Alaska Industrial Development and Export Authority
BOARD WORK SESSION - DAY 1
MINUTES
Thursday, June 9, 2011
Anchorage, Alaska

1. CALL TO ORDER

Chairman Short called the meeting of the Alaska Industrial Development and Export Authority to order on June 9, 2011 at 2:50 p.m. A quorum was established.

2. ROLL CALL: BOARD

Members present: Hugh Short (Public Member); Jerry Burnett (Deputy Commissioner, Department of Revenue); Susan Bell (Commissioner, Department of Commerce, Community, and Economic Development); Ron Arvin (Public Member); Robert Sheldon (Public Member); and Gary Wilken (Public Member);

3. ROLL CALL: STAFF, PUBLIC

Staff present in Anchorage: Ted Leonard (Executive Director); Mark Davis (Economic Development Officer); Chris Anderson (Deputy Director-Commercial Finance); Valorie Walker (Deputy Director-Finance); Jim Hemsath (Deputy Director-Business Development); Aaron Rhoades (Human Resources Administrator); Karl Reiche (Project Development Manager); Shelby Weems (Accountant V); Brenda Applegate (Controller); Sandy Burrows (Administrative Assistant); and Teri Webster (Administrative Assistant).

Others present in Anchorage: Brian Bjorkquist (Department of Law); Pat Clancy and Mark Gardiner (Western Financial Group); and Jim McMillan (First National Bank Alaska).

Listen to the full audio recording of the 6/09/2011 meeting at http://www.aidea.org/boardmin.html

4. Work Session, Strategic Planning

Mr. Leonard deferred to Mark Gardiner who presented the Board with a 45-page slide handout covering Parts 1 & 2 of 6 parts in this two-day work session. He skipped Part 1 – Introduction/Organization and started with Part 2 – AIDEA Balance Sheet/Credit. Parts 3-6 will be covered on June 10, 2011, detailing programs, policies, and dashboards.

AIDEA has two goals for the balance sheet.

- Expand Program Capacity (and balance sheet $) through increase balance sheet-supported financing/projects by $150-200 M (from FY 10 levels) and provide support for AIDEA program objectives overall.
- Maintain Creditworthiness and Low Cost of Capital through modified policy basis for balance sheet leverage, effective credit and business analysis/project profiles, and continued independent management/political insulation.

813 West Northern Lights Boulevard Anchorage, Alaska 99503 T 907.771.3000 Toll Free (Alaska Only) 888.300.8534 F 907.771.3044

Overall AIDEA funding policies are to

- Fund growth of existing programs through AIDEA balance sheet with cash, bonds, and “revolving” loan participations.
- Fund AIDEA participation in very large infrastructure projects with third party support using State moral obligation funds, SIB, etc., and appropriated funds.

Financing from AIDEA’s Balance Sheet is for

- Funding for AIDEA’s core programs of Development Projects and Commercial Finance.
- Supported by: cash from projects, cash from loan repayments and interest and bond proceeds.

Financing beyond AIDEA’s Balance Sheet is for

- Financing for mega-projects such as large infrastructure projects, regional development programs, and large, self-supporting projects.
- “Off balance sheet,” i.e. alternative indentures/“moral obligation”/SIB, “Mosaic” financing, and project financing.

Mr. Arvin asked what would be an example of a moral obligation to the State. Mr. Clancy said if the State got a municipal bonding program, that program uses a moral obligation which is usually a year of debt service. The State has an obligation to consider, subject to future appropriations, replenishing the reserve fund if it is drawn on. The bonds are generally created one notch below the State’s general obligation bond rate. This is an implied State guarantee. The State is required to think about it. It is called moral obligation because the implication is that there is moral hazard involved in the process. It is not a real pledge. Deputy Commissioner Burnett said with the bond bank, there is actually a standing appropriation in the operating budget that will replenish that reserve in case of a draw so the State is beyond the moral obligation pledge for the municipal bond bank at this point. Mr. Bjorkquist said there are a number of public corporations that also have statutory authority to have moral obligations. Alaska Energy Authority is one example.

The current bond bank rate is AA. The current rate is two below the general rate. AIDEA’s last bond was AA-.

Mr. Gardiner continued with how the credit markets view AIDEA.

- AIDEA has credibility with the Rating Agencies based on its long-term, proactive ratings approach.
    - Moody’s Investors Services = Aa3 (April 2010; affirmed December 2010)
    - Standard and Poor’s = AA- (May 2008; affirmed December 2010)
- AIDEA’s high ratings are built on strong foundations.
- Changes must be managed carefully to maintain strong favorable credit perceptions of AIDEA.

Mr. Gardiner presented a slide which shows AIDEA is in the higher tier of the Development Finance Agencies.

AIDEA Credit Foundations have strong underlying economics, balanced credit strength, strong security provisions in resolution, and conservative assumptions with robust results.

Credit Markets Perspective on AIDEA's Balance Sheet is supported by good projects, conservative investments, and a strong loan portfolio.

AIDEA's balance sheet capacity is determined/bounded by legal authorities (statutory and regulatory), existing bond indenture/covenants, and practical credit market constraints. The legal authorities and limitations have a statutory limitation of $400M of bonds which may be issued in a 12-month period, excluding refunding bonds; limitations include conduit bonds. Development projects under $10M can be bond financed without legislative approval for specific projects. Tax-exempt bonds are required for eligible tax-exempt loan participations over $1M.

Chair Short asked how many different projects AIDEA received and issued bonds with legislative authority. Ms. Walker said AIDEA has issued bonds for Unalaska, creation of the Skagway Ore Terminal, the Healy Clean Coal Project, Alaska Seafood Industries (ASI) [unused], Red Dog Mine and its expansion, and FedEx. There is a full page list in the financial statements and most bonds listed are very old. Some of the bonds were not projects where AIDEA requested authorization. One year the legislation gave AIDEA authorization so the project could get through a business process. Chair Short asked if AIDEA needs legislative approval to take them off the list. Ms. Walker said her best understanding is that until they are not authorized they remain as eligible so they must be disclosed on the financial statements.

Mr. Sheldon asked how long the $10M dollar limit has been in effect. Ms. Walker said since the late 1980s. Mr. Sheldon said with two decades past, AIDEA's purchasing power has dropped approximately 50%. Can AIDEA ask for the limit to be increased to $18M or $20M? Mr. Leonard said yes, but the challenge with the legislation is this request would be asking them to give up their prerogative and control. Mr. Bjorkquist stated that five or six years ago legislation was introduced to raise that number, but it was rejected. Mr. Davis said in informal discussions with certain chairs it has been suggested that it stay where it is. Mr. Sheldon said on a purchasing power basis AIDEA has to go to them more frequently. Mr. Leonard said we can still go to legislators stating this is our desire and the reason why. It is not consistent since the Board can approve a $20M loan.

Mr. Sheldon asked what AIDEA's limitation with LLC's is. Mr. Leonard said if it is done internally (i.e. with cash), there is no limit. If bonds are used then legislative approval is required. Mr. Sheldon asked what the limits would be if this was part of a syndicate guarantee. Mr. Leonard replied that as long as it is not tied to a bond, there is no limit. Cash could be used with no limit. Mr. Gardiner pointed out this is why guidelines need to be established so AIDEA does not have arguments with the credit markets or the legislators.

Mr. Sheldon asked about aggregating fundings. Historically, AIDEA has only issued bonds for specific projects or loans. There was a discussion about issuing bonds for working capital. Mr. Gardiner also suggested doing a balance sheet funding rather than a project specific funding. Mr. Leonard pointed out per statute when you fund loans through bonds, those loans have to be based on the interest rate on the bonds and that requirement makes setting loan rates hard when you have variable rate bonds. This could be removed out of the statutes down the line.

Mr. Gardiner continued his presentation and talked about the requirement to pay State dividends of not less than 25% or not more than 50% of base-year net income. Deputy Commissioner Burnett said the dividend is a good thing and AIDEA has paid it every year. However, the other State corporations which have similar dividend policies have not necessarily paid it every year. They declared what the dividend would be and then asked that it be given back so it could be used for appropriations internally or for capital projects. There was a brief discussion on whether AIDEA should pay this yearly or use the money to finance projects, and if they pay a dividend, how much should be paid. In more recent years AIDEA and the Board agreed to pay the full 50%. It has been helpful in the past when asking for new legislation or new authorities or an increase in the budget. For projects and capital AIDEA is not under the State budgeting system but for operating budget AIDEA is and therefore goes to the legislature for those requests. Mr. Short said he would like to have a conversation regarding strategies with the dividends. He thinks we need to pay the dividend but not excessively pay them. Mr. Wilken asked staff to provide a chart which shows the history of the payment of the dividend listing the year, the amount and the percentage paid.

Mr. Gardiner talked about the contractual obligations with investors. The Revolving fund bond indenture has restrictions.

- A Liquidity Test: Cash or US Treasuries – one year or less; lesser of $50M or 25% of outstanding principal.
- Debt Service Coverage Test: Net income >= 1.50x debt service; ranged from 4.0 – 9.3X in the last five years. Cash-basis computation which includes principal payments on loans, interest payments, and development project payments less administrative and operating expenses.
- Unrestricted Surplus Test: Lesser of $200M or total outstanding Revolving Fund Bonds but in no event less than $100M.

Practical credit market constraints, which are self-imposed, would be

- Cash and investments
  - Conservative, prudent policies; >=$200M/~1/4 of portfolio; >=$200M US$-denominated liquid securities.
- Debt service coverage of 2.5X.
- High performance loan participation portfolio with low delinquencies and well underwritten, and "Revolving"/self-sustaining.
- "Appropriate" projects/programs that are non-political, conservative business and credit analysis, and secure structures, effective monitoring, active managing.

The role of the investment portfolio for public funds is preservation of capital, policy-governed, mission oriented. The role for the internal portfolio is return and liquidity and for the external portfolio is return and safety.

The Investment policy for internal funds include

- US government, agency, instrumentality issued or guaranteed debt.
- Debt of government sponsored entities (GSEs).
- Money market funds.
- US government and agency collateralized repurchase agreements.
- Other investments specifically approved by the Board.

The Investment policy for external funds include

- US government, agency, instrumentality issued or guaranteed debt.
- Debt of government sponsored entities (GSEs).
- US dollar-denominated debt of domestic and nondomestic entities.
- Mortgaged-backed securities issued or guaranteed by Federal agencies or GSEs.
- Asset-backed securities, including non-leveraged CMOs.
- CDs and term.
- Deposits of US domestic financial institutions meeting guidelines.
- Other money market instruments described in the Investment Policy Resolution.

The following two items are not current policies but are recommendations from the Investment Committee.

- Allow non-US dollar-denominated investments (recommendation of Investment Committee).
- Minimum of $200M or 60% of portfolio in US dollar-denominated investments (recommendation of Investment Committee).

Mr. Leonard distributed a draft form of the potential investment policy to Board members. Mr. Sheldon said the policy adjustment suggested by Callan is excellent. He agreed with all of the items they suggested. The committee will meet again to finalize this proposal before presenting it to the Board.

Mr. Wilken asked for a few examples of a non-US denominated investment. Mr. Sheldon said there are money-market instruments issued by all sovereign governments worldwide and this policy would give an allowance of up to 40% to go into these foreign governments. Some of the money market instruments could be a CD issued by a bank of a foreign country backed by the credit, or it could be in a short term treasury-like holding (i.e. Yuan denominated issues from the Chinese government).

Mr. Gardiner continued his presentation and talked about how project asset quality is maintained.

- “Portfolio Management” approach uses strategic infrastructure: long-term hold and industrial facilities: exit strategy
- Project underwriting and lessons learned are that development finance authorities will have losses (e.g. Seafood Center) and improved project development processes and due diligence, etc., are needed.

Mr. Gardiner showed the capacity expansion credit policy targets.

Item	Current Status	Policy Targets
Liquidity target	50-100% of principal	50% of principal
Unrestricted assets	>$100M 4xprincipal	>$100M
Debt service coverage	3.0x	2.5x
Minimum cash and investments	$300+M	$200M
% of portfolio in cash and investments	1/3	>=15-20%
Total debt capacity (current indenture)	~$200M	Up to $500M

AIDEA Balance Sheet Portfolio Asset Allocation shows the proposed ranges of the Asset classes in the portfolio.

Asset Class	Low	High
Cash	5%	15%
Investments	15%	25%
Loan Participations	20%	40%
Projects	20%	40%

AIDEA Balance Sheet-Projected Financing Capacity is $75M from cash and investments and $400M from bonds.

Mr. Gardiner showed how the proposed changes would look with a two year cash forecast, project cash receipts, development project funds, and debt service and issuance. Mr. Sheldon asked if the Red Dog Project receipts of MAA, CEZ, and reserve releases will be broken down at some point. Mr. Leonard replied there will be a full presentation on Red Dog at the July meeting and he can send the spreadsheet to the Board members ahead of time.

Mr. Gardiner talked about dashboard reports related to the overall finances and the balance sheet. The proposed reports are:

- Financial Highlights – Quarterly showing the Balance Sheet, Income Statement, and Asset Allocation.
- Investment Portfolio – Quarterly.
- Capacity Indicators – Quarterly showing the debt capacity / financing capacity.
- Economic Development Indicators – Annually based on regions and sectors.

He showed examples and asked for feedback from the Board. Board members asked questions for clarification then complimented Mr. Gardiner on the great presentation and the work that went into it.

5. DIRECTOR'S COMMENTS

There were no comments.

6. BOARD COMMENTS

Mr. Wilken said with a little experience, this will be a very valuable tool. Decisions can then be made seeing the cause and effect.

7. ADJOURNMENT

There being no further business of the Board, the meeting was adjourned at 3:55 p.m.

Ted Leonard, Executive Director/Secretary
Alaska Industrial Development and Export Authority