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' Boerner
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.)