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THE ALBERTA HERITAGE FUND IN 1993

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THE HERITAGE FUND ANNUAL REPORT

This paper is the fourth in a series of financial analyses of the Alberta Heritage Savings Trust Fund (Fund) annual reports published by the Western Centre for Economic Research. It will be somewhat different than its predecessors, in that it will relate closely to the new Consolidated Financial Statements of the Province of Alberta (*Public Accounts 1992-93,* Volume 1), reporting the province's overall financial situation.

In reporting its 1993 fiscal year, the Alberta government made major changes both in the substance and form of its public accounts. The new Consolidated Financial Statements of the Province of Alberta (Public Accounts 1992-93, Volume 1) present an easy-to-understand and largely realistic picture of Alberta's fiscal situation. These Consolidated Statements can be readily compared with the Province's separate reporting on the Fund through the Alberta Heritage Savings and Trust Fund annual report (Fund Statement).

To repeat a point made in previous versions, the Fund is not a legal trust. Government assets designated as Fund assets were bought under the authority of the 1976 Alberta Savings and Trust Fund Act, and their financing is traceable to the sale of crown-owned minerals between 1976 and 1987. They are managed by the government, and may be sold at its will. Since Fund assets are not legally separate from other government assets, they are fully accounted for in the Consolidated Statements.

The Consolidated Statements for the March 31, 1993 fiscal year were dominated by an enlarging government debt. The province had, by then, borrowed $20 billion and its total liabilities were approaching $30 billion. Its net debt, after offset of financial assets owned by the province, was nearly $12 billion. An important part of those financial assets, about $8.2 billion, were Fund assets. (Details are shown in Table 4, to be discussed later.)

The Fund Statement for 1993 claimed Fund financial assets of about $12 billion. However, this statement does not adequately recognize the oneness of the Fund and the provincial government. Province of Alberta debt appears in the Fund Statement's listing of assets owned, as if this debt could be collected and used to meet the government's financial needs. The Fund Statement also carries the debentures of some weak-performing Alberta crown corporations at face value, because payment of these debentures is guaranteed by the Alberta government. These intra-government financial relationships must be critically examined .

This paper will attempt to clear up confusion about the current value of the Fund, and it will also describe the Fund's recent performance and its future prospects .

HIGHLIGHTS OF THIS FINANCIAL ANALYSIS

The present analysis presents and justifies asset values that are much lower than those on the Fund Statement, and an annual rate-of-return that is much higher. The Fund Statement's $11.9 billion in equity (assets net of minor liabilities) is adjusted to a more realistic $8.5 billion. The Fund Statement's rate-of-return on investment is 7.2%. Rate-of-return calculated in this paper is 13.4% before correcting for inflation and 11.3% when lost purchasing power is considered.

The Fund Statement shows virtually no change in total assets from 1992. The present analysis indicates a decrease of $0.57 billion. The largest reduction occurred in liquid assets, through disposal of Government of Canada obligations and net collection of accrued interest. Details of asset revaluation are shown in Table 1, and comparisons from 1992 to 1993 in Table 2. Income and rate-of-return is presented in Table 3. An Appendix contains some supporting information.

This paper also examines the relationship between Fund assets and the overall Alberta financial position, supported by the statement in Table 4. A commentary is also included on the policy proposal of liquidating the Fund's assets to pay down debt.

Readers of previous versions of this analysis will notice some difference in nomenclature in the text and on the accompanying financial statements. Financial categories have been renamed to coincide with the usage on the Consolidated Statements.

PROVINCE OF ALBERTA OBLIGATIONS

The Fund Statement lists among its assets nearly $2.5 billion in Province of Alberta obligations. When these obligations were acquired, the province received cash from the Fund and replaced this cash with provincial promises-to-pay. The government promises held by the Fund are artificial; the Fund cannot enforce these debt contracts against its owner-manager. Deleting the $2.5 billion holdings in provincial debt on the Fund balance sheet emphasizes that provincial promises-to-pay are not wealth of the province.

Now that the province has a large public debt, an important test for whether loans to the province should be listed as assets is whether this listing will help the public understand the province's overall fiscal situation. The Consolidated Statements disclose outstanding unmatured debt at $20.2 billion. This amount includes debt that is actually owed to outside creditors, *and it does not count obligations which are nominally "owed" to the Fund.* A reader of the Fund Statement who knew that the debt was $20.2 billion could easily conclude the Fund's "holdings" of Provincial debt could be canceled to reduce the aggregate provincial debt to $17.7 billion. This double-count is encouraged by including Alberta debt in the Fund statement. (See Appendix, Note 5.)

Table 1. Alberta Heritage Fund Valuation
March 31, 1993 (millions of dollars)

	Market estimate	Fund report	*Difference*
MARKETABLE SECURITIES AND LIQUID ASSETS			
Cash and marketable securities			
Government of Canada obligations	1,130	1,116	*14*
Other liquid assets and deposits	2,092	2,092	*0*
Sum, cash and marketable securities			
Accounts receivable: accrued interest (Note 1)	142	198	*-56*
Portfolio investments			
Bonds of other provinces (Canada Division)	1,338	1,175	*163*
Shares and money market certificates (Comm. Inv. Division)	512	339	*173*
TransCanada Pipelines Ltd. subordinated debentures	169	150	*19*
NOVA common and convertible debentures	162	175	*-13*
Sum, portfolio investments	2,181	1,839	
TOTAL MARKETABLE SECURITIES AND LIQUID ASSETS	**5,545**	**5,244**	
MORTGAGES, VENTURE LOANS AND OTHER ITEMS (Note 2)			
Loans and advances			
Alberta Municipal Financing Corporation municipal loans	167	140	*27*
AMHC mortgages (less allowance for guarantees)	379	1,661	*-1,282*
AADC agricultural mortgages and related items	673	1,013	*-340*
AOC loans and related items	92	128	*-36*
Sum, loans and advances	1,311	2,943	
Long-term investments			
Direct loans (Ridley, Millar, Vencap, ALPAC)	488	523	*-35*
Syncrude Project participation	450	499	*-49*
Lloydminster upgrader, etc. (Fund statement value)	76	76	*0*
Alberta Energy Company common shares	470	183	*287*
Sum, long-term investments	1,484	1,281	
Inventories held for resale: real estate	170		*170*
TOTAL MORTGAGES, VENTURE LOANS AND OTHER ITEMS	**2,964**	**4,224**	
Province of Alberta obligations	0	2,477	*-2,477*
FUND NET ASSETS (EQUITY)	**8,509**	**11,945**	*-3,436*

THE FUND'S MAINSTREAM INVESTMENTS

The Fund's holdings of liquid assets and marketable securities, which are described here as mainstream investments, are securities, deposits and other high-quality claims that are commonly held by financial institutions and private investors. These assets can either be collected in cash quickly or have a ready market.

MARKETABLE SECURITIES, LIQUID ASSETS AND ACCOUNTS RECEIVABLE

The liquid assets, consisting of Government of Canada obligations, bank deposits and other cash-like assets, and accruals, comprise a pool of quickly accessible wealth. The Fund Statement shows $3.41 billion and this analysis shows $3.37 billion, a small difference.

There is significant disagreement on only one item, accrued interest (which has been earned but not yet collected because interest payment dates do not usually coincide with the Fund's statement date). This is due to the inclusion of accruals on Provincial obligations in the Fund Statement.

PORTFOLIO INVESTMENTS

Fund assets include major investments in stocks and bonds. The Fund government bond holdings in 1993 included $1.34 billion in the bonds of the Atlantic provinces and Quebec Hydro. These remain from the once-controversial Fund policy of lending to other provinces; all are scheduled for repayment by or before 2005. The Fund owns a broad portfolio of common shares, designated under Fund legislation as the Commercial Division, and also has made investments in NOVA and TransCanada Pipelines; at market, these holdings were worth $.84 billion.

The Fund Statement follows conservative accounting practice by valuing its portfolio investments at the lower of cost or market. Market values are easy to obtain on these assets, since virtually identical assets are regularly traded in public security markets. In this analysis, market values are used, since they are realistic and current; cost is only of historic interest. Falling interest rates have contributed to price increases in bond holdings, and other marketable securities have also appreciated since their original purchase dates. The market value of all portfolio investments exceeds cost by $.34 billion.

THE OVERALL POSITION IN MAINSTREAM INVESTMENTS

The $5.54 billion total value of marketable securities and liquid assets is realistic and realizable. These assets could presumably be sold within days with modest transaction costs. The assets are surprisingly short-term for an investment program with long-term objectives. However, when the Fund is viewed later in the context of the province's overall financial situation, one shall see that these short-term assets are effectively serving as the provincial government 's cash reserves.

The shares of Alberta Energy Company (AEC), worth $0.47 billion, could also be described as mainstream assets. However, in the Consolidated Statements the AEC shares are included in "long-term investments," a category for investments motivated by provincial economic development. This report follows that usage, with reservation and with recognition that those shares have subsequently been sold. If the AEC shares had been counted, mainstream assets would have been $6 billion in March, 1993.

THE FUND'S SINGULAR ASSETS: MORTGAGES, VENTURE LOANS AND OTHER ITEMS

There is another set of assets, smaller in amount and more difficult to evaluate than the mainstream items. They are described here as singular assets, and, with the exception of the AEC shares discussed above, they do not have easily determined market values. The singular assets, besides AEC, include mortgages owned through crown corporations, loans made through Alberta Opportunity Corporation (AOC), loans made for economic development motives to a number of private companies, and two participations in energy development consortia--Syncrude and the Lloydminster heavy oil upgrader.

TWO LARGE CROWN CORPORATION INVESTMENTS: ALBERTA MORTGAGE AND HOUSING CORPORATION AND ALBERTA AGRICULTURAL DEVELOPMENT CORPORATION

The Fund Statement places a value of $1.66 billion on debentures of Alberta Mortgage and Housing Corporation (AMHC). This value is the accumulated cost of investments made in that crown corporation under the authority of Fund legislation. The statement's value for these debentures is based on the abstraction that money invested in provincial crown corporations is protected by provincial guarantee. Provincial guarantees are important to outside investors, but they have no practical importance when the province itself is the investor. Therefore, a market evaluation on the assets held by AMHC must be attempted, since these assets are the only substance behind the Fund investment in AMHC.

AMHC is financed entirely with borrowing, mostly through the Fund. The value of Fund investment in AMHC is effectively AMHC assets net of the claims of other creditors. AMHC reports three major items among its assets, housing , mortgages and unsold real estate (largely acquired through mortgage foreclosure). Housing earns no financial return, is essentially a social assistance program, and is not valued as a financial asset in the Consolidated Statements. Mortgages and real estate are left as the financial substance behind the Fund investment in AMHC.

Presently, the Consolidated Statements reports the combined value of the mortgages and real estate (net of allowance for losses) as $0.38 billion and $0.16 billion respectively. An independent estimate of the market value of the mortgages and real estate (see Appendix, Note 2) agrees with these figures. Liquidation of both assets positions is in process. No attempt is made to estimate the loss potential for the province of the over half-billion in loan guarantees protecting financial institutions which have bought AMHC mortgages.

The Fund has also invested large sums in Alberta Agricultural Development Corporation (AADC). The Fund Statement records this investment at its $1.01 billion cost, but a realistic value of AADC depends almost entirely on the value of its mortgage portfolio. The market value of this portfolio is valued in the Consolidated Statements, net, at $0.93 billion and is realistically estimated to be worth only about $0.67 billion. The low market value is caused by the unusually low interest earnings on the mortgages (Appendix, Note 2.)

The Fund Statement (p. 25) reports that the market values of AMHC and AADC investments exceed cost. This is a seriously misleading statement. The "market value" claimed for AMHC and AADC debentures far exceeds the worth of the financial assets of those corporations. Therefore, the only way these "market values" could be realized would be through a massively expensive provincial guarantee--for which no allowance has been made.

OTHER LOANS AND ADVANCES

On a lesser scale, issues relating to the Alberta Opportunity Corporation investment are similar to AMHC and AADC. The underlying asset on AOC is loans, primarily to small and new businesses. The claimed value of these loans, $.11 billion, is impaired by a disparity between interest rates charged and bad debt losses incurred. A market value of $.09 billion is estimated.

The investment in Alberta Municipal Financing Corporation (AMFC) is distinctly different from the other crown corporation debentures. AMFC is the borrowing agent for Alberta municipalities. Unlike the crown corporations above, it had a long history prior to the 1976 Heritage Fund Act and has accumulated a sizable equity. The loan to AMFC is valued at market as a conventional loan, since it is supported by the taxing power of Alberta municipalities. The market value of $.17 billion exceeds cost, $.14 billion, because of decline in market interest rates.

LONG-TERM INVESTMENTS

Through the Fund the province has loaned money to several private companies--Ridley Grain, Millar Western Pulp, Vencap, and a set of companies in the Alberta Pulp Mill (ALPAC) project. With its recent accounting changes the values claimed for these assets on the Fund Statement has become more conservative, and these assets are now collectively valued at $0.52 billion. An independent analysis (Appendix, Note 2) does not lead to a sharply different result. Both figures should be regarded as very inexact, because of the unusual characteristics of the loan agreements.

The Fund holds a 16.74% interest in the Syncrude tar sands consortium. Petro Canada's recent sale of a 5% interest in Syncrude for $132.5 million supports a *pro rata* market estimate of $0.45 billion, a little lower than the Fund statement value. The Fund is also participating in the Lloydminster heavy oil upgrading facility, and has recently sharply devalued this participation to $0.07 billion, a value that is presumed to reflect market worth. These investments values should also be regarded as broad-range approximations.

Alberta Energy Company shares are located among long-term investments, as noted previously. These shares have appreciated greatly and were worth $0.47 billion in the market, compared to their cost of $.26 billion.

THE OVERALL POSITION IN SINGULAR ASSETS

The Fund's estimated $3 billion collection of singular assets has been motivated by investment objectives and by facilitation of the province's central economic planning. Some of the assets are inherently difficult to value. For example, a debt contract for the ALPAC forestry project allows borrowing at the same interest rate as the province pays on its debt; interest accrues but is not payable for five years and then is paid monthly to the extent of available cash flow, with complete repayment scheduled for 2010. The substance of the agreement appears to be that the Alberta borrowing rate places a ceiling on the return on the Fund investment, but that otherwise the Fund participates in the profits, or lack of profits, of the venture.

Some of the singular assets are speculative, but they are all potentially marketable. The province has already liquidated much of the AMHC mortgage portfolio. AADC and AOC loans could also be sold. All Fund loans and advances and the Ridley mortgage could probably realize an approximated $1.4 billion within a year. A sale of part of the Syncrude position is now pending at a price consistent with this analysis's market value estimate; the remainder is also potentially salable. The income-contingent terms of the Vencap, Millar-Western, and ALPAC investments, and the uncertainty of revenues from the Lloydminster upgrader may make sale of these difficult. The real estate inventories, byproducts of the province's banking activities, are being sold, and the AEC shares were sold after the Fund Statement date.

The total value of loans and advances, long-term investments and inventories has been placed at $3 billion, or $2.5 billion without AEC. Sale of all the singular assets is a matter for negotiation, and the total value retrieved from them in a sale could be significantly lower. Some political will would be required for government disposal of the singular assets, since they are associated with the special interests of regions and industries.

CHANGES IN THE FUND SINCE 1992

Between 1992 and 1993, the financial assets of the Fund decreased, but there was no major change in their composition. The main changes were a reduction in the liquid portion of the assets, following an increase in liquidity in the previous year, and a major appreciation in the market price of Alberta Energy Company shares. Liquidation of AMHC mortgages continued, the value of the Lloydminster upgrader was written down, and additional credit was extended to the ALPAC project.

INVESTMENT PERFORMANCE

The Fund Statement identifies income from the Fund in the year ended in March 1993 with a conventional accounting method:

Fund Statement net income = Interest and dividends earned + gain on disposal of investments - writedown of investments.

This analysis uses the total income method, which is commonly employed for measuring the performance of investment portfolios such as mutual funds:

Total income = withdrawals from the Fund - payments into the Fund - decline in market value of Fund equity.

These two methods lead to different results for a number of reasons:

(a) since the Fund Statement treats provincial obligations as assets, it also recognizes interest "earned" by the province on its own obligations;
(b) the Fund Statement reports capital gains when assets are sold, while this analysis reports these gains or losses in the period in which they occur;
(c) the Fund statement does not recognize that some government costs, such as subsidies to AADC, AMHC and AOC, are required to allow crown corporations to meet their interest payments to the Fund;
(d) finally, the Fund Statement calculates rate-of-return on a much larger asset base, because of the high values it places on assets. (For more detail, see the 1992 version of this analysis.)

With its method, the Fund Statement recorded net income of $784 million in 1993. This analysis finds total income of $1.2 billion, with the $0.4 billion difference mostly attributable to appreciation of assets which was not recognized by the Fund Statement. AEC shares and the portfolio investments rose in the market by nearly $280 million; market estimates on mortgages and loans which were locked in at previously negotiated interest rates were also revised upward because of falling market interest rates during the fiscal year.

RATE-OF-RETURN

Rate-of-return, net income in relation to assets, is a commonly employed measure of investment management success. The Fund Statement (p. 14) asserts a rate-of-return on all assets of 7.2% on all assets. The total return method employed in this analysis leads to a rate-of-return of 13.4% before inflation. The difference is due both to lower income on the Fund statement, as described in the previous section, and to the Fund statement's higher asset values.

Neither method of income measurement gives a true picture of Fund performance without correction for inflation. What is really important in evaluating the usefulness of the Fund is not how much money remains in the Fund, but how much purchasing power remains. While 1993 was a year with low inflation, the principle of correcting for purchasing power change is still sound. The Consumer Price Index (CPI), a widely used indicator of how many goods and services a dollar will buy, was used to measure purchasing power change. During 1993 the CPI rose by 1.9%. This enables the adjustment of the 1993 rate-of-return to 11.3% in effective purchasing power.

Table 2. Alberta Heritage Fund Change
March 31, 1992 to March 31, 1993 (millions of dollars; no inflation adjustment)

	1993 Market value	1992 Market value	*Change from 1991*
MARKETABLE SECURITIES AND LIQUID ASSETS			
Cash and marketable securities			
Government of Canada obligations	1,569	1,569	*-439*
Other liquid assets and deposits	2,092	2,079	*13*
	3,222	3,648	*-426*
Accounts receivable: accrued interest	142	623	*-481*
Portfolio investments			
Bonds of other provinces (Canada Division)	1,338	1,299	*39*
Shares and money market certificates (Comm. Inv. Division)	512	504	*8*
TransCanada Pipelines Ltd. subordinated debentures	169	155	*14*
NOVA common and convertible debentures	162	154	*8*
Sum, portfolio investments	2,181	2,112	*69*
TOTAL MARKETABLE SECURITIES AND LIQUID ASSETS	**5,545**	**6,384**	*-839*
MORTGAGES, VENTURE LOANS AND OTHER ITEMS (Note 2)			
Loans and advances			
Alberta Municipal Financing Corporation municipal loans	167	140	*27*
AMHC mortgages (less allowance for guarantees)	379	497	*-118*
AADC agricultural mortgages and related items	673	660	*13*
AOC loans and related items	92	110	*-18*
Sum, loans and advances	1,311	1,407	*-96*
Long-term investments			
Direct loans (Ridley, Millar, Vencap, ALPAC)	488	330	*158*
Syncrude Project participation	450	450	*0*
Lloydminster upgrader, etc. (Fund statement value)	76	222	*-146*
Alberta Energy Company common shares	470	259	*211*
Sum, long-term investments	1,484	1,261	*223*
Inventories held for resale: real estate	170	154	*16*
TOTAL MORTGAGES, VENTURE LOANS AND OTHER ITEMS	**2,964**	**2,668**	*297*
FUND NET ASSETS (EQUITY)	**8,509**	**9,051**	*-542*

Table 3. Alberta Heritage Fund Income and Rate-of-Return
Year ended March 31, 1993 (millions of dollars)

WITHDRAWALS FOM FUND FOR GENERAL USE			
Income transferred to General Revenue, per Fund statement	785		
Spending in Fund capital projects division	84		
Net increase in Alberta provincial obligations nominally owned by Fund	1,176	2,045	
PAYMENTS OUT OF GENERAL REVENUE FOR FUND ACTIVITY			
Alberta Agricultural Development Corporation grant	-98		
Alberta Mortgage and Housing grant (mortgages, real estate)	-54		
Alberta Opportunity Corporation grant	-14		
Interest received on Province of Alberta marketable securities	-124	-290	
NET MONEY DRAWN FROM FUND FOR GENERAL USE		1,755	
Change in value of Fund equity (Table 2)		-542	
NET INCOME (no correction for inflation)			1,213
Equity, March 31, 1992 (Table 2)			9,051
Rate-of-return (net income + March 31, 1992 equity)			13.4%
Inflation rate (CPI), March, 1992 to March, 1993			1.9%
Rate-of-return (corrected for inflation)			11.3%

Fund assets are an important source of liquidity for the province. Over $3 billion in Canada securities, deposits and other safe, short-term securities provide a buffer to cover revenue shortfalls, unusual costs, or delays in borrowing. This liquidity is an additional benefit from the Fund, besides the rate-of-return calculated above.

COMPARISON WITH THE ALASKA PERMANENT TRUST

Since the Fund and the Alaska Permanent Trust have many similarities, a comparison of their recent financial performance may be of some interest. One should, however, be careful about concluding that one management is superior to the other, from comparison of one year's results. Risk exposure between the two funds may be different, and chance plays a part in investment results.

Following is a calculation the Alaska fund's performance in a year corresponding to Alberta's fiscal year, using a weighted average method. The result suggests that Alberta, with over 11% 1993 return net of inflation, outperformed Alaska.

Year ended December 31, 1992, Alaska fund total return, net of inflation	=	7.0%.
Year ended December 31, 1993, Alaska fund total return, net of inflation	=	9.6%.
Weighted average (3/4 of 1992 return + 1/4 of 1993 return)	=	7.6%.

Another interesting Alaska-Alberta comparison is in method of reporting. If the Fund Statement gave the same type of performance information as the Alaska annual report, supplemental analysis would not be necessary. The Alaska statement identifies total investment performance, which includes both cash receipts and market value changes. An outside consultant is hired to measure total performance on singular investments, which in the Alaskan case are in real estate (nearly all located outside Alaska). Inflation is recognized, and rate-of-return is identified net of inflation.

THE RELATIONSHIP BETWEEN FUND ASSETS AND THE WHOLE OF PROVINCIAL FINANCES

A decade ago the Fund assets were the central feature of the province's finances. Times have changed and now debt is the main theme. Still, the assets accumulated under Fund legislation have an important effect on the province's fiscal situation. Table 4 displays the province's financial assets and liabilities and the contribution of Fund assets to the province's total holdings of financial assets. The column headed "All assets and liabilities, Book value" contains values taken directly from the Consolidated Statements, the province's central financial report. The column confirms the province's serious debt but also allows the reader to see how much worse things would be without the $17.8 billion of financial assets offsetting part of the debt.

Of the province's assets, close to half are attributed to Heritage Fund investment. The column headed "Heritage component, Book value" shows the province's own valuation of all Fund financial assets. For perspective, the right-hand column presents the market value of assets from Table 1 of this analysis. In aggregate, there is little disagreement between the province's own values for Fund assets in the Consolidated Statements, $8.2 billion, and those of this analysis, $8.5 billion.

It is now apparent that one major current role of the Fund is to be the province's major bank account. Most of the province's liquid reserves, $3.2 billion out of $3.8 billion, are Fund assets. Fund assets are also the primary component in provincial portfolio investments, $1.8 billion book value out of $2.6 billion. Essentially all of the economic development assets, described as long-term investments, are Fund assets. The Fund's loans and advances, with book value of $1.5 billion, are also a significant part of the province's $8.5 billion investment in loans and advances.

Table 4. Province of Alberta Finances, and the Heritage Fund
Year ended March 31, 1993 (millions of dollars)

Province of Alberta, Consolidated statement of assets, liabilities and debt	All assets and liabilities Book Value	Heritage component Book value	Heritage component Market value
Assets:			
Cash and marketable securities	3,762	3,208	3,222
Accounts receivable	1,189	142	142
Portfolio investments	2,572	1,839	2,181
Long-term investments	1,285	1,281	1,484
Loans and advances	8,509	1,547	1,311
Inventories held for resale	499	170	170
Total assets	17,816	8,186 (Note 4)	8,509
Liabilities			
Accounts and loans payable	1,550		
Unearned revenue and suspense	68		
Deficiency in commercial enterprises	626		
Unmatured debt	20,181		
Guarantees and indemnities	518		
Pension obligations	4,799		
Other accrued liabilities	1,326		
Restricted profits and equity	572		
Total liabilities	29,640		
Net debt	11,824		

POSSIBLE FUND LIQUIDATION

The enlarging Alberta debt has prompted public policy discussion about liquidating the Fund. The financial consequences of selling the Fund's assets can be considered in two stages: (a)what is the feasibility of selling the assets, and (b) what effect would their sale have on provincial revenues and expenditures?

On the first question, the mainstream assets and the AEC shares would have been worth about $6 billion on March 31, 1993. However, recalling Table 4, Fund assets comprised most of the government's cash and marketable securities. Arguably, the province does not require liquidity to the point of $3.8 billion cash and marketable securities backstopped by extensive portfolio investments; but some liquid assets are needed. Suppose $2 billion of Fund cash and marketable securities are needed for provincial cash reserves. (This would provide total reserves for the government equal to about 2 months of provincial expenditures.) This would reduce money available from the most easily salable assets to $ 4 billion.

Loans and advances and the direct loans included under long-term investments could attract bids from trust companies, chartered banks, investment firms and , for AADC assets, the Farm Credit Corporation. Syncrude and the real estate inventories are for sale now, and Lloydminster is also potentially salable. The combined market value of these singular assets was estimated at $2.5 billion (excluding AEC). Of course, their negotiated price is uncertain and could be lower. (The price would be higher if assets were sold with guarantees, but then, for a truthful accounting, an allowance for the guarantee would have to be subtracted.)

If Fund assets of $6.5 billion were sold and applied to provincial debt, the province would probably lose a little net revenue. This results because Fund assets are likely, over time, to earn somewhat more than the interest rate the province pays on its debt. In the financial markets, higher income and more risk are usually associated. Liquidation of the Fund would be another of those tradeoffs. Keep the assets, and earnings *might* average 2% more than the province's interest rate. Sell them and pay down debt, and the interest saving is sure money.

Not all Fund assets offer a trade-off of higher return for higher risk. Among the Fund assets, the banking operations are systematic and major money losers. Liquidation of the AMHC mortgage position is approaching completion. Extension of that liquidation to AADC and AOC would not bring back money that has already been lost on present mortgages, but it would stop the process of acquiring new losing assets.

Indeed, the primary benefit from liquidation of the Fund could derive from assets which have not yet been acquired. The disposal of singular assets and the overall reduction in the province's liquidity could allay public apprehension about future costs of government economic interventions. This reduction could help the province's credit rating, and could stimulate long-term private investment.

Quitting Fund investment would also eliminate possible side effects. A discretionary investment pool which may be invested to benefit special interests may corrupt government. Fund loans can disorganize a competitive economy by favouring one participant over another. Energy investment participations and income-contingent forestry loans maintain a government financial interest in the results of environmental regulation and thereby a conflict of interest. Fund-financed mortgage lending distorts capital and labor markets, and has probably created extra hardship by drawing young Albertans into a farm sector with decreasing need for personnel.

In deciding to end the Fund, the rationale for its initial establishment should be remembered. An important part of this rationale was the replacement of depleting crown-owned mineral resources with collectively-chosen longer-term investments. Now Fund assets are no longer needed for sequestration of some current revenues for future use. Discharge of the present public debt offers a logical outlet for mineral royalties for many years to come.

PROSPECTS FOR 1994

The scale and role of Fund assets continues to decline . Withdrawals of income, withdrawals by Provincial "borrowing," inflation and continuing spending on deemed assets are likely to reduce those assets more in 1993.

A major change for 1994 that is known now is the sale of AEC shares. About $80 million of additional investment is authorized for ALPAC. Sale of 5% (out of 16.74%) interest in Syncrude is in process and likely to be completed during the fiscal year.

The prospects for Fund investment performance in 1994 are positive. Interest rates have continued to decline, tending to decrease current receipts but to increase the values of fixed income investments. The dramatic price appreciation on AEC shares, recognized in this analysis in 1993 and previous years, is not likely to be repeated on other assets; but neither is there likely to be a counterpart of the Lloydminster write-off. On balance, performance in 1994 may not match the strong total rate-of-return earned in 1993, but it should be satisfactory.

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APPENDIX: NOTES ON VALUATION OF HERITAGE FUND ASSETS

March 31, 1993 (millions of dollars)

1. Fund value for accrued interest was adjusted to exclude estimated accrued interest on Provincial obligations of about $50 million (2% of reported value). Fund liabilities of about $6 million were offset.

2. Estimates of value on mortgages, venture loans and participations were obtained as follows:
   a. Valuation discount rates are based on March 31 long-term Canada bond rates: 1993 8%, 1992 9%

   The following premium for risk, administration and collection are added to the Canada bond rates:

AMHC	2%
AADC	3%
AOC	4%

   b. Valuation of loan positions held through crown corporations, using the following assumptions:
   (i) Crown corporation allowances for doubtful accounts are correct.
   (ii) One maturity date characterizes all loans extended by each corporation.
   (iii) Half of AADC abatements under the disaster assistance program are non-recurrent.

	AMHC		AADC		AOC	
	1993	1992	1993	1992	1993	1992
Loans, per crown corporation statements	375	488	934	1,002	97	114
Interest income	42	61	83	85	14	17
AADC abatements (loan incentives and 50% of disaster assistance)			-22	-22		
AMHC abatements (grant and subsidies)	-3	-4				
Interest earned, net of abatements	39	57	61	63	14	17
Discount rate, as described above	10.0%	11.0%	11.0%	12.0%	12.0%	13.0%
Approx. average maturity	3	3	10	10	5	5
Present value, principal and interest	379	497	687	676	106	122
Other assets, net of liabilities not owed to Fund			-14	-8	-14	-8
Estimated total market value	379	497	673	667	92	113
Property inventory	160	139	8	13	1	2

   c. Market value has been estimated on the combined investment in Ridley Grain, Millar Western Pulp, Al-Pac and Vencap, using projected future cash flows and a discount rate of 3% above the prevailing long-term Canada bond rate (8% + 3% = 11%). The following assumptions were used:
   (i) Payments will be deferred rather than paid if allowed by the contract.
   (ii) Promised amounts, including accrued interest, will be paid at maturity.
   (iii) Vencap's payments until maturity continue at the average of 1990-93 payments.
   (iv) Vencap share option and post-maturity participation are valued at zero.

   d. Syncrude's valuation is described in the 1992 version of this report. Recent Fund income from Syncrude is:

	1992	1991	1990	1989
(millions of dollars)	44.0	43.3	82.1	22.5

   e. The Fund statement value of the Lloydminster upgrader is used as a market estimate.

3. Amounts for 1992 shown in Table 2 differ slightly from amounts shown for that year in a previous version of this rep, due to changes in Provincial accounting, new information and method improvement.

4. Book values for assets held through the Fund are obtained from Government of Alberta consolidated Accounts, including supporting schedules, and from Alberta crown corporation statements.

5. The Fund statement explains that all Fund assets can be used to repay gross provincial debt. The Consolidated Statements balance sheet contains two references to debt, unmatured debt and net debt. A reader could easily assume that unmatured debt was synonymous with gross debt, even though provincial debt held as fund assets has been deducted from unmatured debt. There is nothing to disabuse the reader of this conclusion in the "Overview" version of the Consolidated Statements, intended for the general public. A reader of the full Consolidated Statements must infer the definition of "gross" from a supporting schedule.