Trust
Alaska Mental Health
Trust Authority

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May 1, 2018

Kris Curtis
State of Alaska, Division of Legislative Audit
PO Box 113300
Juneau, AK 99811-3300

Re. Response to Legislative Audit Report

Dear Ms. Curtis,

I am writing on behalf of the Board of Trustees of the Alaska Mental Health Trust Authority to respond to your audit report. We have reviewed the report conclusions and recommendations and are providing a response in the attached document.

It is clear from the report that well intentioned people can have a difference of opinion, which means clarification is needed to ensure the Trust's best performance for the beneficiaries. We appreciate the audit's recognition of the Trustee's motivations. We maintain our position that the Trust's investment choices are appropriate and allowable and have increased the Trust's spendable income. We will undertake a careful examination of the impacts of recommendations one and two on service delivery to our beneficiaries. Ultimately, if these recommendations are found to be in the best interests of the beneficiaries we will implement them. We concur with report recommendations three and four and have already taken actions to plan and execute changes necessary to implement those recommendations.

From its inception 24 years ago, the Trust continues to evolve and grow and we continually seek ways to improve our service to beneficiaries. The audit is a helpful tool for continuing this process and I thank you for your efforts to help build a strong organization.

Sincerely,

Mary Jane Michael

Mary Jane Michael
Board Chair

Alaska Mental Health Trust Authority Response to Preliminary Audit Report

May 1, 2018

Executive Summary:

The audit report makes four recommendations. Two of those recommendations (#3 & #4) deal with process, procedure and operational issues. The Trust concurs with these two recommendations and appreciates the input. The Trust is already implementing substantial portions of these recommendations through the organizational governance initiative that was launched a year ago. The other two recommendations (#1 & #2) deal with the Trust's authority to make management decisions pertaining to how a small class of assets are invested. The Trust will consider accepting those recommendations, but cannot commit to any specific action without a thorough evaluation process that includes discussions with our advisory boards, Alaska Permanent Fund Corporation, and other stakeholders. Since the likely outcome of these recommendations will be less resources available for grants, ultimately these decisions must be determined to be in the best interest of Trust beneficiaries.

Background Information:

The Trust is a complex entity and is continuously evolving in response to changing beneficiary needs and the overall environment. A Trust beneficiary is an Alaskan who experiences mental illness, developmental disabilities, substance use disorder, traumatic brain injury, or Alzheimer's disease and related dementia. Much of the Trust's current governance and operational structure is based on extensive dialogue and negotiations that took place over many years. These communications and dialogue with stakeholders were the foundation for the 1994 settlement as well as the ongoing guidance and direction of the Trust. The Trust considers this dialogue and ongoing relationship between Trust management and advisory boards, non-profit and community partner agencies, and the residents that qualify as Trust beneficiaries as the cornerstone of the organization.

The 1994 Settlement Agreement came about after litigation between beneficiaries and the State over the previous management of Trust assets. At the conclusion of the settlement, the Trust had one million acres of land and a Trust fund of $200 million invested with the Alaska Permanent Fund. These resources are held in a perpetual trust for current and future beneficiaries. An important goal for managing these resources is to generate income, which can then be used to support a comprehensive mental health program for Alaska. Trustees have continued that original vision of carefully shepherding Trust resources for the long-term benefit of beneficiaries. ***Through diligent efforts and careful decision making, that $200 million has grown to a total asset base of $668 million. During the same period the Trust has distributed approximately $300 million to support beneficiary programs and services.***

As trustees consider decisions about investments, expenditures, and other key governance factors they are guided by state and federal law (including generally applicable trust law), state regulations, and a body of historic communications between the settlement participants and other stakeholders that are incorporated into the Settlement Agreement. Some of this material is silent on key components of Trust operations, some of it may be considered contradictory, and some is ambiguous. Therefore, trustees do their best to diligently interpret this complex body of law and policy, to understand the legislative intent at the time that the Settlement was enacted, and most importantly, they work to fulfill their duty as trustees by making decisions that are in the best interest of the beneficiaries.

The audit report accurately portrays the same spirit of service that motivates trustee decisions as well as the daily actions of Trust management and staff, as noted on page i of the audit report. In the context of the report, it is important to consider both the information presented by the audit team as well as the background information and context that may not be easily available to the reader of the report. The audit examined Trust activities from 2008 through 2017, a period that includes a time of unprecedented world-wide financial turmoil, a collapse of the US housing market, as well as the bankruptcy and collapse of iconic American institutions. This volatility led to multi-million dollar losses in the Alaska Permanent Fund. Since the Mental Health Trust Fund is held as an undivided portion of the Permanent Fund, the Trust suffered the same losses.

Financial support for beneficiary programs rely on an annual distribution of 4.25% of the four-year average value of Trust investments. Because of the losses sustained in the collapse of the stock market 10 years ago, the Trust's ability to support beneficiaries at similar levels was in question and trustees acted to secure a diversified and stable source of spendable income for the Trust. The tool that they selected was a portfolio of seven high quality, well managed, and conservatively positioned commercial real estate assets. These buildings are leased to a mix of federal, state, and commercial tenants and generate stable and predictable income. For perspective, the amount of capital invested in these buildings is approximately 6% of Trust assets. Further, they are in an asset class that dampens the daily up and down swings of the financial markets.

Response to Recommendation One:

The report recommends that the Trust stop investing in commercial real estate, consult with the Alaska Permanent Fund Corporation on existing commercial real estate, and transfer the existing cash principal balance from the Trust Authority Development Account to the Alaska Permanent Fund Corporation. This recommendation is based on the conclusion that plain language in statutes prohibits this investment strategy. However, the audit report does not recognize the other legal requirements and obligations that are required of the Trust. When viewed in total, the Trust has acted reasonably.

We respectfully disagree with the report's conclusion about the legality and propriety of the Trust's commercial real estate investments. We maintain the position that these decisions were not a diversion of money from the Trust; they were legitimate management decisions to invest funds in an alternative investment for the benefit of the beneficiaries. The Trust's investment strategy and individual investment decisions were made in dozens of public meetings. The Trust's investment decisions were authorized by and consistent with applicable regulations and legal advice. The Trust's actions were also subject to the oversight of third-party external auditors. Beneficiaries, both as individuals and through their advisory board representatives, as well as the general public and community stakeholders, were all provided opportunities to testify and comment on Trust actions.

However, we recognize that the legal framework could be significantly clearer regarding these investments. As a result, the Trust will take the following actions:

- **Make no further real estate investments at this time.**
- **Work with the Alaska Permanent Fund Corporation (APFC) to evaluate the possible transfer of the existing real estate assets to the APFC.**
- **Continue to consider additional transfers of investable cash to the APFC ($10 million has been transferred in the last six months).**

- **Work with Trust stakeholders to develop forward-looking guidance for Trust investment subject to legislative and judicial review.**

Furthermore, the Trust's commercial real estate investments have been very successful. The underlying values of the investments have increased and they have generated more income for beneficiary programs than a similar transfer from the Trust investment portfolio at the Permanent Fund would have generated. The real estate portfolio has distributed $6.03 million since inception. The same investment of principal, using historic investment results from the Permanent Fund and applying the Trust's 4.25% distribution rate, would have generated $3.26 million. The Trust's actions have not harmed the Trust and its beneficiaries and the investments produced more favorable results than the investment option recommended in the audit report.

Response to Recommendation Two:

Separate from commercial real estate investments, the Trust has invested in Alaska properties to support service delivery to beneficiaries. These are identified as Program Related Investments (PRI) and these assets provide in-kind support for beneficiary programs beyond the financial grants made by the Trust. These investments are strategic assets of the Trust-they are platforms for beneficiaries to receive services as well as a place of stability in the communities that the Trust serves. Most of the Trust's current PRIs are facilities and/or land the Trust received during the reconstitution of the Land Trust and were already being used by Trust providers like the ARC of Anchorage, Assets, Inc, Catholic Social Services, and others. In other cases, like the Fairbanks detox facility, the Trust invested in land or facilities that also support an important Trust service. These assets have been acquired and improved with the use of Trust principal and are intended for the long-term benefit of the beneficiaries. The funding mechanism around making new Program Related Investments is very similar to the commercial real estate investments: the Trust generates principal through the sale of assets (land, coal, etc.) and uses that principal to subsequently acquire and improve property for PRI purposes.

The report recommends that trustees fund future Program Related Investments from Trust income and transfer an additional $2 million out of Trust income to the Permanent Fund to replace funds used for these investments. This is a source of significant concern. Given the state's limited capital budget the Trust is frequently approached by community health clinics, government agencies, and other providers to help meet needs for capital improvements. ***Given the current economic climate, the Trust needs to be able to bring all available resources forward to help meet these needs. A decision to restrict the funding to just the use of Trust income creates a significant barrier for communities to get help meeting their capital project needs. The Trust will respond to this recommendation in the same manner as Recommendation One. Since the recommendation would likely lead to less available resources for beneficiaries, the Trust must carefully consider all available options. In the meantime, no further principal investment funds will be allocated to PRI projects.***

Response to Recommendation Three:

All of the Trust resources, including the land and financial assets, are managed in accordance with a Resource Management Strategy (RMS) and an Asset Management Policy Statement (AMPS). These documents were developed in a public process. These documents are subject to revision as new information becomes available and the Trust becomes aware of new opportunities. ***The Trust completely agrees with the report recommendation that the AMPS & RMS be reviewed and, if needed,***

amended to reflect the best practices in investment management and any changes to state investment law. The Trust is always looking to better serve the beneficiaries and taking this step will help us ensure that their interests are protected. We anticipate completing this work by June 30, 2019.

<u>Response to Recommendation Four:</u>

Since the audit began the Trust has made significant organizational and personnel changes. The Trust has a new chief executive officer, chief financial officer, and executive director of the Trust Land Office. Oversight of programmatic activities as well as land office operations has been consolidated under the chief executive officer creating a unified line of authority. The Trust has also elected a new board chair, seated two new trustees, revised the Trust bylaws, updated job descriptions for officers, and implemented new charters for trustee committees. The audit report raises specific concerns about adherence to open meetings requirements, appropriate notice for trustee meetings, the need for adequate minute taking to capture trustee business decisions, conflict of interest declarations, and other elements associated with the proper conduct of trustee meetings and makes recommendations to correct deficiencies in these areas. ***The Trust completely agrees with the report recommendations and in addition to the governance changes has already established training programs to ensure trustees, management, and staff are familiar with all relevant compliance requirements. We anticipate that this work will be an ongoing effort of the Trust and we will continually seek excellence in this area.***

<u>Conclusion:</u>

For over 20 years, the Trust has advocated in the best interests of beneficiaries, provided direct support to beneficiaries and helped to create positive systems change to improve health care access and the quality of life for beneficiaries. Trustees remain deeply sensitive to the needs of our beneficiaries, the State, local, and tribal government partners, as well as our community non-profit organizations across Alaska. The trustees, management, and staff are committed to managing Trust resources and conducting Trust business in a manner that upholds the highest standards of conduct and protects public trust in the institution.

Our statutory advisory boards include the Alaska Mental Health Board, Advisory Board on Alcoholism and Drug Abuse, Governor's Council on Disability and Special education, and Alaska Commission on Aging. These groups share our interest in serving the approximately one out of ten Alaskans that qualify as a beneficiary. The Trust considers the audit report recommendations to be an opportunity to review all of the elements of Trust operations and to make any necessary improvements to the organization. Such improvements will help ensure the Trust is positioned to advocate and serve beneficiaries in perpetuity. Thank you for your efforts and the hard work of the audit team in completing the audit report, we appreciate your interest in the Trust and how jointly we can meet the needs of the beneficiaries and the people of Alaska.