

ALASKA LEGISLATURE COMMITTEE FILES 1993-1994 8672

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8418 SENATE LABOR & COMMERCE



# RECORDS



# CERTIFICATION

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Signature of Camera Operator

11/6/97  
Date

**SR**

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# Alaska Tourism Marketing Council

## Organization

The Alaska Tourism Marketing Council was created by the Alaska Legislature in 1988 as a joint venture between the State of Alaska and the visitor industry. This truly unique melding of public and private expertise and funding is challenged with keeping Alaska a top contender in the highly competitive, worldwide tourism marketplace.

The ATMC is a public corporation mutually managed through a contract between the Alaska Department of Commerce and Economic Development and the Alaska Visitors Association.

The 21-member council is comprised of 10 directors appointed by the Governor, 10 directors appointed by AVA, and the Director of the Alaska Division of Tourism as an automatic appointment. The council works through a strong committee structure with each director serving on at least one of the following committees: fall/winter/spring promotion; collateral; public relations; research; advertising and planning.

The primary objective of the ATMC is to encourage expansion and growth of the state's visitor industry. It is also charged with ensuring the economic benefits derived from the industry remain in Alaska and that a maximum number of Alaska residents are employed in industry businesses. The council promotes cooperation between state and private sectors in developing visitor marketing campaigns and visitor industry facilities, both in the public and private domain, to ensure the visitor experience is, and continues to be, positive.

## Funding

The council's operating budget is determined by a yearly appropriation from the State Legislature, plus funds from the private industry. The industry is responsible for no less than a 15% cash matching contribution, and must also share a portion of production costs for the Official State Vacation Planner. The sale of vacation planner advertisements, direct mailing labels and stock film footage to industry businesses is administered by the Alaska Visitors Association to generate the private sector's matching contribution.

## Cooperative Marketing Program

The ATMC achieves its promotional objectives through an integrated marketing program directed at domestic and Canadian markets with the greatest potential for producing new and repeat visitors. Components of the program developed by the ATMC include:

- \* The Official State Vacation Planner distributed to more than 500,000 potential visitors;
- \* Domestic and Canadian magazine advertising, targeting adventure and outdoor travelers;
- \* National television image advertising;
- \* National public relations efforts;
- \* Direct mail advertising campaigns;
- \* Special Alaska newspaper sections in major U.S. markets;
- \* Winter campaign promoting "off-season" travel to Alaska.

Through extensive market research, analysis of conversion rates and visitor spending habits, the cooperative marketing effort has resulted in award-winning marketing campaigns and unprecedented growth in Alaska's visitor industry.

## Benefits of Cooperative Marketing

As a comprehensive travel guide created and designed specifically for people who have already indicated a strong interest in an Alaska vacation, the Vacation Planner represents an extraordinarily affordable and effective vehicle for all tourism-related businesses.

For the nominal cost of a narrative advertisement, businesses can reach hundreds of thousands of potential customers through distribution of the planner via direct mail, at trade shows and travel events, and to 50,000 travel

agents around the nation. Moreover, display advertising in the planner offers unparalleled exposure for Alaska tourism businesses.

In addition to offering advertisement, the Cooperative Marketing Program gives industry businesses the option to develop their own customized direct mail marketing campaign through the sale of labels. Using a list generated from requests for the Vacation Planner, this program is capable of sorting names and addresses of more than 450,000 potential visitors based on a variety of demographic data. The labels program offers virtually all industry businesses a highly cost effective promotional avenue to reach an extremely targeted market base.

## Alaska Division of Tourism

The Alaska Division of Tourism is a division of the Department of Commerce and Economic Development. The DOT Director serves as an automatic appointment to the Alaska Tourism Marketing Council, and has a standing seat on the Alaska Visitors Association's Board of Advisors.

The DOT maintains a variety of promotional projects and programs that compliment the efforts of ATMC and AVA to serve the visitor and encourage business development.

### Tourism Marketing

On the international scene, the DOT promotes Alaska, focusing primarily in Japan and the German-speaking countries of Europe. With tourism offices in both Japan and Germany, this promotion includes consumer advertising, travel trade show exhibits, travel writers/tour wholesaler familiarization tours, and production of foreign language collateral.

On the domestic front, the DOT engages in activities, both independent of and in cooperation with the ATMC, to promote Alaska in the Lower 48. Among those activities is an extensive visitor research program used by the division, ATMC, community organizations and private business to guide marketing efforts. In addition, the division directly mails destination information to travel agencies nationwide, and responds to over 131,000 telephone and mail request. for information from potential visitors.

### Visitor Services

The DOT participates with state and federal agencies in operating Alaska Public Land Information Centers in Anchorage and Fairbanks, and fully funds and operates the Tok Visitors Center as an APLIC. The DOT also prints and distributes informational brochures and maps for Alaska trip planning.

### Business Development and Assistance

The DOT provides technical assistance to communities developing visitor attractions and private businesses initiating or expanding their product. As part of that effort, the division is spearheading development of the AlaskaHost customer service training program offered to tourism businesses statewide. In addition, the division's Alaska Film Office promotes Alaska as a motion picture and television production location.

### Product Analysis

DOT participates in feasibility analysis and design of new in-state visitor attractions, and works cooperatively to promote creation of new direct passenger air routes from overseas.

# COOPERATIVE MARKETING

## The Alaska Cooperative Marketing Program

The Cooperative Marketing Program is a unique joint venture between the state and private industry to bring visitors to Alaska. The Alaska Visitors Association, representing private industry, contracts with the State of Alaska to jointly manage the Alaska Tourism Marketing Council which executes the marketing program.

### AVA

The Alaska Visitors Association is a statewide, non-profit trade association representing more than 700 Alaska businesses. With a charter of promoting travel to and within Alaska, the association provides a unified voice for the visitor industry, lobbies the legislature to encourage funding and support of tourism issues and provides a matching contribution to state tourism funds. This match is generated by ad and mailing label revenues from the Official Alaska State Vacation Planner. The association has four primary goals for the coming year:

- Increase the number of visitors to Alaska
- Increase the state funding for tourism promotion
- Educate the visitor industry on important tourism issues
- Encourage and support AVA member businesses

### ATMC

The Alaska Tourism Marketing Council is a public corporation jointly managed by AVA and the Alaska State Department of Commerce and Economic Development. It is charged with development and execution of Alaska's domestic and Canadian marketing program. ATMC promotes Alaska as a world-class visitor destination through marketing, advertising and public relations. A yearly appropriation from the legislature and a 15 percent matching contribution from the AVA gives the council its operating capital. The 21-member council is comprised of 10 governor-appointed members, 10 AVA-appointed members and the Director of the Division of Tourism.

### DOT

The goal of the state Division of Tourism is to foster the growth of tourism in Alaska. The division follows up on more than 50,000 separate requests for information and represents Alaska at consumer and trade shows throughout the nation. The DOT is responsible for developing international markets, developing research data, providing assistance to tourism businesses and overseeing grant programs. The division also promotes Alaska as a filming location to the movie industry.

ATMC



AVA

DOT

## Cooperative Marketing Components

Alaska's Cooperative Marketing Program is a national program promoting Alaska as a visitor destination. The components of the program, which are developed by the ATMC, include:

- The Vacation Planner, sent to more than 700,000 potential visitors
- Domestic & Canadian magazine advertising, targeting adventure/outdoor travelers
- National television image advertising
- National public relations effort
- Direct mail advertising campaign
- Special "Alaska" newspaper sections in major U.S. markets
- Fall/Winter/Spring campaign promoting "off-season" Alaska

# PUBLIC ATTITUDES

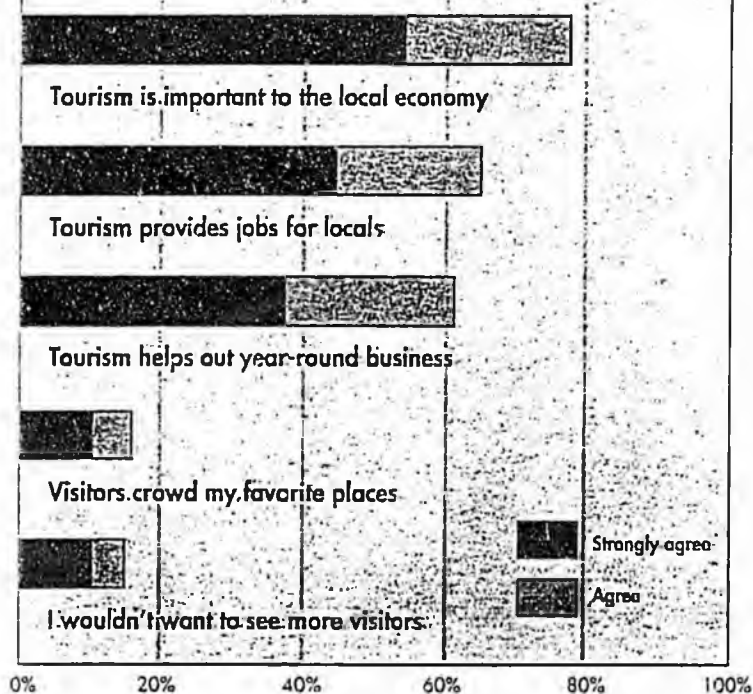
The Alaska Visitors Association (AVA) contracted with Craciun & Associates to conduct a statewide public opinion survey on tourism. The main purpose of the survey was to understand Alaskan residents' experiences and perceptions of the role the tourism industry plays in diversifying the State's economy.

The statewide public opinion survey on tourism was conducted with several objectives in mind:

- gather data on Alaskan views of the tourism industry;
- identify the current image and perception of tourism specifically, and in relationship to other industries (i.e. mining, fishing, timber, oil and government);
- explore attitudes regarding the future economic impact of tourism; and
- track public opinion so that policy makers and businesses can better monitor the growth and development of tourism in the State of Alaska.

## A Survey of Public Attitudes Toward Tourism in Alaska

Conducted by Craciun & Associates July 1991



## Key Findings

If State revenue from oil declines, four out of five Alaska residents, 79.6% of Alaskans surveyed, believe tourism and fishing will be critical for a healthy state economy.

When attention is turned to their local area, seven out of ten Alaskans feel tourism is essential to the local economy. This was especially true for Anchorage, Kenai, Kodiak, Fairbanks, and southeast Alaska. Demographically, more women saw tourism as important to the economy of the area than did men (81% to 63%, respectively). By the same token, a respondent's age and length of residence in Alaska had no bearing on their opinions about the importance of tourism to the local economy.

Half of the respondents either worked or knew someone who worked in a tourism-related industry.

In a series of questions designed to assess underlying values and beliefs about tourism and its effect on the quality of life in Alaska, the public response to arguments for and against tourism revealed a resounding positive experience toward tourism, both economically and personally.

More than three quarters (78%) AGREE with the statement, "Tourism is important to my local economy." When residents were queried about the potential encroachment of tourists, 74% DISAGREE that "I wouldn't want to see any more visitors in my area than there are now." Clearly two-thirds (66%) held strong beliefs that tourists, in fact, provided jobs for locals and helped out year-round local businesses (62%).

A comparison of a similar lifestyle question from a 1989 study on tourism found 24% of Anchorage residents AGREEING with the statement "Tourists crowd all the good places in Anchorage in the summer." In the current study, only 15% of Anchorage residents AGREE that "visitors make it difficult for me to go to my favorite places."

Finally, the study looked at the public sentiment regarding State spending on advertising and promotion. Nearly one-third thought the State should SPEND MORE, (a rare statement of support at a time of increasing cuts in government spending) no doubt to fulfill their hopes of tourism dollars replacing declining oil revenues.

## **The visitor business is Alaska's #1 growth industry.**

### **Specifically, the visitor industry:**

- ☞ Has the highest percentage of Alaska resident hire of all basic industry sectors, with an 84% local Alaska hire rate;
- ☞ Is the second largest private sector employer in Alaska, surpassed only by the seafood industry. The industry employs 18,800 during the peak season and 13,500 people year-round;
- ☞ Affects the employment of more than 52,000 other people in the transportation, retail or service sectors. And, it would most likely account for another 8,000 primary jobs if travel by Alaskans within Alaska had been calculated;
- ☞ Employs the most people in Southcentral (7,256 jobs with a peak season total of 9,578). Southeast accounts for the second highest employment (2,598 with a peak season total of 3,949) and the Interior/Far North employment ranks third (2,038 jobs with 2,975 during peak season);
- ☞ Generates \$244 million in annual payroll (based on 1990 employment data);
- ☞ Generates \$1.1 billion in revenues and spends an estimated \$590 million on inventory, advertising, marketing and labor. An additional \$260 million is paid out in taxes and other business-related expenses;
- ☞ Spends the most in Southcentral (\$168 million in 1990), second highest amount in Southeast (\$56 million), third highest in Interior/Far North (\$52 million) and \$9 million in Southwest Alaska; and,
- ☞ Invests heavily in Alaska. Investments in Alaska are estimated to be \$448 million in property and operating equipment. The industry investment in Alaska is expected to top half a billion dollars within the next few years.

### **Tourism brings \$1.1 billion in revenues to Alaska.**

Between 1989 and 1990, visitor businesses generated \$1.1 billion in revenues. Of this, approximately \$822 million represented business spending, with the remaining \$260 million going for taxes, payment to capital, and profits to business owners.

The total investment in Alaska's visitor industry is estimated at \$448 million, not including an estimated \$2 billion or more in cruiseship investments.

### **Tourism is a statewide industry.**

In all of Alaska's regional economies, the tourism industry is a leading industry in the private sector. In the Southcentral and Interior/North regions, it ranks second, and in Southeast it ranks third. It is a growing factor in the Southwest and Arctic Alaska economies.

**As the fastest growing industry in Alaska, tourism's future promise is a long range economic force offering year-round employment to thousands of residents.**

# Total Revenues to the State of Alaska from the Visitor Industry

As the following table illustrates, a total of over \$30 million attributable to the visitor industry flows into the state's general fund each year. The Alaska Marine Highway System, Department of Fish and Game, and corporate income taxes are the largest sources.

In addition, the Alaska Railroad and International Airport System also receive a significant amount of revenue attributable to the visitor industry. Although these are state operations, their finances are largely independent, and their revenues do not flow into the state general fund. Both of these revenue sources are included under "revenues to other state entities" in the adjoining table. Together, they received close to \$21 million in revenues attributable to the visitor industry.

The figures included in this table represent a *minimum* level of revenues to the state from the visitor industry. There are certainly additional sources of revenue to the state from the visitor industry that could not be quantified here (for example, rental car registration fees).

Despite these limitations, the data presented captures the most significant visitor industry sources of revenue to the state. The figures presented are based on hard data gathered from a variety of sources. Where necessary, conservative estimates were made. The result is a defensible, detailed estimate of the contribution of the visitor industry to state general fund revenues.

## Revenues to the General Fund

### Non-resident Visitor Spending

State Parks, FY91	
<i>Camping Permits, Historical Guided Tours, Other</i>	\$ 273,000
Department of Fish and Game, CY91	
<i>Non-resident and Alien Tags and Permits</i>	\$ 7,607,000
Alaska Marine Highway System, AVSP89-90	
<i>Non-resident Spending on Ferry Transportation</i>	\$ 14,900,000
Gasoline Taxes Paid by Visitors, AVSP89-90	\$ 517,000
State and University Museums, FY91	
<i>Non-resident Visitor Admission Fees</i>	\$ 240,000

### Taxes and Fees from Visitor Industry Businesses

Department of Motor Vehicles Fees, Cy90	
<i>Tour Bus Vehicle Registration Fees</i>	\$ 43,000
Corporate Income Tax, FY91	\$ 4,169,000
Business License Fees, FY91	\$ 125,000
Aviation Fuel Taxes, FY90	\$ 2,000,000
Tour Bus Fuel Tax, CY91	\$ 41,000

### Agencies Promoting the Visitor Industry

Alaska Division of Tourism, FY91	
<i>Program Receipts and Grants</i>	\$ 1,269,000

**Subtotal: Revenues to the General Fund**      **\$ 31,184,000**

## Revenues to Other State Entities

Alaska Railroad, CY91	
<i>Pull Revenues, Specials, and</i>	
<i>Estimated Non-resident ticket Receipts</i>	\$ 7,400,000
Alaska International Airport System, FY91	\$ 13,385,000

**Subtotal: Revenues to Other State Entities**      **\$ 20,785,000**

**Grand Total**      **\$ 51,969,000**

\* (Direct Revenues to the State of Alaska from the Visitor Industry, McDowell Group, May 1992)

STATEMENT OF  
SEN. JAY KERTTULA

On

Senate Resolution No. 3

Supporting the Alaska Tourism Marketing Council  
Before the Senate Labor and Commerce Committee

Sen. Tim Kelly, Chairman

Thursday, March 3, 1994

Good afternoon. For the Committee record, my name is Sen. Jay Kerttula, I am the sponsor of Senate Resolution 3, which calls on the Alaska State Senate to support the Alaska Tourism Marketing Council and full funding of the state's share the Council's budget.

I would like to begin by thanking the Committee Chairman, Sen. Tim Kelly, and Committee members for scheduling SR 3 for this hearing today.

Since its creation by the Alaska Legislature in 1988, the Alaska Tourism Marketing Council has made tourism the state's number one growth industry. As a unique partnership of the state's public and private sectors,

SR 3, Sponsor Statement, Page 2

the Council advertizes and markets Alaska nationwide as a tourist destination. This marketing program helps Alaska's small and moderate tourism businesses as well as the large national and international firms by providing them with a broad customer base, bringing just under 900,000 visitors to the Last Frontier in fiscal year 1991.

As a result, Alaska's tourism industry now has the highest percentage -- 84 percent -- of resident hire of all our state's industry groups. With 13,500 year-round jobs, which grows to 18,800 jobs during the peak summer season, tourism is second only to the seafood industry as an employer. These jobs, in turn, affect 52,000 others in the state's transportation, retail or service industries. Intrastate tourism by Alaska residents, by the way, accounts for approximately 8,000 more jobs.

By region, the tourism industry employs between 7,200 and 9,500 people in Southcentral Alaska; 2,500 and 4,000 people in the Southeast, and between 2,000 and 3,000 people in Alaska's Interior and Far North regions.

According to 1990 employment data, Alaska tourism generates a \$244 million annual payroll; generates \$1.1 billion in revenues; spends an estimated \$590 million on inventory, advertising, marketing and labor; with an additional \$260 million paid out in taxes and other business-related expenses.

1990 tourism investments in Alaska in property and operating equipment are estimated to be \$448 million, and that figure is expected to exceed half a billion dollars in the next few years. Incidentally, that \$448 million figure does not include an estimated \$2 billion more in cruise ship investments.

Tourism figures from calendar year 1990 and fiscal year 1991 show that tourism contributed just under \$52 million to state government coffers in camping permits, park fees, fishing and hunting licenses, fuel taxes, university and state museum fees, corporate and other business taxes, through the Alaska Railroad Corporation and the state's International Airport system.

SR 3, Sponsor Statement, Page 4

Mr. Chairman and Committee Members, as these figures demonstrate, the Alaska Tourism Marketing Council is not only one of the most successful program created by the Alaska Legislature -- it is one of the few that contributes heavily to our local and state economies, and pays money back into state coffers like the General Fund.

Cutting the state's contribution to the Alaska Tourism Marketing Council may be penny-wise but it is dollar-foolish. While such a cut won't hurt the big national and international tourism businesses all that much -- they will still be able to afford national advertising. Such a cut can be disastrous for our small and medium Alaskan-owned businesses, with concomittant consequences on local jobs and local economies.

I thank the Chairman and Committee Members for their time and consideration of this resolution, and respectfully ask them to move Senate Resolution 3 out of committee with do-pass recommendations.

FISCAL NOTE

STATE OF ALASKA  
1994 LEGISLATIVE SESSION

BILL NO. 13

Revision Date: 2/28/94  
Title: "Declaring support for the Alaska Tourism Marketing Council for full funding"  
Sponsor: Senator Kerttula  
Requestor: Senate Labor and Commerce

Department Affected: Commerce and Economic Development  
BRU: Alaska Tourism Marketing Council  
Component: \_\_\_\_\_  
COMPONENT SERIAL NO. \_\_\_\_\_

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
<b>TOTAL OPERATING</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

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
<b>TOTAL</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

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.)

Prepared by: Wendy Mulder  
Division: Commissioners office

Phone: 465-2500  
Date: 2/28/94

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

Date: 2-1-94

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Signature of Camera Operator

11/6/97  
Date

**SCR**

**12**



Official Business

# Alaska State Legislature

Al Adams  
District L

WHILE IN SESSION  
P.O. Box V  
State Capitol  
Juneau, Alaska 99811  
(907) 465-3707

OUT OF SESSION  
P.O. Box 333  
Kotzebue, Alaska 99752  
(907) 442-3245

3111 C Street  
Anchorage, Alaska 99503  
(907) 561-7622

January 24, 1994

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

FROM: Senator Al Adams *AAA*

RE: Waiving of SCR 12

Since I sent you the hearing request memo on the 18th of this month, there has been a new development. I am therefore now requesting that you waive SCR 12 from the Senate Labor and Commerce Committee. The next stop for this resolution is the Senate Finance Committee.

On Friday, January 21, the Legislative Budget and Audit Committee approved the attached motion which directs the Legislative Auditor to conduct a financial analysis of AHFC. As I understand it, an audit team is preparing to begin their review of AHFC this next week. (The review is likely take a minimum of one month.)

Thank you for your consideration of this request.

# Alaska State Legislature

Al Adams  
District L



Official Business

WHILE IN SESSION  
P.O. Box V  
State Capitol  
Juneau, Alaska 99811  
(907) 465-3707

OUT OF SESSION  
P.O. Box 333  
Kotzebue, Alaska 99752  
(907) 442-3245  
3111 C Street  
Anchorage, Alaska 99503  
(907) 561-7622

January 18, 1994

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

FROM: Senator Al Adams. *APA*

RE: Scheduling for a hearing SCR 12

I would appreciate it if you would schedule SCR 12, a resolution requesting the Governor to have prepared a report and recommendations concerning the disposition of certain assets of AHFC, at your earliest convenience.

The intent of this resolution is get an independent assessment of the reserves and other assets of AHFC that relate to the corporation's housing programs which benefit moderate income persons, to analyze whether or not these reserves could be sold or otherwise disposed of, and to get an estimate on the amount of money likely to be obtained from this type of action. I believe this information would be very useful to all of us in our deliberations on how to address the revenue shortfalls for both the FY 94 and FY 95 budgets.

A fiscal note and position paper were requested from the Office of the Governor. As soon as they are available, I will forward a copy to your office.

Thank you for your consideration of this request.

P.1  
1-21-94  
21A  
OF  
Motion  
Passed  
- E  
B-

MOTION FOR AHFC FINANCIAL REVIEW

I MOVE THAT THE COMMITTEE AUTHORIZE THE LEGISLATIVE AUDITOR TO CONDUCT A FINANCIAL ANALYSIS OF THE ALASKA HOUSING FINANCE CORPORATION. THE ANALYSIS SHOULD FOCUS ON THE RELATIONSHIP OF THE CORPORATION'S ASSETS TO ITS LIABILITIES AND THE RESTRICTIONS ON THOSE ASSETS. IT IS UNDERSTOOD THAT THIS ANALYSIS SHOULD BE GIVEN THE HIGHEST PRIORITY BY THE AUDITOR AND THAT HE SHOULD PERIODICALLY REPORT HIS FINDINGS TO THE COMMITTEE.

Post-It<sup>®</sup> brand fax transmittal memo 7671 # of pages 1

To <i>Terry</i>	From <i>Rutledge</i>
Co <i>do Sen.</i>	Co. <i>Sen. Fin</i>
Dept. <i>R. Phillips</i>	Phone #
Fax # <i>4979</i>	Fax # <i>2187</i>

STATE OF ALASKA

WALTER J. HICKEL, GOVERNOR

**DEPARTMENT OF REVENUE**

OFFICE OF THE COMMISSIONER

February 17, 1994

P.O. BOX 110400  
JUNEAU, ALASKA 99811-0400  
TELEPHONE: (907) 465-2300  
FACSIMILE: (907) 465-2389

The Honorable Al Adams  
Alaska State Legislature  
State Capitol, Rm. 417  
Juneau, AK 99801-1182

Dear Senator Adams:

Senate Concurrent Resolution No.12 (SCR 12) requests the Governor to have prepared by March 15 a report and recommendation concerning the disposition of certain assets of the Alaska Housing Finance Corporation (AHFC). The stated goal is to identify reserves and other assets of AHFC benefiting moderate income persons that could be available for deposit into the state's general fund.

Moderate income is not a term associated with most AHFC programs. The standard as determined by the US Department of Housing and Urban Development is 115% of median income. Enclosed is a letter to me dated February 4, 1994 from Will Gay, CEO/Executive Director of AHFC discussing his observations relating to SCR 12. Not mentioned in Mr. Gay's letter is the fact that many of AHFC programs generate income and other monies that are used to finance subsidized housing for weatherization and energy efficiency needs, low income programs, and rural housing needs.

The AHFC board has directed staff to retain an independent financial advisor to perform various tasks. This includes considering the issue of AHFC's resource levels and the ability to support expected program demand. This demand includes that of low income and rural housing needs. The first step in the process involves a planning effort to focus on AHFC's mission and alternatives to accomplish the mission. The assessment of program needs and the means of accomplishing the needs needs to take into consideration currently available resources. The process is important and will be time consuming for staff, financial advisor, and the board. We anticipate the procurement, planning, performance and review process to extend beyond this year's legislative session. Your understanding in this matter will be appreciated.

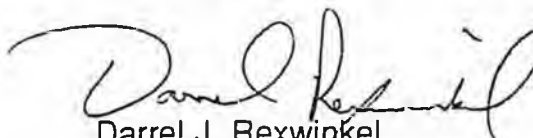
DEPT. OF REVENUE &  
AHFC'S LETTER

The Honorable Al Adams  
February 17, 1994  
Page Two

In the interim, Legislative Budget & Audit commenced an audit of AHFC and my understanding is their focus will primarily be the subject of SCR 12.

Please let me know if you have any questions, or if I can be of further help.

Sincerely,



Darrel J. Rexwinkel  
Commissioner

DJR:ml  
94-026  
Enclosure

cc: Senator Tim Kelly, Chairman ✓  
Labor & Commerce Committee

Raga Elim  
Legislative Liaison

Will Gay, Executive Director  
AHFC

AHFC Board Members



ALASKA HOUSING FINANCE CORPORATION

FEB 10 1994

COMMISSIONER'S OFFICE

520 East 34th Avenue  
Anchorage, AK 99503-4199  
(907) 561-1900

P.O. Box 101020  
Anchorage, AK 99510-1020

February 4, 1994

Darrel J. Rexwinkel  
Commissioner  
P.O. Box 110400  
Juneau AK 99811-0400

Dear Commissioner Rexwinkel:

Thank you for the opportunity to respond to Senate Concurrent Resolution No. 12 with respect to disposition of certain assets of the Alaska Housing Finance Corporation (AHFC) introduced by Senator Adams. The following are some specific observations and recommendations regarding the details of the proposed resolution:

1. The resolution does not identify programs considered for "moderate income." Many of the Corporation's programs provide benefits without consideration to the applicant's income level. It is unclear how the commitment of resources for programs where only some of the participants are of "moderate income" should be handled. Is the request specific to the Special Mortgage Loan Purchase Program that was available, until recently, without regard to the borrowers income level? Does it include the small community programs and veteran's mortgage programs where no income restrictions apply? Is the Corporation's Senior Housing Program considered "moderate income"?
2. What is the definition of "moderate income"? The standard is 115% of median income determined by the United States Department of Housing and Urban Development.
3. The request is to identify assets "related to" moderate income programs. The Corporation has not allocated available resources by program. The only dedication is through revolving funds established pursuant to Statutory requirements and the pledging of specific assets to debt.
4. The resolution requests a report on assets and other resources "related to" moderate income programs. Assets pledged to outstanding debt obligations should be excluded. This will prevent the contractor from reviewing and valuing assets that are not available.
5. The resolution does not detail the method by which the identified resources would be "made available for deposit into the general fund." The transfer method could influence the amount.
6. If the transfer method is via appropriation, the resolution should address the question of appropriating AHFC assets to the general fund, including potential implications. The issues need to be resolved to prevent the State's budget from including revenues which may ultimately be unavailable.

Commissioner Rexwinkel  
February 4, 1994  
Page 2

7. The resolution mentions only assets. Since this resolution will be of interest to credit participants, it should recognize the Corporation's substantial outstanding debt.

A write-up titled "State Housing Finance Agency G.O. Debt Criteria" in the January 17, 1994 edition of Standard & Poor's Creditweek Municipal included the following:

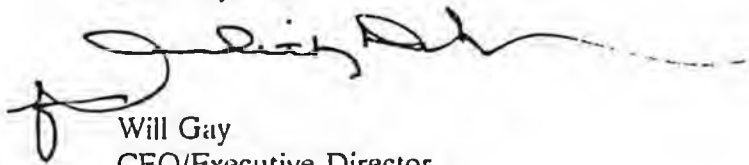
The importance a state government places on housing - both homeownership and rental - can be a significant rating factor. S&P needs to be assured that the long-term viability of the agency has the full support of the governor and state legislature. S&P looks for security of agency fund balances and continued management autonomy...The agency also should anticipate the housing needs of the legislature's constituents and continue to develop programs to address them.

The Corporation provides tremendous value to residents of this State. Alaska Housing Finance Corporation was the first state housing agency to earn ratings based solely on its general obligation - ratings that are now equivalent to that of the State of Alaska. These ratings help lower borrowing costs and allow significant program flexibility. A summary of recent accomplishments of AHFC is attached, the most significant of which is the Streamlined Refinance Program. As a result of the July 1, 1992 consolidation of housing and energy functions, and AHFC's widespread acceptance in the credit markets, this program was extended to individuals with loans originated under the DC&RA Rural Loan Program. Almost 10,000 loans have been approved for refinance under this program, lowering mortgage payments for Alaskan homeowners by approximately \$30,000,000 each year.

The Alaska Housing Finance Corporation is committed to serving the housing needs of the citizens of Alaska as authorized under our statutes. AHFC continues to be a valuable resource to the residents of the State. The critical relationships AHFC has with the credit markets and the United States Department of Housing and Urban Development (HUD) could be seriously impaired if the long-term viability of the Corporation is endangered by impromptu removal of AHFC's assets.

If you need further information or assistance, please contact me.

Sincerely,



Will Gay  
CEO/Executive Director

**ALASKA HOUSING FINANCE CORPORATION**  
**1993 Accomplishments**

- Streamlined Refinance Program--at year-end, refinanced nearly 10,000 mortgages, average monthly savings, \$295. \$33.9 million net spendable income for Alaskans annually
- Built partnerships for affordable housing as evidenced by financing multi-family and special needs housing in the amount of \$24.3 million including:
  - 67 units, Juneau senior citizen housing, \$7,525,000
  - 53 homes, N Slope Borough, \$7,840,510, 1N Housing Authority
  - Fairbanks Neighborhood Housing Services, revolving loan, \$500,000;
  - 16 units, Sitka, \$1,180,811 to the GSW Enterprises Inc.
  - renovation of 4 units, \$250,000, Alaskan Aids Assistance Association
  - \$1.3 million refinance, Allvest Inc.
  - 148 units, \$5,705,000, Anchorage Neighborhood Housing Services
- Granted property, \$20,000 value, to Anchorage Habitat for Humanity
- Increased performance measures for public housing and closed out previous unfavorable audit findings
- Funded \$250,000 in emergency grants for homeless, Anchorage, Fairbanks, Seward and Kenai
- Paid a \$40.7 million dividend from earnings to the State of Alaska
- Implemented/made 1st loan, under program allowing a portion of the home to be used for in-home business purposes
- Made 5-year commitment to AHFC's Warm Homes for Alaskans Initiative, \$37 million
- In partnership with Fairbanks and Juneau electric utilities helped reduce homeowners' electric bills through an energy audit program
- Supported the construction of 753 homes in 44 communities under the Supplemental Housing Development Program
- Developed framework for addressing statewide housing needs
- Enhanced ratings on bonds
- Fairbanks Birch Park Construction, \$4.2 million, 47 units
- Bethel Heights renovation, \$13.9 million, 87 units

- Formed partnerships with Juneau and Fairbanks electrical utilities to save homeowners' energy dollars
- Supported construction of 753 homes in rural Alaska, with \$18 million AHFC funds matching \$100 million HUD funds (Housing Development Program)
- Alaska selected to Participate in National Pilot Energy Efficient Mortgage Program
- Developed Integrated Investment Reporting System
- Spent \$5.2 million upgrading 1,049 homes through 5 non-profits and one municipality in 15 locations
- Completed second year of a \$250,000 federal drug elimination grant
- Secured funds for breakfast club in Juneau
- Began Family Self-Sufficiency Program, acquired 29 vouchers and certificates, obtained \$2 million to purchase 20 units in Anchorage
- Provided literacy training with \$20,000 AK DOE grant
- Set up Arbitrage Earnings Guidelines
- Completed resident handbook and video
- Completed Federally mandated Comprehensive Housing Affordability Strategy
- Reserved 3 projects under the Low Income Housing Tax Credit Program
- Consolidated housing functions with no interruption of service
- Consolidated financial information of Public and Rural Housing Divisions into AHFC financials beginning with Sept. 30 quarterly financials
- Departments with overlapping functions (accounting, finance, administration including procurement, communications, personnel and planning merged
- All regulations and by-laws were consolidated and reorganized
- New personnel rules and job descriptions were developed
- IS connected us all together (relocated and installed 250+ pcs and provided support)
- Developed and finalized accounts receivable system



520 East 34th Avenue  
Anchorage, AK 99503-4199  
(907) 561-1900

P.O. Box 101020  
Anchorage, AK 99510-1020

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**MEMORANDUM**

**DATE:** March 14, 1994

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

**FROM:** Will Gay  
CEO/Executive Director *Will Gay*

**RE:** Follow-up Information from Hearing on SCR 12

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Attached are responses to Senator Adams' and Senator Rieger's questions posed at your meeting on March 3rd.

If they, or other members of the Committee, have further questions please do not hesitate to call.

Attachment

**cc:** Senator Al Adams  
Senator Steve Rieger  
Senator Georgianna Lincoln

Senator Bert Sharp  
Senator Judy Salo  
Commissioner Darrel Rexwinkel

## RESPONSES TO SENATOR AL ADAMS QUESTIONS:

1. AHFC has a clear understanding of the term "moderate income". The point being made in Commissioner Rexwinkel's letter is that AHFC does not have loan programs that are designed to specifically meet the needs of moderate income borrowers. AHFC has some programs in which participation is based on eligibility as a "low to moderate" income borrower. This income restriction is based on 115% of median income as established annually by Housing and Urban Development (HUD). In several AHFC programs, income limitations are set at "very low" which is considered to be 50% of median income; "low" which is considered to be 80% of median income; or in the case of AHFC's Loans to Sponsors, "low to moderate with an emphasis on low" at 100% of median income.

Some AHFC loan programs are without regard to income restrictions. These programs include Rural Housing Division loans; Veterans Mortgage Program loans; Special Needs & Congregate Housing loans; Senior Revolving Loan Fund loans; and the Taxable Loan program which finances single family residences, mobile homes, second deeds of trust for home improvement, refinances of non-AHFC loans.

AHFC loan programs emphasize the housing needs of low income persons, persons in need of special needs or congregate housing, and persons in remote, underdeveloped or blighted areas of the state.

2. Low Income person's housing needs are currently being met through AHFC's Tax-empt First Time Homebuyer program, Multi-Family Loan program, Loans to Sponsors, Mobile Home Loan program, Affordable Housing Enhanced Loan program, and the Homeownership Fund program.
3. (a) The Corporation's financial advisor was Lehman Brothers, Inc. Lehman recently resigned as financial advisor. The Corporation is in the process of soliciting requests for proposals for financial advisor.  
  
(b) The estimated mortgage lending program demand for the Corporation for FY94 is \$912.42 million. In addition to this, the Corporation, through its Public Housing Division, owns and operates 1,600 public housing units, and administers 2,400 federal Section 8 vouchers and certificates of rental subsidy which pays out over \$10 million to private landlords, annually. The Corporation also provides supplemental housing assistance of approximately \$10 million to leverage available Federal funds for housing in rural areas of the state as well as funding and/or operating a number of energy conservation programs.

4. (a) As of December 31, 1993, \$3,627,133,000 of the Corporation's assets were held in funds and accounts considered unavailable for general corporate purposes.  
  
(b) The Corporation had total assets at December 31, 1993 of \$4,734,843. The overcollateralization requirements and defeasement provisions vary based upon the terms of the specific bond indenture or other financial agreement.  
  
(c) Many of the Corporation's loans have been converted to Fannie Mae Mortgage Backed Securities, Freddie Mac Participation Securities or Ginnie Mae Certificates. This has been done to enhance the security for the bonds and obtain higher ratings on the bonds issued by the Corporation.
5. (a) The Corporation does not have AAA ratings based upon its own credit. The AAA rated bonds that the Corporation has issued have been rated so highly based in part on the quality and quantity of the underlying collateral pledged to repayment of the bonds. Where the Corporation's debt has been rated AAA, this collateral has usually consisted of mortgage loans which the Corporation has converted to mortgage backed securities guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. The AAA credit quality of these secondary market participants permits the Corporation to access the capital markets on more favorable terms than would otherwise be available. The Corporation pioneered this concept of teaming up State housing entities with the major Federally sponsored secondary market agencies. It is a technique now widely used by State housing agencies throughout the United States. Currently the Corporation converts only FHA insured or VA guaranteed loans to Ginnie Mae Certificates. The remaining "conventional" loans are unsecuritized.
6. Some of the Multi-Family loans are insured by FHA; however, the majority are not. The level of risk is mitigated by the underwriting criteria established for the loan program (sufficient debt service coverage ratio, adequate replacement reserves, payment reserves, etc).
7. Run-off of AHFC's portfolio is due to prepayments resulting from decreases in interest rates and AHFC borrowers refinancing their existing debt to lower their mortgage payment. Some 10,000 borrowers refinanced (or are committed to refinance) their mortgages through AHFC's Streamlined Refinance program. Others refinanced through traditional secondary markets such as Fannie Mae, Freddie Mac, or FHA/VA pooled to Ginnie Mae. Some of the run-off is misleading in that many of the AHFC Streamlined Refinances have been closed by the lenders, AHFC has been paid off, but the new loan has not yet been delivered to AHFC for purchase. This causes a considerable distortion in the numbers due to the time lag in getting the loans back on the AHFC books.

There are similar streamlined refinances available for FHA insured or VA guaranteed loans, but not for conventional mortgages sold to Fannie Mae, Freddie

Mac, or other secondary investor. Also, AHFC offers fixed rate, long term, assumable mortgages. Most investors do not allow their conventional fixed rate loans to be assumed.

8. (a) The \$2,765,000,000 in outstanding bonds and notes, net of discounts, reflected in the Combined Financial Statements included in the Corporation's June 30, 1993 Annual Report were secured by a combination of mortgage loans, investment securities and other assets. A copy of the June 30, 1993 Combined and Combining Financial Statements is enclosed.  
  
(b) The Combining Statements reflect assets and liabilities by individual fund and account. Investment securities which are not "restricted" or otherwise designated by statute, indenture or other financial agreement are accounted for in the General Account of the Revolving Fund. As of June 30, 1993 investment securities accounted for in these restricted or designated funds and accounts aggregated \$1,547,446,000.
9. The Corporation has not analyzed the cost to refund bonds to free up cash. Our understanding is that the financial analysis being performed by Legislative Budget and Audit includes a review of those bonds eligible for refunding and/or defeasement.
10. As of June 30, 1993, investments aggregated \$1,864,433,000, of which \$395,927,000 were in the General Account of the Revolving Fund. The balance of \$1,468,506 were in funds and accounts restricted or otherwise designated by bond indenture, statute or other financial agreement. The collateral constraints vary from account to account. Most are governed by the terms of bond indentures or statutes. Investments aggregating \$1,445,379,000 at June 30, 1993 were pledged or otherwise designated to the payment of outstanding bonds and notes. The documentation of these pledges is voluminous and is available in Juneau at the State Archives. It is our understanding Legislative Budget and Audit reviewed the documentation regarding the pledge of the Corporation's assets.
11. Minimum Net Worth requirements for Fannie Mae are \$250,000 plus 2/10% of the outstanding principal balance of AHFC's FNMA loan portfolio. Freddie Mac net worth requirements are \$500,000. Ginnie Mae net worth requirements are \$100,000 plus .2% of any additional securities outstanding.

Regarding Senator Steve Rieger's questions concerning the impact of the Corporation's grant programs on the Dividend paid to the State:

The attached Schedule of Grants and Related Funding Sources As of and for the Fiscal Year Ended June 30, 1993 reflects total grant expenses of \$9,162,000 as reported in the Corporation's audited FY 1993 financial statements. Of this, \$8,044,000 was provided from external sources, leaving a balance of \$1,118,000 funded by AHFC. The source of funding these grants is also indicated on the attached schedule.

For financial reporting purposes, grant expenses are recognized when the grant has been earned - which is generally upon fulfillment of all conditions for payment. This differs from budgeting practices which require recording the grant when it is awarded.

The FY 1993 grant expenses reflected in the schedule were funded in part by \$5,567,000 of State funds transferred to the Corporation to cover outstanding but unpaid grant awards on the date AHFC merged with ASHA and the housing and energy conservation functions of DC&RA. As payments are made on grants awarded subsequent to the merger, the amount funded by AHFC will increase. To the extent this occurs, the impact will be to further reduce the Corporation's net income.

Recently, according to the term of the Dividend Plan, the payment to the State has been based upon the Net Income of the General Account of the Revolving Fund. As a result of the pass-through nature of the current grant programs, most of them are accounted for outside of the General Account of the Revolving Fund. Since Net Income of the General Account of the Revolving Fund has been less than total Net Income, the effects on Dividend Payments under the calculations of the current Dividend plan have been minimal.

As the responsibility for funding the grants shifts to the Corporation, however, the grant programs may have to be classified within the General Account of the Revolving Fund. If so, the effect on Dividends will be more significant.

# Alaska Housing Finance Corporation

## Schedule of Grants and Related Funding Sources

As of and for the Fiscal Year Ended June 30, 1993

(Subject to Year-End Audit Adjustment)

\$'s in Thousands

### Grant Sources

Fund Title	Fund No.	Grant Description	Grant Amount	Funding Source of Grant			
				DOE	State	PVE	AHFC
General Account of the Revolving Fund		Emergency housing assistance	\$ 205				205
State Energy Conservation	801		50				
Alaska Energy Efficient Education Fund	801.02					25	
Business Energy Assistance Team	801.03					20	
Energy Programs Analysis	801.04						
Home Energy Rating Collaborative Process	801.05			5			
HUD Energy Efficient Housing Demonstration	801.06						
Energy Extension Service	802		962				
Energy Resource and Information Center	802.02			3			
Warm Home for Alaskans							
Energy Rated Homes of Alaska	802.03					233	
Home Energy Efficiency Programs	802.04					726	
Energy Programs Marketing	802.05						
Institutional Conservation	803		3			3	
Low Income Weatherization Assistance	804		3,052				
Federal Weatherization	804.01			1,360	1,658		34
Federal Training and Technical Assistance	804.02						
Enhanced Weatherization	805		2,065		1,307	51	707
Petroleum Violation Escrow	806		51			51	
Business Energy Assistance	806.03						
Low Income Weatherization Enhancement	806.04						
Rural Capital Projects Retrofit Program	806.05						
Other Energy Programs	807/808		2,774				
Alaska Home Craftsman	808.01				81		172
Energy Rated Homes of Alaska	808.02				158		
Supplemental Housing Program	807.01				1,822		
Senior Citizens Housing Program	807.02				541		
<b>Total Grants</b>			<b>\$ 9,162</b>	<b>1,368</b>	<b>5,567</b>	<b>1,109</b>	<b>1,118</b>

TO: Margaret Nelson, AHFC

FROM: Senator Adams" Office

SCR 12: AHFC

The first set of questions relate to 2/17 letter from Rexwinkel to Adams and a 2/4 letter from Gay to Rexwinkel:

Rexwinkel letter:

① The term "moderate income" has been on the books for over 2 decades. Why is this term so hard for you to understand?

② Please define the needs as you see them for subsidized housing for weatherization and energy efficiency needs, low income programs and rural housing needs. What progress has been made since these programs were merged into AHFC, that would not have otherwise occurred?

③ Who is your independent financial advisor and what is your expected program demand?

Will Gay's letter:

④ #4. How much is this holdback? What are your the asset, over-collateralization requirements, and terms of the defeasement clause. Could laons be rolled into Fannie Mae, Ginnie Mae & Freddie Mac?

⑤ --Why do we need a housing agency with triple A ratings when Fannie Mae, Ginnie Mac and Freddie Mac already have triple A ratings. Do you sell most of your loans to these outfits?

⑥ --Multi-family housing--is this HUD guaranteed? If not, why would the state want to assume this level of risk?

Questions regarding the annual report--

⑦ There was 3.002 B in FY 92 in mortgage loans and backed securities, in 93, 2.558. B. Explain the 443 million run-off. Are you duplicating services already available in the marketplace?

⑧ Explain the 2.765 B in outstanding bonds/notes, net of discounts vs. 2.558 B in mortgage loans and mortgage-backed securities, net How

much cash, above the 2.5 billion in mortgage loans, is pledged to collateralize the notes outstanding?

9 What is the cost to AHFC to do refunding bonds to free up the cash?

10 Liquidity. Under assets, 1.864 billion in investments--  
What are the collateral constraints against these investments?  
How much is pledged to debt? Please provide documentation.

11 What are the net worth requirements for Fannie Mae, Ginnie Mae and Freddie Mac?

said that the attorney general "clearly had the authority to enter into that agreement." He then spoke to policy considerations associated with the arrangement as well as upward negotiation of the interest rate from the London Interbank Overnight Rate (LIBOR) to prime. Mr. Cole stressed that the agreement was not entered into to favor BP or provide BP a tax break. It was signed because it was in the best interest of the state in dealing with "horrendous statute of limitation problems." It was a fair, well-balanced agreement. There was need for time to settle "the underlying accumulative fifteen-year stream of audit assessments." Mr. Cole stressed that the state tried, during the six-month period, to settle the issue but was unable to do so. He acknowledged that he would not have extended the agreement.

In response to a question from Senator Kerttula, Mr. Cole advised that legislation introduced by the administration is intended to clean up statute of limitation problems. Senator Kerttula voiced his distress over lack of progress of the legislation.

Both Senator Sharp and Mr. Cole attested to difficulties associated with developing audit assessments during the irrational markets of early years when there was no spot price. Mr. Cole noted that regulations also need work. He indicated that new, proposed regulations have been developed to address existing problems. Mr. Cole also voiced need to review statutes relating to valuation. He attested to benefits of lengthy agreements relating to royalties, saying that they have solved royalty problems. Need remains to solve ongoing problems in "the tax field."

(Representative Larson arrived at this time.)

In his closing remarks, Mr. Cole cautioned against allowing tax auditors to drive state fiscal policy. He further advised that those authorized by statute to make fiscal decisions must have the confidence of the legislature.

Senator Frank, Senator Kerttula, and Representative Larson expressed their appreciation to the Former Attorney General for his service to the state. Mr. Cole received a standing ovation as he departed the meeting.

#### ALASKA HOUSING FINANCE CORPORATION FISCAL REVIEW

Senator Frank **MOVED** that the Legislative Auditor expand the audit of the Alaska Housing Finance Corporation per the following motion:

I move that the committee authorize the legislative auditor to conduct a financial analysis of the Alaska Housing Finance Corporation. The analysis should focus on the relationship of the corporation's assets to its liabilities and the restrictions on those assets. It is understood that this analysis should be given the highest

priority by the auditor and that he should periodically report his findings to the committee.

Representative MacLean proposed to amend the motion to include review of the Alaska Industrial Development and Export Authority and its assets and liabilities. Chairman Randy Phillips advised that review of AIDEA had already occurred. RANDY WELKER, Legislative Auditor, concurred, referencing a contractual report on AIDEA which he said he would provide to members. Senator Frank suggested that issues relating to AIDEA be raised at a later meeting if further information is deemed necessary following review of the existing report. Representative MacLean concurred and withdrew her proposed amendment. No objection to the original motion having been raised, it CARRIED unanimously.

#### ADJOURNMENT

The meeting was adjourned at approximately 1:35 p.m.

MINUTES  
ALASKA STATE LEGISLATURE  
BUDGET AND AUDIT COMMITTEE  
January 21, 1994  
12:05 p.m.

TAPES

LBA-94, #5, Side 1 (000-end)  
LBA-94, #5, Side 2 (000-530)

CALL TO ORDER

Chairman Randy Phillips convened the January 21, 1994, meeting of the Legislative Budget and Audit Committee at approximately 12:05 p.m., in the House Finance Committee Room, Capitol Building, Juneau, Alaska.

PRESENT

Senators

Sen. Phillips  
Sen. Frank  
Sen. Sharp  
Sen. Kerttula (alternate)

Representatives

Rep. Davies

Representative MacLean arrived soon after the meeting began. Representative Larson arrived as it was nearing conclusion. Senators Adams and Rieger and Representatives Martin, Hanley, and Parnell (alternate) did not attend.

**ALSO PRESENT:** Senator Dave Donley; Representative Kay Brown; Representative Curt Menard; Former Attorney General Charlie Cole; Attorney General Designee Bruce Botelho; Darrel J. Rexwinkel, Commissioner, Dept. of Revenue; Randy Welker, Legislative Auditor; Jim Baldwin, Assistant Attorney General, Dept. of Law; Joe Householder, Tax Counsel, Unocal Corporation; John Ringstad, BP Exploration; Mark Holland, Exxon Company, U.S.A.; Mike Greany, Director, Legislative Finance Division; aides to committee members and other members of the legislature; and representatives of the press and television media.

FORMER ATTORNEY GENERAL CHARLIE COLE

FORMER ATTORNEY GENERAL CHARLIE COLE came before committee to speak to procedures utilized in negotiation of oil and gas tax settlements during his tenure. He explained that when Governor Hickel appointed him, the Governor said he wanted the Dept. of Law and Dept. of Revenue to address outstanding audit assessments and to use the departments' best efforts, "with all deliberate speed," to resolve them. The Governor did not say that particular or special focus should be placed on settlement.

Mr. Cole acknowledged that for a number of years, prior to his tenure, there was a lack of coordination and constructive relationship between the Dept. of Revenue and the Dept. of Law. That "bickering" over authority was impeding state efforts to collect outstanding taxes. A written agreement was thus effected outlining how collection efforts would be pursued. That agreement has worked well. Teams were formed composed of auditors, audit supervisors, attorneys in the Dept. of Law, and outside experts and counsel to address outstanding audits of individual taxpayers.

(Representative MacLean arrived at the meeting at this time.)

Mr. Cole next voiced his belief that auditors in the Dept. of Revenue have the interest of the State of Alaska at heart and have done "a very good job." He took exception to suggestions that they are excessively aggressive, saying that their function and duty in representing the state is to be aggressive. They are the proper ones to raise issues for review by supervisors and analysis by the Dept. of Law. Review of audit assessments requires constant evaluation of each claim to determine its strength. The Former Attorney General stressed that estimates of outstanding taxes are not based on signed promissory notes or contracts from producers. They reflect state claims. Each element of each claim has "various shades of collectibility."

Mr. Cole next spoke to analysis used in selecting cases for negotiations. He noted that the state is an institutional litigant. Decisions regarding which cases to negotiate, take to trial, or settle are based on strategic rather than tactical considerations. For issues that cut across many tax years and assessments, the state selects the strongest case for litigation. (Mr. Cole cited cases involving prevailing values or statutes of limitations as examples.) He explained that the Dept. of Revenue and Dept. of Law serve as fiduciaries entrusted with public moneys, much in the same capacity as classic, common law trustees. It is thus incumbent upon the Commissioner and Attorney General to be conservative in handling state funds.

Comments followed regarding the intricacies of issues surrounding the U.K petroleum revenue tax and whether or not it represents an income tax. The opinions of experts are considered when analyzing cases and evaluating the risk of litigation.

Speaking to settlements, Mr. Cole explained that if a determination is made to move a case into negotiations, various levels ranging from acceptable to unacceptable settlement numbers are established. Those amounts are then reviewed, averaged, and re-evaluated to develop a number with which everyone is in accord. That process has worked well.

Addressing criticism of the most recent settlement, Mr. Cole directed attention to a handout (copy on file as Attachment A) and

recited a list of North Slope royalty case settlements totaling \$444,985,831. He then referenced additional tax settlements totaling \$1,084,276,000 and noted that he had heard no criticism of the foregoing settlements.

Mr. Cole next spoke to charges of secrecy surrounding recent settlements and attested to need to uphold existing statutes relating to confidentiality. He then redirected attention to the approximate \$445 million in royalty settlements and noted that documentation associated therewith is public record on file with the courts. He stressed that review of the documents would conclude that the Dept. of Law and the administration ably and effectively represented the people of Alaska.

Mr. Cole next referenced auditor Stacy Scott's November 5, 1993, memorandum and commenced to speak to the Union settlement. At this point in the meeting, Chairman Randy Phillips queried representatives of the Dept. of Law, Dept. of Revenue, and Unocal regarding their level of comfort with the subject matter. There was no indication that the subject posed a problem.

The Former Attorney General read excerpts from Mr. Scott's memorandum and took exception to comments that no state interests were furthered by the settlement. He pointed to the \$112 million in settlement moneys that flowed to the state treasury as evidence of beneficial impact. He next noted statements in the memorandum suggesting that the major issue in the assessment was the prevailing value for Cook Inlet Gas. Mr. Cole refuted that contention and explained that the major issue was whether it was possible, under Secs. 55.150 and 160 of the regulations, to get to the issue of whether the state could apply prevailing value to the production tax and the income tax. He distributed protest documents (copies on file as Handouts B and C) filed by Union and explained that they evidence that one of the fundamental issues was whether the state was required to accept the value of the subject oil and gas "on the taxpayer's books." Mr. Cole cited difficulties associated with determining prevailing values of Cook Inlet gas due to lack of a posted price and widely differing contracts for the product. He also noted that Cook Inlet oil differs in quality from ANS crude and is thus not comparable.

End, LBA-94, #5, Side 1  
Begin, LBA-94, #5, Side 2

The Former Attorney General spoke to dangers associated with staff and the press "rushing" to claim that the state settled for less than its due. He stressed that in each settlement the state reached its predetermined number. He voiced his satisfaction with settlements achieved by negotiating teams and pointed to unknowns associated with litigation.

Mr. Cole next distributed a decision and order of remand (copy on

file as Handout D) by the Dept. of Revenue.

At this point in the meeting, Attorney General Designee Bruce Botelho noted the presence of Commissioner of Revenue Darrel Rexwinkel and suggested that, in light of the order of remand, the Commissioner remove himself from discussion of the issue.

[Commissioner Rexwinkel left the meeting.]

Mr. Cole advised that the above-noted decision represents an example of an audit assessment case "which went bad." It is not now in a good posture in that the hearing officer found that state audit staff did not comply with regulations.

[Commissioner Rexwinkel returned to the meeting at this time.]

Mr. Cole spoke to discussions within the Dept. of Law during which he learned of statute of limitation problems under the three-year audit statute and the six-year collection statute. He directed attention to a March 4, 1993, affidavit (copy on file as Handout E) from staff at the Dept. of Revenue. He noted that it estimates potential loss from prohibiting amendment of audit assessments beyond the three-year period in AS 43.05.260 at \$600 million in taxes and interest. The Former Attorney General attested to need to eliminate that risk. He acknowledged that there is, at this time, no quantification of risk under the six-year statute. The Dept. of Law undertook research, determined that the statute of limitations could be amended and made retroactive, and introduced appropriate legislation.

Comments followed on the status of the lawsuit regarding the three-year statute. Mr. Cole informed members that appeal to the supreme court has been made from an Anchorage superior court ruling that the three-year statute has no exceptions, and additional assessments may not be made after that period. The state brief to the supreme court is due February 15. The state has taken the position that if the taxpayer appeals the assessment, and the assessment is in the informal conference or formal hearing stage, that action keeps the assessment open for further assessments.

The six-year statute for collection of taxes has been at issue in cases, and the state has settled around it. Mr. Cole voiced his belief that the six-year statute should not apply in instances where the appeal process is ongoing.

The Former Attorney General urged that regardless of whether or not statutes of limitations are made retroactive, they must be "cleaned up."

Mr. Cole next addressed "the BP document." He acknowledged press articles indicating that BP received a tax break and that the agreement between the company and the state was unauthorized. He

ALASKA STATE LEGISLATURE  
LEGISLATIVE BUDGET AND AUDIT COMMITTEE  
Division of Legislative Audit



P. O. Box 113300  
Juneau, AK 99811-3300  
(907) 465-3830  
FAX (907) 465-2347

MEMORANDUM

TO: Jerry Burnett  
Aide to Senator Phillips'

FROM: Randy S. Welker *Randy*  
Legislative Auditor

DATE: March 2, 1994

RE: Status of AHFC Financial Analysis

At the January 21 meeting of the Legislative Budget and Audit Committee, a request was approved to have the Audit Division conduct a financial analysis of the assets of the Alaska Housing Finance Corporation. The analysis is focusing on the Corporation's assets and liabilities and the restrictions on those assets.

The Committee instructed that the analysis be given the highest priority by the Audit Division.

The audit team assigned to this review spent the majority of February in AHFC's offices reviewing the detail records of the Corporation. We are now in the final stages of our analysis and anticipate a final report available to the Legislative Budget and Audit Committee no later than March 18.

If you have any questions, please contact me.

MEMO FROM STATE AUDITOR

## HOUSING AGENCY G.O. PLEDGE RATED FOR FIRST TIME

In its first rating based solely on the general obligation pledge of a housing finance agency, S&P assigns an 'A+' rating to the Alaska Housing Finance Corp.'s (AHFC) \$5.8 million housing development bonds series 1991A (Stevens Park Project). In addition, an 'A-1' rating is assigned to AHFC's Eurocommercial paper program. As a result of the new rating, bonds of the corporation with a G.O. pledge are raised to 'A+' from 'A' (see box). While the majority of the corporation's outstanding debt obligations have a general obligation pledge from AHFC, they are rated at various higher rating levels due to the better quality of their underlying security.

The corporation's rating is based on its strong capital base available to absorb a significant level of loan losses, as well as the quality and liquidity of its assets. AHFC has achieved liquidity by maintaining a substantial percentage of its assets in high-quality short-term investments.

Over the next several years, the current recovery of the Alaska housing market should help keep profitability satisfactory over the next several years. This should allow AHFC to build its equity base through retained earnings. A bleak long-term economic outlook for Alaska should erode some of the corporation's capital base as loan losses mount and the state's need for additional funding sources places pressure on the corporation to transfer funds.

The stability of capital contributed by a state to a state housing finance agency has been a source of continuing concern to S&P. In the past, some states have appropriated funds from their housing finance agencies to be used for other purposes. This reduction in capital can severely weaken the agency's financial position and its ability to withstand losses beyond those provided for through reserves or insurance held under bond resolutions. In light of this risk, S&P has traditionally steered away from rating the general obligation or unsecured pledges of housing finance agencies.

AHFC has been capitalized through state appropriations totaling \$1.03 billion. In 1991, the governor of Alaska attempted to appropriate \$80 million from the corporation. Although unsuccessful, the attempt demonstrated AHFC's vulnerability to raids on its fund balances. In response, AHFC instituted a plan which permits the corporation to remit an annual dividend to the state. S&P expects such attempts to recur and possibly succeed in the future and has therefore factored this risk into the rating.

AHFC was established in 1971 as a nonstock public corporation and government instrumentality of Alaska ('AA-' G.O. rating). Through 1984, the corporation received appropriations from the state, aggregating about \$1.03 billion. The governor appoints all seven members of AHFC's board of directors.

The corporation is a secondary purchaser of mortgage loans and not a direct lender. As such, it acquires mortgage loans after they have been

originated and closed by a direct lender—normally a financial institution or mortgage company. The direct lender generally continues to service the mortgage loan on behalf of the corporation. AHFC acquires mortgage loans with funds raised in the capital markets. Funds raised by the corporation through the issuance of mortgage bonds, notes, and collateralized mortgage obligations have provided approximately 90% of mortgages in the state.

## ECONOMY AND AHFC

The Alaska economy turned down sharply in 1986 after several years of rapid growth. This was caused primarily by the collapse of the price of crude oil, which significantly reduced state revenues. As a result of substantial overbuilding in 1983, the Alaska housing market suffered a decline in housing starts, a drop in the number of new building permits issued, an increase in the delinquency rates on housing loans, and a general

## AHFC RATINGS

## New ratings

\$5.8 million housing development bonds 1991 series A (Stevens Park Project)

Rating: A+

Sale date: Dec. 6, 1991

Investment banker: Security Pacific Securities Inc.

Outlook: Stable

US\$150.0 million Eurocommercial paper program

Rating: A-1

Dealer: Swiss Bank Corp. International Ltd.

Outstanding \$695.5 million insured mortgage program bonds upgraded to 'A+' from 'A'

1975 first series

1976 first and second series

1977 first, second, and third series

1978 first, second, and third series

1979 first and second series

1980 first series

1990 first series

reduction in housing market values for several years—a classic depression. The state economy remained depressed through 1989, but began to revive in 1990, aided significantly by the Exxon Valdez oil spill, which drew more than \$2 billion in clean-up related funds into the state economy.

The impact on AHFC was significant. During 1987 and 1988, approximately 10% of the corporation's mortgages were more than 60 days past due. By the end of 1989, AHFC had an inventory of Real Estate Owned properties (REO) totaling more than 4,100 properties. Its large capital base enabled AHFC to absorb huge losses on its mortgage portfolios, and it did not default on any of

## CREDIT COMMENTS

its outstanding bonds. At the end of its 1991 fiscal year, loans 60 or more days delinquent were down to a more reasonable level of approximately 1.8%.

S&P projects that the economy will enter into another severe depression in approximately 12 to

Senate Environmental Committee to bar exploration there.

### LOAN QUALITY

AHFC's loan portfolio, taking into account its insurance protection, is of good quality. The Federal Housing Administration (FHA) and Veterans Administration (VA) provide primary mortgage insurance and guarantees, respectively, for approximately 31% of the mortgage portfolio. The insurance or guarantee provided by these two U.S. government agencies are 'AAA' eligible under S&P's housing bond criteria, which are applied to the corporation's collateralized bond ratings.

Primary mortgage insurance from private companies rated at least 'AA' by S&P provide insurance for an additional 33% of mortgages. Approximately 19% of mortgages have no primary insurance or guarantees because they have loan-to-value ratios (LTV) of less than 80% and therefore do not require insurance according to market conventions. The remaining 16% of mortgages within the corporation's portfolio are of lesser quality, in that they are either uninsured with LTV ratios of greater than 80% or have primary mortgage insurance from private companies rated lower than 'AA' by S&P. Losses on these lower-quality mortgage loans have been factored into the corporation's rating by measuring their impact on AHFC's fund balances.

In addition to primary mortgage insurance, AHFC maintains a secondary level of loan loss protection on a majority of its mortgage portfolio through the use of mortgage pool insurance policies, self-insurance funds, and U.S. government sponsored agency guarantees. The Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corp. (FHLMC) provide nonrecourse guarantees for approximately 19% of the mortgage portfolio, excluding all FHA insured mortgages. Through a State Mortgage Insurance Fund held outside of the corporation, and not consolidated within the corporation's financial statements, AHFC has self-insured an additional 17% of mortgages, excluding FHA-insured mortgages. Mortgage Guaranty Insurance Corp. ('AA' claims-paying ability) provides mortgage pool insurance policies for 21% of the portfolio excluding FHA-insured mortgages.

The secondary loan loss coverage mechanisms exclude FHA-insured mortgages because the corporation believes the primary insurance to be at a sufficiently high level that further insurance is not necessary. S&P differs on this belief and assumes that a low level of losses will be incurred on these types of loans. Including these FHA-insured loans, 42% of the mortgages in AHFC's portfolio have no pool insurance. Using S&P's published housing bond criteria, S&P estimates that future loan losses in excess of primary and secondary mortgage insurance or guarantees could reach approximately \$85 million during a severe eco-

### FINANCIAL STATISTICS

(\$ 000s)	1991	1990	1989	1988	1987
Total assets	5,319,479	5,327,330	5,528,975	5,827,159	5,708,769
% change	(0.15)	(3.65)	(5.12)	2.07	(11.40)
Total loans	3,262,234	3,250,168	3,411,584	3,732,752	4,064,646
% change	0.37	(4.73)	(8.60)	(8.17)	(4.50)
Total equity	1,488,610	1,405,783	1,371,441	1,495,490	1,521,136
% change	5.89	2.50	(8.29)	(1.69)	1.40
Revenues	475,500	494,903	492,799	498,192	554,525
% change	(3.92)	0.43	(1.08)	(10.16)	(5.80)
Net income	99,998	34,342	(124,049)	(11,454)	20,928
% change	191.18	N.M.	N.M.	(154.73)	(49.97)
<b>Asset quality (%)</b>					
NPAs/loans + REO	3.41	8.52	13.19	16.20	10.94
Net charge-offs/average NPAs	7.25	3.64	5.04	5.05	15.64
REO/total loans	1.79	4.22	6.80	6.21	4.06
Loan loss reserves/total loans	4.37	5.61	4.07	1.42	0.43
Loan loss reserves/NPAs	125.66	63.19	28.90	8.24	3.79
Net charge-offs/average loans	0.86	0.61	0.78	0.42	0.50
<b>Liquidity (%)</b>					
Mortgage loans/total assets	61.33	61.01	61.70	64.06	71.20
Investment securities/total assets	30.71	28.59	26.37	26.22	22.02
Investments due or available at par within one year/total assets	25.06	22.24	19.54	21.13	19.74
Investments due or available at par in greater than one year/total assets	5.65	6.35	6.83	5.09	2.28
Other assets/total assets	7.96	10.40	11.92	9.72	6.78
<b>Profitability (%)</b>					
Return on average assets	1.88	0.53	(2.18)	(0.20)	0.34
Return on assets before loan loss provision	1.94	1.76	(0.73)	0.43	0.73
Return on average equity	6.91	2.47	(8.65)	(0.76)	1.39
Net interest margin	3.37	3.22	1.81	1.32	1.28
<b>Leverage (%)</b>					
Total equity/total assets	27.98	26.39	24.80	25.66	26.65
Total equity + reserves/loans	50.00	48.87	44.27	41.48	37.85
Unrestricted equity/total assets	3.75	9.33	7.24	4.16	4.60
Unrestricted equity/total debt	12.70	13.43	10.48	5.74	6.23

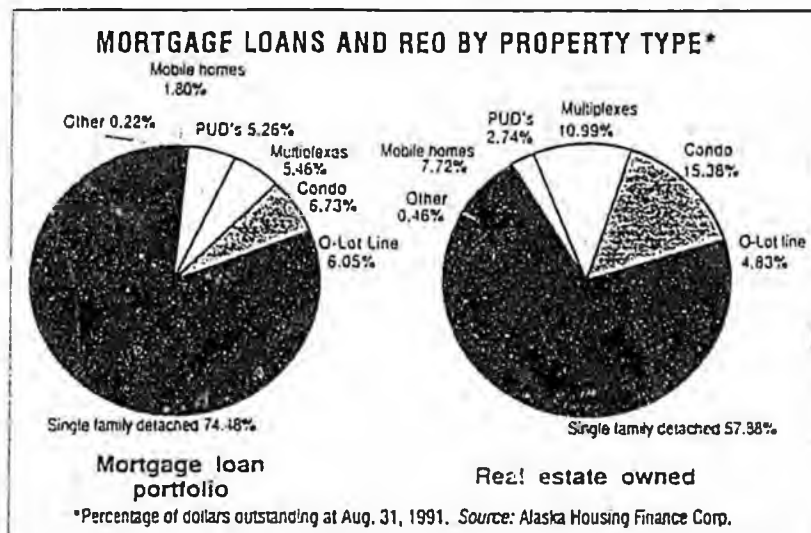
N.M.—Not meaningful.

14 years, when crude oil reserves on Alaska's North Slope are expected to be depleted. The successful development of new oil fields in Mikkelson Bay and the Beaufort Sea could head off this depression. Neither of these oil fields would have as significant an impact on the state's economic horizon as would the opening of the Arctic National Wildlife Refuge to exploration and development, but expectations for such an opening have been squelched by a recent vote of the U.S.

nomie downturn over the life of their bonds at an 'A+' rating level. This should be easily absorbed through the corporation's loan loss reserves and fund balances.

#### LITIGATION

The corporation continues to pursue a legal dispute with Mortgage Guaranty Insurance Corp. (MGIC) over unpaid claims submitted by the corporation under several pool insurance policies



issued by MGIC during 1981, 1982, 1983, 1988, and 1989. As recently as this year, the corporation estimated that MGIC was denying approximately 26% of the interest and expense components and 3% of the principal component of each claim submitted. Based on the current claims denial practices of MGIC, AHFC expects that an additional \$50 million of future claims under the policies, in respect of properties on which the mortgagors have defaulted or are expected to default on mortgage loans, will be denied by MGIC. AHFC and MGIC are currently trying to reach a settlement.

#### UNDERWRITING

Three characteristics of AHFC's loan portfolio had a serious negative impact on the corporation's performance during the mid to late 1980's:

- loan type
- property type
- loan-to-value ratio

Since its inception, the corporation has allowed two types of mortgages to be originated: fixed rate and graduated equity mortgages (GEM). GEMs in the AHFC programs were characterized by 5% increases to monthly payments in years four through nine, with increases applied to principal, resulting in final payment in 16 to 19 years. The increased payments beginning in year four led to payment shocks for unprepared borrowers and increased the level of defaults. During the 1980s, AHFC's loan portfolio reached a point at which these types of loans represented approximately 40% of total loans. At present, GEMs make up 33% of the portfolio. However, the corporation is no longer originating these types of loans; this

should have a positive impact on the mortgage portfolio over time.

The types of properties secured by mortgage loans also affected the corporation's mortgage portfolio performance. During the previous depression, AHFC absorbed heavy losses as a result of condominium and mobile home loans. The chart at left illustrates the difference between property types with respect to the corporation's REO inventory. At Aug. 31, mobile home and condominium loans represented 1.8% and 6.73%, respectively, of mortgage loans outstanding. However, loans for these same types of properties accounted for 7.7% and 15.4% of AHFC's REO inventory. Performance of the mortgage portfolio should be further enhanced in the future by the corporation's scaling back of new condominium loans originated and the exclusion of mobile home loans.

The high level of leverage taken on by the corporation's borrowers compounded the higher default levels in AHFC's portfolio during the last decade. LTV ratios for conventional loans were most often at the 95% limit. That is, mortgagors made down payments of only 5%. FHA and VA loans have maximum allowable LTV ratios of 97% and 100%, respectively. With little equity invested in their properties, many mortgagors in Alaska walked away from their properties and obligations as the value of the properties declined.

The large dollar losses incurred by the corporation resulted primarily from conventional loan defaults, since the FHA and VA loans had deep coverage provided by the U.S. government. As a means of lowering this financial risk, the corporation has changed its underwriting standards for conventional loans to a maximum LTV ratio of 90%. This should have a strong positive impact on the portfolio over time, as 95% LTV loans are believed by S&P to default twice as often as 90% LTV loans.

#### ASSET QUALITY

Nonperforming assets have been decreasing as the state's economic recovery continues. As a percentage of mortgage loans and REO, nonperforming assets have declined from a peak of 16.2% at the height of the depression to 3.4%. As high as these ratios might appear, the actual nonperforming assets that must be charged off is relatively low—under 7.3% since 1988. Actual charge-offs are relatively low due to the corporation's success in receiving value upon property dispositions and receipt of mortgage insurance proceeds.

The corporation's nonperforming asset position is enhanced by its loan loss reserve position. As AHFC built up its reserves at the expense of net earnings during the late 1980s, it put itself in a position to withstand substantial loan losses. For the past three years, loan loss reserves as a percentage of loans outstanding have been greater than 4.1%. Loan loss reserves as a percentage of nonperforming assets have grown steadily from a relatively low 3.8% in 1987 to an overly conservative 125.7% in 1991. That is, AHFC is holding approximately \$1.25 in reserves for each \$1.00 of

nonperforming assets. Based on experience, only about \$0.07 of each \$1.00 of nonperforming assets will have to be written off. Therefore, AHFC's loss absorption capabilities are quite high at this time.

**LIQUIDITY**

AHFC's loan portfolio has been shrinking since 1987 and now accounts for approximately 61% of total assets. The asset shift was primarily into short-term investment obligations rated at least 'AA'. Loans as a percentage of total assets are expected to decrease further due to the recent decline in mortgage interest rates. The proceeds from prepaid mortgages will most likely be used to redeem the corresponding bonds that they

ceeds of commercial paper on speculation of issuing bonds. Instead, the bonds have always been issued first and their proceeds placed in short-term investments until used to purchase mortgage loans.

**PROFITABILITY**

AHFC's earnings potential is strong now that it has established adequate reserves for loan losses going forward. Unexpected heavy losses during 1988 and 1989 resulted from large additions to loan loss reserves and the writing down of REO properties. Return on assets, which had historically been above 1% through 1985, deteriorated annually through 1989.

Return on assets calculated before provisions for loan losses demonstrates the impact of the corporation's failure to reserve adequately during the past. One reason for this failure: it expected to receive claims payments from MGIC. When these claims were denied, AHFC incurred the loss.

The corporation's net interest margin has rebounded from a low of 1.3% in 1987 and should stabilize in the 3%-4% range. The majority of AHFC's liabilities are hedged with assets of like maturities and higher interest rates. The interest margin earned by the corporation is somewhat constrained by federal tax legislation, which limits the amount of arbitrage that housing finance agencies can earn over their liabilities.

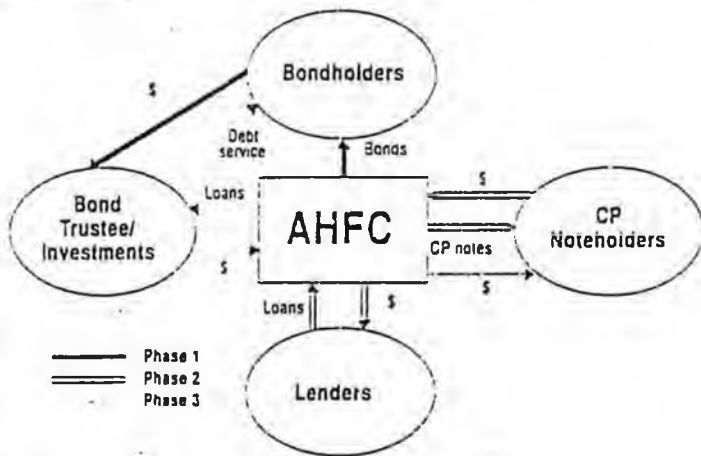
**CAPITAL**

Improved profitability has enabled AHFC to replace much of the capital lost during several unprofitable years. Despite losses incurred in the past, its large capital base—not less than 25% of total assets—is sufficient for its monoline business under the most stressful economic conditions. Likewise, equity plus allowance for loan losses as a percentage of total loans increased steadily from approximately 38% in 1987 to a current level of 50%. Unrestricted equity (equity not pledged to specific bond programs) is 13% of total debt outstanding after adjusting for various financial loss exposures. S&P's criteria for a "top-tier" agency require this ratio to be not less than 4% of bonds outstanding.

Due to the bleak long-term economic outlook for the state, it is expected that this capital cushion will be necessary to weather the next economic depression. At present, this level of capital is sufficient to absorb projected losses over the life of the corporation's bonds and commercial paper.

*David Notkin  
(212) 208-8536*

**BOND PROCEEDS/COMMERCIAL PAPER FLOW**



support. This in turn will increase the proportion of assets composed of investment obligations, which currently account for approximately 31% of total assets.

Investments held by the corporation are primarily short term. At present, almost 82% of the investments held, or 25% of total assets, are due or available at par within one year. The majority of these investments are proceeds available within bond programs to purchase mortgage loans.

Liquidity for the commercial paper program is further enhanced as a result of the warehousing structure of the program. The flow chart above illustrates the relationship between the use of bond and commercial paper proceeds to fund the corporation's mortgage acquisition activities. Liquidity is inherent in this structure because bond proceeds are always available to retire maturing commercial paper. Historically, the corporation has not purchased mortgage loans with the pro-

Moody's  
Public Finance  
Department

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# State Housing Finance Agencies

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## Single Family Programs

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A National Review

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May 1992

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MOODY'S : STATE HOUSING  
FINANCE AGENCIES

## Overview of State Housing Finance Agencies

Few would argue with the contention that the robust real estate activity found in many parts of the country in the 1980s has come to a grinding halt. In recent years, prices in many areas have fallen significantly and regional and national mortgage loan delinquency levels have increased steadily. As the last decade of housing boom is followed by a general bust, state housing finance agencies (HFAs) have been called upon to play a greater role in the delivery of affordable housing. In the context of this expanded role, it is important to consider the differences in the health of a state's overall real estate market and the specific market targeted by these housing agencies.

While the performance of state HFA mortgage loans invariably reflects the ups and downs of that state's economy, as experienced in the oil patch states in the mid-1980s for example, a high degree of correlation does not always exist. Without exception, Moody's has found that recent delinquency levels and median prices of homes financed with HFA-issued tax-exempt bonds have not shown significant negative trends. Even in states such as Massachusetts, New Hampshire, New Jersey, and New York, where the housing recession has been widespread, the individual single-family housing programs continue to exhibit favorable credit characteristics and maintain high ratings.

There are a number of reasons why HFA mortgage loan portfolios do not necessarily mirror the general housing trends in a particular state. For example, federal statutes and Internal Revenue Service regulations target low- and moderate-income mortgagors. By prescribing the maximum income levels of borrowers who may benefit from tax-exempt bond programs, these federal guidelines limit the vast majority of HFA-financed mortgage loans to first-time homebuyers. Moreover, the limitation on the maximum purchase price for the properties financed under these programs results in HFA portfolios that consist primarily of "starter" houses, i.e., small two-to-three bedroom existing townhouses, condominiums and single-family detached homes located in middle-income neighborhoods. Much of the significant deflation in home prices that has taken place across the country has occurred in the middle- to high-priced luxury housing, and the starter-home segment of the market has been fairly resilient. Even today, starter homes are in relatively high demand as a result of historically low interest rates and the fact that first-time homebuyers are not burdened with selling their existing homes. In addition, the structural and legal aspects of a single family bond issue, including below-market interest rates and pool insurance requirements, help guard against huge financial

losses to the programs even in a scenario of high mortgage loan defaults.

Given the difference between the general real estate markets of the states and the concomitant HFA markets, it is revealing to compare and contrast the portfolios and the performance of state housing agencies. The following section of this publication lists various statistics and rankings of the 48 state housing agencies (Kansas and Arizona do not have state HFAs), and the 180 single family mortgage revenue bond programs rated by Moody's. Most performance statistics are as of September 30, 1991.

Due to changes in federal tax laws, the overall financial performance of a housing program is dependent, in large part, on when the bonds were issued. The older the program, the more seasoned the loan portfolio and, in general, the lower the delinquency and foreclosure statistics. Older programs have also had many years to build up large fund balances. In addition, bonds issued prior to 1981, known as pre-Ulman bonds, are not burdened with strict arbitrage and rebate rules. As a result, these bond programs tend to build financial strength at a much quicker pace.

### Composition of Portfolios

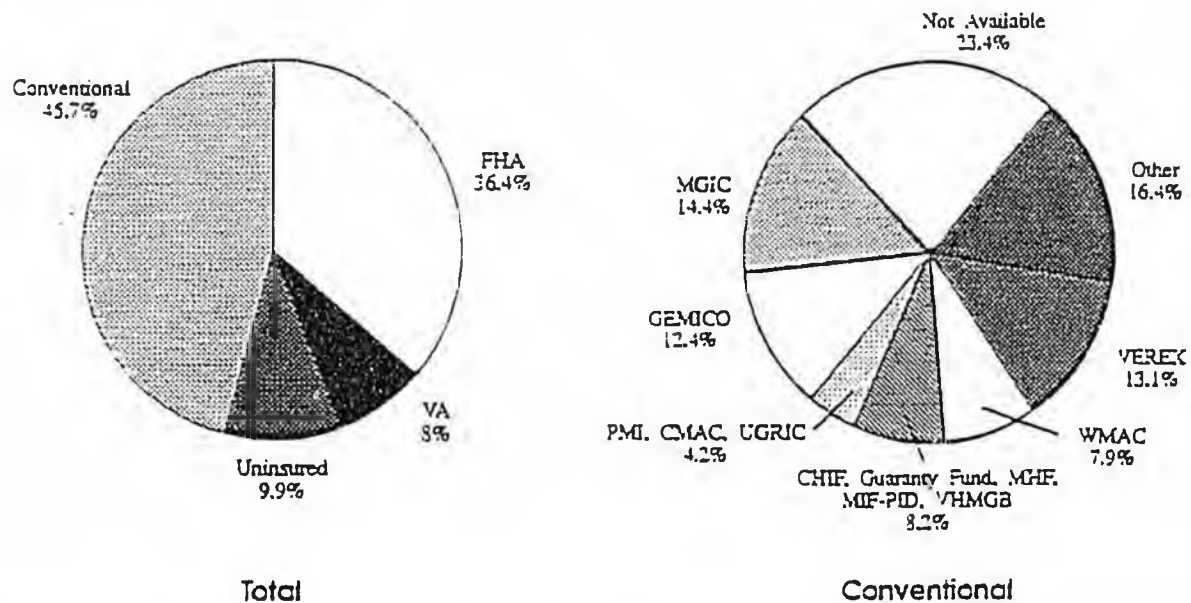
The 180 single family mortgage programs reviewed in this book comprise over \$30 billion of outstanding mortgage loans, representing 600,000 loans. The average HFA loan amount is \$49,990, evidence that state HFAs are reaching first-time homebuyers. Because first-time buyers usually do not have the financial ability to make large down payments, over 90% of the HFA mortgage loans carry some type of primary mortgage insurance. As presented on the chart on the next page, more than one-third of the loans are insured by FHA, and just under 8% are guaranteed by the Department of Veterans Affairs. The largest amount of private insurance—just over 22%, or almost \$3.1 billion—is provided by MGIC (including all loans insured under the MGIC name and the WMAC label). Verex is also a large presence in the private insurance business, at 13% of the loans, although this percentage is decreasing since Verex has not written any new business since 1988.

### Delinquencies and Foreclosures

The highest delinquency rates by a large margin were found in those regions affected by the petroleum recession of the mid-1980s. With regard to the eight federal census regions, HFAs from the Southwest region report the highest average serious delinquency rate (60 days or more), at 4.22%. This region

## Overview of State Housing Finance Agencies

## Distribution of Loan Insurance



includes the states of Texas, New Mexico, and Oklahoma—all states with significant reliance on the oil and gas industry. Not surprisingly, the highest average cumulative foreclosure rate is found in the Rocky Mountain region, which includes Colorado and Wyoming—two states that were also hard hit by the oil bust. The average delinquency and foreclosure rates for the Southeast, geographically the largest region, fall in the middle of the range, at 5.76%. Louisiana's performance statistics were the weakest of all the states: over 25% of its Series 1982A program loans were seriously delinquent.

On the positive side, the Great Lakes and Far West regions tie for the lowest average delinquency rate, 1.56%. The New England region shows the lowest cumulative foreclosure rate in the country, at a total of 0.54%. Although this region's real estate market is currently undergoing significant stress, its cumulative foreclosure rate is low as a result of the very favorable housing market that existed for most of the 1980s. It is expected that this rate will rise somewhat over the near term if serious delinquencies and foreclosures persist. (See the chart on the next page.)

### Finances

Despite the current housing market woes being experienced across the country and the harsh realities that took place in the rust belt and oil patch states over the last decade, most state housing agencies are financially and administratively stronger than ever before. Many HFAs have generated substantial General Fund balances, including significant cash and

investments. While the average General Fund balance is over \$45 million, certain agencies have far more resources. Alaska, for example, has a General Fund balance of more than \$680 million—an amount that exceeds 16% of its total debt outstanding.

An agency's combined fund balance is another measure of its fiscal strength. On average, state HFAs have an average combined fund balance of more than \$165 million of total bonds outstanding. Leading all agencies in this ranking is the Hawaii Housing and Finance Development Corporation (HHFDC), which has more than \$390 million in combined fund balances, representing more than 64% of all the corporation's debt. While a significant amount of this combined fund balance is derived from state appropriations made over the years and earmarked for specific programs, HHFDC has also built up monies from its single- and multi-family bond programs.

In addition to the general financial strength of state HFAs, the overwhelming majority of the states' individual single family programs also exhibit continued sound financial performance. Thirty-three of these programs have assets exceeding liabilities by over 25%. Indeed, nine programs, or 5%, have more than one-and-a-half times the amount of assets as liabilities.

Many housing agencies have used a variety of methods to maintain the financial integrity and credit quality of each program. Refinancing techniques, such as the refunding of outstanding issues to take advantage of lower interest rates, are used by virtu-

ally all of the agencies. When necessary, some agencies have transferred monies from one program to another—or even from the General Fund—in order to protect weaker programs.

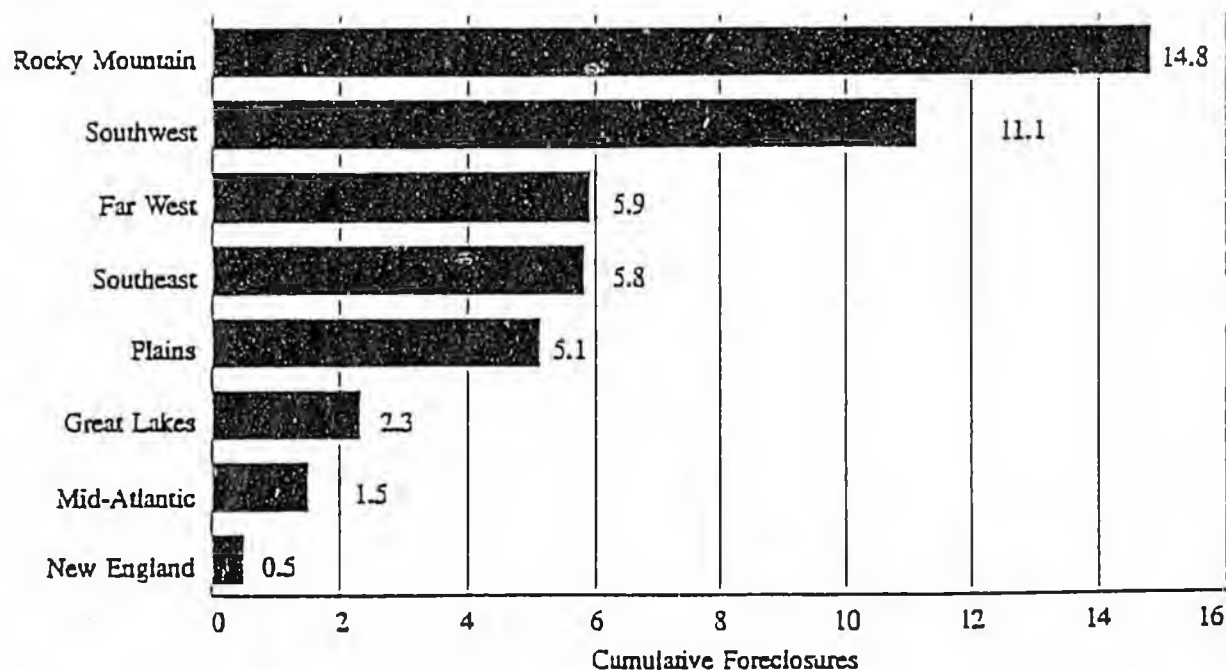
#### State HFAs Generally Stronger Than Ever

The last decade provided an effective laboratory in which to evaluate the resilience of mortgage revenue bond programs and the adaptability of state housing agencies. Throughout the 1980s, state HFAs were faced with a constant barrage of new challenges. Virtually every agency endured at least one economic downturn during the 1980s; some economies, such as that of Texas, have come almost full circle in the last 12-year period alone. Most agencies have gained from this experience and have learned to compensate for the downturns in program performance that are likely to prevail in harsh economic times. To that end, many agencies have expanded their functions and staff sizes to include servicing, investment management, primary and pool insurance, construction

financing, and property management, reflecting their growing expertise.

As a result of this sound management, as well as the accumulation of considerable reserves and the unique role that state HFAs play in delivering affordable housing, most state housing finance agencies are financially and administratively stronger than ever before. Moreover, Moody's has found that the overall portfolio performance of these bond programs has been better than state and national averages. Last year, in recognition of that exceptional strength, Moody's reassessed each of the 180 state single family programs and, for the first time, began to assign **Aaa** and **Aa1** ratings to programs that demonstrate superior and stronger performance and resilience, respectively. Moody's currently has **Aaa** ratings assigned to three programs, representing just under 2% of the universe, and **Aa1** ratings assigned to 18 programs, or 10% of the total. Most of the remaining single family housing programs are rated **Aa**; only 38, or 21%, are rated **A1** or below.

#### Foreclosure Experience



## State Single Family Programs— Portfolio and Financial Rankings

Agency/Program	Program Asset/Debt Ratio	Rank	Total Delinquencies as % of Loans Outstanding	Rank
<b>Alabama Housing Finance Authority</b>				
Single Family Mortgage Revenue Refunding Bonds, Series 1991 C	NA	NA	2.87	106
Single Family Mortgage Senior Revenue Bonds, Series 1984 B	1.040	110	3.31	120
Single Family Mortgage Senior Revenue Bonds, Series 1984 A	1.068	87	3.57	129
Single Family Mortgage Revenue Bonds, Series 1983B	1.082	79	2.69	101
Single Family Mortgage Revenue Bonds, Series 1983A	1.129	56	2.97	111
Single Family Mortgage Revenue Bonds, Series 1982B	1.028	130	2.94	110
Single Family Mortgage Revenue Bonds, Series 1982A	1.096	75	2.49	92
Single Family Mortgage Revenue Bonds, Series 1981A	1.019	141	3.21	166
<b>Alaska Housing Finance Corporation</b>				
Home Mortgage Revenue Bonds, 1983 Second Series	1.549	8	2.16	75
Home Mortgage Revenue Bonds, 1983 First Series	1.254	32	3.43	127
State Assisted Mortgage Bonds, Series J	4.858	1	2.40	86
Home Mortgage Revenue Bonds, 1982 Second Series	2.034	4	1.76	56
Home Mortgage Revenue Bonds, 1982 First Series	2.190	3	2.26	77
Home Mortgage Revenue Bonds, 1981 Second Series	1.345	15	2.02	67
Home Mortgage Bonds, 1981 First Series	3.450	2	1.63	47
Insured Mortgage Program Bonds	1.197	39	1.17	24
Housing Mortgage Program Bonds	1.524	9	2.38	84
<b>Arkansas Development Finance Authority</b>				
Single Family Mortgage Revenue Bonds, Series 1985 A	1.039	116	3.34	121
Residential Mortgage Revenue Bonds	1.079	81	3.42	126
Single Family Mortgage Revenue Bonds	1.135	54	3.23	116
Single Family Mortgage Purchase Bonds, Series 1978 A	1.344	16	4.91	151
<b>California Housing Finance Agency</b>				
Home Ownership Mortgage Bonds	1.139	53	2.50	94
Home Mortgage Revenue Bonds	1.027	133	1.50	37
Home Ownership and Home Improvement Revenue Bonds	1.122	61	2.90	107
Single Family Mortgage Purchase Bonds	1.190	42	1.70	50
<b>Colorado Housing and Finance Authority</b>				
Single Family Residential Housing Revenue Bonds	NA	NA	5.30	157
Single Family Revenue Bonds	NA	NA	4.63	145
Single Family Mortgage Program Bonds, 1984 Series A	NA	NA	4.60	144
Single Family Mortgage Revenue Bonds	NA	NA	5.11	156
Single Family Housing Revenue Bonds	NA	NA	3.28	119
<b>Connecticut Housing Finance Authority</b>				
Housing Mortgage Finance Program	1.040	112	4.68	147

State Single Family Programs—  
Portfolio and Financial Rankings

Cumulative Foreclosures as % of Number of Loans Originated		Average Outstanding Loan Amount		Program Fund Balance as % of Bonds Outstanding	
	Rank		Rank		Rank
7.6	74	38,597	77	NA	NA
4.6	51	45,145	110	4.33	122
4.5	49	45,506	114	3.66	37
NA	NA	43,531	103	10.29	78
NA	NA	42,846	100	15.42	54
NA	NA	40,375	92	3.96	128
NA	NA	40,386	93	10.13	30
NA	NA	31,520	45	1.23	14
12.2	39	71,557	159	-47.13	162
26.7	111	72,057	162	14.24	57
19.7	104	75,760	166	453.09	1
32.9	115	65,744	153	52.17	7
31.6	114	64,196	151	81.62	5
26.6	110	71,731	160	32.92	21
25.4	108	68,862	155	252.18	2
6.0	68	64,398	152	18.72	46
5.7	65	50,699	136	51.25	8
4.9	52	39,997	89	3.15	138
7.1	73	39,006	83	4.91	116
6.7	72	31,748	47	14.12	58
2.8	34	22,705	10	34.99	18
1.0	19	72,439	164	12.72	66
0.9	17	78,447	167	1.72	143
3.6	42	38,629	78	12.71	67
0.7	11	23,920	12	19.53	43
3.8	45	57,037	145	3.65	129
17.9	103	55,198	144	3.17	137
13.8	95	49,957	133	NA	NA
25.6	109	46,077	119	1.77	142
8.9	79	36,371	67	NA	NA
0.0	NA	71,960	161	5.10	113

## State Housing Agencies— Financial Rankings

State Housing Finance Agency	General Fund Balance as % of Bonds Outstanding
Alaska Housing Finance Corporation	16.3
Pennsylvania Housing Finance Agency	6.3
Connecticut Housing Finance Authority	5.9
Tennessee Housing Development Agency	5.2
Virginia Housing Development Authority	4.9
Missouri Housing Development Commission	4.8
New Hampshire Housing Finance Authority	4.7
Iowa Finance Authority	4.6
Georgia Housing and Finance Authority	3.3
Nevada Housing Division	3.2
Michigan State Housing Development Authority	2.9
Wisconsin Housing and Economic Development Authority	2.8
Illinois Housing Development Authority	2.8
New Jersey Housing and Mortgage Finance Agency	2.6
Minnesota Housing Finance Agency	2.4
West Virginia Housing Development Fund	2.1
Colorado Housing and Finance Authority	2.0
Massachusetts Housing Finance Authority	1.8
Wyoming Community Development Authority	1.5
Nebraska Investment Finance Authority	1.5
North Dakota Housing Finance Agency	1.4
Utah Housing Finance Agency	1.4
Mississippi Home Corporation	1.3
Oregon Housing and Community Service Department	1.3
California Housing Finance Agency	1.2
Ohio Housing Finance Agency	0.9
Maryland Community Development Administration	0.9
Washington Housing Finance Commission	0.9
Louisiana Housing Finance Agency	0.8
North Carolina Housing Finance Agency	0.8
Alabama Housing Finance Authority	0.8
Florida Housing Finance Agency	0.7
Indiana Housing Finance Authority	0.7
South Dakota Housing Development Authority	0.7
Maine State Housing Authority	0.7
Vermont Housing Finance Agency	0.7
Arkansas Development Finance Authority	0.6
Idaho Housing Agency	0.6
Kentucky Housing Corporation	0.5
Montana Board of Housing	0.3
Delaware State Housing Authority	0.3
Oklahoma Housing Finance Agency	0.2
State of New York Mortgage Agency	0.2
New Mexico Mortgage Finance Authority	0.2
Texas Department of Community Affairs	0.1
South Carolina State Housing Finance and Development Authority	0.1
Rhode Island Housing and Mortgage Finance Corporation	0.1
Hawaii Housing Finance and Development Corporation	NA

State Housing Agencies—  
Financial Rankings

State Housing Finance Agency	Combined Fund Balance as % of Bonds Outstanding
Hawaii Housing Finance and Development Corporation	64.4
Alaska Housing Finance Corporation	42.8
West Virginia Housing Development Fund	23.1
Kentucky Housing Corporation	19.1
Minnesota Housing Finance Agency	18.9
Iowa Finance Authority	16.0
New Jersey Housing and Mortgage Finance Agency	15.1
Virginia Housing Development Authority	13.7
South Carolina State Housing Finance and Development Authority	13.6
Missouri Housing Development Commission	12.4
South Dakota Housing Development Authority	12.3
New Hampshire Housing Finance Authority	11.6
Rhode Island Housing and Mortgage Finance Corporation	11.5
Maine State Housing Authority	11.4
Montana Board of Housing	11.3
Pennsylvania Housing Finance Agency	11.0
Connecticut Housing Finance Authority	11.0
Oregon Housing and Community Service Department	10.8
North Carolina Housing Finance Agency	10.4
Massachusetts Housing Finance Authority	10.4
Tennessee Housing Development Agency	9.7
Wyoming Community Development Authority	8.9
Nevada Housing Division	8.9
State of New York Mortgage Agency	8.4
Idaho Housing Agency	8.4
Michigan State Housing Development Authority	8.3
Wisconsin Housing and Economic Development Authority	8.2
Georgia Housing and Finance Authority	7.7
Utah Housing Finance Agency	7.7
California Housing Finance Agency	7.4
New Mexico Mortgage Finance Authority	7.1
Vermont Housing Finance Agency	6.4
Arkansas Development Finance Authority	6.2
Maryland Community Development Administration	6.2
Delaware State Housing Authority	5.7
Mississippi Home Corporation	5.6
Colorado Housing and Finance Authority	5.3
Alabama Housing Finance Authority	4.9
Nebraska Investment Finance Authority	4.8
Florida Housing Finance Agency	4.4
Illinois Housing Development Authority	4.3
Indiana Housing Finance Authority	4.2
Texas Department of Community Affairs	3.6
Louisiana Housing Finance Agency	3.1
Oklahoma Housing Finance Agency	2.6
Ohio Housing Finance Agency	2.4
Washington Housing Finance Commission	2.3
North Dakota Housing Finance Agency	2.2

## Alaska Housing Finance Corporation

### Overview

Established in 1971, the Alaska Housing Finance Corporation (AHFC) is a non-stock, public corporation and government instrumentality of the State of Alaska. AHFC was initially empowered to purchase only federally insured or guaranteed loans for low- to moderate-income Alaska residents. Subsequent legislation expanded the corporation's powers by allowing it to purchase conventional loans while removing income and purchase price limitations. Today, AHFC represents the major source of mortgage capital within the state, with more than 42,000 loans outstanding as of September 30, 1991, representing \$3.3 billion in mortgage principal outstanding. Through the use of highly sophisticated financing structures, the corporation has purchased these loans with the issuance of more than \$8.5 billion of debt, \$3.4 billion of which was outstanding as of September 30, 1991. The corporation continued its active issuing role throughout 1991, with seven issuances in the long-term capital markets, totaling approximately \$568 million. Although a very small portion of these issues represented new money, more than \$200 million will be made available for the funding of AHFC mortgage purchasing programs. For the first time, the corporation entered the multi-family housing market, with a \$5.8 million Housing Development Bond issue to provide funding for a 160-unit, low-income housing complex in Anchorage. This issue was unique in that the bonds were rated **Aa** based on the general obligation pledge of the corporation alone and not on the quality of the mortgage loan's pledge to repay the bonds.

AHFC became the first state housing agency to receive both long- and short-term ratings from Moody's based solely on the credit of the corporation. In April 1991, Moody's assigned a **Prime-1 (P-1)** rating to the Euro Commercial Program Notes of the corporation. AHFC plans to issue approximately \$20 million of additional Housing Development Bonds over the next year. A \$10 million issue was sold mid-February. AHFC also took advantage of the low interest rate environment, with the issuance of \$332 million in General Mortgage Bonds. AHFC used these proceeds to refund a comparable amount of bonds from the Insured Mortgage Program and Housing Mortgage Program, and assigned a portfolio of seasoned, well-performing loans to secure the new bonds, which were sold as variable rate securities. The variable interest rate of the securities allows the corporation to hedge against volatile interest rate swings, while reaping the benefits of very low interest rates. The bonds carry a subordinate pledge from the two indentures from which the bonds were refunded. The general obligation pledge, the assigned loans and reserves, together with the subordinate

pledge of the senior issues, provide high-quality security to bondholders and, therefore, received Moody's **Aa** rating. A consortium of highly rated European banks provide a liquidity facility for mandatory and optional tenders on the General Mortgage Bonds.

Over the last year, AHFC received four upgrades on its bond programs. The State Assisted Mortgage Bonds, Series J and K, were upgraded to **Aaa** from **Aa**, based on the superior levels of overcollateralization of bonds and very strong cash flow generated by mortgage portfolios carrying deep mortgage insurance coverage. The Housing Mortgage Program Bonds and the Home Mortgage Bonds, 1981 Second Series were upgraded to **Aa1** from **Aa**. The Housing Mortgage Program was upgraded based on a continued trend of strong net revenues, a very well-performing and seasoned loan portfolio of mostly federally guaranteed and insured loans, and the large fund balances and reserves. The Home Mortgage Bond Program was upgraded based on high level of collateralization and the loan security provided by the primary and remaining pool insurance. In addition, the general obligation pledge from AHFC—with its strong balance sheet and management—provided additional security for all AHFC debt. The State Assisted Mortgage Bonds, Series J, were fully redeemed on December 2, 1991, and are no longer outstanding.

The corporation is governed by a seven-member board of directors, all of whom are appointed by the governor. The chairman is elected annually. Corporation activities are managed by a staff of 128 permanent and 14 part-time employees. The corporation runs a variety of programs, most of which are targeted to single family homeowners, although the corporation recently established a multi-family loan purchasing program. AHFC finances tax-exempt single family programs, a taxable single family program, a veterans' single family program, several refinancing programs, a mobile home loan program, a condominium stabilization program, homeownership assistance programs, and a health and safety repairs program established to provide assistance to mortgagors whose properties have deteriorated to the point where safety may be threatened.

The corporation has nearly 60 ratings assigned by Moody's on programs that were established to provide single family mortgage loans. All but nine of these ratings, however, are based on third-party guarantees on the loans or the bonds from government sponsored enterprises (GNMA, FNMA, FHLMC), the State of Alaska, or bank letters of credit. The nine issues for which the bonds and loans are not guaran-

teed and which are backed by single family mortgage loans are reviewed in this report.

### Portfolio Performance

The corporation's portfolio performance has improved dramatically over the last few years. Serious delinquencies and foreclosures stood at 1.66% as of September 30, 1991, well below the state average of 3.73% and the national level of 2.63%. AHFC's real-estate-owned inventory (REO) as of the same period was 1.7%, or approximately \$36 million. These figures represent a vast improvement over the same period in 1988, when REOs exceeded \$250 million and delinquencies exceeded 15%, due primarily to the severe economic downturn that began in 1986. The improved portfolio can be attributed to a number of factors, including general improvement in the economy and housing markets, but more so to the effort by the corporation to deal with delinquent borrowers and foreclosed properties. Refinancing and loan workout programs and asset management controls were established and enabled AHFC to reverse the trend.

Although a significant portion of the mortgage portfolio is securitized by the corporation into mortgage-backed securities issued or guaranteed by FNMA, FHLMC, and GNMA, most of the loans backing the securities have recourse to the corporation, along with the general obligation pledge on all the corporation's debt.

Bond programs are sufficiently insulated from the deteriorated loan portfolio, as adequate primary and pool insurance, loan loss reserves, and overcollateralization cushion the loss on defaulted loans. Substantial pool insurance policies (15-25% of loan balance) have been obtained for roughly a quarter of the portfolio and, although some are exhausted or close to exhausted, the remaining insurance is a key security provision in absorbing losses on defaulted properties.

The corporation continues to discuss with MGIC discrepancies regarding claims submitted under a number of pool policies issued by WMAC from 1981 to 1984, and by MGIC in 1988 and 1989. MGIC has been denying full settlement of claims under these policies. MGIC and AHFC are currently in litigation. The corporation has been reserving for possible loss against these claims to reduce the impact against bond programs. Moody's continues to monitor the situation and will report on any developments of significance, as well as the outcome of the suit and its effect on bond programs and assets of the corporation.

### Financial Characteristics

Financially, AHFC is quite strong, with undesignate fund balances at fiscal year-end June 30, 1991 of \$569 million, or about 16.3% of total outstanding debt. As of the same period, the combined fund balance of the corporation was \$1.49 billion, nearly 43% of bonds outstanding. All AHFC's debt carries its full faith and credit pledge; however, all of its programs, including the guaranteed issues, are self-sustaining even under stressful loan loss scenarios. The corporation earned \$113 million in combined net income in fiscal 1991, before a \$13 million expense of losses due to early retirement of debt and an annual dividend paid to the state of Alaska, which totaled \$17 million. This dividend plan was established by the corporation in 1990. According to its terms, AHFC agrees to pay the state each year a portion of the net income of the corporation, based on a formula that excludes any amounts the corporation deems necessary to protect its financial integrity. The corporation paid the state \$15 million on December 1, 1991, representing the dividend due based on fiscal 1991 earnings.

AHFC's financial performance has also improved dramatically from prior years. The corporation reported net losses in 1988 and 1989 of \$21 million and \$124 million, respectively. These losses were a result of conservative increases in loan loss reserves and write-offs and write-downs of REOs and losses incurred from foreclosures. The large loss in 1989 effectively accounted for the expected losses on the portfolio for the remaining life of the bonds. Fiscal 1990 showed a return to profitability with a combined net income before extraordinary items of \$34 million. As a whole, the individual bond programs—with some exceptions in the older, more seasoned programs—followed the same pattern as the corporation. Program cash flows remain sound.

### State Highlights

Alaska prospered in the late 1970s and early 1980s, riding a wave of oil revenue. The state estimated that every \$1 change in the price of oil affects in-state revenue by \$150 million. During this period, the construction industry and housing markets flourished, eventually leading to substantial overbuilding, particularly in 1983. By 1985, home prices had appreciated 40% over 1980. In 1986, the price of oil dropped sharply, state spending of oil revenues ceased, and the economy spiraled into a severe recession. Unemployment was twice the national average and the housing demand disappeared, driving delinquency rates for home mortgage loans owned by AHFC and

elsewhere in the state into the high teens. Home prices fell dramatically, virtually erasing all gains achieved since 1980. Substantial losses on foreclosures were incurred, caused by the price declines, holding and restoration costs, and other expenses related to foreclosure. By the end of the decade, the recession began to subside, aided by the oil cleanup, a rebound in state and local spending, and the creation of new jobs in trade, services, and the fishing and logging industries. Unemployment reached an all-time low in 1990, dipping under 6% for a brief period. Although the economy has diversified somewhat, it is still highly dependent on petroleum and related industries, which makes the economy volatile to economic swings. Home prices appear to have stabilized, although no real price appreciation is evident, partly due to the disposal of REO inventory by institutions such as AHFC. The market is absorbing

the supply, without any real depreciation, which reflects a trend of stabilization.

In 1991, however, unemployment soared to a level not experienced in the state since May 1988, when the rate stood at 10.1%. Unemployment for November 1991 was 9.8%, 3% higher than just one year ago, when jobless Alaskans numbered 16,900 compared to 25,000 this past November. The economy shows signs of weaknesses, similar to the nation as a whole, which marks the first time in 15 years that the state's economy is behaving like that of the nation. Alaska's economy was expanding during the national recessions of 1972, 1980, and 1982, and faltered in 1986-1988, when the nation was growing. AHFC's financial position and management controls should enable the corporation to weather the swings of the state's economy.

outstanding  
ratings:

Program	Rating
General Mortgage Revenue Bonds	Aa
State Assisted Mortgage Bonds, Series J	Aa
Home Mortgage Revenue Bonds, 1983 Second Series	Aa
Home Mortgage Revenue Bonds, 1983 First Series	Aa
Home Mortgage Revenue Bonds, 1982 Second Series	Aa
Home Mortgage Revenue Bonds, 1982 First Series	Aa
Home Mortgage Revenue Bonds, 1981 Second Series	Aa1
Insured Mortgage Program Bonds	Aa
Housing Mortgage Program Bonds	Aa1

financial  
overview:  
(\$000)

	6/30/89	6/30/90	6/30/91
General Fund balance	\$519,102	\$586,744	\$568,604
General Fund balance as % of bonds outstanding	14.3%	16.7%	16.3%
Combined fund balance	\$1,371,441	\$1,405,783	\$1,488,610
Combined fund balance as % of bonds outstanding	37.8%	39.9%	42.8%
Transfers in and (out) of General Fund	\$(5,594)	\$(5,341)	\$(12,676)

analysts: Chris Martin  
(212) 553-4836  
Marc Paskulln  
(212) 553-7759

# FISCAL NOTE

**STATE OF ALASKA**  
**1994 LEGISLATIVE SESSION**

**BILL NO.** SCR 12

Revision Date: February 28, 1994 Dept. Affected: Department of Revenue  
 Title: A Resolution requesting the governor to have prepared a report BRU: Alaska Housing Finance Corp  
and recommendation concerning the disposition of certain assets of the AHFC. Component: Operations  
 Sponsor: Senator Adams  
 Requestor: Senate Labor & Commerce COMPONENT SERIAL NO. 0110

**Expenditures/Revenues:** (Thousands of Dollars)

	FY95	FY96	FY97	FY98	FY99	FY00
<b>OPERATING</b>						
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
<b>TOTAL OPERATING</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>CAPITAL</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>REVENUE FUND SOURCE:</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

**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
1022 Corporation Receipts	0	0	0	0	0	0
<b>TOTAL</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

**POSITIONS:**

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

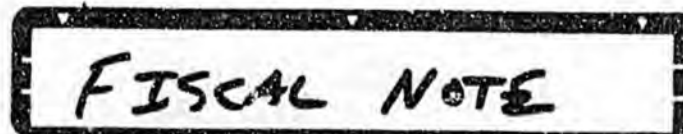
Estimate of current year (FY94) Impact: \$ 0

**ANALYSIS:** (Attach a separate page if necessary.)

The AHFC Board has directed staff to retain an independent financial advisor to perform various tasks including the analysis of resource levels and program demand. The complex process required to complete this important analysis will be time consuming for staff, financial advisor, and the Board. The estimated time for completion is Fall of 1994, during the FY 95 budget year. The estimated cost of the contract to perform the analysis is \$250,000.

Prepared by: Judith DeSpain Phone: (907) 581-1900  
 Division: Alaska Housing Finance Corporation Date: February 28, 1994  
 Approved by: [Signature] Date: 2/28/94  
 Agency: \_\_\_\_\_

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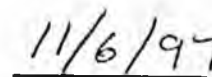




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Signature of Camera Operator

  
Date

**SJR**

**45**



# Alaska State Legislature

SENATOR JIM DUNCAN

February 22, 1994

## **SPONSOR STATEMENT, SJR 45 INCLUDING ALASKA SEAFOOD PRODUCTS IN BILATERAL TRADE TALKS**

**SENATOR JIM DUNCAN**

Senate Joint Resolution 45 requests the Clinton Administration to include Alaska seafood products in on-going bilateral trade talks with Japan. The resolution is the first step to opening discussions with the Japanese about business practices and fair pricing for Alaska seafood products.

The resolution was suggested by the chief investigator into the Alaska attorney general's inquiry of the Bristol Bay sockeye salmon industry. The 1993 attorney general's report suggests price fixing on the part of the Japanese, who purchase the majority of Alaska salmon, and own and operate many processing firms in Alaska. Low salmon prices are, of course, the result of many factors, including competitive market forces. According to the Alaska Seafood Marketing Institute and the Division of Economic Development, wild Alaska salmon is losing its dominance in the Japanese market to Chilean, Norwegian and Russian farmed salmon.

At this time of severely depressed Alaska seafood prices and increased competition, this is a small step the Alaska Legislature can take to support efforts for fair pricing for our seafood products.

**SJR**

**51**

## TONKON, TORP, GALEN, MARMADUKE &amp; BOOTH

ATTORNEYS AT LAW

1600 PROMENADE TOWER  
 688 S.W. FIFTH AVENUE  
 PORTLAND, OREGON 97204-3099  
 (503) 221-1440  
 FAX (503) 274-8779  
 TELEX 580822-HQ-PTL

WILLIAM R. MARSTON, JR.

February 10, 1994

VIA TELEFACSIMILE AND CERTIFIED  
RETURN RECEIPT REQUESTED

Mr. Michael Barton  
 Regional Forester  
 United States Forest Service  
 P.O. Box 21628  
 Juneau, Alaska 99802-1628

Dear Mr. Barton:

I have been asked to respond on behalf of Alaska Pulp Corporation to your letter of January 13, 1994.

Alaska Pulp Corporation ("APC") is concerned about both the content and timing of the government's January 13, 1994 letter. APC is not repudiating its contract, either in fact or by operation of law. On the contrary, it is the Forest Service, at the urging of certain groups, which is threatening to ignore its obligations under the contract, the plain words of the contract, and the past dealings of the parties under the force majeure and other clauses of the contract, in order to "terminate" it. 1/

The government's interpretation of the contract is inconsistent with the parties' course of conduct since the contract's inception. APC's invocation of the force majeure clause in this case is consistent with the language of Section 5(s)(2) of the contract, and with how the parties have consistently treated mill closures on other occasions.

The contract provides for flexibility in how APC meets its obligation to primarily manufacture the harvested timber

1/ APC does not intend by this letter to make a claim against the United States, or any agency, official or employee thereof.

0000

TONKON TORP FX B

5803 274 8779

02/10/94 10:18

LTR. FROM WILLIAM MARSTON  
 COUNSEL TO AK PULP CORP.

Mr. Michael Barton  
February 10, 1994  
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within Alaska so as to effectively deal with economic changes over the 50-year term of the contract. It does not require that the dissolving pulp mill, nor any other specific facility, be operated continuously for 50 years. The proposed modification of the dissolving pulp mill to an MDF facility is fully in accord with the express terms of the contract and with the parties' conduct over time.

The demands made on APC in the January 13, 1994 letter are also commercially unreasonable and substantively improper. As you knew when you signed the letter, the time within which the government requires "cure" and what the government requires APC to do by way of "cure" are impossible.

Finally, the timing of your letter may well interfere with or even prevent APC from moving forward on or finalizing plans for "an alternate pulp facility." This will have a materially adverse effect upon APC, its employees and timber dependent communities in southeast Alaska.

1. Which is the Contract Between the Parties?

In September 1989, APC and the United States executed a bilaterally negotiated contract ("Settlement Contract") that became effective June 30, 1990. After enactment of the Tongass Timber Reform Act ("TTRA"), the United States purported unilaterally to impose new and different contract terms ("Unilateral Terms") on APC. In Alaska Pulp Corporation v. United States, et al., USDC District of Alaska, Case No. J93-010 (JKS), APC is challenging the validity and applicability of the Unilateral Terms. In that action, the United States admitted that APC "has never signed nor agreed in a binding manner" to the Unilateral Terms. APC continues to object to the United States' efforts improperly to impose the Unilateral Terms. It is the Settlement Contract which controls the relationship between the parties.<sup>2/</sup>

The contract changes the Government has sought to impose unilaterally on APC cannot be ignored. Even assuming (which APC does not) that the TTRA was constitutional, in drafting the Unilateral Terms, the Forest Service imposed far more economically onerous terms than were required by the TTRA. There is nothing improper in APC seeking corrective revisions to the Unilateral Terms, first through negotiations and then by

<sup>2/</sup> The language found in Section 5a2 and General Term 4 of the Settlement Contract are the same in the Unilateral Terms.

TONGKON, TORP, GALEN, MARMADUKE & BOOTH

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judicial intervention.

## 2. Background

On June 30, 1993, APC notified the Forest Service of its intention "to indefinitely suspend pulp mill operations at the Sitka mill effective September 30, 1993." APC's notice referenced Section 5a2 of the contract and cited the serious adverse impacts of the Unilateral Terms as a principal reason for its action. The next day, July 1, the contracting officer wrote APC acknowledging receipt of the June 30 letter, expressing surprise at APC's decision, and stating that APC's concerns about the adverse economic impacts of the Unilateral Terms were "well known to [him]." He then invited APC to discuss ways to minimize the impact of the decision on southeast Alaska's economy and "projections of future market demands for dissolving pulp and other products." (Emphasis added.)

For almost three months thereafter, the contracting officer and APC worked on a preliminary study of the feasibility of converting the pulping operations in Sitka from the production of dissolving pulp to the manufacture of medium density fiberboard (MDF). With the contracting officer's help, the Forest Products Lab rendered substantial assistance. At each turn, the preliminary assessment of MDF was encouraging.

During this three-month period, APC took the steps necessary to shut down the Sitka mill on September 30. It laid off a substantial number of employees. It enhanced their retirement plan. It sold its winter inventory of pulp logs to KPC so that this material would receive primary manufacture in Alaska as required by the contract. It also made plans to winterize the plant. This latter activity was necessary because a pulp mill must either be run for the entire winter season, or the machinery must be protected from the cold weather. In short, throughout the summer logging season, APC built saw log inventory, sold pulp logs to KPC and made other preparations for the shutdown of the dissolving pulp mill for at least the winter. By September 24, 1993, the plan to shut down the mill for at least the winter of 1993-94 was irreversible. All of this activity was consistent with the language of the force majeure clause, General Term No. 4, and the parties' course of conduct pursuant to those and other contract provisions on other occasions. (See Exhibit A.)

Yet, three days later, on September 27, 1993, APC received its first notice that the Forest Service was considering taking the position that APC's announced actions constituted a

TONKON, TURP. CALEN, MARMADUKE & BOOTH

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repudiation of the long-term contract. Throughout this three-month period, APC knew that certain groups who were never satisfied with the results of the TTRA, were urging the government to use the shut down as an excuse to terminate the contract -- a goal held by some of these groups for a long time. However, before September 27, 1993, APC never received any official or even private indication from the Forest Service or its contracting officer that the United States would accede to this clamoring.<sup>3/</sup> Only through a response to a Freedom of Information Act request, has APC learned that the interference with its long-term contract by certain groups intensified after September 24, 1993. The positions adopted by the Forest Service in its January 13, 1994 letter simply reflect its capitulation to the arguments made by these groups. The positions taken to justify termination are inconsistent with the plain words of the contract, with the government's prior practice in response to APC's shutdowns, and with the government's duty of good faith and fair dealing.

3. Section 5a2 was Properly Invoked and Does Not Provide a Basis for Termination by the Forest Service

Section 5a2 of the contract was properly invoked by APC. This section is a force majeure clause which gives APC the right to suspend certain operations because of abnormal causes beyond APC's control (including acts of the government). Such force majeure clauses are commonplace and routinely upheld by courts.<sup>4/</sup> More importantly, once a force majeure clause has

<sup>3/</sup> Indeed, one of these groups, in connection with an appeal of the North and East Kuiu Final Environmental Impact Statement, asserted that mill shutdown constituted a material breach. The contracting officer refused to accede to this argument.

<sup>4/</sup> The courts have consistently held that the government can, by the use of force majeure or other contract clauses, assume the risk and costs of its own actions. Hughes Communications Galaxy, Inc. v. U.S., 998 F2d 953, 958-59 (Fed Cir 1993); Amino Brothers Co. v. U.S., 372 F2d 485, 491 (Ct Cl 1967); see Minstar Corp. v. U.S., 994 F2d 797, 812-13, withdrawn pending en banc review (Fed Cir 1993) (parties who failed to negotiate force majeure provision could not complain about Sovereign Act changing regulations that were the subject of the contract); see also Northern Indiana Public Service Commission v. Carbon County Coal Co., 799 F2d 265, 274-76 (7th Cir 1986) (discussing force majeure provisions generally);

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been invoked properly, the noninvoking party (here the Forest Service) cannot hold APC in breach because of the consequences of proper invocation.

This is not the first time the dissolving pulp mill or sawmill facilities have been shut down for reasons beyond the control of APC (i.e., under circumstances to which Section 5a2 applies). The dissolving pulp mill has been shut down for some period of time during 13 of the 30 years since 1962 for reasons covered by Section 5a2. (See Exhibit A.) Some of these shutdowns lasted several months. The Forest Service never asserted or even hinted at breach. Yet, now, after only 3 1/2 months of down time, the Forest Service asserts that APC is in breach of its contract. In addition, during the past 34 years, APC's sawmills (included in the definition of "pulp mill" under the contract) have been shut down and even dismantled. The shutdowns lasted for months. There were no claims of breach by the Forest Service. The Forest Service's January 13, 1994 notice is, at a minimum, premature and is inconsistent with its past actions under the contract.

The interpretation of Section 5a2 which the Forest Service has now adopted is incorrect. You assert that this section applies only when the pulp mill shuts down "in conjunction with shutdown of logging." It is certainly true that both a pulp mill shutdown and logging shutdown are discussed in Section 5a2. However, the disjunctive word "or" separates these separate possibilities, not the conjunctive word "and." The section provides in pertinent part:

"If the operation of the pulp mill<sup>5</sup>/ ... or  
timber harvesting operations is shut down ...  
." (emphasis added)

This certainly means that the events are independent, not dependent as asserted in the January 13, 1994 letter.

Having attempted to transmute the word "or" into "and," the January 13 letter next seeks to excise the words "acts of the Government" altogether. Section 5a2 may be invoked for:

"... abnormal causes beyond the control ...  
of Purchaser which would permit operation of  
a pulp mill ... only at a loss, including but

5/ Under General Term 4, the defined term "pulp mill" includes sawmills.

TORONTO, TORP, DALEY, MAJUMDAR & BOOTH

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not limited to ... acts of the Government  
 ... ." (emphasis added)

It was the United States ("the Government") which unilaterally and so fundamentally changed the long-term contract between it and APC. It was "the Government" which struck out the economic heart of the contract -- the mid-market test. It was "the Government" which unilaterally reduced the volume of the contract. And it was "the Government" which imposed a material price surcharge. These "acts of the Government" aimed at this and only one other contract were abnormal -- such governmental conduct is almost unprecedented -- and permit APC the ability to operate "a pulp mill ... only at a loss." <sup>6/</sup> Section 5a2 could not be more clearly applicable.

Another problem with your interpretation and attempted use of Section 5a2 is that it does not provide a basis for the United States to terminate the contract. It is a section which establishes the preconditions which must be met before the contract term can be extended. That is, if APC does not meet the preconditions of Section 5a2, it simply does not qualify for an extension of the contract. Section 5a2 is utterly silent as to what happens if APC does not meet its preconditions, but does not ask for a contract extension. APC has met Section 5a2's preconditions. You dispute that. However, APC has not as yet asked for a contract extension.

4. The Nature of the Activity Constituting "Primary Manufacture" Can and Has Changed with Time.

Contrary to the statements in your letter, the contract does not require APC to operate any particular mill facility -- whether it be a dissolving pulp mill, an MDF plant, or a sawmill -- continuously over the 50-year term of the contract. Again, the express terms of the contract are quite clear. General Term 4 provides, "Prior to December 31, 1981, the Purchaser ... shall install ... a mill or mills for the manufacture of pulp ... ." (emphasis added) The contract does not say "install and operate" as stated in the January 13, 1994 letter. It only says "install." Therefore, once APC met its construction obligation by installing a mill for the manufacture of pulp by the specified date, the United States became obligated to make the timber purchased by APC available over the following 50 years.

<sup>6/</sup> In some cases, such as the inclusion of utility volume in the contract volume, only APC's contract was modified by the TTRA.

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The contract is quite clear on this point because neither party could predict how economic forces would change over the 50-year term of the contract. After all, there had been revolutionary economic and political changes in the preceding 50 years. All the parties knew was that it was highly likely that there would be major economic and political changes in the next 50 years as well. Hence, they carefully crafted a contract which allowed for flexibility in how APC's primary manufacturing obligation could be satisfied over time as major economic changes occurred. This was only reasonable. No one in any manufacturing sector would ever agree to operate a manufacturing facility continuously for 50 years without any changes -- small or large.

To the extent that the contract is considered at all ambiguous on this issue, the historical record concerning the formation and evolution of the contract over time makes it clear that the United States' prime concerns were full utilization of the minimum cut and primary manufacture, not the form of either. The Tongass contained large volumes of timber that were not merchantable as sawlogs at the time the original contract was executed. Because of the species and quality of timber available, it was essential that there be a manufacturing facility capable of utilizing the non-sawlog timber so as to avoid leaving those trees in the forest.

In the 1950s, the Forest Service believed that a pulping facility was necessary to utilize all the timber in the Tongass. The Forest Service did not care what type of facility was installed -- and there were many different ways to fully utilize the timber at that time -- so long as the facility, in conjunction with any other facilities built by the purchaser, was able to utilize all of the timber in the sale area and meet minimum cut requirements. By requiring APC to build a "mill for the manufacture of pulp," the United States achieved its goal of establishing a year-round industrial enterprise at the same time that it ensured that lesser quality trees would not be left in the forest. The contract's utilization, minimum cut, and primary manufacture requirements, along with APC's initial \$60 million investment in the construction of the pulp mill, set into motion economic forces which have resulted in virtually continuous operations of the mill until now.

But the creation of economic forces which result in the

The Forest Service believed that it was important that trees not be left in the forest because this would promote better regeneration and better prevent damage from blown down trees.

TONGASS, TOP, GALEN, MANULIK & BOUTH

THE  
FOLLOWING  
DOCUMENTS  
ARE  
POOR  
ORIGINAL  
COPIES

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operation of a particular facility (e.g., a dissolving pulp mill) is far different from an express contract term mandating operation of a dissolving pulp mill or any other particular facility. The contract between the United States and APC did not expressly require operation of any particular mill continuously over the 50-year term of the contract. If that had been the parties' intention, all they had to do was insert the words "and operate" after "install." They did not.

The parties' performance under the contract makes it clear that how APC can meet its obligations of primary manufacture and full utilization has in fact changed in response to changes in economic forces. After 1961, as markets developed for hemlock and spruce cants, APC diverted more of the timber away from its dissolving pulp mill to its Wrangell saw mill. To avoid putting what had become marketable saw timber through the dissolving pulp mill, APC harvested even more of the lower quality pulp timber, which it previously had not been required to harvest because it was considered unmerchantable. Having become merchantable, this pulp timber came to be defined as utility logs under the contract, and APC became obligated to harvest them and to pay stumpage for them. APC has spent over \$100 million altering the dissolving pulp mill.

It has also dramatically changed its sawmill operations. In 1960, APC operated an older sawmill in Wrangell which only produced waney cants. Another mill was purchased several years later which produced baby squares (4" x 4"). Starting in 1979, both mills were shut down and then demolished. A totally new mill was then constructed in Wrangell to take advantage of new manufacturing technology and to produce additional products to meet changed economic demand. This new mill produces baby squares, flitches and finished lumber.

In short, both the dissolving pulp mill and the sawmill which exist today are very different from what existed in 1961.<sup>8/</sup> All of these changes were obviously accomplished with full knowledge of the Forest Service. They were also accomplished without any change in the language of General Term No. 4.

The nature of the timber the Forest Service offers APC has been changing too. This is having an increasingly dramatic

<sup>8/</sup> This improved (and different) utilization also has been reflected in the appraisal process integral to pricing the timber APC harvests under the contract.

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pulp, but into medium density fiberboard. Because of its use of chips, an MDF mill provides utilization for all the non-sawlog, non-cedar logs produced from the long-term sale area.

APC is pursuing conversion of the Sitka facility for the following principal reasons: 1) MDF will provide a more economical return than continued dissolving pulp production, which will permit APC to salvage its investment in the Sitka facility and provide employment in Sitka; 2) environmental concerns associated with production of dissolving pulp can be responsibly dealt with through manufacture of MDF; and 3) the economic improvements in the integrated facility will help secure the future of the logging and sawmill operations in Wrangell.

Although APC can meet the primary manufacture, minimum harvest and utilization requirements by running only the Wrangell sawmill, it makes good business sense to maximize returns by converting to MDF with its improved economics. To continue to sell residual chips and pulp logs to KPC, which operates a dissolving pulp mill, makes less economic sense.

6. APC Has Made a Commercially Reasonable Commitment to Construct an MDF Plant.

In response to your letter of February 4, 1994, on February 8, 1994, APC Chairman and President George Ishiyama stated very clearly the company's intention to convert the Sitka dissolving pulp mill and the basis for the six-month study schedule required. A six-month schedule is commercially reasonable.

7. The Demanded Cure is Unreasonable.

The Forest Service has sent APC a notice of intent to terminate which provides that the only way to avoid a declaration of breach and termination of the contract is to restart the dissolving pulp mill within 30 days. Even assuming that the Forest Service has the right to require the restarting of the dissolving pulp mill (which APC denies), the timing of its demand and the time within which the restarting is demanded are both commercially unreasonable. While it was working with the Forest Service to explore an MDF alternative, APC sold its 1993-94 winter pulp log inventory to KPC with the Forest Service's approval. Hence, it currently has no pulp log inventory at its Sitka mill, and has no ability to get any until logging resumes this spring. Further, it laid off its work force (again without objection or protest from the Forest Service). Finally, it drained pipes and otherwise secured the plant for a winter

TOWNSON-TORRETT-BARNADUCE & SOUTH

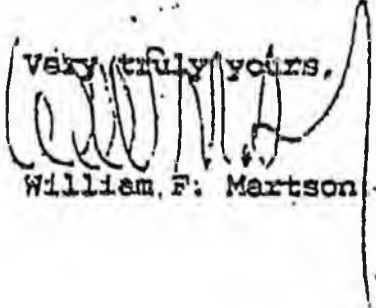
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without operation. Then, in the dead of winter in Alaska, APC receives a demand by the Forest Service to restart the plant -- not within a reasonable time, allowing it to secure inventory and a work force, but within 30 days. At the very least, the Forest Service waived any default by APC by allowing APC to take these actions over the summer.

### 8. Conclusion

APC, its employees, and the citizens of southeast Alaska merit a resumption by the Forest Service of its performance of the long-term contract in accordance with its express terms and the past practices of the parties. APC is in full compliance with its contract obligations by operating the Wrangell sawmill and by selling its chips and pulp logs for primary manufacture in Ketchikan. APC's conversion of its dissolving pulp mill to an MDF plant is just another in a series of facility modifications authorized by the contract. As such, your letter of January 13, 1994 should be withdrawn. At a minimum, it should be modified so as to allow APC a commercially reasonable time (six months) to pursue the next step in converting to an MDF facility. This result is required by the express terms of the long-term contract and the United States' obligations thereunder -- including its obligation of good faith and fair dealing.

Very truly yours,

  
 William F. Martson Jr.

WFM:ehd

THOR & BENDIS, ATTORNEYS AT LAW, SEASIDE, CALIFORNIA

EXHIBIT A

ALASKA PULP CORPORATION  
 SITKA DISSOLVING PULP MILL  
 OPERATING DAYS AND SHUTDOWN DAYS

FISCAL YEAR	CALENDAR DAYS	SCHEDULED SHUTDOWNS	SHUTDOWNS FOR REASONS BEYOND APC'S CONTROL	OPERATING DAYS
1960	365	17	-0-	348
1961	365	17	-0-	348
1962	365	24	17	324
1963	366	16	-0-	350
1964	365	10	-0-	355
1965	365	12	26	327
1966	365	11	-0-	354
1967	366	11	-0-	355
1968	365	18	-0-	347
1969	365	15	-0-	350
1970	365	15	-0-	350
1971	365	22	-0-	344
1972	365	17	-0-	348
1973	365	18	70	277
1974	365	18	10	337
1975	366	37	26	303
1976	365	35	-0-	330
1977	365	23	-0-	340
1978	365	23	-0-	342
1979	366	19	-0-	347
1980	365	12	-0-	353
1981	365	10	-0-	355
1982	365	14	76	275
1983	366	14	57	295
1984	365	14	56	295
1985	365	14	107	244
1986	365	10	27	328
1987	366	10	-0-	356
1988	365	13	-0-	352
1989	365	14	-0-	352
1990	365	21	46	298
1991	365	21	18	327
1992	365	21	19	325

## ACKNOWLEDGEMENT

On February 10, 1994, I received a 12-page letter dated February 10, 1994 from William F. Martson, Jr. on behalf of Alaska Pulp Corporation.

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Michael Barton  
Regional Forester Contracting  
Officer



# UNITED PAPERWORKERS INTERNATIONAL UNION

LOCAL NO. 962

P.O. BOX 804

SITKA, AK 99835

April 4, 1994

ATTN: Jack Ward Thomas, Chief

United States Forest Service  
Department of Agriculture  
P.O. Box 96090  
Washington, D.C. 20090-6090

Dear Chief Thomas:

On behalf of the members of Local 962, of the United Paperworkers International Union, I would like to strongly urge you to cancel the 50-year long-term federal timber contract of Alaska Pulp Corporation (APC).

Our union represented the hourly workers at the APC mill prior to April 1, 1987, when our union was de-certified after a 10 month strike. Local 962 represented the workers at APC from 1959, up until the end of the strike. During the years immediately prior to the strike, our membership made many concessions to, in APC's words, "keep the mill going". These concessions were made in good faith, and always with APC management's promise that the union would be fully compensated "when the market improved".

Instead of repaying the union workers who had voluntarily sacrificed wages and benefits to help the company stay alive, APC ruthlessly elected to act in bad faith, and to abrogate their moral and financial responsibility to us, their most loyal workers . . . by forcing us into a strike situation, and then hiring scabs to "permanently replace" us.

Alaska Pulp's 50-year contract is, basically, a trade for a given amount of federal timber, in return for a specific number of jobs involved in operating a pulp mill. Our workforce, historically numbered 390 to 400. It seems that now, APC wants to give the government "short shrift" . . . they want more timber, but in return, won't even make a commitment to provide a quarter of the jobs (in their proposed MDF plant) that they have previously committed to provide, under the terms of the 50-year contract. APC is clearly in breach of both, the spirit, and the letter of the contract.

Alaska Pulp has a proven record of being a bad employer; and a worse neighbor. The National Labor Relations Board (NLRB) is on record as saying that APC owes our members in excess of \$12,000,000 in back pay, as a result of APC's proven guilt in committing unfair labor practices against most of our members . . . *and continuing to do so, over a seven year period.* APC has no moral or legal right to hold a federal timber



USIS/Local 962

April 4, 1994

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contract, based upon the circumstances surrounding their treatment of our members; and the closure of the pulp mill. If there is any justice in this world, APC's contract *must* be cancelled.

Unless APC's contract is cancelled, the majority of our members will be forever foreclosed from working in Southeast Alaska's timber industry. The original framers of the 50-year contract intended us, the workers, to be the beneficiaries of the 50-year contract. We were the originally-intended heirs to the 50-year contracts. APC has abrogated their responsibility to us, and thus, the government has no further responsibility to them. The contracts must be cancelled.

The sustainable timber harvest resources of the Tongass must be placed on the open, free market if the maximum value of the timber is to be realized by the government. If the timber is sold to the highest bidder, more and higher-paying jobs will appear in Southeast Alaska; the Tongass contains the last, largest viable stands of high quality wood left in the Pacific Northwest. Why give it away . . . for nothing?

In closing, once again, our local strongly urges you to cancel the APC 50-year contract, and allow the free market to take its course.

Sincerely,

  
John W. Lawson, Vice President



The Foundation for the  
**PROTECTION** of the  
**COMMON PEOPLE**  
P.O. Box 3122, Sitka AK 99835

April 5, 1994

Chairman Tim Kelly  
Senate Labor and Commerce Committee  
Alaska State Legislature  
Juneau, AK 99801

RE: Opposition to SJR 51

Dear Chairman Kelly:

The Foundation for the Protection of the Common People, Inc ("FPCP") is an organization recognized by state and federal governments as one which acts in the best interests of the general public. Our stated purposes are to promote compliance with all environmental laws and regulations; and, to *protect the civil and human right of all individuals.*


In light of the above statements, I must hereby lodge the most stringent objections to the process which is being followed in the instant hearing, concerning SJR 51. I believe that the speed at which the instant Resolution is being "ram-rodged" through the Alaska State Legislature is a blatant abuse of the legislative process.

The citizens of Sitka, *who will be most affected by the passage of SJR 51*, are being *denied* their right to take part in the hearing process. I believe your Committee is doing a disservice to the people of Alaska, and causing further damage to the already tarnished credibility and integrity of the Alaska Legislature.

I ask that you kill SJR 51, in the best interests of the legislative process, the general public; and on the merits of the Resolution.

SJR 51 is a classic representation of self-serving politics. You are not doing the business of the public; you are simply pandering to the greed of the timber industry. In fact, you are taking up the Legislature's valuable time promoting the financial interests of a single corporation. This exercise is a sham, and a mockery of the legislative process. The passage of this Resolution will once more demonstrate this Legislature's persistent and autocratic refusal to do the will of the people.

Sincerely,

  
Florian Sever, President

April 5, 1994

Senator Tim Kelley:

Please include my comments in your deliberation today of SJR 51.

I am speaking as a Sitka business person, for the last 18 years being manager and co-owner of a general bookstore.

I strongly oppose the continuation of the APC 50-year contract, and I strongly oppose the development of an MDF plant operated under such a contract.

My comments regarding the timber and contract issue are contained in the attached testimony and map. The contract goes against sustainable use of the forest and will result in a de-stabilization of the economy of the entire region. One final quote from a recent Forest Service publication (Tongass National Forest: Annual Monitoring and Evaluation Report, Fiscal Year 1993): "The Chatham Area has not participated in the Small Business Administration set-aside program for the past six years, since all the timber volume available on the Area is being scheduled to meet the obligations of the Alaska Pulp Corporation 50-year timber sale contract." In other words, there is no room available for small timber operations because APC has it all.

Regarding the MDF plant: because of statements made by APC and other individuals and agencies, the impression is falsely being promoted that the MDF process is non-polluting (e.g. the following statement from the Ketchikan Daily News, 1/22/94: "...making MDF is non-polluting..."). In fact, MDF plants are significant sources of air pollution, especially volatile organic chemicals and particulates. One of these chemicals is formaldehyde, a known carcinogen. Other toxic chemicals include acetaldehyde, acrolein, acetone, and methyl ethyl ketone. And, as recently reported in a draft report from the industry-sponsored National Council of the Paper Industry for Air and Stream Improvement, 12/30/93, "...it has become apparent that emissions of volatile organic compounds (VOCs) are larger than initially believed."

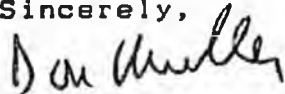
It seems to me that the MDF process can be opposed on the grounds of pollution alone. In the case of APC, an additional problem exists with the 50-year contract. APC claims that it must have the timber volume guaranteed before it can even open an MDF plant, i.e. it must have the long-term contract. You should know that no other MDF plant in the United States has a 50-year contract, that no other wood product industry in the United States has a 50-year contract, that there is no other 50-year contract anywhere in the United States other than the Ketchikan contract. It seems to me that if APC wants to open an MDF plant, they can do so without the 50-year contract.

Thank you for the chance to make these comments. I do believe,

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however, that you should have made this a teleconference--this is a major issue here in Sitka and I'm sure others would like to comment. By restricting the hearing to Juneau, for a short one-half hour, the impression is made that this whole thing is a "done deal."

Sincerely,



Don Muller  
Old Harbor Books  
201 Lincoln St.  
Sitka, Alaska 99835  
747-8808  
747-6813 Fax