Trust
Alaska Mental Health
Trust Authority

3745 Community Park Loop, Suite 200
Anchorage, AK 99508
Tel 907.269.7960
www.mhtrust.org

MEETING AGENDA

Meeting:	Finance Committee
Date:	July 30, 2020
Time:	11:30 AM
Location:	online via webinar and teleconference
Teleconference:	(844) 740-1264 / Meeting Number: 133 944 4474 # / Attendee Number: # https://alaskamentalhealthtrust.org/
Trustees:	Laraine Derr (Chair), Verné Boerner, Rhonda Boyles, Chris Cooke, Anita Halterman, Ken McCarty, John Sturgeon

Thursday, July 30, 2020

		Page No.
11:30 am	**Call Meeting to Order (Laraine Derr, Chair)**	
	Roll Call	
	Announcements	
	Approve Agenda	
	Ethics Disclosure	
	Approve Minutes	
	• April 22, 2020	4
	• May 20, 2020	13
11:40	**Staff Report Items**	
	Financial Dashboard – Carol Howarth, CFO	Hand-Out
	Revenue Forecast FY 21-FY23 – Carol Howarth, CFO	Hand-Out
	Fund Balances – Mike Abbott, CEO	
12:15	**Lunch Break**	
12:45	**Planning Items**	
	Trust Land Office Operating Budget FY22 – Wyn Menefee, Executive Director	20
	Trust Authority Office Operating Budget FY22 – Mike Abbott, CEO	22
	Break	
1:40	**Planning Items – (continued)**	
	Commercial Real Estate Portfolio Discussion	24
	• Jusdi Doucet, Deputy Director TLO	
	• Carol Howarth, CFO	
	Break	
3:20	**Approval**	
	NCL Sale - TADA Transfer Request – Carol Howarth, CFO	43
3:25	**Trustee Comments**	
3:40	**Adjourn**	

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Future Meeting Dates

Full Board of Trustee / Program & Planning / Resource Management / Audit & Risk / Finance

(Updated – July 2020)

• Full Board of Trustee	August 26-27, 2020	(Wed, Thu) – Anchorage
• Full Board of Trustee	November 18-19, 2020	(Wed, Thu) – Anchorage
• Audit & Risk Committee	January 6, **2021**	(Wed)
• Finance Committee	January 6, **2021**	(Wed)
• Resource Mgt Committee	January 6, **2021**	(Wed)
• Program & Planning Committee	January 6, **2021**	(Wed)
• Full Board of Trustee	January 27-28, **2021**	(Wed, Thu) – Juneau
• Audit & Risk Committee	April 21, **2021**	(Wed)
• Finance Committee	April 21, **2021**	(Wed)
• Resource Mgt Committee	April 21, **2021**	(Wed)
• Program & Planning Committee	April 21, **2021**	(Wed)
• Full Board of Trustee	May 26, **2021**	(Wed) – TBD
• Program & Planning Committee	July 27-28, **2021**	(Tue, Wed)
• Audit & Risk Committee	July 29, **2021**	(Thu)
• Resource Mgt Committee	July 29, **2021**	(Thu)
• Finance Committee	July 29, **2021**	(Thu)
• Full Board of Trustee	August 25-26, **2021**	(Wed, Thu) – Anchorage

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Future Meeting Dates

Statutory Advisory Boards

(Updated – May 2020)

Alaska Mental Health Board / Advisory Board on Alcoholism and Drug Abuse

- Executive Committee – monthly via teleconference (Second Wednesday of the Month)

Governor's Council on Disabilities and Special Education

- Sep. 29-30, 2020 – Anchorage/ZOOM
  (possible pre/post-meeting for Autism Ad Hoc and/or Workgroup on FASD)
- February 2021 Juneau/ZOOM

Alaska Commission on Aging

- Aug 10-14, 2020 – Quarterly Meeting (Teleconference / Zoom)
- August 2020 – Rural Outreach Trip (tentative)

ALASKA MENTAL HEALTH TRUST AUTHORITY

FINANCE COMMITTEE MEETING
April 22, 2020
8:30 a.m.
WebEx Videoconference/Teleconference

Originating at:
3745 Community Park Loop, Suite 120
Anchorage, Alaska

Trustees Present:
Laraine Derr, Chair
Rhonda Boyles
John Sturgeon
Ken McCarty
Chris Cooke
Verne' Boerne
Anita Halterman

Trust Staff Present:
Mike Abbott
Steve Williams
Carol Howarth
Miri Smith-Coolidge
Kelda Barstad
Luke Lind
Michael Baldwin
Carrie Predeger
Katie Baldwin-Johnson
Jimael Johnson
Valette Keller
Eric Boyer
Autumn Vea
Allison Biastock
Katie Vachris
Kat Roch

Trust Land Office:
Wyn Menefee
Jusdi Doucet
Marisol Miller

Also participating:
Angela Rodell; Erin O'Boyle; Gayle McDonough; Charlene Tautfest; Rebeka Carpenter; Sheila Harris; Stephanie Hopkins.

PROCEEDINGS

CALL TO ORDER
CHAIR DERR called the meeting to order and began with a roll call.

MR. ABBOTT stated that there were six committee members present.

CHAIR DERR asked for any announcements. There being none, she moved to approval of the agenda.

APPROVAL OF AGENDA

> **MOTION:** A motion to approve the agenda was made by TRUSTEE STURGEON; seconded by TRUSTEE BOERNER.
>
> *There being no objection, the MOTION was approved.*

ETHICS DISCLOSURES
CHAIR DERR asked for any ethics disclosures.

TRUSTEE McCARTY respectfully submitted an ethics consideration statement. "I am the founder and executive director of Discovery Cove Recovery and Wellness Center which is a for-profit community mental health care facility. It employs licensed clinical therapists, physicians, and psychiatrists. Its outreach directly affects Trust beneficiaries whether through services of mental health, developmental disabilities, or substance use. Our opioid, our medication treatment program reaches beneficiaries from Juneau to Nome. Through appointment by the Governor and confirmation by the Legislature of a vote of 59 to 1, with full knowledge of my background, I am honored to be a trustee of the Mental Health Trust. If in due course of discussions regarding Trust matters which may be seen to have a conflict of interest due to my position as executive director of Discovery Cove, that I understand that I may not be able to participate, thus, to cease the direction of the Chair and trustee bodies as to whether I should recuse myself for such individual matters that may be discussed on our current agenda and throughout this current meeting. Thank you."

CHAIR DERR thanked Trustee McCarty and stated that if anything came up in regard to his organization, it will be decided at that time on whether he would be able to vote or not. She asked for any other ethics disclosures. There being none, she moved to the approval of the minutes of the January 3. 2020 meeting.

APPROVAL OF MINUTES

> **MOTION:** A motion to approve the minutes of the January 3, 2020 Finance Committee meeting was made by TRUSTEE COOKE; seconded by TRUSTEE HALTERMAN.
>
> *There being no objection, the MOTION was approved.*

CHAIR DERR moved to the next item on the agenda, and recognized Angela Rodell.

PLANNING ITEMS
MS. RODELL thanked all and began by explaining, historically, how the asset allocation for the

Fund had changed over the years. She stated that asset allocation is where the cash is, which allows the Fund to continue to generate returns, and also spreads risk around. Having this diverse asset allocation allows the management of returns and risk in a more prudent manner. She moved to the global economy and stated that 73 percent of the Fund is in the United States. She talked about the effect that the pandemic has had on the global markets and that some will be able to recover sooner, and we will be able to take advantage of the recovery efforts that happen. She added that the results of the real impact of what is happening to companies on their revenues, and their ability to maintain their business models will be seen in July, the second quarter of calendar year 2020. She moved to the value of the Mental Health Trust assets that the Fund manages. As the Fund grew, the funds managed on behalf of the Mental Health Trust have grown. She explained the lows as they came about in March, and then stated that they are coming back up. On April 30th, an updated balance on that Mental Health Trust balance should be provided.

CHAIR DERR thanked Ms. Rodell and called a break.

(Break.)

CHAIR DERR called the meeting back to order and recognized Carol Howarth.

FINANCIAL DASHBOARD

MS. HOWARTH stated that she would go through the dashboard by first focusing on expenditures, then the receipts, and finally the fund balances. She talked about how the process went in regard to the total program number and explained how it related to the COVID-19 special funding. She stated that the team in the process looked at the existing grants issued with a good communication between parties and, given the current situation, those funds will be expanded. She moved on to Trust receipts and began with the Trust Land Office which has two sources of income: One is principal income that goes directly to the Permanent Fund; the other, Trust Land Office income, goes into the ultimate spendable account. She recounted the Trust Land Office's revenue to date, and moved to the investment activity.

TRUSTEE COOKE found the new dashboard easier to follow and understand, with the ability to compare categories.

MS. HOWARTH gave credit to Andy Stemp and Sarah Morrison, who got the report to this point.

CHAIR DERR thanked Sarah for stepping in for Mr. Stemp and doing an excellent job. She asked Mr. Abbott to continue.

FY2021 BUDGET UPDATE

MR. ABBOTT moved into the conversation about what the changes in the financial position mean for the near-term revenue streams. He stated that the impact on revenues for FY21 between what was anticipated in January and what is anticipated now is about $650,000 less revenue for the fiscal year that will start July 1st. He explained that the reason for the small change is that a relatively conservative averaging process was used so there is no overreaction in any given year to either good or bad news. The same thing is true of investment earnings. The impact of that overall means that for all of the different revenue types, using the four-year averaging methodology that the trustees approved many years ago, is that the spendable revenue in FY21 is only 2 percent less than what it was thought to be a few months ago. He added that it is entirely possible that those numbers will get better if investment performance is even marginally positive for the rest of the current fiscal year. He continued that the reason that it is not necessarily impactful in the near term is that the revenues anticipated for FY21 have not been fully allocated for spending yet.

CHAIR DERR moved to Harvest Capital on the agenda.

HARVEST CAPITAL
MS. HOWARTH introduced Erin O'Boyle and Gayle McDonough from Harvest Capital and stated that they joined as a third-party real estate investment adviser to do an objective analysis of the Trust Land Office's real estate portfolio.

MS. O'BOYLE stated that she is the managing partner of Harvest Capital Partners and appreciated the opportunity of being the real estate adviser, supporting the great mission of serving the beneficiaries. She stated that the presentation would cover the role of Harvest Capital, the fiduciary evaluation of the portfolio, an overall portfolio overview, the findings, and the recommendations. She continued that she is a founder and managing partner of Harvest, which is an SEC investment registered adviser, a minority women-owned business enterprise. She added that she had a master's in real estate from MIT.

MS. McDONOUGH stated that she was also a graduate of MIT and has 30-plus years in investment management with a background in acquisitions, dispositions, asset management portfolios of property and advising projects.

MS. O'BOYLE stated that their duty was to advise, advocate, and protect the Trust to maximize value of the assets; provide leadership in advocacy and planning to maximize the total return for the funding of programs; and, as a SEC registered adviser, they have to fulfill their obligation as a fiduciary to act in the Trust's best interests in making recommendations for those best interests. She continued that there are three primary criteria in the evaluation: Portfolio quality, management, and performance. She reported that on portfolio quality, the assets were bought at the right time, at good prices, and in good, solid submarkets. She continued on to management and stated that they have worked closely with the TLO staff and have met all the property managers. She added that they were on regular calls with the team as they have been managing through this crisis, and they are strong capable managers. She moved to performance and stated that the legislative audit did not evaluate performance. Their scope was to evaluate processes and capabilities, establish guidelines, policies, following the enabling legislation. It also cited a lack of guidance to consider the real estate holdings in the context of the allocation of the real estate through the Alaska Permanent Fund. She stated that she cannot speak to past events, but she can speak to the ownership of a portfolio and the fiduciary responsibility to recommend investment decisions. She continued that the income stream has proven to be exceptionally durable at a time when liquidity and durability are at a premium.

MS. McDONOUGH went through the portfolio beginning with Israel Road in Tumwater, Washington, which is 100 percent leased credit tenants; next was North Rulon in Ogden, Utah, 100 leased to the IRS, a long-term credit lease; San Pedro Avenue in San Antonio, Texas, which is 97 percent leased; True Source lease renewal has been complete; and the Marriott Worldwide renewal is fully negotiated and out for signature with the tenant. She stated that next was Amberglenn Boulevard, Austin Texas, 97 percent leased; Ridgepoint Drive in Austin, Texas, is 100 percent leased; Cordova Street in Anchorage, 82 percent leased, and 97 percent occupied; Commercial Drive, Anchorage, Alaska is 100 percent leased to Cummins Northwest.

MS. O'BOYLE stated that the valuations of the portfolio, from the last external appraisals to this valuation, went from $95 million to $99 million. She continued that one of the findings included that the portfolio debt does not follow best practices. The practices that it did not follow at this loan to value was interest only, with other provisions such as loan extensions, favorable prepayment provisions, et cetera. She added that an extensive cash-flow analysis was done with the team and is appended in the packet. She talked about the flexibility in financing interest only to make whatever amortization payments desired that is not contractually required and is a big difference. She continued that flexibility is especially important. The portfolio has been financed with extremely high quality life companies and banks, and those are very preferred lenders for real estate. She stated that the final recommendation is to refinance the portfolio with interest-only debt, conservatively 3 to 3.5 percent, with flexible prepayment terms that would increase the cash flow by almost $20 million compared to the existing financing. She continued that if it is not refinanced, then there is a need to fund the maturing loans. She suggested engaging a mortgage broker to market the portfolio to lenders and negotiate best terms, and then consider a portfolio loan instead of individual loans.

MS. McDONOUGH went through the final summary and stated that this was done to highlight the differences between the scenarios and to show that there can be some cash flow benefits. Scenario A provides $26 million to the Trust over ten years. Scenario B models the existing debt and provides roughly $19 million to the Trust over the same ten years. Scenario C is that recommended refinance which provides approximately $45 million for the Trust over those same ten years.

MS. O'BOYLE talked about the impact of COVID-19 on the debt market. She stated that they appreciated the opportunity to present.

CHAIR DERR thanked Harvest and called a break.

(Break.)

CHAIR DERR called the meeting back to order and asked Mr. Menefee for a presentation on COVID-19 effects on real estate cash flows.

COVID-19 EFFECTS ON REAL ESTATE CASH FLOWS

MR. MENEFEE talked about the impacts on commercial real estate properties with the COVID-19 pandemic going on. He stated that it is having an effect on properties by restricting cash flows for businesses, and then adding to business uncertainty. That is the main focus of why COVID affects business. The uncertain economy and the future business strength is all uncertain. Businesses that depend on tourism or doing business with people in person are being affected more. He explained that some of the properties are government tenants which were considered essential services, and the Trust benefited from that. He continued that having this affecting the businesses means that it could affect the lease renewal process and extension negotiations. It reduces the confidence in being able to say that a vacated space can be filled right away because of dependence on the market of the local conditions. He added that there will be a bit of a dip in revenue in the commercial real estate investment properties. The revenue projections have been revised as the year goes on, and we are starting to have to set aside cash reserves to potentially deal with vacancies, rent abatements, tenant improvements for people that do early lease renewals or extensions. He moved on to the 2021 real estate budgets, and talked about how the whole document would flow structurally. In order to expend the Trust funds to pay for all the operating and capital expenses and such, we need to request approval. He continued that Motions 2 and 3 are a combination dealing with expenses not covered by the rents. He asked for a motion.

> **MOTION:** A motion that the Finance Committee recommends that the Alaska Mental Health Trust Authority Board of Trustees concur with the recommendation to approve the incremental building expenditures totaling $10,405,837 budgeted for the fiscal year 2021 to be paid by the property manager from rents and other income collected from the properties was made by TRUSTEE COOKE; seconded by TRUSTEE HALTERMAN.

MS. MILLER stated that for proposed Motion 1, it is anticipated that fiscal year gross revenues from both rents and program-related investment properties are $11,799 million. She continued that they are anticipating that to both maintain and service the properties, pay the property managers everything required to keep the buildings in proper functioning capacity, will be $10,405,836.86. She talked about the methods used to come up with the needs of the properties to keep them in the best operating function.

MR. ABBOTT clarified that this was about two groups of properties in one motion and not just the investment properties. He added that the list of the properties are in the packet.

CHAIR DERR asked for any other questions or comments. She called the vote.

> *After the roll call vote, the MOTION was approved (Trustee Boyles, yes; Trustee McCarty, yes; Trustee Cooke, yes; Trustee Halterman, yes; Trustee Boerner, yes).*

CHAIR DERR asked Mr. Menefee to do the overview for the next two motions.

MR. MENEFEE stated that there is not enough rent to pay the property expenses, and we are looking at pulling money from the Central Facility Fund. Essentially, Motion 2 is to approve the use of CFF funds to pay for some of the expenses.

MS. MILLER explained that there is a request for $15,000 in capital improvements for the primary tenant at the Trust Authority Building, and the additional funds will be for operating and maintaining the building, keeping it up to ADA standards. She continued that there is a request for $53,032 to make capital improvements that are needed to the building for the Anchorage School District who occupy much of the first floor of the Trust Authority Building.

MR. ABBOTT explained that the reason the TAB is a poor-financially-performing asset is that the Trust Authority does not pay rent. Half of the building that the school district does not rent is utilized by the Trust Authority, which is why the building barely breaks even on an operating basis and does not generate enough additional income to support periodic capital improvements.

CHAIR DERR asked for a motion.

> **MOTION:** A motion that the Finance Committee recommends that the Trust Authority Board of Trustees approve funding the expenditures for the noninvestment-program-related real estate and REMP real estate Trust-funded properties, in the amount not to exceed $53,032 for the fiscal year 2021 from the Central Facility Fund, which appropriation shall not lapse, was made by TRUSTEE COOKE; seconded by TRUSTEE HALTERMAN.

CHAIR DERR called the vote.

> *After the roll call vote, the MOTION was approved (Trustee Boyles, yes; Trustee McCarty, yes; Trustee Cooke, yes; Trustee Halterman, yes; Trustee Boerner, yes; Trustee Sturgeon, yes; Trustee Derr, yes).*

CHAIR DERR moved to Motion 3.

> **MOTION:** A motion that the Finance Committee recommends that the Trust Authority Board of Trustees instruct the CFO to transfer up to $53,032 to the third-party property manager, as requested by the TLO, for capital improvements to the noninvestment/program-related real estate and REMP real estate Trust-funded properties was made by TRUSTEE COOKE; seconded by TRUSTEE HALTERMAN.

CHAIR DERR called the vote.

> *After the roll call vote, the MOTION was approved (Trustee Boyles, yes; Trustee McCarty, yes; Trustee Cooke, yes; Trustee Halterman, yes; Trustee Boerner, yes; Trustee Sturgeon, yes; Trustee Derr, yes).*

MR. MENEFEE thanked the trustees for the consideration and, with this approval, we will continue to keep the buildings in good order and try to keep them filled.

CHAIR DERR asked for the next item on the agenda.

REAL ESTATE PORTFOLIO REFINANCE

MR. ABBOTT replied that the next item is the refinance discussion. He stated that staff is not recommending an approval of a specific strategy or specific refinance approach, but would like the committee to direct staff to continue to develop options for the trustees to consider. He suggested the motion be read and then discussed.

TRUSTEE COOKE questioned the necessity of a motion.

CHAIR DERR asked if trustee direction to staff would come from the motion or would it be better to just discuss it.

MR. ABBOTT replied that talking about it would be fine.

CHAIR DERR stated that there would be discussion, and then direction as to what the trustees wanted. She recognized Ms. Howarth.

MS. HOWARTH stated that staff highly valued the perspectives and recommendations that Erin O'Boyle and Gayle McDonough presented. She continued that two things happened with this proposal: One explored the interest-only refinance of the assets. Looking at this from a portfolio perspective gives the Trust the opportunity to look at the impact of restructuring the debt on the cash flow. She added that interest rates are lower than when the initial mortgages were utilized, and there are two properties that have balloon payments coming up. Third is that the equity in the property is very high, so the loan to value is good. She went through some of the scenarios on the cash flow and how they affect the operation. She added that it is critical to understand the cash-flow implications.

CHAIR DERR asked the trustees for their individual thoughts and comments on the recommendations from Harvest. After the discussion, she asked Ms. Howarth if she had an idea of what to be prepared for in May.

MS. HOWARTH recapped that there is a lot of concern about the market with regards to real estate with a need to put this in a broad context. Some political factors have to be factored in, and we need to do a professional evaluation because there are some options that might have been missed.

MR. ABBOTT stated that this was very helpful and gives staff a chance to deliver products going forward that meet the trustees' expectations, and they hopefully address trustees' concerns.

CHAIR DERR moved to the inflation-proofing discussion.

INFLATION-PROOFING DISCUSSION

MR. ABBOTT stated that in January the reserves were in excess of the 400-percent target, which triggered a conversation about inflation-proofing options. He continued that since then the markets have changed radically and the value of the investments have declined significantly. He added that the reserves now sit well below the target at which inflation-proofing would be considered, and it is now a moot point.

MS. HOWARTH stated that one of the questions to think about is this kind of a standard protection, or do we need to look for strong protection for those beneficiaries long term through inflation-proofing, because that would be more aggressive.

CHAIR DERR asked for any questions from the trustees on inflation-proofing. There being none, she moved to the investment policy.

INVESTMENT POLICY UPDATE

MR. ABBOTT moved to the packet and the list of the trustee obligations related to reviewing and overseeing the investment allocation, investment performance, essentially the investment behavior. He stated that Ms. Howarth developed a presentation in a calendarized version of when these different opportunities will be brought in to weigh in on the asset management and asset performance. He continued that some are new requirements and others are legacy requirements that have been worked on, but we do want to get on track with an updated asset management policy statement.

MS. HOWARTH stated that she could use some thought and guidance on the Central Facility Fund which did emerge in the discussion.

CHAIR DERR asked for anything else to come before the Finance Committee before adjournment. There being nothing, she asked for a motion to adjourn.

> **MOTION:** A motion to adjourn was made by TRUSTEE BOERNER; seconded by TRUSTEE STURGEON.
>
> *There being no objection, the MOTION was approved.*

(Finance Committee meeting adjourned at 12:53 p.m.)

ALASKA MENTAL HEALTH TRUST AUTHORITY

FINANCE COMMITTEE MEETING
May 20, 2020
8:30 a.m.
WebEx Videoconference/Teleconference

Originating at:
3745 Community Park Loop, Suite 120
Anchorage, Alaska

Trustees Present:
Laraine Derr, Chair
Rhonda Boyles
John Sturgeon
Ken McCarty
Chris Cooke
Verne' Boerne
Anita Halterman

Trust Staff Present:
Mike Abbott
Steve Williams
Carol Howarth
Miri Smith-Coolidge
Kelda Barstad
Luke Lind
Michael Baldwin
Carrie Predeger
Katie Baldwin-Johnson
Jimael Johnson
Valette Keller
Eric Boyer
Autumn Vea
Allison Biastock
Sarah Morrison
Travis Welch

Trust Land Office:
Wyn Menefee
Jusdi Doucet

Other Participants:
Greg Jones
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PROCEEDINGS

CALL TO ORDER
CHAIR DERR called the meeting to order and began with a roll call. With all trustees present, she asked for any announcements. There being none, she moved to the approval of the agenda.

APPROVAL OF AGENDA

> **MOTION:** A motion to approve the agenda was made by TRUSTEE COOK; seconded by TRUSTEE BOERNER.
>
> *There being no objection, the MOTION was approved.*

ETHICS DISCLOSURES
CHAIR DERR asked for any ethics disclosures. There being none, she moved to the reason for the Finance Committee meeting, explaining that at the last meeting there was talk about doing a debt-free payment system for commercial real estate. With no trustees having a background in commercial real estate, more information was requested. Greg Jones has had a varied perspective on the Trust, being head of the Land Office for a while, being CEO for a while, and a trustee for a while. She recognized Greg Jones.

HISTORY OF COMMERCIAL REAL ESTATE INVESTMENTS
MR. JONES stated that he was not a lawyer and there are legal concepts involved; he was not a CPA or a finance expert; he has done quite a bit of real estate and has a very good familiarity with the Trust. He continued that the questions asked were why real estate and why debt, and is interest-only debt a good idea. There is also a question of portfolio versus facility debt that he would weigh in on, but that should be explained by the TLO. The last question addressed was "under what conditions can the Trust deploy principal?" He began with "why real estate?" He stated that his memo covered it fairly straightforwardly. The falling sources of revenue were hit by multiple negative trends. The TLO was out of lumber, and the marketable land had been hydrated. The stuff that was easy to sell was sold off. Then the Trust fund was hit by a recession and, for the first time, the Permanent Fund started suffering some losses. He reminded all that as the Trust manages its assets, the principal from the sale of an asset is considered principal and has restrictions on how it can be used and where it can be placed. Income that does not involve the sale or the disposal of an asset is used for administrative costs of the Trust, as well as programs. He explained that the same recession that hammered the Trust fund and everyone's 401(k) in 2008 created a buyer's market in commercial real estate nationwide. A plan was worked on to see if principal could be invested in hard assets, in commercial real estate that would generate revenue. This was discussed with the in-house lawyer, the Attorney General's office, financial experts, and at multiple work sessions with the board of trustees. He added that this was all in the records with conflicted state and federal statutes. There was confusion in the way the settlement was done and the way the statutes were written. The final conclusion reached with the lawyers was the use of principal on a temporary basis for improving income was defensible, and all were convinced it was the right thing to do. He continued with how it all developed; the chart of income produced by the Trust Land Office since 1995. The Permanent Fund returns starting in 1980 were always choppy, and the Trust gets reported income exactly in concert with the Permanent Fund income. A system was developed so income would not get as choppy; and we got to the point of needing to do something to get a consistent, safe source of income in these programs. In 2010, the lands were prepared for sale. In the early

2000s, the Trust had been preparing to invest in their own real estate by building roads, subdividing, getting permits, resolving wetlands issues, and principal was used to make those investments. In 2012, investment in real estate was begun with excellent long-term tenants, excellent credit, and the performance showed it. The income from those commercial real estate investments grew and is still a consistent income. It was believed to be the right thing to do. He moved on to the debt and explained what happened. There was an 8 percent return based on the market and, in today's market, it is a good investment. He explained how this worked in greater detail. He gave an example of interest-only debt. He stated that the last thing he did before he left the Trust Land Office, after implementing the real estate investment plan, was stating the need to go to the Legislature. Found were ambiguities and conflicting statutes and regulations that needed to get clarified and cleaned up so that the Legislature was comfortable with what was being done. He added that, to his knowledge, that was not done. There is a need to resolve what the role of the trustees are and how they can manage the assets. He explained that what was done was very responsible and conservative, and from a financial standpoint, it did the best possible job of benefitting the beneficiaries of the Trust. He stated that there are still unresolved questions that the audit did not resolve. He continued that one of the most important functions going forward would be to develop an investment plan that is easily explainable, credible, explains rates of return, diversity standards, criteria for purchases, annual income targets, sources of funds; to work with the Legislature to establish the Trust's role in that. Then, to seek regulatory and statutory changes to facilitate the implementation.

TRUSTEE HALTERMAN stated that it was her understanding that changing the State statute opens the Trust up to potential court involvement and that has slowed down the process. She asked what progress has been made on that.

MR. JONES replied that he did not know of any. The TLO got their head down and started implementing the real estate investment program. The Legislature jumped up and started the conversation on their terms and, to the best of his knowledge, there has been no progress or opportunity to sit down and ask how this could be resolved.

CHAIR DERR stated that legislation had been drafted, and it was ready to be introduced when the legislative audit came up.

MR. ABBOTT explained that the audit was authorized in late 2016, to be completed in 2017. It was not completed until June 2018. Senator MacKinnon was interested in sponsoring legislation that would essentially confirm the Trust's authorization to make the sort of investments that were going in commercial real estate. He continued, because of the audit's timing, Senator MacKinnon was no longer in the Legislature, and Senator Stedman was skeptical of the Trust's choices. There has not been any opportunity to consider a legislative adjustment. He added that a judicial review would be required or recommended to preclude litigation. Getting a bill through is hard enough, and then adding getting it through judicial reviews is another layer. The bill was not withdrawn, but it died from about April 2018 until now.

TRUSTEE HALTERMAN asked for a better understanding of the legislative process related to this issue.

MR. ABBOTT explained what happened and the process involved in greater detail, and stated that he did not believe that there would be any significant legislative interest in any adjustment to the statutes in this area until after the second round of legislative audit review is completed.

TRUSTEE COOKE added that the Trust did make a vigorous effort to get legislative changes made to expand the flexibility of the Trust to develop and make use of its commercial properties and certain other authorities, and to also clarify things that were unknown at the time of the original settlement and when the enabling legislation was passed in the early '90s. He stated that part of the problem with the audit is that there will always be uncertainty as to how to resolve these issues because there is no review. He continued that the Trust has done the best it can to respond to this uncertain reality.

MR. JONES echoed that there was no clearly defined policy for returning principal. He stated that there was a mistake made in the initial Real Estate Investment Plan that should be there. It clearly defines policy for returning principal. Then, from a historical perspective, it is important to remember why this happened. The State was sued because the Legislature, acting as trustees, had not acted in the best interest of the beneficiaries of the Trust. The Alaska Mental Health Trust board was created to be that advocate for those beneficiaries, and it is imperative to take the position that the board decisions are what counts in terms of the management of those assets. He advocated that the Trust recognize its role as the chief investment manager for the assets.

CHAIR DERR stated that the judge took the Trust away from the Legislature and gave it to the board with the realization that as it developed things would and do change. She asked Trustee Halterman for any other questions.

TRUSTEE HALTERMAN stated that she would like to work cooperatively with the Legislature. We have a strong commitment to the fiduciary responsibilities of this Trust, but she felt conflicted. She would like to work to get these things fixed and stated that it seems worthy to reach out to the Administration to ask for assistance so progress can be made. She stated her concerns on the unresolved issues.

CHAIR DERR asked Mr. Jones to expound on using principal to generate income, which is needed at the Trust.

MR. JONES stated that one of the conversations had with the outside counsel, one that made a significant difference, was whether or not the use of principal could be defended. Principal does make its way to the Permanent Fund but gets used on an interim basis to acquire real estate. The income from the real estate pays down the debt; then the income from the real estate reimburses or deposits in the Permanent Fund. He continued that this could be done in several ways. It can be done quickly with debt or long term with debt payments. Those types of decisions were never made. He explained that the principal was not being spent, but was being temporarily invested to be reimbursed later. That policy is the policy that was never articulated well.

CHAIR DERR called a break.

(Break.)

CHAIR DERR called the meeting back to order and continued with questions and comments.

TRUSTEE COOKE stated that there will always be a kind of tension with the Legislature. The

Trust is a unique organization that the Legislature has the power to pass and amend statutes to authorize what the Trust can do, but they do not have direct oversight. He continued that the budget goes through the Legislature and it can alter it, but cannot decide on staffing or what the budget is. He added that the thought that the Trust can readily fix things through the Legislature is a good idea, but he has not seen it play out in practice.

TRUSTEE McCARTY stated appreciation for what Mr. Jones shared and Mr. Abbott's clarification. He continued that it would speak loudly to beneficiaries to say that what is being done will bring good stability.

MR. JONES added that a period of economic instability is being entered and two things come to mind. First is that there will be consistent cash flow with the institutional-type tenants which really emphasized the importance of what was done. Second, the Trust would have huge opportunities to reinforce this with additional investments as we are about to enter another period of few and far between buying opportunities for an institutional investor.

CHAIR DERR appreciated the point of the good opportunities now. With the people working at home, they may not continue to come to offices. The supposition is that huge companies are going to realize that their employees can work okay at home and may work on incentives for people to establish offices in their homes. There will be changes coming to office buildings.

MR. JONES agreed that there will be significant changes, but it will be hard to say what they will be. The changes will be in both retail and office space.

CHAIR DERR asked Trustee Boerner for any questions or comments.

TRUSTEE BOERNER stated appreciation for Mr. Jones' statement reminding the Trust's duty is to the beneficiaries, whereas the Permanent Fund does not have that same charge or responsibility. She also appreciated the presentation and the discussion.

CHAIR DERR recognized Trustee Boyles.

TRUSTEE BOYES thanked Mr. Jones for his approach to educating the board on investments in commercial real estate. She stated the need to educate the Legislature about the Trust and moving forward to clean up the legislation. She talked about the possibility of having a small meeting with Senator Stedman

CHAIR DERR asked Mr. Abbott to respond to meeting with Senator Stedman.

MR. ABBOTT replied that a relationship with Senator Stedman, or whoever is the key in leadership in the House and the Senate, needs to be reformulated. He reminded all that Senator Stedman is the co-chair of the Finance Committee, which may not be the case in January. He stated that he is optimistic that the follow-up audit will validate the work done and will show that the original has been honored even though every argument made was not agreed with. The quid pro quo for that needs to be that the Legislature be open-minded to considering statutory changes that maintain the spirit of the original settlement, but recognizes 25 years of experience and 25 years of quality management and leadership by the Trust Authority and its trustees. He continued that a role for trustees in a communication process with key legislators makes a lot of sense. He added that he is open to that conversation.

CHAIR DERR thanked Mr. Abbott, and recognized Trustee Sturgeon.

TRUSTEE STURGEON thanked Mr. Jones for the presentation and stated that it was very helpful to catch up on what has happened in the past. He expressed his appreciation.

CHAIR DERR brought it back to Mr. Jones.

MR. JONES stated that the Legislature is not the bad guy. They were sued for not working on behalf of beneficiaries, but were working on behalf of the public, which is their charge. They did not do anything bad. What they did was they served their constituents with the wrong asset. He continued that the key fact that they need to understand is that these assets are not for the benefit of the public. That is a hard concept for a public servant to swallow. A path needs to be created to get to where this can be considered in depth by the Legislature.

CHAIR DERR thanked Mr. Jones, and recognized Carol Howarth.

MS. HOWARTH stated that Harvest was engaged to look at their operations and make an evaluation in terms of the performance of them. The asset management strategy was set as an umbrella, and then we got the operational goals for real estate that fall from that umbrella. Then, financing is the tool to assist making sure there is the cash flow. She added that she would be happy to answer any questions.

CHAIR DERR asked Mr. Abbott if the decision on refinancing would be made at the next meeting.

MR. ABBOTT replied the need to make progress towards a decision on refinancing. There are some looming requirements for refinancing that come due towards the end of this year and in 2021. He stated that the next Finance Committee meeting is currently scheduled for mid-July. If there is an emerging consensus from the committee that it is ready for staff to bring refinancing options for consideration, potentially a recommendation in July can be done in that direction. He asked the Chair if that consensus has been achieved.

CHAIR DERR stated that she is comfortable with the refinancing aspect and, with today's information, is comfortable with going forward. She asked the rest of the trustees what more information they would like to help make their decision.

TRUSTEE HALTERMAN thanked Mr. Jones and Mr. Abbott for providing a great deal of additional information that is helpful in setting the foundation. She requested laying out the potential sale and what that would look like. This can be brought to the Legislature, stating that this is what the sale would have looked like versus reinvesting. She stated that she was leaning heavily on a financial side thinking of beneficiaries' best interests. Refinancing sounds like it is in the best interest of the beneficiaries. She stated her concerns about real estate bubbles and the uncertain stock market.

CHAIR DERR asked Ms. Howarth to add what happens if we sell the real estate to the information for the next meeting.

TRUSTEE COOKE echoed Trustee Halterman's comments about thanking Mr. Jones. He stated that the background gives an understanding of how we got to where we are. But where do we go from here? He continued that he would like Mr. Jones' input from his experience and knowledge on where the trustees might want to take the investments.

TRUSTEE BOYLES stated that she would like to know all the parameters. She would like to look at the risks and minimize them as much as possible. Timing is critical because all this could take too long and may end up in a cash-flow position that is not wanted.

TRUSTEE McCARTY stated that he is trying to understand the long-term benefit or not of the different types of options and to have that comparison.

MR. ABBOTT stated that this was helpful in getting a sense of what information, types of analysis folks are looking for to bring back for July.

CHAIR DERR appreciated Mr. Jones' willingness to come back again and again to help. She asked him for any final thoughts.

MR. JONES appreciated the opportunity to do this and stated that he likes the Trust conceptually. It is one of the best entities of its type of a public trust in the United States. He stated that, before a decision is made on the commercial real estate, either refinance or sell, there is the need to definitively determine the status of the equity in that commercial real estate. He continued that if it was originally purchased with principal and that principal was paid back with income, which converted the equity in the real estate into income, it is no longer principal. That principal has been reimbursed. He added that clarifying and defining the status of the equity of that commercial real estate is important before making any other decisions. He stated that a high priority for the trustees is to verify that portfolio management is happening. He added that he is happy to help.

MS. HOWARTH thanked everyone for laying out the questions which have indeed been addressed, in some cases, by Harvest. She looked forward to getting information for the trustees to start thinking this through.

MR. ABBOTT stated that this was an excellent conversation.

CHAIR DERR asked for any other comments. There being none, she asked for a motion for adjournment.

> **MOTION:** <u>A motion to adjourn the meeting was made by TRUSTEE BOERNER; seconded by TRUSTEE HALTERMAN.</u>
>
> *There being no objection, the MOTION was approved.*

(Finance Committee meeting adjourned at 10:24 a.m.)

Trust Land Office

2600 Cordova Street
Anchorage, Alaska 99503
Phone: 907-269-8658
Fax: 907-269-8605

To:	Laraine Derr, Chair Finance Committee
From:	Wyn Menefee, Executive Director
Thru:	Mike Abbott, Chief Executive Officer
Date:	7/20/2020
Re:	FY22 Operating Budget – Item 1
Fiscal Year:	2022
Amount:	$4,393,800

Approval

Proposed RMC Motion:

"The Finance Committee recommends that the Alaska Mental Health Trust Authority board of trustees approve the Trust Land Office operating budget for FY22 in the amount of $4,393,800."

Background:

The Trust Land Office (TLO) seeks the recommendation of the Finance Committee for the FY22 operating budget. Please see Exhibit 1 for a breakout of the proposed line items.

For this request, the FY22 budget is compared against the FY21 budget.

Exhibit(s):
Exhibit 1 – FY22 Trust Land Office Budget Proposal

TRUST LAND OFFICE OPERATING BUDGET

FY22 Proposal

Expenditures	FY19 Budget	FY19 Actuals	FY20 Budget	FY20 YTD as of 6/30/20[1]	FY21 Trustee Approved Budget	FY21 Mgmt Plan	FY22 Proposal	FY21-22 %
Personal Services	$ 2,842,800	$ 2,557,207	$ 2,900,100	$ 2,502,974	$ 2,973,700	$ 2,895,907	$ 2,963,770	2%
Travel	$ 133,000	$ 105,872	$ 94,600	$ 60,936	$ 94,600	$ 94,600	$ 94,600	0%
Services	$ 1,507,400	$ 1,320,404	$ 1,451,200	$ 1,523,352	$ 1,298,800	$ 1,376,593	$ 1,277,430	-8%
Supplies	$ 56,000	$ 81,906	$ 58,600	$ 114,769	$ 58,500	$ 58,500	$ 58,000	-1%
Capital Outlay		$ 131,549						
Total	**$ 4,539,200**	**$ 4,196,937**	**$ 4,504,500**	**$ 4,202,030**	**$ 4,425,600**	**$ 4,425,600**	**$ 4,393,800**	-1%
						Total FY21 Decrease	(31,800)	

Revenue	FY20 YTD as of 6/30/20[1]	FY21 Trustee Approved Budget	FY21 Mgmt Plan	FY22 Proposal	FY21-22 %
Principal	$ 6,369,620	$ 5,694,500	$25,180,000	$ 5,885,000	-77%
Income	$ 5,853,230	$ 5,120,038	$ 4,034,108	$ 6,085,643	51%
Total	**$ 12,222,850**	**$10,814,538**	**$29,214,108**	**$ 11,970,643**	**-59%**

(1) Numbers are not final until the reappropriation period ends August 31. Revenue deferrals not yet completed.

FY22 TRUSTEE REQUEST:
$4,393,800

Personal Services*	
FY22 Merit Inc. Est.	$ 51,243
FY22 Benefits Inc. Est.	$ 16,620
Total Merit and Benefits Inc. Est.	$ 67,863

*Request is rounded

Position Counts FY19-FY22

Year	# Employees
2019	19
2020	19
2021	19
2022	19

Trust
Alaska Mental Health
Trust Authority

3745 Community Park Loop, Suite 200
Anchorage, AK 99508
Tel 907.269.7960
www.mhtrust.org

MEMO

To: Laraine Derr, Finance Committee Chair
Thru: Mike Abbott, Chief Executive Officer
From: Carol Howarth, Chief Financial Officer
Date: July 21, 2020
Re: FY 22 Trust Authority Office MHT Admin budget request

REQUESTED MOTION:

The Finance Committee recommends that the full Board of Trustees approve the FY 22 Trust Authority Office MHT Admin budget of $4,197,897.

BACKGROUND

Staff have prepared the FY 22 Trust Authority Office administrative budget based on the anticipated activity levels of the Trust. The Trust staff request that the Finance Committee recommend that the full board of trustees approve the MHT Admin funds as detailed in the attached document.

The FY 22 proposed budget reflects a net decrease of $35,239 (0.8%) from the amount approved by the full board for FY 21. The proposed budget reflects the changes outlined below:

Budget Line	Amount over (under) FY21	Major Component
Personal Services	50,586	Reflects increases in labor costs and employee benefits partially offset by a decline in one authorized position
Travel (line 2000)	0	Reflects no anticipated increase in FY22 budgeted travel
Services (line 3000)	(71,825)	Reflects decreases in legal and shared services costs for State of Alaska, offset in part by expected increases to support work-at-home and consulting contracts.
Supplies	0	Reflects no anticipated increase in FY22 budgeted supplies
Equipment (line 5000)	(14,000)	No capital equipment purchases anticipated

MENTAL HEALTH TRUST AUTHORITY
OPERATING BUDGET

EXPENDITURES	FY19 Approved	FY19 Actuals	FY20 Mgmt Plan	Actual + Projected as of July 20, 2020	FY21 Approved	FY22 Proposal	21-22 %age
1000 Personal Services	2,937,106	2,720,541	2,922,600	2,739,143	2,983,111	3,033,697	1.7%
Personal Services	2,882,106	2,657,580	2,861,644	2,687,935	2,914,655	2,965,241	1.7%
cell phones			3,456		3,456	3,456	0.0%
Honorarium	55,000	62,960	57,500	51,208	65,000	65,000	0.0%
2000 Travel	127,000	112,891	82,000	63,401	82,000	82,000	0.0%
3000 Services	1,009,225	687,270	1,026,000	742,242	1,069,025	997,200	-6.7%
4000 Supplies	62,000	46,674	64,700	48,250	67,000	67,000	0.0%
5000 Equipment	-	-	-	-	14,000	-	
Total	**4,135,331**	**3,567,376**	**4,095,300**	**3,593,036**	**4,215,136**	**4,179,897**	-0.8%

FTEs	**18**	**18**	**18**	**17**	**17**

FUNDING SOURCE	FY19 Approved	FY19 Actuals	FY20 Mgmt Plan	FY21 Approved Budget	FY 22 Proposal
MHT Admin	4,135,331	3,567,376	4,095,300	4,215,136	4,179,897

FY2022 Request to TRUSTEES:

<u>$4,179,897</u>

Commercial Real Estate Lease Space Reduction Trend

Office market has been swayed by COVID-19 crisis

1. Near Term
2. Long Term

Trust
Alaska Mental Health Trust Authority

Near Term

- ***Right now: Successful implementation of work-from-home policies***
  - Production
  - Check-ins
  - Communication tools
  - Office time
  - Ergonomics
  - Printers, computer screens, chair, desk
  - Wifi
  - VPN
  - Time

Near Term

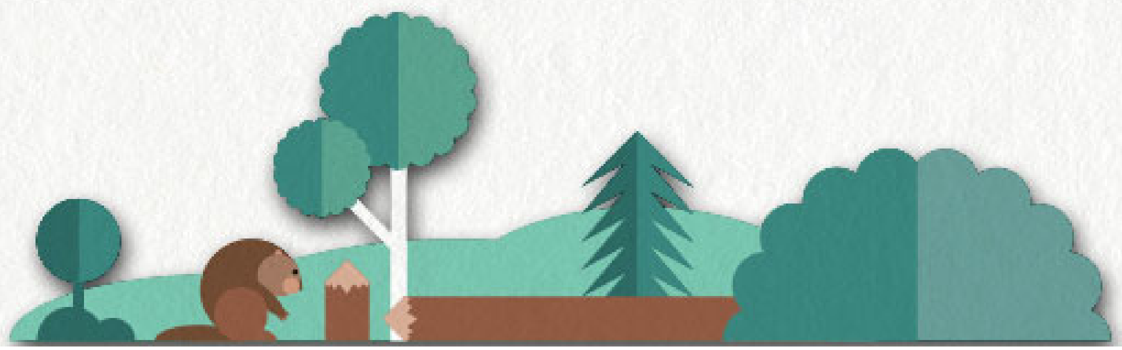
- *Contraction of office space leasing*
- *Impact of lock down due to COVID-19*
- *Social Distancing Guidelines*
- *Slipping economy*
- *Exposure Procedures*
- *Cost savings*
- *Cost increases*

Long Term

- *Recovery of economy*
- *Benefits of office space*
- *Cost savings*
- *Cost increases*
- *Balance between employees and employers*
- *People*

National Trend

- *Right Now:*
  - *Office space contraction driven by pandemic/economy*
- *Expectations:*
  - *Expect the office market to rebalance along changing preferences toward more individual space.*
  - *Expect the economy to shift*
  - *Expect short term impacts will no longer be projections*



Trust Commercial Real Estate Office Space

- Israel (Washington)*
- North Park (Texas)*
- AmberOaks (Texas)*
- Promontory Point (Texas)*
- Rulon (Utah)
- Cordova (Alaska)*
- Commercial Drive (Alaska)

Trust Commercial Real Estate

- No current vacancy.
- Approximately 16% potential office space vacancy in the near term.

Trust
Alaska Mental Health
Trust Authority

3745 Community Park Loop, Suite 200
Anchorage, AK 99508
Tel 907.269.7960
www.mhtrust.org

MEMO

To:	Laraine Derr, Finance Committee Chair
Thru:	Mike Abbott, Chief Executive Officer
From:	Carol Howarth, Chief Financial Officer
Date:	July 21, 2020
Re:	Commercial Real Estate Evaluation

At the May 2020 board meeting, staff were directed to address holding strategies for the CRE, in which refinancing the real estate assets would be considered, as well as the anticipated impact of the strategies, and the pros and cons of these options, including legislative, legal and financial risks.

Summary

The Trust retains ownership of seven investment properties. All properties except for Cordova are financed with amortizing debt. Four properties, San Pedro (North Park), Ridgepoint (Promontory Point), Israel and Rulon, are financed with balloon payments due FY22, FY26, FY30 and FY34, respectively. The remaining mortgage lives are 14 years for Commercial and 17 years for Amberglen. Below is a summary by property of the recent fair market appraisal valuations, debt summary, and leasing status.

$MM

Cordova (2011)	
(TLO)	
Current Value:	$4.100
Debt:	$0
100% leased (including TLO)	

Commercial (2013)	
(Cummins)	
Current Value:	$2.870
Debt:	$1.010
Rate:	3.94%
Prepay Penalty:	None
100% occupied with anticipated lease renewal	

Rulon (2013)	
(IRS)	
Current Value:	$20.100
Debt:	$6.556
Rate:	4.20%
Prepay Penalty:	None
100% occupied with long-term, strong-credit, single-tenant lease	

Israel (2014)	
(WA)	
Current Value:	$18.860
Debt:	$6.809
Rate:	4.35%
Prepay Penalty:	$0.506
WA purchase option at 98% of appraisal. Current lease negotiations expected to set a	

Ridgepoint (2015)	
(Promontory Point, TX-DOT)	
Current Value:	$15.500
Debt:	$9.408
Rate:	4.69%
Prepay Penalty:	$1.158
100% occupied. DOT backfilling upcoming vacancy	

San Pedro (2015)	
(North Park, Marriott)	
Current Value:	$13.500
Debt:	$6.628
Rate:	5.20%
Prepay Penalty:	$0.197
Active leasing	

Amber Glen (2016)	
(Amber Oaks, Xerox)	
Current Value:	$27.644
Debt:	$11.592
Rate:	4.25%
Prepay Penalty:	$1.573
Active leasing	

<u>Performance</u> Expectations for returns are through a) dividends distributed from the individual LLCs to the Trust, providing ongoing revenue for Trust beneficiary benefit, and b) investment earnings on returned principal and capital gains after the assets are sold, which benefit future beneficiaries.

In 2020, the Commercial Real Estate portfolio's (CRE) operations generated a $1.6MM distribution to the Trust for a 4% return on the Trust's investment, and a 6% year-over-year unrealized gain from asset appreciation, totaling 10% for FY20. Despite the impact of Covid 19, year-end 2020 appraisals and broker's opinions demonstrate portfolio stability with $102.6MM combined asset value, up $1.6MM from the prior year. With $42MM mortgage debt outstanding, the Trust's equity at YE2020 Fair Market Value is $60.6MM, 1.5 times the $39MM invested between 2011 and 2016.

The portfolio's unrealized annual gain averages 7% since inception. This is in the ball park for the investment objectives for the properties at the time of purchase. Cordova is the sole unlevered asset. Understandably with the TLO as a non-paying tenant, it has not held value.

Comparing purchase price to market value, the portfolio has gained $63MM for the Trust, a 7% average annual gain since inception. Pulling down the average are Cordova, which would be out of pocket close to $1MM, but also has the TLO as a non-paying tenant, and San Pedro and Ridgepoint. The valuations for the latter two were essentially flat and up 1%, respectively, but their market values are expected to recover with upcoming leasings.

Looking forward, the TLO's 5-year forecast for cash generated for Trust benefit averages $6.2MM <u>before</u> debt service. Cash flow is influenced by management decisions about reserves for capital expenditures, tenant improvements, lease commissions and general uncertainties. Distribution to the Trust, after debt service is paid, is influenced by the properties' financing structure. Under the current debt structure, distributions are forecast to average $1.6MM (without the balloon payments, the 5-year average increases to $2.8MM.)

Holding and Financing Options

Four holding and financing options are outlined in this memorandum:

1. Maintain the Status Quo (with no refinancing, paying off loan balances at maturity)
2. Refinance Assets as a Portfolio—Interest Only (I/O)
3. Refinance Israel, San Pedro, Ridgepoint and Rulon—I/O as-needed
4. Sell the Assets, Reinvesting Proceeds with APFC

The following chart is a snapshot of the first five years of cash generation for the four options.

Operating Cash Flow After Debt Service For Options Evaluated
FY21-FY25

Fiscal Year	Year 1 FY21	Year 2 FY22	Year 3 FY23	Year 4 FY24	Year 5 FY25
Operational Baseline: Cash Flow Before Debt Service	$4,562,396	$6,288,377	$6,486,028	$6,689,609	$6,899,297
Income Generated Under Alternate Financing Scenarios:					
Option 1: Maintain Status Quo (No Refinancing)	$756,640	($3,417,786)	$3,281,344	$3,484,924	$3,694,613
Option 2: Refinance Assets as a Portfolio	$2,895,546	$4,621,527	$4,819,178	$5,022,759	$5,232,447
Option 3: Refinancing As Needed	$756,640	$2,638,456	$3,016,401	$3,199,684	$3,388,466
Option 4: Sale & APFC Reinvestment	$0	$632,219	$1,301,976	$2,004,782	$2,735,484

Note: TLO 5-year forecast. Assumes 3.7% refinancing rate. Option 4 sale of assets in FY21, 7% APFC return.

Considerations regarding the CRE applying to options:

- Real estate values may move independently from the broader financial markets, providing some hedging protection to the Trust's cash investments. Historically, real estate investments have provided protection in an inflationary environment, with rents able to rise with inflation.
- Commercial real estate performance varies by assets over time due to regional market fluctuations and asset-specific dynamics. Within a well-balanced portfolio, an individual asset's short-term negative operating performance can be expected to be supported by strong operating performance of the portfolio as a whole, allowing for a long-term investment horizon.
- Financing choices—such as balloon payments, rate structures, substitution rights or prepayment conditions—can enhance and/or limit cash flow flexibility depending upon objectives.
- Current market interest rates are for the most part significantly below the CRE's current existing mortgage rates. The general rule of thumb is if a refinancing is expected to generate 3% or more cash in present value terms, refinancing should be pursued.
- The Trust has implemented the Legislative Audit recommendations, including retaining a real estate advisor.
- The Trust's Asset Management Policy Statement and the TLO's Real Estate Management Policy guide decision making on the CRE. These assets are evaluated for benefit to future beneficiaries, with the same time frame as the principal in the Trust Fund, and measurement is based on Net Present Value evaluation.

Benefits of the CRE holdings:

- The real estate portfolio has 60% Rated Credit tenancies, providing durable income to the Trust.
- Lease arrangements providing stability to Trust Land Office managed revenues.

- There continues to be potential for properties to appreciate in value, particularly when securing long term leases with high quality tenants.

Uncertainties or negative considerations of the CRE holdings:

- The Trust Land Office has major short-term decisions on three properties.
  - Israel's operations may be close to break-even before its current debt service (depending on the outcome of lease negotiations).
  - San Pedro and Ridge Point's upcoming mortgage balloon payments of $6.2MM and $8.2MM, respectively, require use of Trust reserves or other funding or financing sources.
- As for all investments, the duration and depth of business disruptions from Covid 19 are still uncertain.
- Although the portfolio is balanced overall and has proven to have durable income with 98%+ rent collection, three properties are leased to either single credit long and short term tenants, or to a small number of users, which creates some level of concentration risk.
- As the IRS shifts more to electronic processing, focus should be on US congressional committee power in Utah versus the states with similar processing facilities, and the Trust may frame its Rulon hold/sell strategy accordingly.
- The Legislative Audit has been postponed from July 2020 until likely January 2021. The concerns from some in the State's Legislative body over the CRE results in the Trust's need to allocate financial and personnel resources away from beneficiary focus.

General Recommendation:

- The original strategy was that a TLO-managed real estate portfolio would be a permanent addition to the Trust's overall mix of investment assets. The Trustee's strategy should be reviewed in the future.
- Specific holding strategies should be reviewed based upon anticipated investment needs, market conditions, financing obligations, and accretive investing on behalf of the beneficiaries.

Option 1: Maintain Status Quo

Present Value Contribution to the Trust: $26.0MM over 17 year forecast period

Since inception the CRE has generated on average $1.6MM to the Trust. The TLO anticipates cash to increase 3% per year long-term.
Three assets – Israel, San Pedro and Ridgepoint—present short-term challenges to the Trust under the Status Quo. San Pedro has a $6.3MM mortgage balloon payment required 10/31/21.

Ridgepoint has an $8.2MM balloon payment required 7/1/25 (not shown, FY26). These cash payment cannot be supported by the annual operating cash flow from the portfolio as a whole.

Status Quo 5-Year Forecast

Fiscal Year	Year 1 FY21	Year 2 FY22	Year 3 FY23	Year 4 FY24	Year 5 FY25
Cash Flow Before Debt Service	$4,562,396	$6,288,377	$6,486,028	$6,689,609	$6,899,297
Annual Debt Service	$3,805,756	$3,404,684	$3,204,684	$3,204,684	$3,204,684
Balloon Payment	$0	$6,301,478	$0	$0	$0
Cash Flow After Debt Service	$756,640	($3,417,786)	$3,281,344	$3,484,924	$3,694,613

The TLO and Harvest note, with caveats, that Israel's operating profit is not strong enough given its debt service to repay the debt nor fund significant leasing costs. The pending lease renewal for part of the State of Washington lease is at a breakeven rent with the existing debt service. Harvest's worst case scenario is that Israel will require cash support in FY22 and FY24 of $1.7 million. Under best case, if re-leasing costs do not occur, there will negligible cash needs.

Considerations

Three basic options exist for the Status Quo: debt repayment from existing Trust reserves, debt repayment payoff from the sale of assets, or refinancing the mortgages. At this point, given financial market uncertainty, the Trust should not plan on drawing from its reserves. Harvest advises against asset sales at this time, anticipating uncertainty in market interest and potential for a deep price discount.

Benefits of the Status Quo

Maintaining the current financing provides the following benefits to the Trust:

- Additional annual operating cash flowing to the Trust as mortgages are paid off.
- Continued equity build as amortized mortgages are paid down, with each year accruing more equity available for investment at the point of sale.
- After the balloon payments are made, operating cash to the Trust will increase by the amount of the mortgage payment:
    - FY22 San Pedro $600K
    - FY26 Ridgepoint: $636K
    - FY30 Israel: $909K
    - FY34 Rulon: $620K

  This increase in cash flow for beneficiary use will continue as other mortgages are paid off.

Option 2: Refinance Assets as a Portfolio

Present Value Contribution to the Trust: $54.1MM over 17 year forecast period

Summary

Harvest Capital, after being engaged in October 2019, quickly recommended that the commercial properties be refinanced as a portfolio with interest-only (I/O) financing. The arguments Harvest presented were that an estimated $2MM per year in cash would be generated by eliminating the principal payments and securing a lower market interest rate, and noted that this was a "best practice" in the commercial real estate investment environment.

Harvests' recommendation is to target January 2021 to close on an interest-only $45MM mortgage, based on an estimated $41MM debt outstanding and roughly $4MM in closing costs and pre-payment fees associated with some of the existing mortgages.

The table following shows an eight-year time horizon to reflect two balloon payments. The estimated difference between the Status Quo and an Interest Only structure shows the cash flow relief to the Trust. This benefit on a nominal basis decreases as more mortgages are paid off as can be seen on the last line of the table.

Interest Only Financing

Fiscal Year	Year 1 FY21	Year 2 FY22	Year 3 FY23	Year 4 FY24	Year 5 FY25	Year 6 FY26	Year 7 FY27	Year 8 FY28
Cash Flow Before Debt Service	$4,562,396	$6,288,377	$6,486,028	$6,689,609	$6,899,297	$6,779,958	$6,409,782	$7,032,679
Total Debt Service	$1,666,850	$1,666,850	$1,666,850	$1,666,850	$1,666,850	$1,666,850	$1,666,850	$1,666,850
Cash Flow After Debt Service	$2,895,546	$4,621,527	$4,819,178	$5,022,759	$5,232,447	$5,113,108	$4,742,932	$5,365,829
Status Quo Cash Flow After Debt	*$756,640*	*($3,417,786)*	*$3,281,344*	*$3,484,924*	*$3,694,613*	*($4,168,055)*	*$3,841,040*	*$4,463,937*
Cash Increase with Portfolio I/O	$2,138,906	$8,039,312	$1,537,834	$1,537,834	$1,537,834	$9,281,163	$901,892	$901,892

Uses Assumes 3.7% interest rate with substitution rights and excluding penalties per Northrim, May 2020, and the continuation of a real estate advisor.

Trust Investment guidelines require evaluation in present value terms. Over the forecast time horizon of 17 years (based on the last mortgage pay-off under the Status Quo), the CRE refinanced under Interest Only is expected to generate $54MM to the Trust versus $26MM under the Status Quo.

Here is where evaluation becomes more complex: Balloon payments are still required. These balloon payments may be refinanced, or the asset could be sold with part of the proceeds used to pay the balloon payment and the remainder invested with APFC. So, it is important to consider different time horizons for holding the properties and how proceeds from the sale of the assets are reinvested. Under various scenarios run, regardless of when the assets are sold and proceeds are reinvested, there is a large benefit over the Status Quo—up to doubling the cash flow (in today's dollars) to the Trust over a 20 year time horizon.

Considerations of Interest Only

- Interest-Only financing does not preclude accelerated principal payment, rather the minimum payment is the interest portion of the debt.
- A portfolio structure allows cash flow management at the Trust Land Office level.
- The liability firewall between the Trust and LLC structures would continue to exist with a portfolio. The portfolio of assets would be held in a special purpose vehicle.
- Interest rates currently remain low, and an estimated 3.7% rate is below the average interest rates of the existing mortgages. However, there is no certainty that this rate can be secured.
- Because of refinancing costs, there should be agreement among Trustees regarding the holding period of the assets unless there is an advantageous outsized sales opportunity above appraisal valuation(s). If after refinancing a decision is made to, in the near term, reduce the real estate holdings, the financial benefits of refinancing will be reduced and may be worse than the Status Quo (unless it is well above appraisal valuations).
- It is hoped marketing a portfolio refinance to the two lenders with highest prepayment penalties, Principal and State Farm, would find either willing to renegotiate their penalties. There is no assurance that either lender would be interested in financing the portfolio.
- There is no guarantee that the assets in the portfolio will increase in value as originally proposed during the remaining holding period. However, with loan-to-value currently at 45%, the cash value generated for the Trust at the time of sale would not be expected to be much below the current $60MM value in a worst case scenario.

Option 3: Refinance Assets As-Needed

Present Value Contribution to the Trust: $43.0MM over 17 year forecast period

A partial refinancing strategy is to secure interest only mortgages for Israel, San Pedro, Ridgepoint and Rulon. This can either be done as-needed—immediately for Israel, FY22 for San Pedro, FY26 for Ridgepoint and FY29 for Rulon—or in the near future as a portfolio, with the remaining assets maintaining their current financing. The table below outlines cash flow generated on an as-needed basis as compared to the Status Quo.

Fiscal Year	Year 1 FY21	Year 2 FY22	Year 3 FY23	Year 4 FY24	Year 5 FY25
Cash Flow Before Debt Service	$4,411,510	$5,631,491	$5,809,435	$5,992,718	$6,181,500
Annual Debt Service	$3,654,870	$2,993,034	$2,793,034	$2,793,034	$2,793,034
Balloon Payment	$0	$0	$0	$0	$0
Cash Flow After Debt Service	$756,640	$2,638,456	$3,016,401	$3,199,684	$3,388,466
Status Quo Cash Flow After Debt	*$756,640*	*($3,417,786)*	*$3,281,344*	*$3,484,924*	*$3,694,613*

Refinancing as-needed appears over the short term to be marginally beneficial over the Status Quo—save stabilizing cash flow in FY22. However, as discussed above, depending upon the holding period, there is significant benefit over the long-term. For example, compared to the Status Quo if each asset were sold 15 years after refinancing, roughly $12MM more, or 35%, in present value terms is generated after 20 years. This partial refinancing option does not outperform a full Interest Only refinance, but it outperforms selling the portfolio's assets and reinvesting in APFC, the last option evaluated.

Considerations for Partial Refinancing using Interest Only

- Given Israel's recent appraisal of $18.86MM and a 36% loan-to-value, the TLO should be able to refinance the asset under favorable terms. Harvest calculates a prepayment penalty of $506K, but with an expected interest rate of roughly 0.5% below the current mortgage rate, there is strong cash flow benefit to refinancing.
- San Pedro's balloon payment of $6,274,290 is due 10/31/21. Because of the large short term decline in valuation, the current the Loan-to-Value ratio is 49%. The TLO is expects that tenants will be secured prior to refinancing.
- Ridge Point's balloon payment of $8,242,487 is due 7/1/2025. With a Loan-to-Value of 40% and Texas-DOT assuming upcoming available space, refinancing the balloon payment is supportable.

Benefits of Partial Interest Only Refinancing

- This financing strategy allows for the Trust to become comfortable with interest only structures over time, while addressing near-term cash flow shortfalls.

Uncertainties or negative considerations of a Partial Interest Only Refinancing:

- The partial interest only structure does not pool all the assets into a single special purpose vehicle. The ability of the TLO to manage cash flows across all assets does not occur.

- It is not expected that the interest rates will be as low for refinancing individual assets as for a portfolio of assets.
- The cost of financing on an individual basis will be higher than for the portfolio.

Option 4: Asset Sale/Reinvestment with APFC

Present Value Contribution to the Trust: $26.1 MM over 17 year forecast period

The current net value of the CRE is $60.6MM. For this scenario, we assume the CRE is liquidated in FY21 at current fair market value and reinvested in an APFC managed fund. We assume $57.5MM is realized and APFC realizes a 7% return. Using the Trust distribution policy of a four-year rolling average and 4.25% drawdown, the Trust would receive its first distribution in FY22 of roughly $630K.

As can be seen in the table below, distributions would increase incrementally to $2.7MM by FY25, then continue to grow.

Fiscal Year	Year 1 FY21	Year 2 FY22	Year 3 FY23	Year 4 FY24	Year 5 FY25
Principal Balance, YE	$59,502,957	$63,035,945	$66,146,486	$68,771,957	$70,850,510
APFC Draw		1.06%	2.13%	3.19%	4.25%
Net Cash Flow	$0	$632,219	$1,301,976	$2,004,782	$2,735,484
Status Quo Cash Flow After Debt	*$756,640*	*($3,417,786)*	*$3,281,344*	*$3,484,924*	*$3,694,613*

<u>Performance Summary</u>

- Since the Trust began investing in commercial real estate in 2011, the average combined realized and unrealized return was 11.7%, exceeding both APFC's Fund and real estate investment performance, both averaging 7.8%.
- Both APFC and the Trust use the NCREIF index as a benchmark. This is a quarterly index and assumes assets are debt-free. For FY20, where data is available, the CRE exceeded NCREIF benchmark 6% to 5.2%.
- Using the TLO's 5-year forecast and the average historical 2.6% unrealized return for the CRE, the CRE's average expected return of 10.9% would exceed Callan's 7% APFC forecast annual return over the next five years.

<u>Considerations</u>

- Past returns are not an indication of future returns, but on average the CRE has outperformed the APFC. With current investment market volatility there is no assurance that over the next few years the Trust would see 7% annual appreciation for the commercial real estate assets. Likewise there is no certainty that APFC will achieve a 7% annual gain.
    - For example, in a flat equity and bond market, cash flow from the APFC managed funds would start at $632K and reach $2.4MM in FY25, roughly $450K less than the forecast above and erode principal. This sensitivity also applies to the reinvestment of sales proceeds in the other financing scenarios.
- Actual sales prices are uncertain. Harvest is concerned that due to market volatility sales prices will be below the recent valuations from appraisers and brokers.
- Proceeds from asset sale under any scenario will require a Trustee decision regarding fund distribution. A decision does not need to be made at this point: if capital gains are placed in APFC Trust Fund or Budget Reserves the year-over-year cash generated for distribution will be the same, at 4.25%.

Summary data is provided on the following page.

Commercial Real Estate Evaluation: Hold/Sell/Refinance
Ms. Derr
July 21, 2020

Summary of Commercial Real Estate Financing Options																	
Fiscal Year	**Year 1 FY21**	**Year 2 FY22**	**Year 3 FY23**	**Year 4 FY24**	**Year 5 FY25**	**Year 6 FY26**	**Year 7 FY27**	**Year 8 FY28**	**Year 9 FY29**	**Year 10 FY30**	**Year 11 FY31**	**Year 12 FY32**	**Year 13 FY33**	**Year 14 FY34**	**Year 15 FY35**	**Year 16 FY36**	**Year 17 FY37**
Operational Baseline: Cash Flow Before Debt Service	$4,562,396	$6,288,377	$6,486,028	$6,689,609	$6,899,297	$6,779,958	$6,409,782	$7,032,679	$7,370,353	$7,761,360	$8,124,359	$7,034,362	$7,206,355	$7,383,508	$7,565,976	$7,753,918	$7,947,498
Income Generated Under Alternate Financing Scenarios:																	
Option 1: Maintain Status Quo (No Refinancing)	$756,640	($3,417,786)	$3,281,344	$3,484,924	$3,694,613	($4,168,055)	$3,841,040	$4,463,937	$4,801,611	($7,530,854)	$6,464,436	$5,374,439	$5,546,432	$4,474,767	$6,624,799	$6,812,741	$7,790,636
Option 2: Refinance Assets as a Portfolio	$2,895,546	$4,621,527	$4,819,178	$5,022,759	$5,232,447	$5,113,108	$4,742,932	$5,365,829	$5,703,503	$6,094,510	$6,457,509	$5,367,512	$5,539,505	$5,716,658	$5,899,126	$6,087,068	$6,280,648
Option 3: Refinancing As Needed	$756,640	$2,638,456	$3,016,401	$3,199,684	$3,388,466	$3,841,784	$4,042,062	$4,248,347	$4,460,822	$4,679,670	$4,905,084	$5,137,261	$5,953,703	$6,255,417	$6,509,123	$6,770,440	$7,823,923
Option 4: Sale & APFC Reinvestment	$0	$632,219	$1,301,976	$2,004,782	$2,735,484	$2,856,052	$2,961,431	$3,056,555	$3,147,163	$3,239,739	$3,334,719	$3,432,381	$3,532,887	$3,636,329	$3,742,799	$3,852,386	$3,965,181
	$2,138,906	$8,039,312	$1,537,834	$1,537,834	$1,537,834	$9,281,163	$901,892	$901,892	$901,892								
Present Value Benefit of Alternative over a 17 Year Horizon																	
Option 1: Maintain Status Quo (No Refinancing)	$25,997,257																
Option 2: Refinance Assets as a Portfolio	$54,068,938																
Option 3: Refinancing As Needed	$42,958,415																
Option 4: Sale & APFC Reinvestment	$26,138,352																
Assumes a 6% cost of capital, no sale of assets for Options 1-3.																	

Trust
Alaska Mental Health
Trust Authority

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To:	Laraine Derr, Finance Committee Chair
Through:	Mike Abbott, Chief Executive Officer
From:	Carol Howarth, Chief Financial Officer
Date:	July 30, 2020
Re:	Trust Authority Development Account Transfer

REQUESTED MOTION:

The Finance Committee recommends the Alaska Mental Health Trust Authority Board of Trustees authorize the Chief Financial Officer to transfer upon receipt the proceeds from the Juneau Subport sales transaction from the TADA account to the Permanent Fund for investment.

Current Status: The Juneau Subport transaction is expected to close as planned in September 2020. At closing, $20MM in sales proceeds will be transferred into the Trust Authority Development Account (TADA), managed by the State's Treasury Department, and then transferred upon Trustee authorization to the Trust Fund managed by the Alaska Permanent Fund. If Norwegian Cruise Lines defaults on its agreement, though not anticipated, the escrow amount will be transferred to TADA. In either case, the amount of funds received in September are of a material amount.

The TADA balance at Fiscal Year-end 2020 stood at $3.1MM. The TADA account is part of a pooled State Treasury fund with a median 10-year expected annual return of 2.35%. The APFC FY20 forecasted its median 10-year expected annual return at 7.0%.

Existing Commitments: In FY20 the Trust Land Office recommended a $2.4MM balance to cover existing projects, and at this point, no additional projects are anticipated to require funding.

Anticipated Risks/Concerns: There are no risks to this motion. APFC's professional asset managers will invest Trust proceeds according to sound investment principles.

Alternatives: There is one alterative: delay authorization to the November 2020 Board of Trustees meeting.

Recommendation for TADA Funds: We recommend Trustee authorization at the August board meeting to transfer the Juneau Subport proceeds upon receipt rather than delaying until the November 2020 Trustee meeting. By transferring funds upon receipt, the Trust Fund would be expected to accrue an additional $77,500 per month return than if held in the TADA account.

Consistency with the Asset Management Policy Statement: This recommended motion is consistent with the Trust's Asset Management Policy Statement approved August 2019.

Applicable Authority: AS 13.38 and AAC 440.610.