

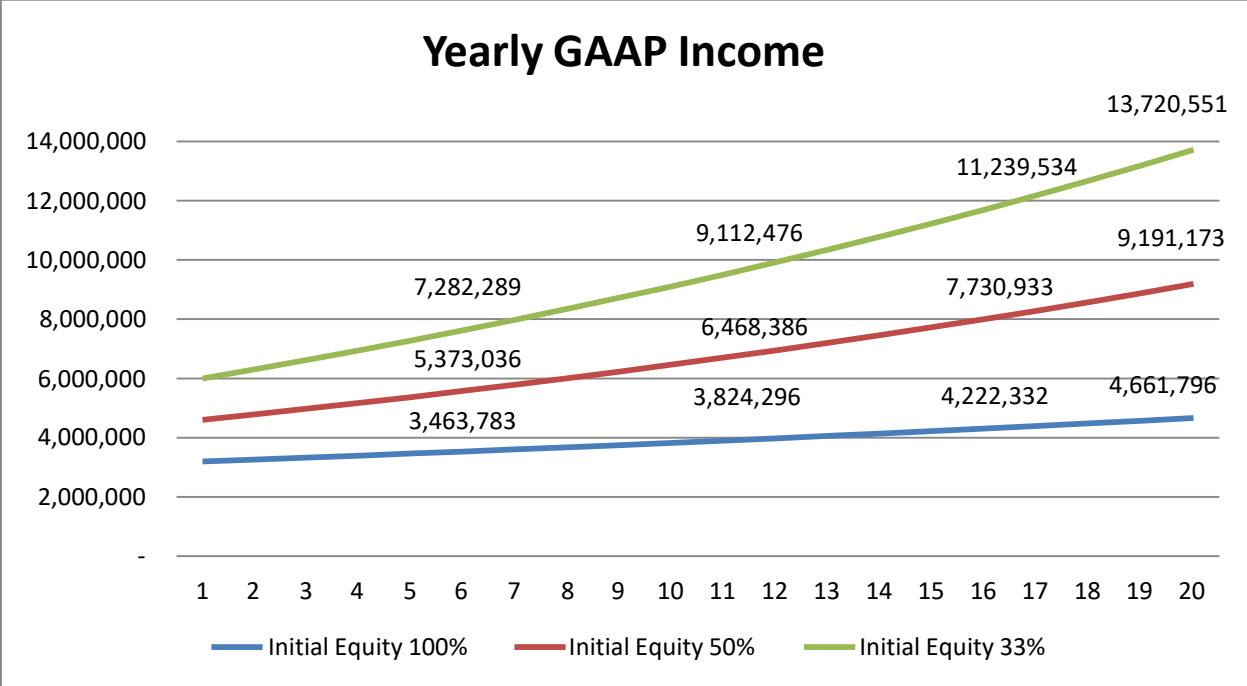
**Executive Session: Attachment 5 (Confidential)**

**Alaska Mental Health Trust Authority  
Board of Trustees Consultation  
February 28, 2013**

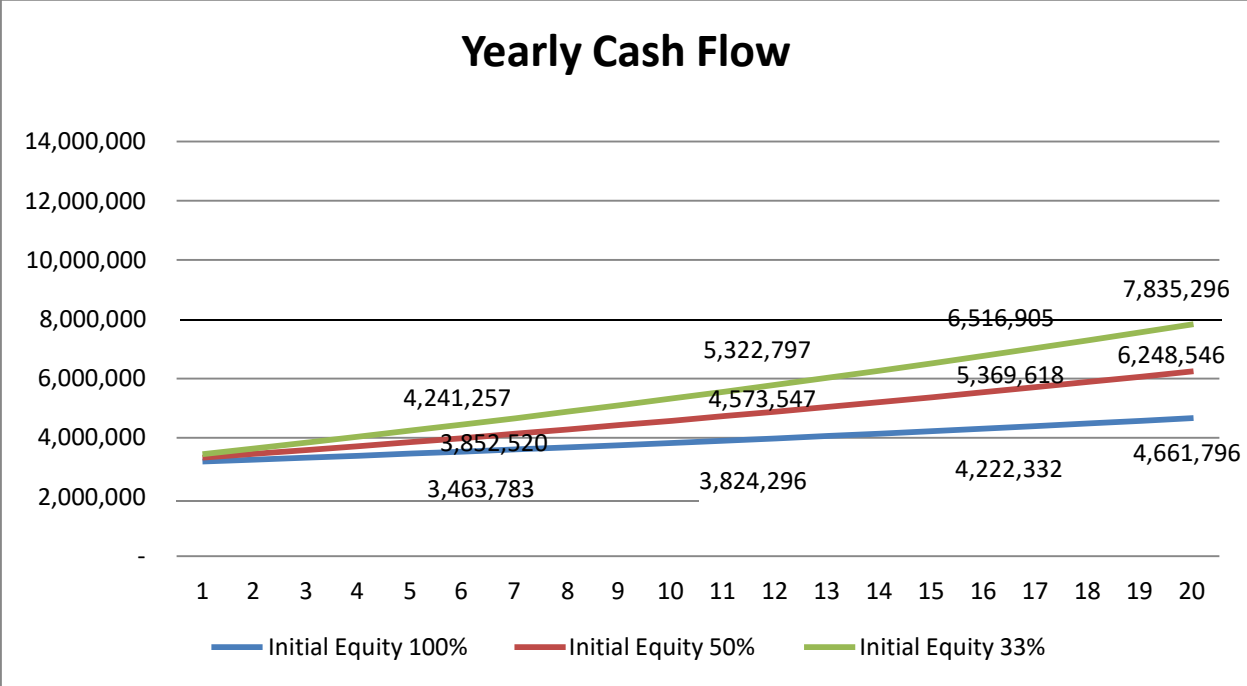
The purpose of the following information is to demonstrate how debt can function to increase the income, cash flow, and total portfolio value of real estate holdings. It is not a prediction of actual results; it merely shows the different outcomes possible using three different debt scenarios. There are many assumptions that weigh heavily on this data. Key assumptions are as follows:

1. Quality assets exist for acquisition
2. Debt is available at 4.5% interest
3. Debt fully amortizes over the 20 year period
4. No new debt is acquired
5. No new assets are purchased
6. All income is distributed to owner
7. All assets are:
  - a. Acquired simultaneously at the beginning of Year 1
  - b. Held for the entire 20 year period
  - c. Acquired with debt where applicable
8. Inflation averages 2% for the period
9. Cap rate of 8% is used for both purchase and sale
10. Permanent Fund will meet its projected 7% rate of return
11. The payout will be calculated on 4.25% of value

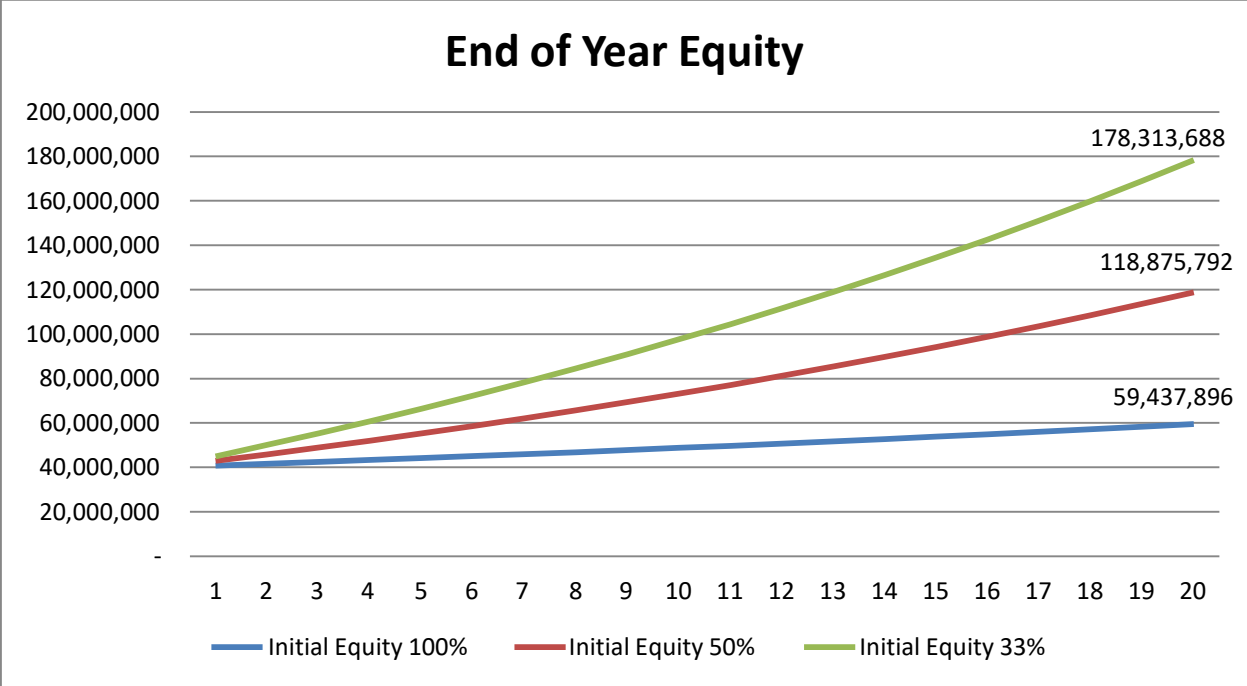
A change in any of these factors will affect how the plan functions.



The Yearly GAAP Income chart shows the differences in income potential between the various debt scenarios. Income for this exercise is revenue minus interest paid on the debt, if debt is in place. Even in year one (1), the income of either debt option beats the income from the non-debt option. In year ten (10) 50% and 66% initial debt balances beat the non-debt option by \$2,644,090 and \$5,288,180 in annual income generation respectively. By year twenty (20) the differences are \$4,529,377 and \$9,058,755.

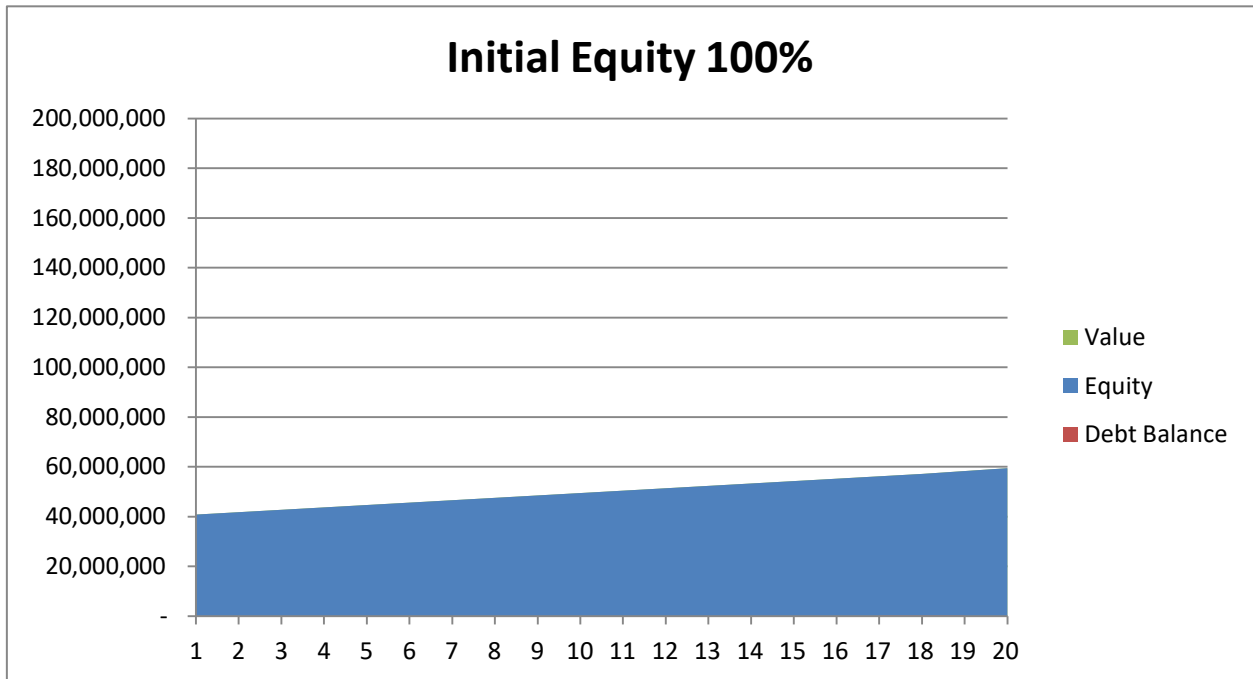


The Yearly Cash Flow chart shows the differences in cash generation potential. Cash Flow is revenue minus the mortgage payment if debt is in place. Even in year one (1), the cash flow of either debt option outperforms the cash flow from the non-debt option. In year ten (10) the 50% and 66% initial debt balances beat the non-debt option by \$749,251 and \$1,498,501 in income cash flow respectively. By year twenty (20) the differences are \$1,586,750 and \$3,173,500 respectively. The cash flow potential could be increased to a greater degree by partnering with a taxable entity that would compensate The Trust for tax deductible attributes such as interest expense and depreciation. In both cases the tax attributes are the most valuable in the early years. If the tax attributes were sold, to a joint venture partner, it would prove to raise and flatten the debt lines. The timing of the tax attribute sale proceeds is an important consideration from a NPV standpoint as cash received in early years is valued more highly.

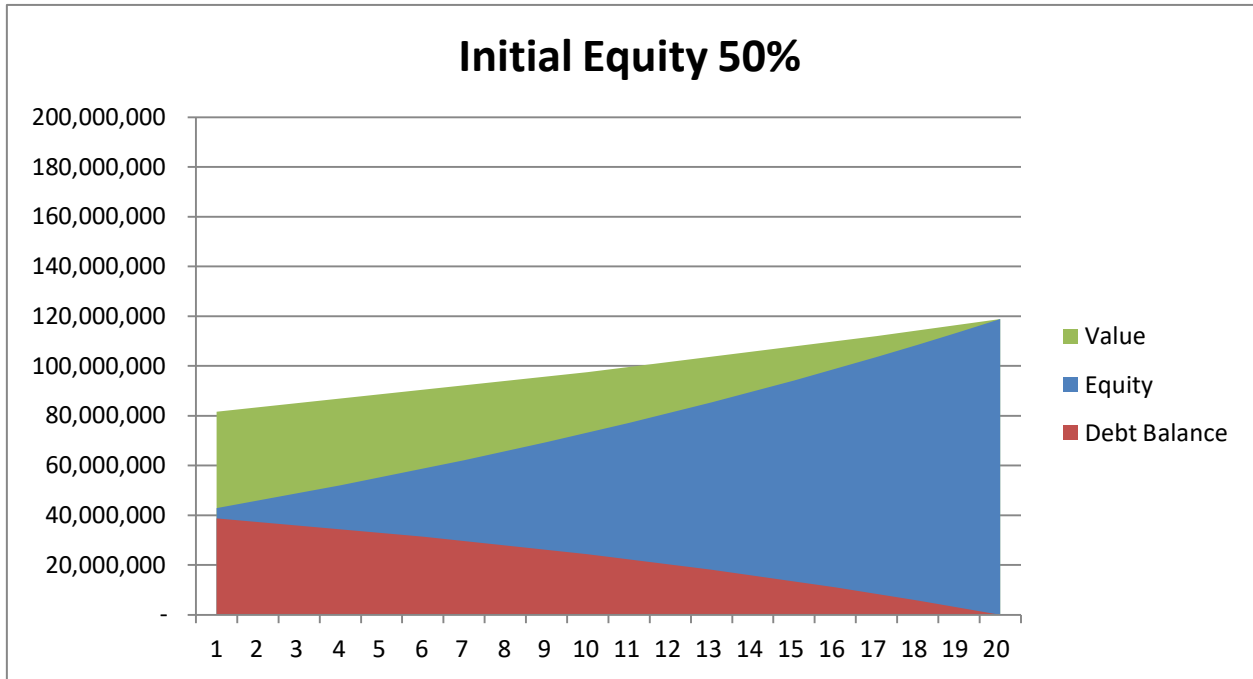


The End of Year Equity chart shows the differences in unencumbered value to The Trust. Equity is value minus debt, and is representative of Trust corpus value. The End of Year Equity of either debt option outperforms the Equity from the non-debt option. In year ten (10) 50% and 66% initial Equity balances beat the non-debt option by \$24,423,806 and \$48,855,612 respectively. By year twenty (20), the increased value differences to The Trust are \$59,437,896 and \$118,875,792.

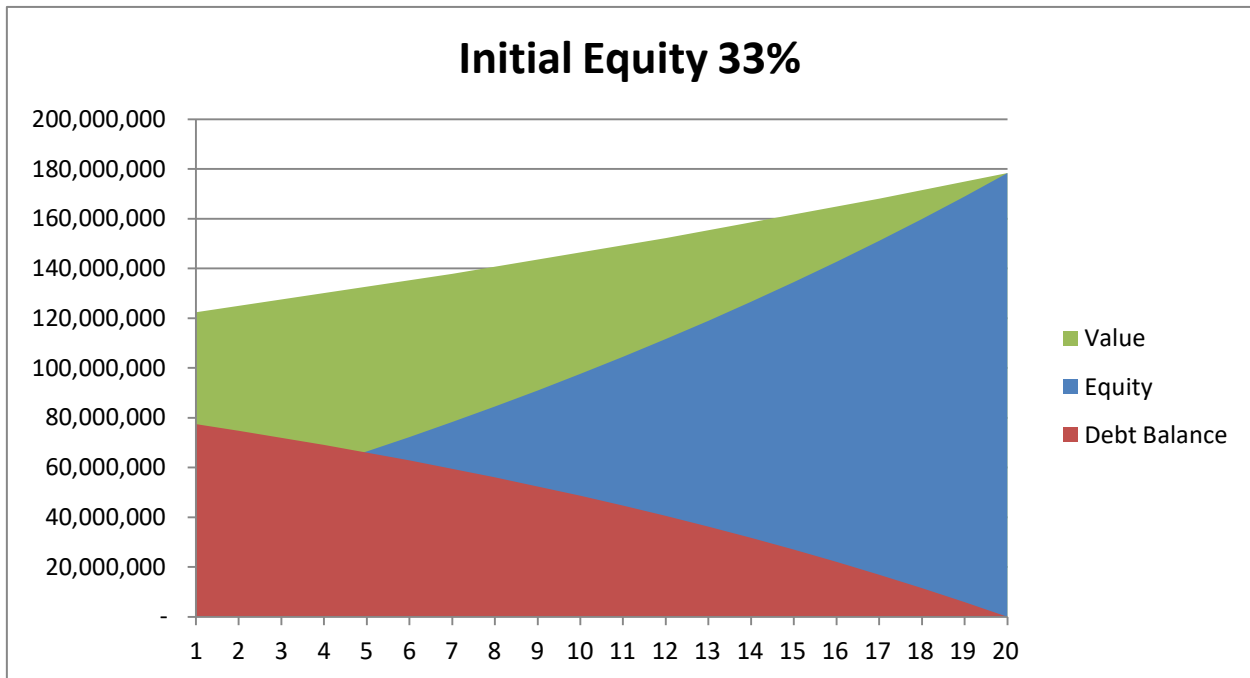
The following three charts give a comparative visual analysis of the interaction between value, equity, and debt under the preceding scenarios. As you will notice the equity and value meet at the point where there is no debt. The scenario without debt equity and value are synonymous. The greatest long term value to The Trust under these scenarios is the scenario that proposes the highest initial debt balance of 67%. In the end it creates \$178,313,688 of principal value while generating \$110,252,919 Income Revenue to The Trust.



The Initial Equity 100% chart is representative of the expected value over time when no debt is used. The total of assets purchased is limited to the \$40,000,000 designated as equity in the Real Estate Management Plan. The increase in principal value is limited to the effects of inflation. The effect of limiting value increase to inflation is that, although the assets have produced \$78,000,000 of Income Revenue over the period, the true value of the corpus has remained the same.



The Initial Equity 50% chart is representative of the expected value over time when cash and debt are initially used in equal amounts. The total of assets purchased is doubled through leverage to \$80,000,000, increasing the buying power of the \$40,000,000 designated as equity in the Real Estate Management Plan. The increase in principal value of the corpus through the hold period is \$78,000,000 - far outpacing the effects of inflation. In addition, the assets have produced \$134,000,000 of Income Revenue over the period.

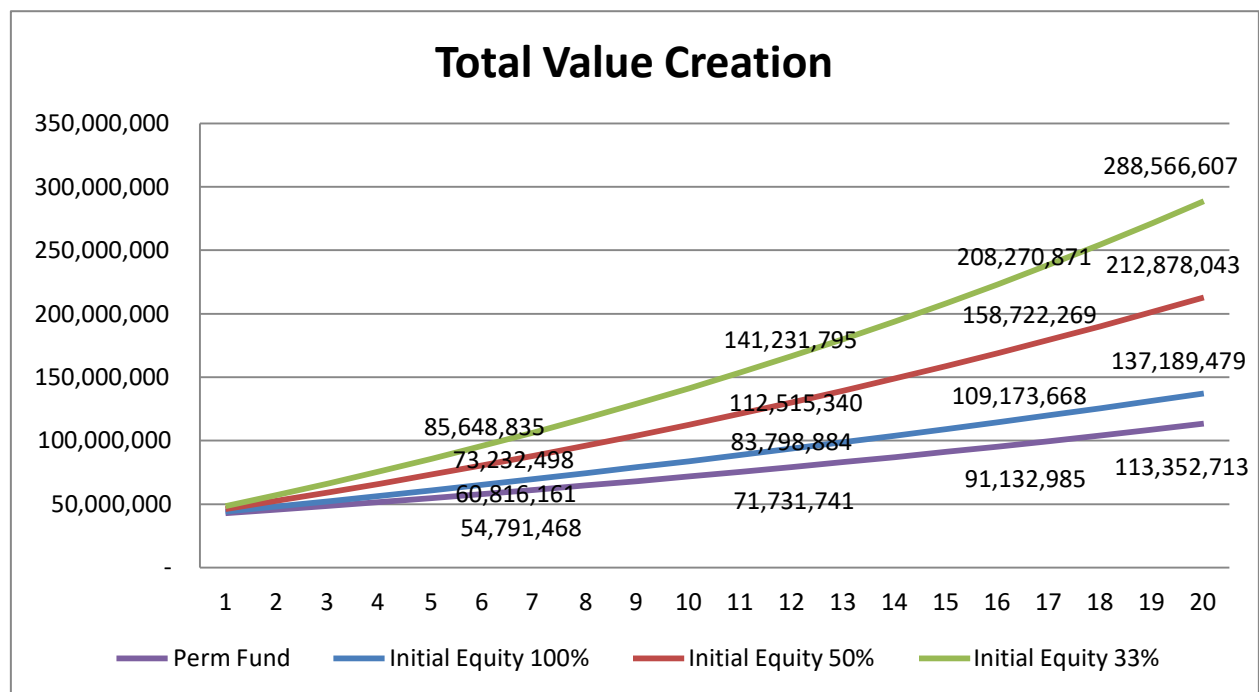


The Initial Equity 33% chart is representative of the expected value over time when cash is 33% and debt is 67%. The total of assets purchased is tripled through leverage to \$120,000,000, increasing the buying power of the \$40,000,000 designated as equity in the Real Estate Management Plan. The increase in principal value of the corpus through the hold period is \$138,000,000 - far outpacing the effects of inflation. In addition, the assets have produced \$190,000,000 of Income Revenue over the period.

Under these scenarios, the key reason greater debt results in greater income generation and value to The Trust is the cost of capital in relation to the returns provided by the assets. The assets are generating an initial return of 8% so any money that can be used at a cost of less than 8% (debt) will increase the return on the equity. One might conclude upon the results of these exercises that debt of 100% would be appropriate. However, that conclusion would be incorrect for two key reasons. First, it is unlikely that any lender would make such a loan. In fact, the current market will only support debt up to around 80%. Secondly, as debt approaches 100% the risk of default increases. More specifically, as the debt service approaches the cash generated by the asset, the less cash is available as a cushion. The Real Estate Management Plan anticipates that although certain assets may be leveraged up to 75%, the overall portfolio should be leveraged at an average of 50%.

The alternative to investing in Income Revenue producing property through the Real Estate Management Plan is to place the principal in the Permanent Fund. Once funds are sent to the Permanent Fund they may never be withdrawn, save for the standard payout of 4.25%. One stated goal of the Real Estate Management Plan is to outperform the earnings of the Perm Fund. The Perm Fund has a stated projected return of 7%. The return generated by the Perm Fund cannot be directly compared to the earnings generated by the Real Estate investments. The return from each source differs on two key points. First, the income generated by the perm fund goes to increase the value that is used to determine the 4.25% payout. The Income Revenue generated by the real estate can be used dollar for dollar by The Trust immediately for programmatic needs or administration. In other words a dollar of income in the Perm Fund only produces \$.0425 that can be used by the trust. Secondly, distributions from the Perm Fund reduce the corpus while income generated from Real Estate does not produce a reduction in the value of that Real Estate.

Considering these differences, one way to analyze performance over time is to take into account total value to the Trust of the cash flow from each investment and the value of the underlying asset. For Real Estate that would be the sum of all rents received in addition to the value to the property. For the Perm Fund it would be the sum of all payouts in addition to the value of the remaining corpus. As you can see under the current set of reasonable assumptions, every level of Real Estate equity investment outperforms the value created by the Perm Fund, every year of the twenty years presented.



**SUMMARY:**

The conclusion is The Trust should proceed with the Real Estate Management Plan, which directs the TLO to locate and acquire Income Revenue generating assets using the funds of the TADA, leveraged where debt will increase returns to The Trust and decrease risk.