of Loans	Prln. Balance Outstanding
Upper Yukon	7	\$231.4	189	\$4,164.3
Lower Yukon	14	109.1	8	149.3
Kuskokwim	27	509.6	11	356.0
TOTAL	48	\$850.1	208	\$4,669.6

Altogether, there are 256 DCED loans in the Y/K area with a total outstanding principal balance of \$5,519.7.

**WESTERN ALASKA COMMERCIAL
FISHING LOAN STATISTICS**

Division of Investments
Alaska Department of Commerce and Economic Development

Commercial Fishing Revolving Loan Fund
Upper Yukon Area
July 21, 1993

Zipcode	Town	Outstanding Principal	Payment Amount	Number of Loans
99558	Aniak	0.00	0.00	0
99733	Circle City	66,161.84	10,154.00	1
99701	College	0.00	0.00	0
99701	Fairbanks	60,221.51	9,636.00	2
99740	Ft. Yukon	0.00	0.00	0
99741	Galina	0.00	0.00	0
99590	Grayling	0.00	0.00	0
99602	Holy Cross	0.00	0.00	0
99746	Huslia	0.00	0.00	0
99748	Kaltag	0.00	0.00	0
99754	Koyukuk	0.00	0.00	0
99756	Manley Hot Springs	0.00	0.00	0
99760	Nanana	0.00	0.00	0
99705	North Pole	96,211.71	17,372.00	3
99765	Nulato	0.00	0.00	0
99767	Rampart	0.00	0.00	0.00
99768	Ruby	8,800.00	1,068.00	1
99714	Salcha	0.00	0.00	0
99774	Stevens Village	0.00	0.00	0
99777	Tanana	0.00	0.00	0
	TOTALS	231,395.06	38,230.00	7

Division of Investments
Alaska Department of Commerce and Economic Development

All Loan Portfolio's Excluding Commercial Fishing
In The Upper Yukon Area
July 22, 1993

Zipcode	Town	Outstanding Principal	Payment Amount	Number of Loans
99558	Aniak	0.00	0.00	0
99733	Circle City	0.00	0.00	0
99701	College	0.00	0.00	0
99701	Fairbanks	3,599,528.61	491,326.37	151
99740	Ft. Yukon	45,245.52	667.00	1
99741	Galina	0.00	0.00	0
99590	Grayling	0.00	0.00	0
99602	Holy Cross	0.00	0.00	0
99604	Hooper Bay	0.00	0.00	0
99746	Huslia	0.00	0.00	0
99748	Kaltag	0.00	0.00	0
99754	Koyukuk	0.00	0.00	0
99756	Manley Hot Springs	0.00	0.00	0
99760	Nanana	0.00	0.00	0
99705	North Pole	496,654.18	51,635.01	32
99765	Nulato	0.00	0.00	0
99767	Rampart	0.00	0.00	0
99768	Ruby	0.00	0.00	0
99714	Saicha	8,044.91	175.00	4
99774	Stevens Village	11,778.28	108.00	1
99777	Tanana	0.00	0.00	0
	TOTALS	4,164,251.50	543,911.38	189

Division of Investments
Alaska Department of Commerce and Economic Development

Commercial Fishing Revolving Loan Fund
Lower Yukon Area
July 21, 1993

Zipcode	Town	Outstanding Principal	Payment Amount	Number of Loans
99581	Emmonak	0.00	0.00	0
99632	Mountain Village	0.00	0.00	0
99554	Alakanuk	15,856.58	5,258.00	3
99620	Kotlik	0.00	0.00	0
99658	St. Mary's	18,845.93	9,268.00	3
99650	Pilot Station	5,782.25	4,403.00	2
99585	Marshall	0.00	0.00	0
99662	Scammon Bay	38,469.80	10,187.00	3
99666	Sheldon Point	16,531.53	3,492.00	1
99657	Russian Mission	13,602.82	4,694.00	2
99585	Fortuna Ledge	0.00	0.00	0
99602	Holy Cross	0.00	0.00	0
99730	Central	0.00	0.00	0
99604	Hooper Bay	0.00	0.00	0
99714	Salcha	0.00	0.00	0
	TOTAL	109,088.81	37,302.00	14

Division of Investments
Alaska Department of Commerce and Economic Development

All Loan Portfolio's Excluding Commercial Fishing
In The Lower Yukon Area
July 22, 1993

Zipcode	Town	Outstanding Principal	Payment Amount	Number of Loans
99581	Emmonak	0.00	0.00	0
99632	Mountain Village	0.00	0.00	0
99554	Alakanuk	0.00	0.00	0
99620	Kotlik	0.00	0.00	0
99658	St. Mary's	0.00	0.00	0
99650	Pilot Station	0.00	0.00	0
99585	Marshall	0.00	0.00	0
99662	Scammon Bay	0.00	0.00	0
99666	Sheldon Point	0.00	0.00	0
99657	Russian Mission	0.00	0.00	0
99585	Fortuna Ledge	0.00	0.00	0
99602	Holy Cross	47,451.39	477.22	1
99730	Central	11,215.92	508.00	1
99604	Hooper Bay	82,628.21	1,156.64	2
99714	Salcha	8,044.91	175.00	4
	TOTAL	149,340.43	2,316.86	8

STATE OF ALASKA

COMMERCIAL FISHERIES ENTRY COMMISSION

WALTER J. HICKEL, GOVERNOR

8800 GLACIER HWY, #109
JUNEAU, AK 99801
(907) 789-6150 Licensing Calls
(907) 789-6160 Other Business
(907) 789-6170 FAX

January 13, 1994

(907)
(907)

1~

Re: IRS v. Alaska Limited Entry Permits

Dear [Legislator]2~:

Last year we corresponded with you concerning the IRS and its claims against Alaska limited entry permits. This letter conveys a timely update which should provide a better grasp of the problem. See Attachment A (5 pages of correspondence).

After months of correspondence and meetings, the IRS has now shared with the Entry Commission statistics describing the extent of noncompliance among Alaska limited entry permit holders. See Attachment A (5 of 5). The statistics show that the areas of greatest noncompliance with federal tax obligations are the Rural areas of the State, where access to traditional fisheries is most important to our economy. The IRS has broken out statistics for two types of delinquent taxpayers: (1) those who have failed to file returns (for whom IRS can only estimate the amount owing); and (2) those who have filed but failed to pay taxes owed (for whom the IRS can provide a fairly accurate estimate).

1,111 Alaska permit holders are in the latter group. However, only 4.8% of them owe more than \$50,000 to the IRS. The vast majority (827 or 74%) owe the IRS \$10,000 or less. This majority can be increased to 86% by adding in the additional 130 individuals who owe the IRS up to \$20,000. See Attachment A (5 of 5).

For most fishermen, the loss of an entry permit destroys their means of earning a living. At the same time, with appropriate assistance, most fishermen have a realistic hope of working their way out of trouble. Alaska fishermen currently face problems beyond those of self-employed people throughout the rest of the country (who often face similar tax problems). For the most part, IRS difficulties among Alaska fishermen are a symptom of generally hard times in the Alaska fishing industry which will call for long-term adjustments. Unfortunately, Alaska fishermen are a distinctly attractive target to the IRS because they are easily identified and they hold permits of value.

Preliminarily, we have discussed with Commissioner Paul Furi the possibility of a statutory change to make the existing revolving loan funds of the Commercial Fisheries Loan Program available to help Alaska fishermen avoid seizure and forced sale of their entry permits by the IRS.

IRS v. AK LIMITED ENTRY PERMITS

January 13, 1994

We are also very interested in the professional help that the Alaska Business Development Center and its President Gary Selk have provided fishermen to help them work their way out of their difficulties. We hope that these services can be sustained.

Additionally, there are other initiatives we would be happy to discuss with you. However, be aware that the IRS is now suing the Entry Commission to strike down those elements of State law which it believes may present obstacles to its seizure and forced sale of entry permits.

We hope that this information is helpful. These are issues which we would be happy to discuss further with you and any other interested individuals.

We thank you for your interest.

Sincerely,

COMMERCIAL FISHERIES ENTRY COMMISSION

Bruce Twomley, Chairman
Frank Homan, Commissioner
Dale G. Anderson, Commissioner

by: 

Enclosure

cc: Commissioner Paul Fuhs
Clement V. Tillion,
Special Assistant to the Governor for Fisheries
Richard Romer,
Special Staff Assistant to the Governor for Rural Affairs
Raga Elim, Legislative Liaison, Office of the Governor

MEMORANDUM**STATE OF ALASKA**

TO: Paul Fuhs, Commissioner
Department of Commerce and
Economic Development
MS 0800

DATE: January 3, 1994

FAX NO: 789-6170

TELEPHONE NO: 789-6160

and

SUBJECT: IRS vs. Limited Entry
Permits

Donna Parker
Fisheries Development Specialist
Department of Commerce and
Economic Development
Division of Economic Development
MS 0800

FROM: ~~Bruce Twomley, Chairman~~
~~Frank Homan, Commissioner~~
~~Dale Anderson, Commissioner~~
COMMERCIAL FISHERIES
ENTRY COMMISSION

Enclosed is a copy of our recent correspondence with Martin Richard, Director, Division of Investments. As the correspondence indicates, we have finally gotten data from the IRS in response to correspondence that we shared with you last summer. See Attachment A (5 of 5).

The data from the IRS highlights the importance of the problem to Alaska permit holders but also suggests that, given the direction of adequate resources, the problem may be more manageable than we have believed in the past. From the data, the vast majority of permit holders in trouble individually owe the IRS only modest sums of money. However, unlike many other self-employed people throughout the country with similar problems, Alaska fishers face structural changes in their industry, the effects of which will not be removed by a general improvement in the economy. In fact, as our correspondence with Martin Richard indicates, the State may wish to consider whether some commercial fisheries loan program funds could be made available to individuals for the purpose of avoiding seizure and forced sale of their entry permits by the IRS.

You should also be aware that a group of volunteer professionals called the Bad Times Group has been conducting workshops around the State to help fishers survive the current crisis. This group has developed a very useful pamphlet Alaska Commercial Fishermen and the IRS (September 1993), which CFEC would be happy to make available to anyone interested.

In turn, one member of the Bad Times Group is Gary Selk, President of the Alaska Business Development Center. The need for the Alaska Business Development Center to remain available to help individual fishers in trouble remains as critical as ever.

Additionally, there are some beginning efforts in Bristol Bay through the Bristol Bay Economic Development Corporation (BBEDC) to reach and help permit holders who may be in trouble.

As a related matter, I have been appointed to an Alaska Federation of Natives (AFN) Task Force to address this issue, and, among other things, the Task Force will be looking at BBEDC's approach to see if it could serve as a model for other areas of the State.

Finally, the IRS is willing to work with the State to explore ways to avoid widespread seizures and forced sales of entry permits. This presents an opportunity. At the same time, be aware that the IRS is currently suing the Entry Commission to strike down those elements of State law which it believes may get in its way [more specifically, Paul, Governor Hickel's SB 449 enacted in 1992, which became AS 16.43.170(g) and (h)].

Enclosures

cc: Clement V. Tillion, Special Assistant to the Governor for Fisheries
Richard Romer, Special Staff Assistant to the Governor for Rural Affairs

MEMORANDUM


STATE OF ALASKA

TO: Martin Richard, Director
DCED
Division of Investments
MS 0802

DATE: January 3, 1994

FAX NO: 789-6170

TELEPHONE NO: 789-6160

FROM:  Bruce Twomley, Chairman
Frank Homan, Commissioner
Dale Anderson, Commissioner
COMMERCIAL FISHERIES
ENTRY COMMISSION

SUBJECT: IRS vs. Limited Entry
Permits

With this memo is information I promised you by phone describing Alaska limited entry permit holders who are currently in trouble with the IRS.

As we know, the federal tax problems experienced by Alaska fishers are consistent with problems of self-employed individuals throughout the nation. The problems are also symptomatic of broader dislocations affecting the Alaska fishing industry at this time. Nonetheless, because entry permits represent access to Alaskans' traditional fisheries, and because the IRS has the power to take away that access, preserving entry permits in the hands of their holders appears to be a pressing issue at this time—particularly in Rural Alaska, where there are few other sources of cash income.

As we discussed, for a long time, Ed Crane and I have been attempting to get more detailed information from the IRS about the extent of the problem. Finally as the result of some pressure from CFEC and resulting data sharing between CFEC and the IRS, we have a statistical breakdown from the IRS which is helpful in understanding the magnitude and locus of the problem. Attached to this memo (Attachment A, p. 5 of 5) is the statistical information developed by the IRS. We have also included some related correspondence with Dave Tucker, Chief of Enforcement for the IRS in Alaska.

IRS' figures apply only to individuals who hold transferable limited entry permits (those permits subject to forced sale) and break out numbers of permit holders (1) who have failed to file tax returns (for whom the IRS can only estimate the amount owing), and (2) who have filed returns but owe balances to the IRS (where the IRS has a fairly accurate estimate as to the amount owed).

The IRS and we draw some encouragement from these figures. As you can see, the 83 permit holders who have filed but owe balances to the IRS of \$10,000 or less represent 74% of the total. If you add in the additional 130 who owe up to \$20,000, you have then accounted for 86% of the permit holders owing balances. In contrast, among the tougher cases, only 53 permit holders (or 4.8% of the total) owe more than \$50,000.

These figures show that the largest group of people in trouble owe the IRS only moderate sums of money. This group is likely to represent more marginal fishers with limited earnings from their fisheries. This group would not appear to face immediate risk of losing their permits and may well have a realistic hope of working their way out of trouble with appropriate assistance.

Also noteworthy is the fact that the regions listed by the IRS as having the greatest incidence of tax delinquencies among permit holders are predominately rural areas of the State. These are areas where access to commercial fisheries as the primary means of earning cash is critical.

In short, I believe that these figures highlight the importance of the problem but also suggest that, given the direction of adequate resources, the problem may become manageable. In particular, I wanted you to have these figures, because it may be appropriate at this time to consider whether the Commercial Fisheries Loan Program might be modified to make available funds to help at least some of these fishers avoid loss of access to their fisheries. Because of the relatively low amount of taxes owing by the largest identifiable group of permit holders, existing funds could go a long way to address the problem.

The IRS would be willing to work with us to explore any means which would help the IF avoid having to employ its more heavy handed enforcement tools (that is, seizure and forced sale of entry permits). At the same time, our relationship with the IRS is not entirely an easy one. As you know, the IRS is presently suing us to strike down those elements of state law that the IRS believes may get in its way.

Please call if you wish to discuss this or if you need any additional information from the Commission.

(Commissioner Fuhs and Donna Parker expressed an interest in the IRS issue last summer so I am sharing this information with them as well.)

Enclosures

cc: Paul Fuhs, Commissioner DCED
Donna Parker, Fisheries Development Specialist, DCED

STATE OF ALASKA

COMMERCIAL FISHERIES ENTRY COMMISSION

WALTER J. HICKEL, GOV

8800 GLACIER HWY, #108
JUNEAU, AK 99801
(907) 788-6150 Licensing Calls
(907) 788-6160 Other Business
(907) 788-6170 FAX

November 9, 1993

Mr. Dave Tucker
Chief, Collection Division
Internal Revenue Service
Department of the Treasury
P.O. Box 101500
Anchorage, AK 99510

Re: IRS analysis of tax delinquencies among limited entry permit holders

Dear Mr. Tucker:

We received your figures concerning tax liabilities among Alaska limited entry permit holders yesterday. I know from our conversations that the production of this information demanded considerable time and attention by you and your staff. Thank you.

As you pointed out in our phone discussion last week, the information does not go as far as we had hoped in delineating the problem by geographic areas. You made clear that the information in this form was as far as the IRS would go in satisfying our request. Nonetheless, the information does help to provide a more informed view of the problem than has been available in the past.

I believe that the information will help get the attention of people who may be willing to help address the problem. I plan to distribute the information as we have discussed. Before I do, I will call you with some questions. I want to make sure that I have a clear understanding of this material. From our previous conversation, I understand that the geographic areas listed as having the greatest incidence of tax delinquencies among limited entry permit holders are set forth in alphabetical order rather than in an order that would reflect magnitude of the problem. I also understand that, for nonfilers, the IRS is drawing upon information from the years 1989 through 1991. As to those permit holders who have filed but owe balances to the IRS, I understand that the IRS is drawing from information through July of 1993.

ATTACHMENT A
(1 of 5)

Mr. Dave Tucker
November 9, 1983
Page 2

Again, thank you. I believe that the information will serve our joint outreach efforts.
I will call you shortly.

Yours Truly,

A handwritten signature in black ink, appearing to read "Bruce Twamley", written in a cursive style with a large, sweeping flourish at the end.

Bruce Twamley, Chairman

ATTACHMENT A
(2 of 5)

Internal Revenue Service

Department of the Treasury

District
Director

P.O. Box 101500, Anchorage, Alaska 99510

RECEIVED

NOV 28 1993

CFEC

NOV 3 1993

Bruce Twomley, Commissioner
State of Alaska
Commercial Fisheries Entry Commission
8800 Glacier Highway, #109
Juneau, AK 99801

Dear Mr. Twomley:

This letter is in response to your request of September 20, 1993, that the Internal Revenue Service provide your agency with data detailing the scope of tax delinquencies among limited entry permit (LEP) holders.

As you know from our ongoing discussions, a dilemma is posed for the Service by your request. We are actively pursuing ways to reduce the incidence to tax delinquencies through improvements to our own education and assistance efforts, and by encouraging involvement of interested third parties. For this reason we would like to meet your request for detailed information. The dilemma results from the extremely restrictive language and intent of IRC 6103 which prohibits disclosure of tax information without specific authorization. In fact, the Internal Revenue Code imposes criminal penalties for breaches of confidentiality.

We have reviewed the data and have determined that in most locales the incidence of tax delinquencies exceeds our disclosure threshold. That is, the specific data is of such magnitude that the confidentiality of individual taxpayers would be breached by disclosure. By definition the locales of the greatest magnitude are the ones in which we have the greatest common interest. Even taxpayers in full compliance could by unfortunate inference have their reputations tarnished.

What we can provide is summary data for both Alaska resident and non Alaska resident limited entry permit holders. In addition, we can list the regions of Alaska with the highest incidence of non filing and non payment problems.

Be assured that all regions share in the overall high volume of tax delinquencies. The IRS will continue to provide service to all Alaskans. We invite the ideas and assistance of all

ATTACHMENT A
(3 of 5)

Bruce Twonley

interested parties. We would welcome joint sponsorship of outreach activities, particularly in the seven regions identified. Please contact me at (907) 271-6353 to discuss our plan of action.

Sincerely,



Dave Tucker
Chief, Collection Division

Enclosure

RECEIVED

MAY 18 1981

CFEC

SUMMARY of Tax Delinquencies Among LEP Holders

	IRS Non Filers	IRS Balance Due*	IRS Total	LEP Holders	Percent	Amount Due
Alaska Resident	1,173 (Actual)	1,111 (Actual)	2,284 (Actual)	8,802	26	\$13.7M (Actual)
Non Alaska Resident	333 (Estimate)	315 (Estimate)	648 (Estimate)	2,504	26	\$3.9M (Estimate)
Total	1,506 (Estimate)	1,426 (Estimate)	2,932 (Estimate)	11,306	26	\$17.6M (Estimate)

** Estimate Including Non-Filers = \$30M+

*Breakdown of Alaska Resident Balance Due Taxpayers by Amount Owed

\$0-10,000	\$10,001-20,000	\$20,001-50,000	\$50,001-100,000	\$100,000+	Total	Balance Due
827	130	101	32	21	1111	\$13

Regions with the Greatest Incidence of Tax Delinquencies Among LEP Holders

Region	Greatest Problem(s)
Bethel	Non Filing/Non Payment
Bristol Bay and Dillingham	Non Filing/Non Payment
Haines Borough & Skagway-Yakutat-Angoon	Non Filing/Non Payment
Kenai Peninsula Borough	Non Payment
Kodiak Island Borough	Non Payment
Lake and Peninsula Borough	Non Payment
Wade Hampton	Non Filing

ATTACHMENT A
(5 of 5)

STATE OF ALASKA

COMMERCIAL FISHERIES ENTRY COMMISSION

WALTER J. HICKEL, GOVERNOR

8800 GLACIER HWY, #109
JUNEAU, AK 99801
(907) 789-6150 Licensing Calls
(907) 789-6160 Other Business
(907) 789-6170 FAX

January 25, 1994

Dear Anchorage Daily News Editor:

On Friday, January 21, 1994, you issued a "Jeer" to Senator Jacko for introducing proposed legislation which would authorize existing revolving loan funds of the State's Commercial Fishing Loan Program to be made available to help Alaska fishermen meet federal tax and child support obligations. (The Commercial Fishing Loan Program is a primary source of loans to Alaska fisherman and one of only two lenders authorized by law to take Alaska limited entry permits as collateral.) In your apparent eagerness to attack the messenger, you harshly condemned the message despite the fact that, on the previous day, your paper carried two articles about the crisis in the Alaska salmon industry which cried out for more thoughtful consideration of the issue.

As your paper reported, Alaska salmon fishermen have been struck by forces beyond their control. Your article pointed out that many have lost nearly 75% of their prior earnings due to changed world market conditions. Their earnings may be cut in half again during the coming season with no assurance that prices have hit bottom. At the same time, fishermen's fixed costs remain the same or are rising. These fishermen are having a difficult time paying any of their creditors, including the IRS and child support claimants.

Your paper also correctly reported that 74% (or 827) of the Alaska resident limited entry permit holders, who have filed returns but who have not been able to pay their taxes, individually owe the IRS \$10,000 or less. Clearly, these Alaskans are not tax evaders but, simply, as your paper reported, fishermen facing a crisis.

As self-employed risk takers, Alaska fishermen are similar to self-employed people throughout the rest of the country who have troubles with the IRS in similar proportions. As small businessmen, they labor without the comfort and security of a salary and mandatory tax withholding. What makes Alaska fishermen different is that the IRS has the power to strip them of their limited entry permits and thereby destroy their means of earning a living for all time. This power over already suffering fishermen is a threat to the economic support of Alaskan children, families, villages, and the State as a whole.

The legislative proposal would provide some relief by authorizing loans of already appropriated funds from one of the few lending sources available. These would be secured loans--not grants or give-aways.

COMMERCIAL FISHERIES ENTRY
COMMISSIONS' LTR TO THE
DAILY NEWS

Anchorage Daily News Editor

-2-

January 25, 1994

Every legislator has at least some constituents caught in this financial crisis. These Alaskans would prefer to work, meet their obligations, and contribute to the Alaska economy. They do not want to be forced to seek welfare. The legislative proposal would help to relieve some of the suffering and to protect Alaskans' necessary access to their traditional fisheries and their means of earning a living.

Your paper has won the print news war. From the security of your salaries and mandatory tax withholding, are you being fair, when you condemn a modest legislative proposal and say:

If paying off tax or child support debts costs [Alaska fishermen] their limited entry permits, that's the price they pay for their own irresponsibility.

If you honestly believe this, you should travel beyond Anchorage more often (or, at least, read more closely your own paper).

Yours Truly,

COMMERCIAL FISHERIES ENTRY COMMISSION

Bruce Twomley, Chairman
Frank Homan, Commissioner
Dale G. Anderson, Commissioner

by: 

cc: Members of the Alaska Legislature

SENATOR GEORGE JACKO

STATE CAPITOL, ROOM 125 JUNEAU, ALASKA 99801-1182 (907) 465-4942 FAX: (907) 465-2997

COMMITTEE CHAIRMANSHIPS

Rules, Chair
Finance, Vice-Chair
Finance Subcommittees
DC&RA, Chair
DM&VA, Chair
Revenue, Chair

COMMITTEE MEMBERSHIPS

Judiciary
Legislative Council
Finance Subcommittees
Public Safety
Fish & Game
University

MEMORANDUM

TO: Senator *Tim Kelly*, Chair
Senate Labor and Commerce Committee

FROM: Senator *George Jacko*, Sponsor
Senate Bill 251

DATE: January 28, 1994

RE: Scheduling request for SB 251

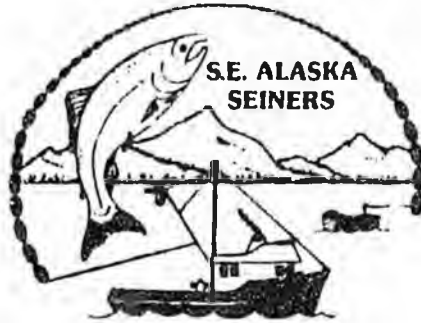
I respectfully request the scheduling of Senate Bill 251 in the Senate Labor and Commerce Committee at your earliest convenience.

SB 251 proposes to change the Commercial Fisheries Revolving Loan Fund to allow fishermen greater access to the loan program. Spiralling downward prices combined with low returns have put the near-term future of the fishing industry in serious question. I am particularly concerned about the loss of limited entry permits.

SB 251 will expand the Commercial Fisheries Loan Fund to enable refinancing of existing debt from other financial institutions, pay off IRS debts, and to a far lesser extent, meet child support obligations that threaten the ownership of a limited entry permit.

SB 251 also establishes the authority to appropriate excess revenues from the Commercial Fisheries Loan Program to the Fisheries Enhancement Revolving Loan Fund and vice-versa. Currently, additional program monies are appropriated directly to the General Fund. SB 251 has a zero fiscal note.

[] Ketchikan Office
P.O. Box 9579
Ketchikan, AK. 99901
phone: (907) 225-5156
fax: (907) 225-5258



[] Juneau Office
9226 Long Run Dr.
Juneau, AK. 99801
phone: (907) 789-5117
fax: (907) 789-5117

February 8, 1994

Senator Tim Kelly, Chair
Labor and Commerce Committee
Alaska State Legislature
Juneau, Alaska 99801-1182

Dear Senator Kelly;

I have had the opportunity to discuss SB 251 with SEAS's Executive Committee. SEAS has a few concerns with this legislation as currently drafted. First, SEAS Executive Committee found the idea of extending the loan program for child support and taxes objectionable. While they too feel the financial pinch caused by these succeeding years of low salmon prices, they believe that a responsible skipper should account for these obligations off the top of his projected gross. To paraphrase their concern, "If a guy can't meet his child support obligations, maybe he has no business fishing that season." Furthermore, they did not like the negative image that this particular section casts on all commercial fishermen in the state. To this end, SEAS encourages you to delete Section 1. (a)(1)(A)(iii), lines 3-6 on page 2.

While the idea of using fisheries loan revenues for fisheries enhancement has some appeal, SEAS also has some major concerns about allowing excess funds from the Commercial Fishing Revolving Loan Fund to be used for the Fisheries Enhancement Revolving Loan Fund. Our primary concern is that these funds might be used to artificially prop-up hatchery programs that are not likely to succeed for one reason or another and in the process exhaust the Commercial Fishing Revolving Loan Fund. This legislation offers no safeguards to address this concern.

Concern about hatcheries being financially feasible and beneficial to users of the common property fisheries is not new, nor is it a concern exclusive to SEAS. In 1992, the Special Committee on Domestic and International Commercial Fisheries, chaired by Senator Dick Eliason, released their final report which contained these relevant options for legislative and administrative consideration:

- 1) "Requiring a more extensive public benefit-cost analysis before providing enhancement loans. This means that a project or facility expansion would not only have to be financially feasible--capable of paying back loans--but also provide net benefits to the public." and
- 2) "In light of declining state revenues and lower fish prices, development of an auditing mechanism to ensure that annual PNP operating costs, paid by loans, enhancement tax receipts and cost recovery, are "reasonable."

In light of this overriding concern, I have an amendment to suggest. At the end of Section 6 (c), line 31, page 4 add:

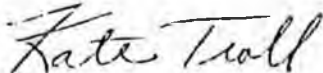
only if the commissioner determines in consultation with the applicable Regional Planning Team that the hatchery seeking these funds is (1) providing a significant contribution to common property fisheries, (2) operating in a manner that is beneficial to Alaska's public interest, and (3) managing the facility in a financially viable manner with reasonable expectations of repayment.

To ensure that enough funds remain in the Commercial Fishing Revolving Loan Fund to meet anticipated and unanticipated needs of commercial fishermen, perhaps a simple guideline could be inserted. . . excess is what remains after retaining the previous year requested loan amount plus 20%. Adopting such a guideline, instead of just relying on the commissioner's discretion in determining excess, would raise the comfort factor for commercial fishermen fearful of hatchery needs exhausting their loan fund.

In looking down the road when domestic marketing will hopefully provide the rebound for fishermen and hatcheries, why not enable funds to flow in the other direction. . .any excess enhancement funds to be made available for purposes of the commercial fishing revolving loan fund?

Given the State's financial situation and the Legislative Hatchery Review conducted in 1992, it appears that safeguards are warranted in this legislation. To this end, I hope you give the suggested amendment and guideline serious consideration. Please feel to call if you have questions or desire more information.

Sincerely,



Kathryn Troll
Executive Director

Distribution List:
Senate Labor and Commerce Committee
House Labor and Commerce Committee
Southeast Alaska Legislators

BRISTOL BAY NATIVE ASSOCIATION
P. O. Box 310
Dillingham, AK 99576

(907) 842-5257 FAX: (907) 842-5932
Toll free: 1-800-478-5257

February 8, 1994

The Honorable George Jacko
Alaska State Legislature
State Capitol
Juneau, AK 99801-1181

Re: SB 251

Dear Senator Jacko:

In regards to SB 251 that deals with enabling fishermen to obtain financing to payoff their delinquent taxes with IRS, I fully support the legislation.

You know as well as I do that we have a real serious problem with a number of Bristol Bay fishermen who owe money to the IRS. According to Dave Tucker of IRS in Anchorage, he estimates that about 40% of the total 2,284 Alaskan limited entry permit holders who have have not filed and owe money to IRS are Bristol Bay salmon permit holders. That calculates to slightly over 900 Bristol Bay permit holders. With a total of 3,099 Bristol Bay permit holders (both setnet and drift), that means about 1/3 of all Bay permit holders owe taxes to IRS.

It's an alarming figure. Without question, this figure is attributed to Alaska's beleaguered salmon industry. Bay fishermen have seen their salmon prices drop from \$2.25 per pound in 1988, to 60 cents per pound last season, and lower salmon prices are anticipated this next season.

An increasing number of fishermen are seeking loan extensions on their current boat and permit loans payments, and a growing number are on the verge of losing their boats and permits.

We feel the court ruling enabling the IRS to seize limited entry permits has resulted in a surge of fishermen selling their permits to pay off their tax debts. We feel most of the permits that are sold end up in the hands of outside nonresident fishermen. If this trend continues, it will erode and take its toll on the economic benefits derived by area communities.

LETTERS OF SUPPORT:
BRISTOL BAY NATIVE CORPORATION
CALISTA CORPORATION

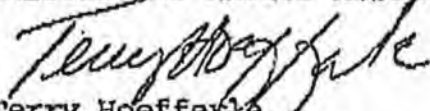
PAGE TWO
Letter to Senator Jacko
February 9, 1994

The outmigration of permits from our area has far-reaching implications. Not only do we lose the local job of the limited entry permit holder, but we lose the jobs of at least two (2) crew members. Outside nonresident permit holders who come to Alaska to fish usually bring their own outside crew members.

It's in the best interest of the State of Alaska, Alaska's coastal communities, and the Bristol Bay area, that this legislation be approved this session.

Sincerely yours,

BRISTOL BAY NATIVE ASSOCIATION


Terry Hoeffel
Chief Executive Officer

FEB 07 1994

Calista Corporation

Office of the Chairman • Box 1508 • Bethel, Alaska 99558 • Phone (907) 543-5557 • Facsimile (907) 543-3068

February 7, 1994

Senator George Jacko
State Capitol
Juneau, AK 99801-1182

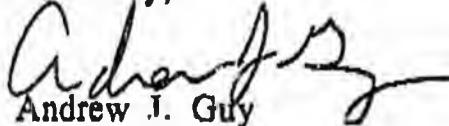
Dear Senator Jacko:

Thank you for providing my office with a copy of your proposed legislation, SB 251. I am writing to express my support for this bill.

Commercial fisheries in the Yukon-Kuskokwim Deltas have been dealt severe blows during the last few years, both in terms of lower salmon prices and fewer openings. In fact, this region was declared as a disaster area by Governor Hickel following last seasons chum salmon failure. Inability to pay debts following our dismal commercial fishing seasons should not be allowed to govern whether or not our limited entry permits stay here.

Again, thank you for advising me of your proposed legislation and please do not hesitate to contact my office on any other matter.

Sincerely,



Andrew J. Guy

Chairman

DIVISION OF LEGAL SERVICES

LEGISLATIVE AFFAIRS AGENCY STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

130 Seward Street, Suite 409
Juneau, Alaska 99801-2105

MEMORANDUM

February 9, 1994

SUBJECT: Sectional Summary of CSSB 251(); An Act relating to the commercial fishing revolving loan fund and the fisheries enhancement revolving loan fund. (Work Order No. 8-LS1512\E)

TO: Senator George Jacko

FROM: George Utermohle *GU*
Legislative Counsel

You have requested a sectional summary of CSSB 251(); An Act relating to the commercial fishing revolving loan fund and the fisheries enhancement revolving loan fund.

A sectional summary of a bill is not an authoritative interpretation of the bill. The bill itself is the best statement of its contents.

Section 1 of the bill amends AS 16.10.310(a) to authorize

- (1) loans to certain commercial fishermen to upgrade existing vessels and gear or to pay past due federal tax obligations that threaten the fisherman's interest in a limited entry permit;
- (2) refinancing of debts, not to exceed \$300,000, incurred to purchase a commercial fishing vessel or gear; and
- (3) the Department of Commerce and Economic Development to collect a refinancing loan origination charge.

Section 2 of the bill amends AS 16.10.320(d) to provide that the total amount outstanding on all loans to a person may not exceed \$300,000, including amounts loaned to refinance debt.

Section 3 of the bill provides that money in the commercial fishing revolving loan fund that is excess to the needs of the commercial fishing loan program may be used for the fisheries enhancement loan program.

Senator George Jacko
February 9, 1994
Page 2

Section 4 of the bill makes a technical amendment to AS 16.10.505(a) to conform to sec. 5 of the bill.

Section 5 of the bill provides that money in the fisheries enhancement revolving loan fund that is excess to the needs of the fisheries enhancement loan program may be used for the commercial fishing loan program.

If I may be of further assistance, please advise.

GU:mi
94-029.mai

State should aid salmon industry

2/7/94 EMPIRE

Falling prices create a crisis

The following editorial appeared recently in the Ketchikan Daily News:

Teamwork and diversity, that's what it is all about. The Alaska fishing industry is in a crisis. Salmon prices continue to plummet as worldwide competition increases.

Fishermen can catch all the fish they want, processors can package it, but if there isn't a market for it, the resource doesn't do us much good.

Alaska is being pushed aside in the Japanese market by increased production from other countries. But there is another opportunity here in the United States. If we don't continue building on our domestic marketing program, Alaska will lose that opportunity to foreign companies.

Reports are that Chilean farmed salmon are being sold in Florida for \$1.80 a pound. Alaska needs to move fast to target the basically untouched domestic market.

Chicken, beef and pork are staples in most U.S. households. It's time salmon and other seafood be included in the weekly dinner menus. But the average consumer doesn't know how to fix salmon. We need to educate consumers, and we need to convince traders about the benefit of seafood.

Most of all, we need to diversify.

Salmon can be fixed in a variety of dishes. There has been some experimental work done in Alaska to develop value-added products, such as microwave menus. But there needs to be more work.

Convenience is what will attract U.S. consumers to buy salmon. To expand the marketplace, there has to be cohesiveness and not divisiveness in the industry. There has been some movement by Southeast fishing gear groups to come together. We hope that continues to build. We hope strong relationships are fostered statewide to give strength to the entire industry.

The industry also needs to form a group devoted to developing ways to break into the domestic market.

Other industries have taken such steps and have been successful. Turkey, for instance, is now a year-round food product.

It is encouraging that money for domestic marketing will quadruple this fiscal year from the new 1 percent tax paid by salmon fishermen. About \$4 million will be available for such marketing. That's a start. But more money will be needed to do the job.

The Washington apple industry, for instance, spent approximately \$7 million on a promotion touting its fruit. An "Eat Beef" promotion cost about \$27 million.

But to be successful, it isn't all up to industry. The state needs to support the industry. Our state is fortunate to have such a viable resource. But there needs to be more research and more development.

Our policy makers need to realize that the fishing industry is in a crisis. Some progress is being made, but at a snail's pace. Let's make this industry a priority before we lose the one untapped market we could make successful here in the U.S.A. We can no longer depend on the old ways of relying solely on the Japanese market.

We need to look at new, innovative ideas. For that to happen, the industry and state need to work together. This resource is too precious to waste.

JUNEAU EMPIRE

JUNEAU EMPIRE ARTICLE

LOAN PROGRAMS CASH FLOW ANALYSIS (shown in thousands)

PROGRAM	6/30/83 Balance (Act)	FY 83 Income (Act)	FY 83 Oper/ Debt/ Oth (Act)	FY 83 Loans Issued (Act)	FY 83 Trs to GF	6/30/83 Balance (Act)	FY 84 Income (Proj)	FY 84 Oper/ Debt/ Oth (Proj)	FY 84 Loan Demand (Proj)	FY 84 Trs to GF	6/30/84 Balance (Proj)	FY 85 Income (Proj)	FY 85 Oper/ Debt/ Oth (Proj)	FY 85 Loan Demand (Proj)	6/30/85 Balance (Proj)	FY 85 trs from Loans to GF	FY 85 General Fund Request	FY 85 Other Funds Request	FY 85 Gov
Postsecondary Education																			
Student Loan Program	15,200.0	105,874.3	38,878.8	55,500.0	0.0	25,887.7	102,040.5	40,837.8	58,650.0	0.0	28,250.8	95,200.0	41,621.4	60,000.0	21,828.2	0.0	0.0	0.0	0.0
Commerce and Economic Development																			
<i>Active Loan Funds</i>																			
Small Business	148.3	480.3	0.0	508.2	0.0	100.4	228.2	0.0	328.8	0.0	0.0	81.2	0.0	81.2	0.0				
Commercial Fishing	12,183.4	18,982.2	1,380.8	10,213.6	1,238.1	18,313.0	15,489.3	1,655.9	14,000.0	1,891.7	18,134.7	14,771.9	1,860.0	14,000.0	15,048.8	0.0	(2) 0.0	-8,934.8	-8,934.8
Fisheries Enhancement	1,270.3	8,143.2	287.3	8,372.4	0.0	743.8	4,714.8	251.8	5,208.4	0.0	0.1	11,424.7	281.8	11,183.0	0.0	0.0	0.0	8,934.8	8,934.8
<i>Inactive Loan Funds*</i>																			
WW Veterans*						0.0	347.6	307.3	0.0	40.3	0.0	295.5	292.3	0.0	3.2	3.2	0.0	0.0	
Small Business*						0.0	79.2	78.9	0.0	0.3	0.0	27.8	27.6	0.0	0.2	0.2	0.0	0.0	
Child Care*						0.0	110.2	25.7	0.0	84.5	0.0	92.8	17.6	0.0	75.3	75.3	0.0	0.0	
Tourism* (1)						0.0					0.0				0.0	0.0	0.0	0.0	
Historical District*						0.0	86.7	7.0	0.0	79.7	0.0	82.1	3.0	0.0	79.1	79.1	0.0	0.0	
Alt. Tech. & Energy*						0.0	920.4	347.3	0.0	573.1	0.0	782.3	301.0	0.0	481.3	481.3	0.0	0.0	
Res. Energy Conservation*						0.0	208.4	207.5	0.0	0.9	0.0	83.3	33.6	0.0	49.7	49.7	0.0	0.0	
Mining*						0.0	572.7	202.8	0.0	369.9	0.0	487.5	178.1	0.0	309.4	309.4	0.0	0.0	
Water Resources*						0.0	75.0	0.0	0.0	75.0	0.0	75.0	0.0	0.0	75.0	75.0	0.0	0.0	
Subtotal inactive loans						0.0	2,400.2	1,176.5	0.0	1,223.7	0.0	1,926.4	853.2	0.0	1,073.2	1,073.2			
Community and Regional Affairs																			
Bulk Fuel	1,588.7	1,845.8	77.5	1,802.7	0.0	1,555.3	1,800.0	72.5	1,800.0	0.0	1,282.8	1,850.0	0.0	2,200.0	732.8	0.0	0.0	0.0	0.0
Power Development						0.0					0.0				0.0				
Power Project	838.9	1,041.3	12.4	250.0	891.3	727.5	58,783.8	23.0	13,463.2	0.0	46,034.9	5,400.0	0.0	51,434.9	0.0	0.0	(3) 0.0	4,400.0	2,140.0
Rural Electrification	388.9	101.3	12.8	0.0	0.0	477.8	83.9	3.2	337.8	200.5	0.0	65.0	0.0	0.0	65.0	65.0	0.0	0.0	0.0
Rural Development Init.	0.0	500.5	28.0	112.2	0.0	380.3	744.4	70.0	787.3	0.0	247.4	183.2	95.4	315.2	0.0	0.0	0.0	0.0	0.0
Natural Resources																			
Agriculture	8,789.4	2,849.0	1,121.2	1,911.7	0.0	8,415.5	2,800.0	1,385.0	2,000.0	0.0	5,630.5	2,820.0	1,389.2	5,535.0	3,528.3	0.0	0.0	0.0	0.0
Environmental Conservation																			
Alaska Clean Water	9,971.0	2,870.8	88.1	292.4	0.0	12,481.3	4,000.0	127.7	4,000.0	0.0	12,333.8	4,894.4	149.8	5,850.2	11,328.0	0.0	0.0	0.0	0.0
TOTAL	48,370.9	142,048.7	42,674.8	78,783.2	2,129.4	88,852.4	185,052.9	48,779.8	100,571.3	4,839.8	108,914.8	140,423.2	47,084.0	148,578.5	54,874.3	2,211.4	0.0	4,400.0	2,140.0

* 6/30 year end balance is automatically transferred to General Fund for revenue in next fiscal year

LOAN PROGRAMS CASH FLOW ANALYSIS - FY 95 BUDGET PREPARATION

PROGRAM	8/30/82	FY 93	FY 93 Oper/			8/30/83	FY 94	FY 94 Oper/	FY 94 Loan		8/30/84	FY 95	FY 95 Oper/	FY 95 Loan	8/30/95	FY 95 Trs	FY 95	FY 95	
	Balance (Act)	Income (Act)	Debt/ Oth (Act)	FY 93 Loans Issued (Act)	FY 93 Trs to GF	Balance (Act)	Income (Proj)	Debt/ Oth (Proj)	Demand (Proj)	FY 94 Trs to GF	Balance (Proj)	Income (Proj)	Debt/ Oth (Proj)	Demand (Proj)	Balance (Proj)	Loans to GF	General Fund Request	Other Funds Request	FY 95 Gov
Postsecondary Education																			
Student Loan Program	15,200.0	106,074.3	39,076.8	55,600.0	0.0	25,897.7	102,040.6	40,837.8	58,850.0	0.0	28,250.8	05,200.0	41,821.4	80,000.0	21,828.2	0.0	0.0	0.0	0.0
Commerce and Economic Development																			
<i>Active Loan Funds</i>																			
Small Business	148.3	480.3	0.0	508.2	0.0	100.4	228.2	0.0	328.8	0.0	0.0	81.2	0.0	81.2	0.0				
Commercial Fishing	12,103.4	19,982.2	1,300.8	10,213.8	1,238.1	18,313.0	15,469.3	1,655.8	14,000.0	1,991.7	18,134.7	14,771.9	1,860.0	14,000.0	15,048.6	3) 0.0	0.0	-9,934.9	-9,934.9
Fisheries Enhancement	1,270.3	8,143.2	297.3	8,372.4	0.0	743.8	4,714.8	261.9	6,208.4	0.0	(1) 0.1	11,424.7	281.8	11,183.0	0.0	0.0	(2) 0.0	9,934.0	9,934.0
<i>Inactive Loan Funds*</i>																			
WW Veterans*						0.0	347.6	307.3	0.0	40.3	0.0	285.5	282.3	0.0	3.2	3.2	0.0	0.0	
Small Business*						0.0	79.2	78.9	0.0	0.3	0.0	27.8	27.6	0.0	0.2	0.2	0.0	0.0	
Child Care*						0.0	110.2	25.7	0.0	84.5	0.0	92.8	17.6	0.0	75.3	75.3	0.0	0.0	
Tourism* (6)						0.0					0.0				0.0				
Historical District*						0.0	86.7	7.0	0.0	79.7	0.0	82.1	3.0	0.0	79.1	79.1	0.0	0.0	
Alt. Tech. & Energy*						0.0	820.4	347.3	0.0	573.1	0.0	782.3	301.0	0.0	481.3	481.3	0.0	0.0	
Res. Energy Conservation*						0.0	208.4	207.5	0.0	0.9	0.0	83.3	33.6	0.0	49.7	49.7	0.0	0.0	
Mining*						0.0	572.7	202.8	0.0	369.9	0.0	487.5	178.1	0.0	309.4	309.4	0.0	0.0	
Water Resources*						0.0	75.0	0.0	0.0	75.0	0.0	75.0	0.0	0.0	75.0	75.0	0.0	0.0	
Subtotal inactive loans						0.0	2,400.2	1,176.5	0.0	1,223.7	0.0	1,826.4	853.2	0.0	1,073.2	1,073.2			
Community and Regional Affairs																			
Bulk Fuel	1,588.7	1,845.8	77.6	1,802.7	0.0	1,556.3	1,800.0	72.6	1,800.0	0.0	1,282.8	1,850.0	0.0	2,200.0	732.8	0.0	0.0	0.0	0.0
Power Development						0.0					0.0				0.0				
Power Project	838.8	1,041.3	12.4	250.0	891.3	727.5	58,793.8	23.0	13,483.2	0.0	48,034.8	5,400.0	0.0	51,434.8	0.0	0.0	0.0	7,400.0	2,140.0
Rural Electrification	388.8	101.3	12.9	0.0	0.0	477.8	83.8	3.2	337.8	200.5	0.0	86.0	0.0	0.0	86.0	86.0	0.0	0.0	0.0
Rural Development Init.	0.0	600.6	28.0	112.2	0.0	380.3	744.4	70.0	787.3	0.0	247.4	183.2	85.4	315.2	0.0	0.0	0.0	0.0	0.0
Natural Resources																			
Agriculture	0,788.4	2,848.0	1,121.2	1,811.7	0.0	8,415.5	2,890.0	1,385.0	2,000.0	0.0	5,830.5	2,820.0	1,389.2	4) 3,635.0	3,628.3	0.0	0.0	0.0	0.0
Environmental Conservation																			
Alaska Clean Water	9,971.0	2,870.8	88.1	292.4	0.0	12,481.3	4,000.0	127.7	4,000.0	0.0	12,333.8	4,904.4	149.0	5,850.2	11,328.0	0.0	5) 0.0	0.0	0.0
TOTAL	48,370.0	142,048.7	42,074.6	78,783.2	2,128.4	88,852.4	195,052.9	48,779.8	100,571.3	4,039.8	109,814.8	140,423.2	47,084.0	148,578.5	54,874.3	2,211.4	0.0	4,400.0	2,140.0

* 8/30 year end balance is automatically transferred to General Fund for revenue in next fiscal year

SENATE COMMITTEE REPORT

DATE: 1/14/94

FURTHER: FINANCE

Date of 5-Day Notice: 2/3/94
(in accordance with Uniform Rule 23)

DATE TURNED INTO OFFICE: 2/16/94

L&C Committee considered SB 251

"An Act relating to the commercial fishing revolving loan fund and the fisheries enhancement revolving loan fund."

and recommends:

replace with _____ CS SB 251 (L&C) same title
 adopt previous _____ CS _____ new title
 attaches amendment(s) technical title change (HB only)

adopts _____ Letter of Intent

further referral to the _____

do pass

do not pass

no recommendation

individual recommendations

NEW FISCAL NOTES

Department Date Zero Fiscal

SB & CS

Department	Date	Zero	Fiscal
DCED	2/8/94	<input checked="" type="checkbox"/>	

PREVIOUS FISCAL NOTES

Department Date Zero Fiscal

Department	Date	Zero	Fiscal

Appropriation No Fiscal Note

DO PASS:

OTHER RECOMMENDATIONS:

Tom Kelly - No Rec
 Chair: Signature and Recommendation

FISCAL NOTE

STATE OF ALASKA
1994 LEGISLATIVE SESSION

BILL NO. SB 251

Revision Date: February 8, 1994
Title: An Act Relating to the Commercial Fishing and Fisheries Enhancement Loan Funds
Sponsor: Senator Jacko
Requestor: Senate Labor and Commerce

Department Affected: Commerce and Economic Development
BRU: Investments
Component: _____
COMPONENT SERIAL NO. 0384

Expenditures/Revenues:

OPERATING EXPENDITURES	FY 95	FY 96	FY 97	FY 98	FY 99	FY 00
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0

CAPITAL EXPENDITURES	0	0	0	0	0	0
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CHANGE IN REVENUES ()	0	0	0	0	0	0
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FUND SOURCE

1002 Federal Receipts	0	0	0	0	0	0
1003 GF Match	0	0	0	0	0	0
1004 GF	0	0	0	0	0	0
1005 GF/Program Receipts	0	0	0	0	0	0
1006 GF/MHTIA	0	0	0	0	0	0
Other	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

Estimate of current year (FY 94) cost: \$ 0

POSITIONS

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary.)

The Department is confident that they will be able to adequately handle loan requests generated as a result of this legislation with existing staff. This legislation will expand the loan demand for the Commercial Fishing Revolving Loan Fund. We are unable, at this time, to forecast the exact amount of this increase, but estimate it to be several million dollars.

Prepared by: Martin J. Richard
Division: Investments

Phone: (907) 465-2510
Date: 2/8/94

Approved by Commissioner: Paul Fuhs
Agency: Commerce and Economic Development

Date: 2-9-94

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Office

FISCAL NOTE