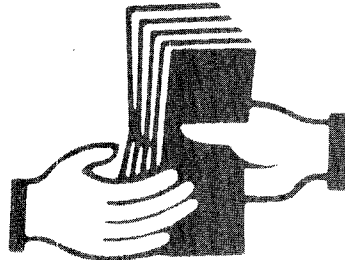


ACTION PAPER

THE PROMISE AND THE PITFALLS OF ALASKA'S STATE LOAN PROGRAMS



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A Report by
Commonwealth North

Prepared by the Banking and Loan Committee

May 1981

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OF ALASKA'S STATE LOAN PROGRAMS

A Commonwealth North Report

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THE COMMONWEALTH NORTH BANKING AND LOAN COMMITTEE

On December 11, 1980, Commonwealth North published an extensive report on government spending, prepared by the Resource Income Committee. The authors warned against the state "jumping into the banking business" and recommended that most state loan programs be administered by private lending institutions.

Four days later, the Board of Directors launched a follow-up study on this issue. Co-chairman William A. Egan, long an observer of the central bank of North Dakota, suggested that its experience be reviewed. Co-chairman Walter J. Hickel urged that ways be devised to make state loan programs strictly accountable and avoid the abuse of political favoritism, an obvious danger in a time of revenue surplus.

The charge for the Committee was defined as follows:

To study the North Dakota experience with its central bank; to review the multitude of Alaska state lending agencies; to involve the input and opinions of the private financial community of Alaska; to make detailed recommendations as to if and how the legislature should consolidate state programs and avoid direct competition with the private sector.

Board member David Chatfield, who participated in the year-long Resource Income study, was named chairman of the working group, which was called the Banking and Loan Committee.

The Committee met weekly for four months. Subcommittees formed to examine all of the state loan programs currently on the books. These programs were divided into renewable resource programs, housing programs, business programs and social programs. For the most part, these subcommittees also met weekly.

Where necessary the sub-committee chairmen invited resource people from the community to assist in the extensive work required to review so many diverse and complicated programs.

To study the North Dakota Bank, a special sub-committee was formed. Telephone interviews and correspondence were

followed by a trip by Committee Chairman Chatfield to Bismarck, N.D., headquarters of the bank. Meetings were held with both Herb Thorndahl, President of the bank and Harry Argue, Executive Director of the North Dakota Bankers Association. The results of those meetings, and a study of the material provided, is included in the following report.

The members of the Committee are as follows: John Norman, Joan Sheppard, Bob Baer, Kris Lethin, Fred Ferrara, Dick Miller, Stan Howitt, Bob Lowe, Edith Bullock and Jim Faiks.

Thanks are in order to the following for their assistance in the research for this study: Walt Alexander, Michael Lynch, Steve Shropshire, Margo Armistead, Earl Miller, Bob Kubick, Patricia Corbett, Al Strawn, and Ski Olsonoski.

The Committee also wishes to acknowledge the cooperation and assistance rendered by state employees involved in the administration of the various loan programs in providing information and analysis of program status.

CONCLUSIONS

1. The proliferation of state loan agencies must be checked lest the private sector be swamped in the wake of the ship of state.
2. The legislature is strongly urged to launch an independent audit and examination of all state loan programs to determine and disclose their true financial performance and current status.
3. Twelve of the state loan programs exist in name only and should be removed from the books.
4. The great majority of the state loan programs should be consolidated into three loan authorities.
5. State loan activity should be confined to a secondary market support function, with no direct public contact.
6. The Alaska Renewable Resource Corporation (ARRC) and the Commercial Fishing and Agricultural Bank (CFAB) should be abolished or have their operations severely curtailed.
7. Inequities created by current state loan programs should be corrected by allowing re-financing of the existing indebtedness on residential and commercial real estate through state loan programs as restructured in this report.

8. Alaska should not establish a central bank. State loan programs, properly restructured, can fulfill the more beneficial functions performed by the Bank of North Dakota without undermining Alaska financial institutions by competing directly for deposits and loans.

9. The state must outgrow its "crisis mentality" and institute a long-term approach to state loan programs, thereby bringing stability to the financial market of Alaska.

FOREWORD

Alaska's strong financial balance sheet, the result of North Slope oil production and rising world oil prices, has impelled state government to attempt to use revenue dollars for the enhancement of the life and economy of state residents.

While billions of dollars have been placed in Alaska's "nest egg", the Permanent Fund, a barrage of new legislation has been submitted to provide loans and grants to Alaskans for a wide variety of pursuits and purposes.

This effort takes many forms, trying to address both the unique problems of rural Alaska as well as the needs of citizens who live and work in an urban setting. There are dangers in assuming that any one approach can apply to all parts of the state. Rural Alaskans want to improve their communities and services, find jobs locally and yet retain their cultural and traditional ways of living.

Urban Alaskans seek ways to improve their cities, rejuvenate sagging economies and yet are leary of the competitive disadvantages which can result from selective state loan programs.

While this report is being published, another Commonwealth North study nears completion. It will address perhaps Alaska's highest priority; the creation of an economic infrastructure which can help both rural and urban citizens.

In studying the state's loan policies, this Committee discovered well-founded concerns centered around the practice of artificially influencing the economy. Loans made at below market rates for selected individuals or purposes distort and interfere with a free market, creating inequities among citizens and encouraging pursuits for other than prudent reasons.

In addition to the implications of state interference with economics there is also the very real problem of state participation in economic activities. By allowing and fostering direct loans to citizens, the state unfairly competes with and undermines the private lending institutions, including banks, credit unions and savings and loan associations. In other cases the state enters into "joint ventures" with selected business enterprises, resulting in direct competition with private firms.

Several programs, however, have succeeded in investing in Alaska without competing with the private sector. These programs have channeled state money, or state-backed money, into the economy, and have done so by utilizing private lending institutions. Lenders originate and service the loans, and in some cases participate in them while selling the loans to the state. This behind-the-scenes financial investment is referred to as secondary market activity.

The above approach is seen as a preferred model for all state loan programs, except those with strictly social purposes.

The concern of many that unrestricted state loan activity can swamp the private financial sector is illustrated by the fact that present balances in state loan programs equal more than \$1.8 billion, or nearly the total of loans in all Alaska banks.

This concern is heightened by the fact that new appropriations for state loan activities introduced in the legislature thus far this year amount to an additional \$3.3 billion, more than the total assets of all financial institutions in the state.

This trend is particularly disturbing when a look at other states with surplus revenues reveals an almost complete absence of state loans to citizens. Louisiana residents amended their constitution to prohibit virtually all state lending. Wyoming has but one direct loan program, a seldom-used remnant of the Great Depression.

Montana has eliminated almost every loan program, one of which was "a terrible experience. All but one loan went bankrupt," officials say. All of these states do provide, through the bonding mechanism, a secondary lending function. But years of experience have discouraged other forms of lending.

Whereas many of Alaska's problems originate outside of the state and are often out of the control of its citizens, the issues addressed in this paper have solutions that Alaskans can administer.

It is hoped that the recommendations presented are adopted by Alaska's legislative leaders. These conclusions are the result of careful review of the state's loan programs and months of debate on the best course to take to benefit all Alaskans.

CONCLUSION 1:

The proliferation of state loan agencies must be checked lest the private sector be swamped in the wake of the ship of state.

Concern has been expressed throughout Alaska that the government, in its desire to help the private sector, may become an enormous lending institution. Indeed, the state is currently by far the largest Alaska lender and, as we have shown, new loan appropriations bills now before the legislature equal more than the total assets of all Alaska financial institutions.

Favorable loan terms, artificially low rates, and relative ease of loan acquisition through marginal underwriting sometimes prevalent in state loan programs encourages the private sector to acquire "cheap" funds. This lures many individuals into the expansion of businesses or property purchases merely to obtain the loans and often at the cost of burdensome debt service. These expansions may not be economically viable and in some instances will lead to business difficulties or perhaps outright failure.

In addition, some state-sponsored organizations seem not the least bit reluctant to use their government-supplied, low-cost capital advantage in direct, open competition with private financial institutions for loans, deposits and personnel.

If this public policy direction continues, Alaska is in danger of becoming a "company town," with state government as the proprietor of the company store.

CONCLUSION 2:

The legislature is strongly urged to launch an independent audit and examination of all state loan programs to determine and disclose their true financial performance and current status.

Despite the best efforts of some, no one in government has a handle on the 38 state loan programs. These programs are administered by 22 different state divisions and agencies resulting in considerable overlap and duplication of effort representing substantial redundancy and waste.

Without benefit of an independent audit and examination of state loan programs, it is difficult to determine their total staffing and administrative costs with any degree of accuracy. (In fact, it is difficult to be certain that all loan problems have even been located and identified for review). It appears, however, that the annual cost of staff, supervision, facilities, travel and other overhead amounts to an annual expenditure of state dollars somewhere between \$50 and \$200 million.

State employees administering the various loan programs were found to be, by and large, cooperative and thorough in providing information concerning their activities. Though they generally act in good faith, they are understandably interested in showing their programs in the best possible light.

In addition, there is a lack of uniformity and consistency in financial reporting among the various agencies. Several different methods of calculating delinquency and loss are utilized.

In the absence of a complete, independent audit and examination, it is impossible to determine the extent of use of extension

agreements and other devices which can artificially improve delinquency and loss statistics.

Such a comprehensive review should be completed by independent auditors at the earliest possible date.

CONCLUSION 3:

Twelve of the state loan programs exist in name only and should be removed from the books.

1. Alaska State Housing Authority Revolving Loan Fund

This program has not been funded for many years. The temptation now will be to fund all programs regardless of their worth. It should be officially scrapped.

2. Housing Development Revolving Loan Fund

This program is presently inactive and has not been funded in several years.

3. Alaska Economic Disaster Impact Fund

This program has not been funded and is not operating. When disasters strike, needed funds should be allocated from the Governor's contingency fund.

4. Residential Care Facility Revolving Loan Fund

This program is presently inactive and has not been funded in several years.

5. Temperate Social Activities Revolving Loan Fund

This program is presently inactive and has not been funded in several years.

6. Tourism Revolving Loan Fund

This program has already been given new guidelines and shifted to AIDA.