

MEETING AGENDA

Meeting: Special Full Board of Trustee Meeting
Date: March 30, 2021
Time: 1:30 PM
Location: online via webinar & teleconference
Teleconference: (844) 740-1264 / Meeting No: 133 170 8674 # / Attendee No: #
<https://alaskamentalhealthtrust.org/>
Trustees: Chris Cooke (Chair), Verné Boerner, Rhonda Boyles, Brent Fisher, Annette Gwalthney-Jones, Anita Halterman, John Sturgeon

Tuesday, March 30, 2021

Page No.

1:30 **Call to Order – Chris Cooke, Chair**
Roll Call
Announcements
Approval of Agenda
Ethics Disclosure

Inflation Proofing

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Adjourn

Future Meeting Dates

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

(Updated – March 2021)

- | | | |
|--|----------------------------|------------------------|
| • Audit & Risk Committee | April 21, 2021 | (Wed) |
| • Finance Committee | April 21, 2021 | (Wed) |
| • Resource Mgt Committee | April 21, 2021 | (Wed) |
| • Program & Planning Committee | April 22, 2021 | (Thu) |
| • 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 |
| | | |
| • Audit & Risk Committee (tentative) | October 20, 2021 | (Wed) |
| • Finance Committee (tentative) | October 20, 2021 | (Wed) |
| • Resource Mgt Committee (tentative) | October 20, 2021 | (Wed) |
| • Program & Planning Committee (tentative) | October 21, 2021 | (Thu) |
| • Full Board of Trustee | November 17-18, 2021 | (Wed, Thu) – Anchorage |
| | | |
| • Audit & Risk Committee | January 5, 2022 | (Wed) |
| • Finance Committee | January 5, 2022 | (Wed) |
| • Resource Mgt Committee | January 5, 2022 | (Wed) |
| • Program & Planning Committee | January 6, 2022 | (Thu) |
| • Full Board of Trustee | January 26-27, 2022 | (Wed, Thu) – Juneau |

Future Meeting Dates

Statutory Advisory Boards

(Updated – March 2021)

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

AMHB: <http://dhss.alaska.gov/amhb/Pages/default.aspx>

ABADA: <http://dhss.alaska.gov/abada/Pages/default.aspx>

Executive Director: Bev Schoonover, (907) 465-5114, bev.schoonover@alaska.gov

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

Governor’s Council on Disabilities and Special Education

GCDSE: <http://dhss.alaska.gov/gcdse/Pages/default.aspx>

Executive Director: Kristin Vandagriff, (907) 269-8999, kristin.vandagriff@alaska.gov

- May 13-14, 2021 – via zoom

Alaska Commission on Aging

ACO: <http://dhss.alaska.gov/acoa/Pages/default.aspx>

Executive Director: Lisa Morley, (907) 465-4879, lisa.morley@alaska.gov

- May 4-6, 2021 – Kenai TBD and via zoom

To: Chris Cooke, Chair
Through: Mike Abbott, Chief Executive Officer
From: Carol Howarth, Chief Financial Officer
Date: March 23, 2021
Re: Finance Committee Report

REQUESTED MOTION:

The Board of Trustees approves the designation of up to \$120,280,300 of Alaska Mental Health Trust earnings as principal for the purpose of inflation proofing. The Board of Trustees authorizes the Chief Financial Officer to designate \$50,000,000 as soon as practicable, and designate, before the close of FY21, the amount necessary to achieve the total designation that will maintain a year end FY21 budget reserve balance of at least 400% of the FY21 payout, or \$96,628,400.

Meeting Summary:

There has been one meeting of the Finance Committee since the last board report, occurring on March 5, 2021. The meeting was attended via the online WebEx platform by trustees Chris Cooke (designated chair), Vernè Boerner, Rhonda Boyles, Chris Cooke, Annette Gwalthney-Jones, Brent Fisher and John Sturgeon. Anita Halterman was excused from the meeting.

The meeting of the Finance Committee was called to order by Chairman Cooke at 1:30 pm to address a motion recommending a formal designation and transfer of budget reserves to principal for the purpose of inflation proofing.

Motion: The Finance Committee recommends that the board of trustees approve the transfer of \$120,280,300 from the Alaska Mental Health Trust Authority budget reserve account to the Alaska Mental Health Trust Authority principal account managed by the Alaska Permanent Fund Corporation.

The motion was presented by Trustee Boyles and seconded by Trustee Sturgeon.

Mike Abbott provided an overview of past inflation proofing discussions, highlighting that Trustees had the authority by statute and by the Asset Management Policy Statement to use budget reserves for the purpose of inflation proofing when reserves exceed 400% of approved spending. He noted that the Trust was in a strong financial position. He also noted that the Governor has proposed use of an additional \$16MM of Trust Reserves in the near term, and another \$50MM in subsequent years.

It was noted by both Chair Cooke and Mr. Abbott, and observed by other Trustees, that at the Senate Finance Committee presentation, senators had expressed a level of concern that the Trust had not been more consistent with the annual transfer of funds to principal for the purpose of inflation proofing.

Carol Howarth explained that Trustees had a choice in the method of protecting Trust purchasing power. They could use the endowment method, where purchasing power would be protected by following the Trust's spending and reserve discipline. Or, following the traditional principal & interest model, a permanent designation of funds, as proposed in the motion, could be used for inflation proofing. She noted that using the endowment model at the end of FY20 there was a shortfall of \$33.6MM and that as of December 2020, with the market recovery, there was a \$23.5MM surplus. Under the principal & interest model, a designation of \$107MM was required to protect the purchasing power of the Trust Fund at the end of FY20 and that amount had increased to \$120MM by December 2020.

The Trustees commented and asked a number of questions for clarification.

Trustee Boyles asked for perspective on the history of using the endowment method. Ms. Howarth explained that up to 2009, earnings in excess of 400% were transferred. In 2009 there was a shift towards the endowment model: spending based on net asset value to support long-term beneficiary needs and reserves leveling out near-term needs. She noted that the Governor's proposed additional spending exceeded the Trust's 4.25% spending policy.

Trustee Sturgeon's comments focused the message from members of the Senate Finance Committee regarding inflation proofing, and on being proactive in communicating the Trust's intent. His questions centered on the impact of inflation proofing on available reserves should there be a large market decline. Mr. Abbott assured Trustees that under a market decline, there would be reserves available to support spending.

Trustee Gwaltney-Jones question involved assurance that Budget Reserve commitments were considered.

Trustee Fisher requested three tables showing the inflation proofing effects over time 1) principal, 2) reserves, and 3) a combined chart. There was assent that this could be made available before final board action.

Trustee Cooke asked if it was a recommendation to set up a regular practice of inflation proofing. Mr. Abbott assented that he would like Trustees to consider it. Trustee Cooke expressed that the action would not eliminate all reserves, and the Trust would still get benefit of annual withdrawal from reserves; if taken and spent in other ways, it would affect the income and spending; and the Senate Finance Committee wanted the Trust to proceed with inflation proofing. The inflation proofing action would ensure the sustainability and permanence of the fund, side-step legal issues, and avoid a confrontation.

Trustee Boerner noted that Trustees had been raising the topic of inflation proofing but not acting on it, and requested that Mr. Abbott provide Trustees with perspective. Mr. Abbott discussed the history, noting that in May the target had been below 400% and has since recovered. Trustee Boerner noted that inflation proofing had been a consideration for awhile and this was the right time to inflation proof.

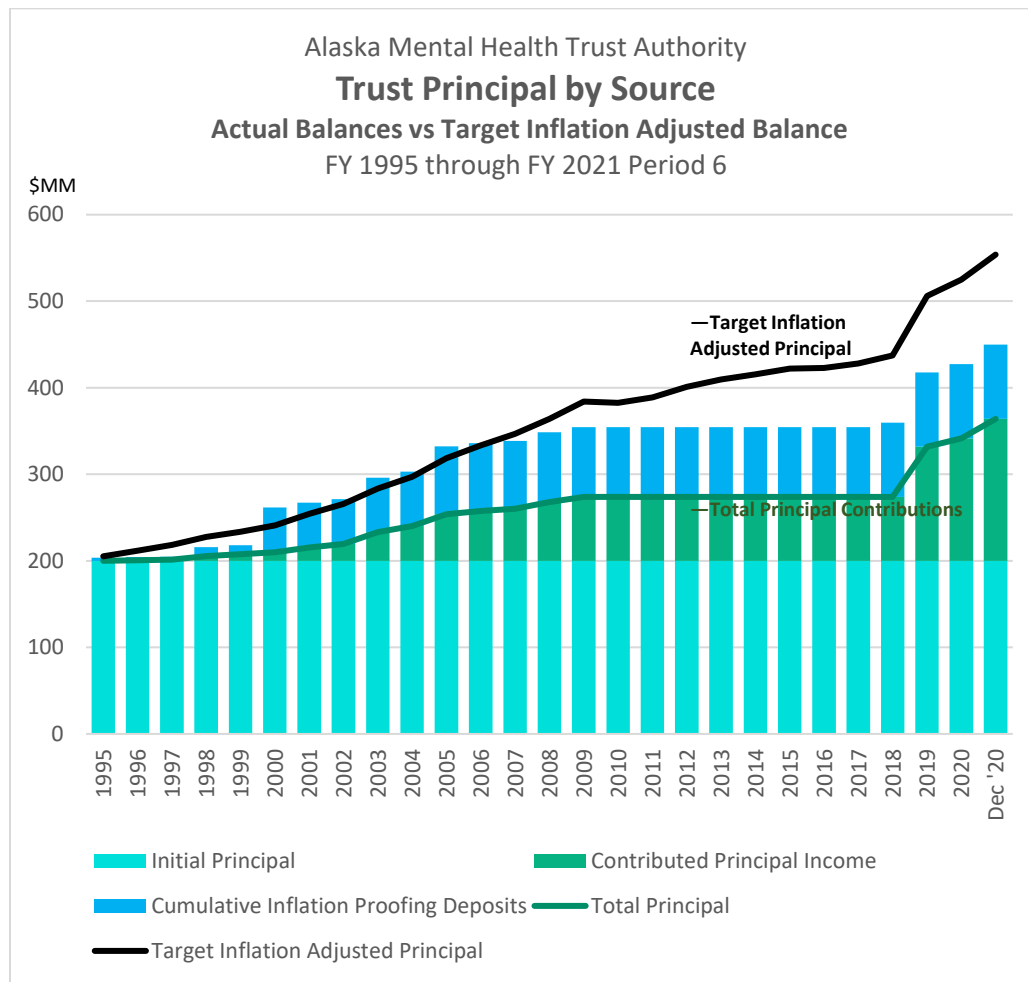
Trustee Boyles commented that from listening to the Senate Finance Committee discussion, she questioned legislators' understanding of the Trust and the role of the Trust, and commented on the importance of inflation proofing. Trustees Boyles and Sturgeon commented that Trust's policy adherence kept Trust spending within its means, contrasting the Trust with the State of Alaska. There was general agreement by all Trustees.

Trustee Sturgeon called the question. The motion passed unanimously.

Chair Cooke expressed his desire to have a special board meeting at the end of March and instructed Mr. Abbott and Ms. Smith to take action to schedule the meeting.

The Finance Committee adjourned at 2:22 pm. The next scheduled meeting of the Finance Committee is ***April 21, 2021.***

Supplemental Tables



This table shows contributions to the Alaska Permanent Fund Corporation (APFC)-managed Trust Fund since inception, and the level of principal that would be required to preserve the Trust Fund's purchasing power through a designated transfer of budget reserves.

Working from the bottom, the chart shows the original principal contributions to the Trust Fund plus cumulative Trust Land Office (TLO) principal income deposited into the Trust Fund. The strong green line is equivalent to total principal contributions since inception.

Added to principal in blue are cumulative, formal contributions of investment earnings to principal for the purpose of inflation proofing.

The combined bar-chart total can be compared to the strong black line that reflects the "should be" balance if principal were fully inflation-proofed. This "should be" balance is based on the annual changes in the Consumer Price Index-All Urban (CPI-U).

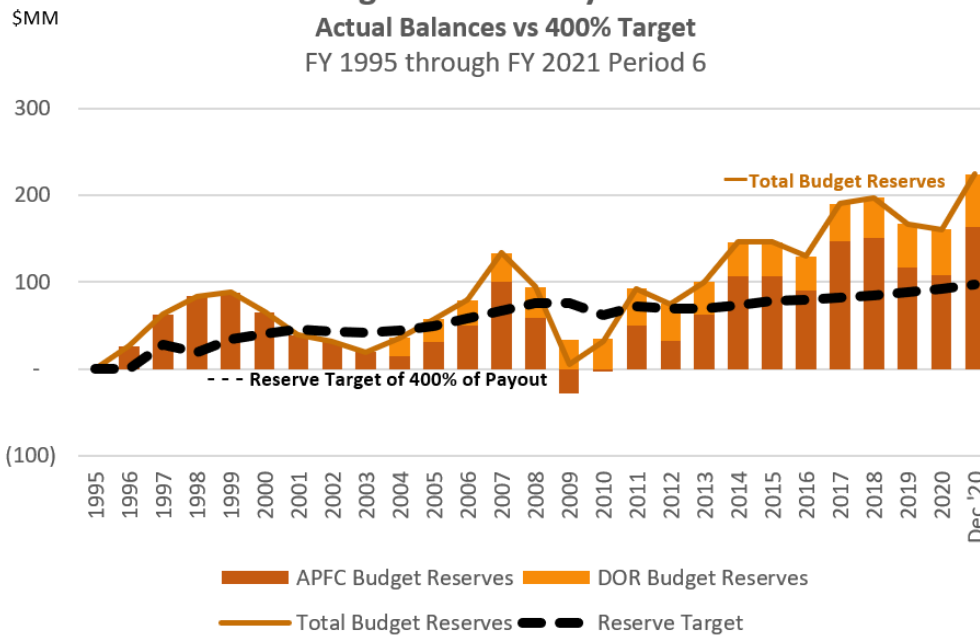
Transfers from earnings into principal kept purchasing power in line with inflation through 2006. Subsequent to market declines in 2008/2009, earnings retained in Trust budget reserves have sustained purchasing power, as will be seen in the following chart.

Alaska Mental Health Trust Authority

Budget Reserves by Source

Actual Balances vs 400% Target

FY 1995 through FY 2021 Period 6



Note: Recent reserves were restated in May 2020, resulting in a \$41MM increase in reserves and a similar decline in principal balance.

This table shows earnings from Trust principal and retained since inception, and the level of reserves required to meet the target of four-times the percent of market value (POMV) spending approved each year.

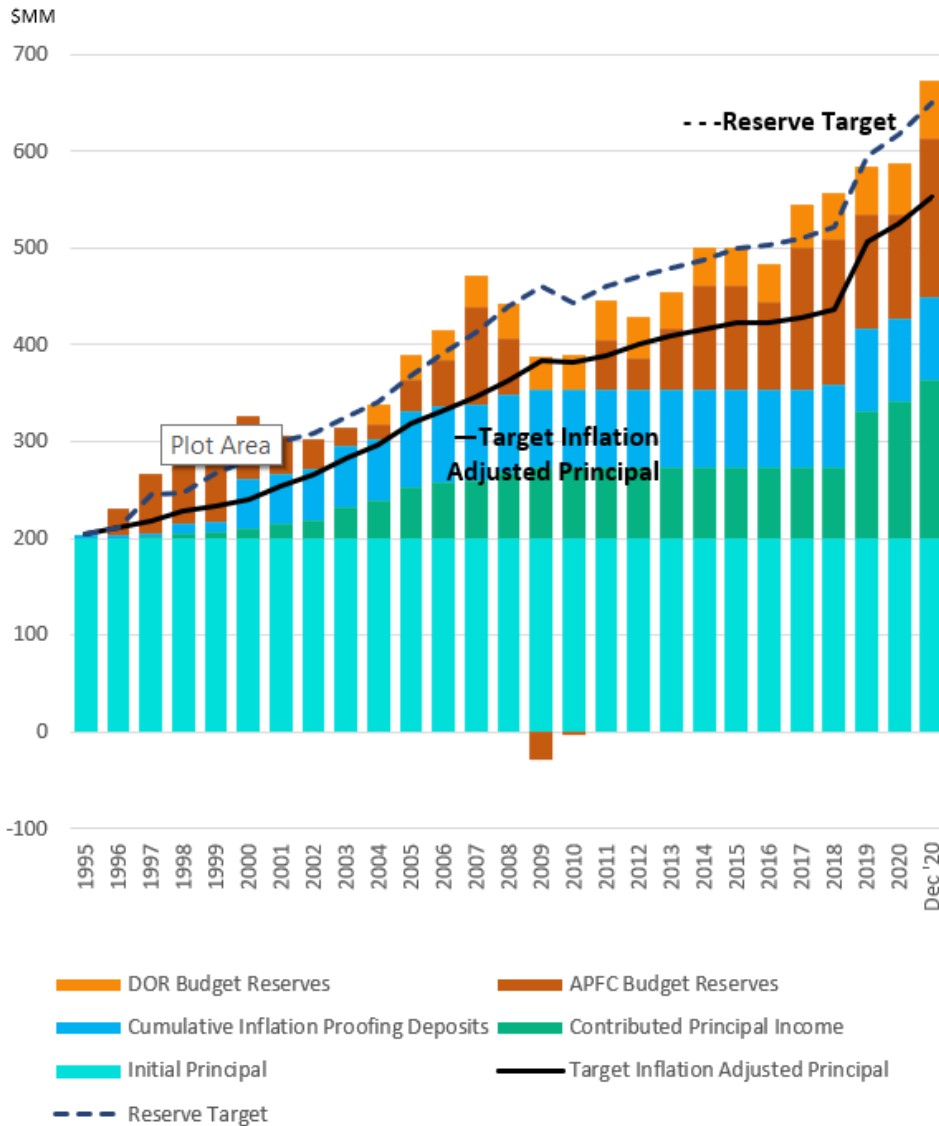
Working from the bottom, the chart shows budget reserves managed by the APFC (dark orange), and then earnings managed by the Department of Revenue Treasury Division (DOR) (light orange).

The strong orange line represents total budget reserves (those managed by APFC and DOR).

The combined bar chart total can be compared to the black dashed line that reflects the target budget reserves, four-times (400%) the annual payout for the year.

When looking at reserves on a standalone basis, Trust reserve balances at the FY-end 2013 to the present have exceeded the 400% target.

Alaska Mental Health Trust Authority
Principal and Budget Reserves by Source
Actual and Targets
FY 1995 through FY 2021 Period 6



This chart combines actual principal and budget reserve balances through the bar charts. It combines the target principal balance adjusted for purchasing power and target budget reserves through the solid and dashed lines, respectively.

Focusing on the solid black line in relationship to the cash balances, one can see that purchasing power has been protected through inflation proofing and reserve balances. Layering the 400% target reserve balance (dashed line) on top of the fully inflation proofed Trust Fund total (black line), one can see budget reserves have supported year-over-year market fluctuations.

Comparing these targets to the actual balances represented through the colored bars, one can see that in 2019 and 2020, from a total fund basis, the budget reserves were short of that which was needed, but earnings through December 2021 exceed Trust Fund and budget reserve requirements.

MEMO

To: Anita Halterman, Finance Committee Chair
Through: Mike Abbott, Chief Executive Officer
From: Carol Howarth, Chief Financial Officer
Date: February 26, 2021
Re: Inflation Proofing

REQUESTED MOTION

The Finance Committee recommends that the board of trustees approve the transfer of \$120,280,300 from the Alaska Mental Health Trust Authority budget reserve account to the Alaska Mental Health Trust Authority principal account managed by the Alaska Permanent Fund Corporation.

Background

The Authority has an obligation to ensure mental health trust resources are available to support the needs of both current and future beneficiaries. AS 37.14.009 and AS 47.30.036(1) guide the Authority's responsibilities to future beneficiaries. To meet this obligation the Authority must maintain near-term spending discipline in order to take steps necessary to preserve the real value of Trust resources in perpetuity.

The Authority has established policies that are designed to generate the resources necessary to inflation-proof the Mental Health Trust Fund ("Trust Fund" or "principal"¹). The spending policy is the most important tool available to the Authority to ensure that resources are available decades from now to support the mission of the Trust. An equally important tool can be designated inflation-proofing of the Trust Fund. With inflation proofing, which will help ensure that income can increase in line with inflation, the buying power of the principal is irrevocably protected.

By setting an annual withdrawal of 4.25%, the Trust Fund and reserve funds can be expected to generate enough earnings in excess of the payout to make periodic transfers to the Trust Fund to offset the impact of inflation. The investment earnings in excess of the 4.25% annual payout are designated as Trust reserves and are not reinvested in the

¹ The Alaska Mental Health Trust Fund, or Trust Fund is designated by the Alaska Permanent Fund Corporation as "principal."

Trust Fund without express board approval. Annual earnings cannot be perfectly predicted, but over time, the investment earnings (above the 4.25% payout) are very likely to produce sufficient funds to allow Trustees to protect the real value of the Trust Fund.

Although reserves can be used for virtually any Trust approved purpose, inflation-proofing is specifically identified as a Trust option in statutes. From 1994 - 2005 the Authority prioritized its responsibility to future beneficiaries when Trust reserve balances were high enough to support inflation-proofing. Since 2005 the Authority has not made significant inflation-proofing deposits into the Trust Fund. In part, the lack of inflation-proofing during this period was due to the dramatic loss in value of Trust reserves in FY2009 and FY2010 due to investment market declines and the subsequent strategy to further diversify Trust investments. The last time the Trust Fund was considered fully inflation-proofed was 2005.

A summary of inflation-proofing actions is provided in the following table.

| Year | Inflation-Proofing Transfer (\$) |
|--------------|---|
| FY1995 | \$ 3,533,000 |
| FY1998 | 6,910,543 |
| FY2000 | 41,544,000 |
| FY2003 | 11,059,800 |
| FY2005 | 15,337,401 |
| FY2008 | 2,436,354 |
| FY2018 | 5,000,000 |
| Total | \$85,821,098 |

Trust Reserves

In 2004, based on guidance from our investment advisor Callan Associates², the Authority established a target for Trust reserves in the its Asset Management Policy Statement (AMPS). The Trust reserves target was set at 400% of the most recent year's annual payout. This level was established to provide high confidence that the Trust would have enough reserves to maintain Trust funding for important beneficiary-serving programs during periods of significant declines in investment values.

The AMPS directs the Authority to divide the investment of the reserves between the Alaska Permanent Fund Corporation (APFC) and the state's Department of Revenue

² Founded in 1973, Callan Associates is one of the largest U.S. independent investment consulting firms, advising both governments and the private sector on investment strategy, performance and risk monitoring. Its clients include APFC and the State's Treasury department, as well as entities such as CalPERS.

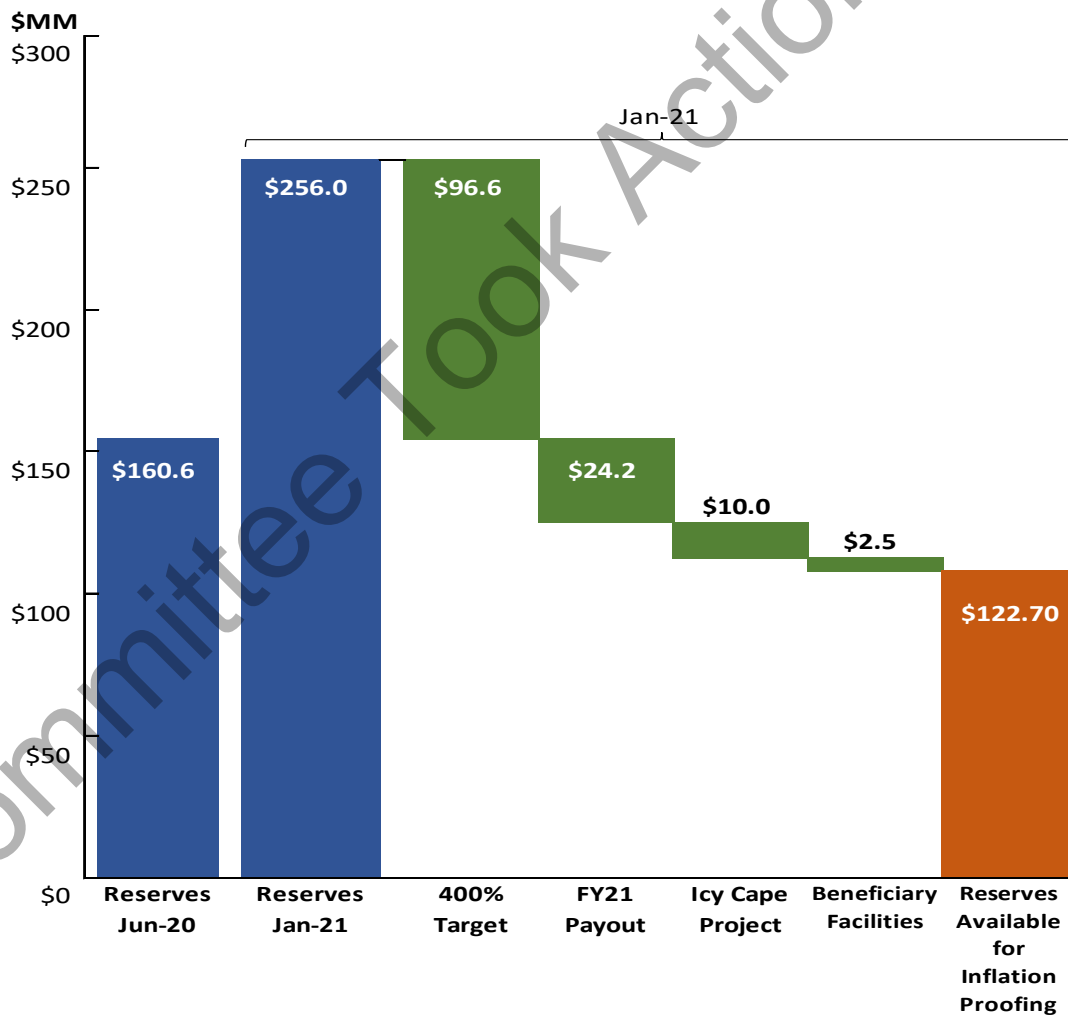
(DOR) in separately managed portfolios. The reserves managed by APFC are co-mingled with the Trust Fund, which is co-mingled with the Alaska Permanent Fund. The reserves managed by DOR are in a portfolio customized for the Trust. Historically, the DOR returns are slightly lower than APFC due to a shorter investment horizon.

Once the budget reserve target is achieved, the AMPS directs the Authority to consider inflation-proofing the Trust Fund with any excess reserves. At the end of FY20, Trust Reserves stood at \$160.6MM. Since then, the reserve balance has grown to \$256.0MM as of January 31, 2021. After adjusting for the 400% reserve target (\$96.6MM), the FY21 payout (\$24.2MM), reservations for Icy Cape development approved in January 2021 (\$10MM), and beneficiary facilities approved in FY19 (\$2.5MM), the reserves available for inflation proofing totaled \$122.7MM.

Trust Budget Reserves

Balances, Obligations, Reservations, and Funds Available for Inflation Proofing

FY2020 Balance and Status as of January 31, 2021



* Beneficiary Facilities reservation, which is subject to Trustee approval, sets aside funds to acquire property(s) to support beneficiary serving partners (approved by Trustees in November, 2018).

According to the AMPS, the effect of inflation is to be estimated using the U.S. Department of Labor Bureau of Labor Statistics CPI-U index³. To match the purchasing power of the original \$200MM and subsequent contributions to the Trust Fund as of December 31, 2020, a permanent transfer of \$120,280,300 is needed.

| | As of December 31, 2020 |
|--|------------------------------------|
| Initial Trust Fund Contribution (FY95) | \$200,000,000 |
| Subsequent Trust Fund Contributions | 163,990,000 |
| Total Trust Fund Contributions | 364,026,000 |
| Inflation Proofing (FY95-FY18) | 85,821,100 |
| Trust Fund | \$449,847,100 |
| Fully Inflation Proofed Trust Fund | \$570,127,400 |
| Inflation Proofing Required | \$120,280,300 |

Alternative Approach

Another option for preserving long-term value of the Trust's assets over time is "soft" inflation-proofing ("hard" inflation-proofing is the approach described previously). In this approach funds need not be transferred to the Trust Fund to inflation proof. Funds may stay in reserves. By managing spending at a rate below the real rate of return, the growth of the total invested cash assets—principal and earnings—builds a total fund balance that has an increasing purchasing power and supports spending growth⁴. One evaluates the market value of budget reserves and the Trust Fund against what the total balance "should be" if the AMPS is followed. As of Fiscal Year-End 2020, there was a \$33,572,000 shortfall in funding. As of December 31, 2020, there was a surplus of \$23,496,000.

The "soft" inflation-proofing approach is not recommended at this time. To ensure long-term protection of the Trust's ability to support beneficiaries, funds must be transferred to the Trust Fund and thereby receive the protection against spending provided by the Alaska Mental Health Trust statutes.

³ ³ Alaska Mental Health Trust Authority. (2019). *Asset Management Policy Statement, Adopted August 29, 2019*. Retrieved from: <https://alaskamentalhealthtrust.org/wp-content/uploads/2019/08/AMPS-adopted-Aug2019.pdf>.

⁴ For example if in a given year inflation is 2%, the return target is a 5% real return, the Trust needs to earn 7%. (7% less 2% inflation = 5% real rate). If the planned payout is 4.25%, after the payout, there should be an increase of 2.75% in reserve balances. (5% real rate less 4.25% = 0.75% left over, yet the Trust must also maintain inflation proofing of 2%, for a total of 2.75% increase).

Conclusion and Recommendation

The Trust is in a sound financial position, having maintained purchasing power through its spending discipline and adherence to its reserve model. While the Trust's investment performance will be the same with or without trustees designating permanent inflation proofing, permanent inflation proofing reduces flexibility to increase withdrawals beyond the Trust's spending policy. When this discipline is balanced with the 400% reserve model, the Trust can ensure a buffer exists to support spending to meet beneficiary needs should markets experience a severe decline.

As of December 31, 2020, fully inflation proofing the Trust Fund requires \$120,280,300. If earnings were to stay at the January 31, 2021 earnings level, nearly \$123MM would be available at fiscal-year end to meet the current inflation proofing needs.

Trust policy and past practice prioritizes inflation-proofing when sufficient reserves are available. As described above, the Trust can both meet its reserve target, which will prudently insulate the Trust from market volatility, and transfer available reserves to fully inflation-proof the Trust Fund. This action will provide confidence that the Trust is well positioned to serve beneficiaries now and into the future.