Permit seller financing poses difficulties

by Norman Stadem
for the Tundra Times

Seller financing, using a promisary note from the buyer, is extremely risky under the present Commercial Fisheries Entry Commission statutes.

This is because only the Alaska Commercial Fishing and Agriculture Bank or the state are legally allowed to use permits as collateral to secure a loan. Furthermore, the law requires that the owner of a permit be on board a vessel while it is actively fishing.

The permit must be signed over to the buyer, without recourse, in order for the buyer to be able to fish. Unless the seller can get other valuable collateral to secure the loan he must assume the risk of accepting an unsecured promisary note from the buyer.

So where does this leave the elder who would like to retire but cannot find a local buyer who "qualified" for bank financing? He has two options, unless the buyer can "self-finance" the transaction.

He can sell to someone outside the community who can "qualify" for financing and be assured of getting his money. Or, he can sell to a "non-qualifying" borrower locally, and accept the risk of carrying the unsecured note, himself.

The final tragedy is that the elder has no way of getting the permit back if the buyer defaults. There are cases where elders have sold to "outsiders" rather than chancing an unsecured sale to a local person.

For most, it is a bitter pill to see permits leave the community, but the chance of losing one's retirement nest egg, if the borrower fails to pay, is even less palatable. If the elder could retain control of the permit, by legally taking it as collateral until the loan was paid off, rural communities would have an alternative for financing local transactions in permit sales.

From the point of view of a lender, a permit is the ideal form of collateral. It represents a legal right of access to the fishery — there are no physical elements that are subject to depreciation or destruction. The lender does not have to worry about insurance.

Proper recording is all that is necessary to protect his preferred position in the collateral. If the buyer defaults, the seller initiates foreclosure proceedings and reclaims the permit.

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Only by being defrauded can the seller be harmed. Under a properly designed legal sales contract, monitored by the Commercial Fisheries Entry Commission, both the seller and the buyer could be protected. Whereas, banks must require that the borrower meet strict guidelines, the individual can be flexible. This puts the permit owner at an advantage in financing his own sale.

A side benefit of being able to personally finance the sale is that additional interest income will remain in the village, and provide more wealth locally. For example, a locally financed debt of $150,000 at 10 percent for 20 years will yield $202,500 in interest income over the 20-year period.

Under the current law it is difficult for rural people to enter the more productive fisheries (those with high permit prices). Financing institutions can only lend a part of the value of a permit. The borrower must either provide additional collateral or make a cash down payment.

For example, a permit with a market price of $150,000 requires a $30,000 down paryment if CFAB or the state can lend 80 percent of its value. In many cass the official loan value is lower than the market price. In that case a larger down payment is required. For example, if the loan value of the $150,000 permit is $120,000, the buyer will have to raise $54,000 from his own funds. This is a significant barrier to entry into the more productive fisheries unless one has an alternative source of income or a lot of additional collateral —another contradiction of the limited entry legislation.

The implication of this is obvious. If rural residents have limited access to capital markets, and if their ability to generate capital within the community is limited, their ability to enter the more productive fisheries is restricted. Again, seller financing could provide a solution.

Because of the risks associated with seller financing, most sellers require full, lump sum payment before they sign the permit over. They get their money, but not without a fairly high cost. They not only lose interest income, but their federal income tax bill is much higher than if they could receive their money over several years. This will be discussed next time.

Editor's Note: This is the second of a three-part series by Norman Stadem, economist with Bio Economic Research & Analysis. He is vice president of the Alaska Independent Fishermen's Marketing Association and secretary/treasurer of the United Fishermen of Alaska.