Alaska Industrial Development and Export Authority
BOARD WORK SESSION MEETING MINUTES
Friday, August 13, 2021
Anchorage, Alaska
Via Teleconference

1. CALL TO ORDER

Chair Pruhs called the work session meeting of the Alaska Industrial Development and Export Authority to order on August 13, 2021, at 8:35 am. A quorum was established.

2. ROLL CALL: BOARD MEMBERS

Members present: Chair Dana Pruhs (Public Member); Vice-Chair Bernie Karl (Public Member); Julie Anderson (Commissioner, DCCED); Albert Fogle (Public Member); Bill Kendig (Public Member); Anna MacKinnon (Special Assistant to the Commissioner-DOR); and Julie Sande (Public Member).

3. AGENDA APPROVAL

MOTION: A motion was made by Mr. Kendig to approve the agenda as presented. Motion seconded by Mr. Fogle.

The motion to approve the agenda as presented passed without objection.

4. PUBLIC COMMENTS *(2 minutes per person, for one hour)*

Chair Pruhs reminded the public that comments are limited to two minutes per person. One hour has been set aside for public comments. He noted the importance that each person speaks clearly and states their name and their affiliation, if any. He will remind the public when they are close to their two-minute allocation, so that they may conclude their comment. David Kennedy, AIDEA, instructed the public participating telephonically to press star-nine if they wish to make a public comment.

Rick Whitbeck, Alaska State Director of Power the Future Alaska, acknowledged that he is sitting in his home office utilizing power, heat, and internet. None of that would be possible without energy workers. He thanked energy workers for giving us the ability to go about our daily lives without considering rolling blackouts, the lack of water or sewer, the need to put on seven layers of clothing to stay warm, or any other myriad of ugly realities that would occur if the eco-left got its way and transitioned to so-called green energy as the sole source of power and heat.

Mr. Whitbeck commented that AIDEA's recent decision to ignore the despicable action of the Biden Administration and forge ahead with seismic studies on the 1002 leases should be commended. He thanked AIDEA for that decision. Mr. Whitbeck stated that without proactive steps being taken, the bought and paid for federal administration would catapult Alaska back into pre-oil days with little economy, few jobs, and miniscule hope. Instead, AIDEA has the foresight to push back the radical environmental stupidity and provide future opportunity for Alaska. Mr. Whitbeck encouraged the Board to pay attention to pages 17 and 18 of the presentation during today's meeting. Mr. Whitbeck noted that the list of companies, although not complete, looking to block Alaskan opportunity is disgusting to him and to every other rational Alaskan, who know how the great state balances environmental stewardship with responsible development every day.

Mr. Whitbeck reminded Board members and those listening on the line that it is because of the potential for extraction of Alaska's abundant natural resources that the U.S. made Alaska the 49th state. Because of oil and gas development specifically, Alaskans have a permanent fund worth over $81 billion that spins off annual dividend checks to each Alaskan and ultimately pays for the majority of state government. Mr. Whitbeck recommended that when a person meets an energy worker on the street, in church, or in the store, they should be thanked profusely. They may respond, "You're fracking welcome."

Margi Dashevsky noted that she works for one of the organizations that she believes Mr. Whitbeck called despicable. Ms. Dashevsky thinks that the opportunity for AIDEA to invest in Alaska's next economy would be bolstered by the increasing best practices in the investments of environmental, social, and governance criteria, which proactively invests in holdings that will be profitable for the long-term. Some of the banks on the list of restricted companies on page 17 of the presentation have taken proactive actions to look toward the future. Ms. Dashevsky noted that if AIDEA is considering divesting from the entities that have business practices and policies against Arctic drilling and development, she is concerned that would be a hindrance, rather than proactively investing in companies that are looking to the future.

Ms. Dashevsky expressed curiosity to learn more about AIDEA's fiduciary responsibility. She believes that acting in a way that benefits the public of Alaska with financial management is incredibly important and that AIDEA should be looking to partner with the public. Ms. Dashevsky invited AIDEA to be a partner with the Fairbanks Climate Action Coalition and other similar community groups. Fairbanks Climate Action Coalition is hosting a local investing training and would be honored to count AIDEA as one of their cosponsors.

There being no further public comments, Chair Pruhs closed public comments.

5. PRIOR MINUTES – None

6. NEW BUSINESS

6A. Review of Investment Policy for Outside Advisor-Managed Investment Assets

Alan Weitzner, Executive Director, advised that this work session is follow-through of a request at a previous Board meeting to review AIDEA's Investment Policy, specifically regarding external money managers that manage a large portion of AIDEA's capital reserves that are available for project investment in Alaska. Mr. Weitzner noted that Morgan Neff, Chief Investment Officer, was requested to interact with AIDEA's external advisor for these funds and different managers. Callan is a common advisor among the investment companies within Alaska and externally. Mr. Neff interacted with Callan to create this presentation and address some of the questions that were asked at a previous Board meeting and at previous Budget and Audit Subcommittee (BAS) meetings.

Mr. Weitzner asked Mr. Neff to introduce the Callan representatives, as well as to introduce the information that will be discussed. Mr. Neff noted that it is his pleasure to speak with the Board today regarding AIDEA's investment performance, Investment Policy, and Investment Management Agreement. Several questions that have been asked at previous Board meetings will be discussed today. The topics include investment performance, composition, hypothetical return analysis with incremental exposure associated with the equity markets, review of the Investment Policy Statement, proposed amendments, and introduction of an Investment Management Agreement that will replace what has been previously been used as procurement for external managers.

Mr. Neff introduced Alex Ford, Callan, and provided a summary of his professional background. Mr. Ford gave additional information regarding his professional background. He discussed that Callan works with a diverse mix of clients from small to large in size, and from simple to complex in scope, including retirement plans, pension plans, and municipal funds. Callan works specifically with the Municipality of Anchorage. Mr. Neff noted that he and Mr. Ford spent much time working on the provided presentation that Mr. Ford will review. Mr. Neff encouraged Board members to ask questions during the presentation.

Mr. Ford agreed and welcomed Board members to discuss the topics as they are being reviewed. He noted that the presentation will additionally review past results and hypothetical portfolios that examine risk, return, liquidity, and options for the most appropriate asset allocation for AIDEA going forward. Mr. Ford described asset allocation as the expression of the fund's tolerance for investment risk. He stated that asset allocation drives 90% of returns and drives 90% of risk to return. Mr. Ford explained that risk is the downside volatility around the expected outcome or the results that come in less than the expected returns. The downside risks are those that investors want to avoid and to mitigate.

Mr. Ford commented that AIDEA's investment structure and asset allocation since inception has been 100% in fixed income for the reserve capital, which funds development projects in the state. He noted that today's presentation will review that approach and discuss if that is the most appropriate structure going forward. Mr. Ford discussed that another important characteristic that investors need to consider is liquidity, which is the ability to convert assets into cash to fund projects and obligations as they come due. Currently, AIDEA invests in highly liquid investments. Mr. Ford presented a scenario in which AIDEA invested in the stock market and obligations become due at a time that the stock market had declined by 30%. The investment conversions could occur, but the sale would be at distressed prices and at an inopportune time. This type of scenario should be mitigated. Mr. Ford discussed the importance that the stated purpose of AIDEA's investment fund matches its asset allocation. This provides consistency in the use of the assets and how they are invested.

Mr. Ford reviewed AIDEA's investment analysis through back-testing of performance returns. He showed a graphic looking at the rolling three-year returns for AIDEA's externally managed portfolio compared to hypothetical portfolios that had increasing amounts of equity allocation;

75% fixed income (fixed) / 25% equity, 50% fixed / 50% equity, and 25% fixed / 75% equity. AIDEA's fixed income portfolio tracks closely to the Bloomberg Aggregate Index benchmark. The hypothetical portfolios with more equity tend to deliver higher returns through time. The hypothetical portfolio with the 25% fixed / 75% equity ratio typically had the highest returns, except for the years between 2008 and 2010, when negative returns persisted. This would be reported as significant unrealized losses to the investment program. Additionally, the return swings are much wider for the 25% fixed / 75% equity linked portfolio. AIDEA's current fixed income portfolio tends to be more consistent with the returns and have not dipped into negative returns over the history.

Ms. MacKinnon asked for an indication of what the chart would look like if inflation numbers were overlaid. Mr. Ford noted that the chart shows nominal returns, which are returns that do not consider inflation. Real returns include the consideration of inflation. He discussed that the real returns for the last decade would have been lower across the board by 1% or 2%. Inflation coming out of the global financial crisis (GFC) has been very low.

Ms. MacKinnon commented that the majority of AIDEA's returns shown on the graphic fall within 1% to 3%. She asked if inflation averaged 2% or under 2% during the time period between 2004 and 2021. Mr. Ford discussed that previous to 2008/2009, inflation averaged 2% to 3%. He noted that inflation averaged 1% to 2% post GFC. Mr. Ford indicated that if inflation was subtracted out of AIDEA's nominal return, the real return would range between right above 0% and right below 5%.

Ms. MacKinnon agreed with Mr. Ford's statement. She commented that while the back-testing of AIDEA's performance is showing an average of between 3% and 5% returns, the real return is much lower. Ms. MacKinnon noted that she has also asked the question of staff regarding the additional cost to manage the portfolio. She asked what the chart would look like if the fees associated with the investment managers were layered onto the overlay of inflation numbers. Ms. MacKinnon noted that if the real return is 1%, then the intent to preserve the capital has been fulfilled. Mr. Ford informed that all of the results in Callan's presentation are net-of-fees, which are the results after the payment of investment costs.

Mr. Neff highlighted that the hypothetical return analysis of any blend of equities and the Bloomberg Aggregate is not factoring in fees because there are no fees associated with indices. Mr. Ford agreed and noted that this is not exactly a fair comparison. The equity portfolios would be lower because the returns are based on indices, which do not have fees attached.

Mr. Neff asked if equity managers and fixed income managers have quite different manager fee structures. Mr. Ford explained the fee structure for equity index funds is conceivably less than 10 basis points, which is less than the fees paid for active management of fixed income portfolios. A portfolio with active equity management could have higher fees than the active fixed income management. Mr. Ford commented that Callan performs a comprehensive fee analysis across all asset classes every two years. He indicated that AIDEA's managers are currently below the median for their asset class. Mr. Ford noted that moving to a new arrangement with the contracts could be an opportunity to negotiate even lower fees.

Mr. Ford reiterated that the returns translate into dollars, but that the investment program needs to be viewed holistically. He reviewed the graphic showing the back-testing of risk utilizing the same asset mixed portfolios as the previous chart. Mr. Ford indicated that standard deviation is used to measure the risk shown. The chart shows the dispersion of returns around the average of returns. The volatility of risk is much more elevated for the portfolio that contains the highest concentration of equities and tends to surge dramatically during periods of market stress. The Bloomberg Aggregate portfolio is more stable through time and does not tend to fluctuate as much.

Mr. Ford highlighted the importance that the periods shown overlap the reporting schedules of calendar years and quarters, which could affect that way the program is managed. If negative results are showing in any one period, it may have an implication for contributions or distributions going forward. Mr. Neff asked if it is fair to assume that the lower the volatility of a portfolio, the more predictable the cash flow component will be. Mr. Ford agreed, and noted that the calculation with fixed income is often straight simple math. The forward-looking return expectation can be modeled more simplistically, which allows for easier budgeting. Portfolios that contain stocks have additional moving parts that include valuations and macro drivers in the market that cannot be timed or foreseen. This adds another layer of uncertainty that can come at inopportune times. Sometimes when the portfolio needs liquidity, volatility is spiking. Mr. Ford emphasized the correlation between the risk concept and the return factor.

Ms. MacKinnon noted that the footnote on Slide 6 indicates the graph is showing external money managers. She asked for information regarding where AIDEA's internal money managers would be located on the slide. Ms. MacKinnon additionally commented that she has asked repeatedly to see an analysis and a break out of the actual costs to manage AIDEA's portfolio, including the two external money managers and the internal money manager. Ms. MacKinnon explained the reason she has been asking for this specific information is to review if AIDEA is investing in the right place. She noted that her position on the Board represents the Department of Revenue and she is acting on behalf of the Commissioner of Revenue in her role at AIDEA.

Ms. MacKinnon discussed that she observed early on that it appears that the fees that AIDEA is paying may be different than the fees AIDEA could acquire by having the money managed in a portfolio by the State of Alaska, Department of Revenue. Ms. MacKinnon informed that she has not spoken to the Department of Revenue, other than to provide information to the staff about opportunities that are available there by their investment management team. She asked for the amounts of the actual management fees that AIDEA is paying for externally managed investments and how they compare to investment costs by the State Department of Revenue investment teams' managed portfolios. Ms. MacKinnon believes she has seen a portion of the fees that were provided by staff, but the list was not a total review. She asked Mr. Fogle, Chair of Budget and Audit Subcommittee (BAS), for clarification.

Mr. Fogle indicated that at the previous BAS Committee meeting, members requested a delineation of all of the fees associated with AIDEA's money managers. He does not believe the information has been provided. He noted that the BAS Committee asked for an analysis of fees that compared a portfolio utilizing external money managers with a portfolio utilizing the State's internal money managers.

Mr. Neff stated that the fees for the external money managers have always been disclosed in the previous presentations to the BAS Committee, as well as this presentation. He has no comment related to any additional fees because his understanding is that the fees that are being charged by each representative are incorporated into the presentation as net-of-fees. There are no additional fees outside of management fees. Page nine of the presentation shows that Barrow Hanley's fee is 21 basis points on a tiered schedule and Alaska Permanent Capital's fee is 11 basis points. They have two different styles of management. The blended fee scheduled on a dollar-weighted basis is approximately 16 basis points.

Mr. Fogle asked regarding the cost for Callan. Mr. Ford discussed that the contract cost for Callan that was renegotiated in 2019 is a flat fee of $39,400 for certain services, including performance reporting, monitoring of external managers, and other criteria. That cost is not borne out of the funds' returns.

Mr. Weitzner addressed the question regarding the internally managed funds. AIDEA has allocated a certain amount of the capital reserves maintained for liquidity purposes to be invested by the CFO. He noted that the annual reports are issued and available to the public on the website, and the investment information is included in those annual reports. The investments are invested through the Alaska Municipal League investment pool. The amount of fees that are being assessed on that portion of the portfolio is what is assessed generally to all municipalities and other investors within that pool in the State of Alaska. Mr. Fogle asked what the fee is on that portion of the portfolio. Mr. Weitzner noted that he does not have that information and it is not stated in the presentation. Chair Pruhs commented that information can be determined and provided at a later date. He requested that the presentation continue.

Ms. MacKinnon reiterated the question regarding the rates compared to fixed income versus the higher equities, and trying to understand AIDEA's overall rate of return. She understands that there is either one full year or two full years' worth of AIDEA's operating capital that is managed by the Alaska Municipal League, which is mitigating some of the risk of volatility in needing operational funds.

Ms. Sande asked for clarification regarding the amount that is held for the 24 months of operating capital in reserve. Mr. Neff noted that he does not have the historical context with him to answer the question, but that he can follow up and provide the information. Mr. Weitzner indicated that AIDEA carries about $80 million dollars, and that the information is within the financial statements that are online, available to the public and to Board members. The financial statements are issued every year by September 30. The information is on page 41 under Cash and Investment Securities. As of fiscal year-end last year, there was $80.5 million that AIDEA was holding for short-term liquidity purposes. They include short-term investments that are meant to be liquid, and therefore will have a smaller yield that is attached.

Ms. Sande requested additional information as to how the operating capital dollar amount is calculated. Mr. Weitzner indicated that the amount is determined by AIDEA's CFO to identify the future funding requirements. The amount fluctuates based upon the funding requirements and resolutions for capital projects that are approved by the Board.

Mr. Ford continued the presentation and emphasized the importance that risk and reward are evaluated together when considering any investment choice. This is a known duty of Board members and how any investment program is approached. The Sharpe Ratio risk-adjusted performance returns are used to evaluate alternative investment choices. This takes the excess return that a portfolio earned above the risk-free rate, also called cash, and divides it by its own volatility. The return is standardized based on the amount of risk taken.

Mr. Ford showed the graphic of the risk-adjusted performance over the same time period as the previous charts. Through the Sharpe Ratio lens, AIDEA's fixed income portfolio has at times been above the equity portfolios, and it has generally tracked relatively close to the equity portfolios. In 2017 through 2019, the risk-adjusted returns for fixed income lagged. Mr. Ford pointed this out as an anomaly; since 2017 was the year the S&P Index was almost up 25% and had its lowest volatility in history. This is not expected going forward. The risk-adjusted returns for AIDEA's allocation look appealing.

Mr. Ford discussed that investment drawdowns are the measure of downside volatility that is below the expected returns. The graphic showed recent examples of drawdowns and how long it takes to recover. The most severe example was in 2008/2009. The more recent drawdown was attached to the coronavirus in early 2020. Over the last five years, the stock market has lost a significant amount of money at times from the prior peak, ranging from 6% to nearly 35%. Mr. Ford explained the importance of recognizing that returns through time may be better over long periods, but there may be significant pain on the way there. This observation is related to the liquidity discussion.

Mr. Neff asked for more information regarding the typical liquidity framework within the equity market during periods of high downside volatility. Mr. Ford explained that the equity market is liquid, in that investors are essentially always able to transact in the stock market. The problem is that the investor may not get the price they want and may be selling at very distressed prices. The equity market pendulum tends to swing very significantly away from the consensus valuation. When there are macro drivers, the market is going to sell off more than it should and it will take time to come back to the level where fundamentals are reflected.

Mr. Neff asked if it is fair to say that any type of short-term downside volatility with the bond portfolio is generally met with immediate recovery because of the contractual obligation that the bondholder has to the company. Mr. Ford agreed. He explained that the graphic shows that the bond market's price sell-offs are milder and are usually tied to the prevailing interest rate environment. The recovery is also more quickly compared to equities.

Mr. Neff asked if there is any contractual obligation from the equity portion of the portfolio that requires it to return back to the positive performance. Mr. Ford advised that there are absolutely no requirements as such. He indicated that the rapid recovery in the equities market in 2020 was unexpected. The GFO produced negative equity markets for several quarters, spanning almost two years. There is no contractual obligation that drives equities back to their fundamental value.

Mr. Ford highlighted an important concept to understand is the impact that negative returns can have on the investment program, even if the losses are not realized. Compounding works against a portfolio on the way down. He gave the example that if 20% of the assets are lost, it will take a 25% investment return to reach back even with the original investment amount. If 50% of the assets are lost, it will take a 100% investment return to reach back to even. This is why drawdown consideration and mitigation is important.

Ms. MacKinnon asked if it is fair to assume that Mr. Ford's division at Callan has expertise in and is involved with retirement funds and other organizations that need to maintain their asset base. Mr. Ford agreed. Ms. MacKinnon asked how AIDEA's portfolio's asset allocation of 100% in fixed income compares with most of the other organizations' asset allocation. Mr. Ford commented that the organizations with retirement funds are very different because they have a long-term actuarially determined return target that they need to reach to fund those future obligations. They have to take on risk in order to achieve the long-term return. Mr. Ford noted that working capital or a reserve pool that is used to fund projects does not have to strive to reach a specific return target. Instead, the portfolio is attempting to protect the purchasing power and have it grow safely through time on a real basis in order to fund projects. These differences cause the asset allocation of the two portfolios to look significantly different due to risk.

Chair Pruhs asked if the risk AIDEA takes is in the project side. Mr. Neff agreed. Chair Pruhs asked if that side of the ledger will be discussed at a later point. Mr. Neff concurred, and noted AIDEA's portfolio is very different than the Alaska Permanent Fund or any other State pension fund's portfolio allocation because they are investing to meet the critical liabilities. AIDEA is investing the pool of capital to preserve and to provide a level of risk-adjusted return in order to take the risk back into the Alaska market through AIDEA's programs and statutes.

Mr. Weitzner explained for the public that AIDEA, through discussions with the Senate Finance and House Finance Committees, has generally approached and defined its asset base with three distinct areas. The first area is the commercial finance programs, which are predominantly the loan participations that contain about $460 million in net asset base. These have been impacted by modification issues on their income from the Covid-19 pandemic. The second area is the investments that are directly in the projects, which is about $500 million in net asset base. Some of those asset investments are being administered by AIDEA and are not returning funds. The third area is the pool of assets which are defined as the capital reserve, which is about $399 million. These are the aggregate returns from the projects that are held for future investments in projects solely within Alaska.

Chair Pruhs asked for the amount of committed capital within the $399 million of capital reserve. Mr. Weitzner noted that part of the $80.5 million funds discussed earlier is the short-term capital in place. Part of that is related to certain bonding requirements held and reserve funds. Mr. Weitzner stated that AIDEA does keep a large portion as liquid and available. Some of the funds are held with external money managers. Mr. Weitzner asked Mr. Neff to provide the level of investment with external money managers. Mr. Neff asked Mr. Ford to give the most recent balances of the two managers. Mr. Ford indicated that the amounts at the end of the second quarter were approximately $380 million, of which $187 million is with Alaska Permanent

Capital and $194 million is with Barrow Hanley. Mr. Weitzner indicated all of the information is included and delineated on the website in the FY2020 financial statements.

Chair Pruhs gave the analogy that these investments are one leg of AIDEA's three-legged portfolio stool. Mr. Weitzner agreed. Chair Pruhs encouraged that the presentation keeps moving because all three legs will be discussed during today's meeting.

Ms. MacKinnon asked the question again to Mr. Ford regarding how AIDEA's asset allocation and management in this leg of the portfolio compare to other similar types of organizations, and do those other similar types of organizations contain 100% fixed income or do they have a fixed income and equity asset mix. Mr. Ford informed that AIDEA is similar to other portfolios with the same mission and purpose. He stated one difference is loosening investment guidelines to permit not investing in certain grades of fixed income. Mr. Ford stated that AIDEA is generally in line with other similar organizations.

Mr. Ford explained the graphic on Slide 9 highlights the best performers each year in the three categories; net-of-fee returns, risk, and Sharpe Ratio. The combination of AIDEA's external managers has resulted in a superior Sharpe Ratio more than half the time over the last 15 years. The environment has been unusual due to the incredible bull market over the last decade. The separate managed accounts (SMA) enable AIDEA a degree of customization that would not be available in a comingled pool of funds.

Mr. Neff inquired if the SMAs are held in AIDEA's name at a custodian and AIDEA owns the underlying securities. Mr. Ford agreed that because it is an SMA, AIDEA owns the securities and can liquidate or transfer the securities at any time. Mr. Neff discussed the next slide, which reflects the correlation matrix measuring the relationship between asset classes. He explained that a portfolio mix should include uncorrelated asset classes, especially in review of the placement of the risk-associated capital. The S&P 500 and Barclays US Aggregate are correlated against categories, including AK GDP, AK Govt GDP, and Crude. The matrix shows that as Alaska's GDP is performing poorly, the Barclays Aggregate tends to perform better. This is an inverse relationship and is identified as an uncorrelated component of proper diversification.

Ms. Sande expressed appreciation for the presentation and noted that her background is not in finance. She asked if it is possible for Mr. Neff and Mr. Ford to present and summarize the slides for the general public's understanding in the most simplistic way. Mr. Neff agreed. He explained that Slide 10 is showing how the Barclays US Aggregate, which is representative of AIDEA's portfolio, and the S&P 500 behave from a correlation standpoint with Alaska's GDP, which is Alaska's economy. In looking for proper portfolio diversification, it is important to ensure that the investments are uncorrelated, which means they do not behave the same at the same time.

Mr. Ford described the graphic on Slide 11 shows the back-tested results of the investment earnings through time, considering the previous asset allocation mixes. Since 2005, AIDEA's external managers have delivered about $240 million of investment earnings either as increased market value or withdrawal amounts. Over the same period of time, the hypothetical blended portfolios with increasing equity exposure would have delivered more earnings, with the exceptions of the years 2008 and 2018. Mr. Ford noted that the blended portfolios also had to take on more risk. AIDEA has to determine whether or not it is appropriate to assume additional risk, given the obligations and projects AIDEA has to fund.

Mr. Ford discussed that although investment earnings cumulatively increase as equity is added to the portfolio, there are years when that is not the result, as in 2008 and 2018. He noted that these losses may be unrealized and could be earned back, but if the portfolio has to sell during those declines, then the losses are made permanent.

Mr. Neff requested additional explanation regarding the scenarios of how quickly portfolios can recover depending on the asset mix. Mr. Ford explained that AIDEA's fixed income managers have rarely delivered a calendar year with negative performance and are investing in bonds that pay interest. This is a big component of their return. The securities are core investments that generate income and boost the return, even when markets are selling off or are stressed.

Mr. Fogle asked how many years since 2005 has AIDEA drawn from this account. Mr. Weitzner stated that every year AIDEA has drawn a portion of this allocation to fund what the Board has approved for capital investments, but it is not usually quantifiable. The dividends get declared and paid. The $50 million investment into Mustang for the production facility in 2014 was an allocation and AIDEA made a designation to the external managers to set aside a certain amount of funds to make available. Mr. Weitzner explained that management reviews the different projects and gives the information to the Board to identify and set aside capital for that particular year. He noted that he cannot say that there is a specific average amount every year for funding projects.

Mr. Fogle asked if there is a future forecast of estimated amounts of funding that will be needed. Mr. Weitzner explained that staff gives indication of the number of projects within the development project pipeline report. At this point in time, there are 14 projects that could have investments of up to $1 billion. Mr. Fogle asked if the Board should be taking that $1 billion figure into account when deciding the asset allocation for investments. Mr. Weitzner discussed that not all of those projects are going to come to fruition. Mr. Fogle asked if there is a target investment amount that should be used. Mr. Weitzner added that the initial forecast and when looking at the impact of the Covid-19 pandemic, the scenario used was an average of $25 million to $50 million in funding per year for new projects.

Ms. MacKinnon reflected on past comments of the Chair regarding that Red Dog has a specific lifetime of generating income for AIDEA. She believes that consideration has to be given to the larger amount of money, and while it may have sat underutilized for the last 20 years, AIDEA now has to look long-term at the end date on the Red Dog contract. AIDEA has been looking for opportunities to replace that income. She commented that this exercise is an excellent tool to engage Alaskans to understand that AIDEA is very complex in efforts to achieve returns that are invested into Alaska. This is attained in three different interconnected ways. This piece is one component of that connection. Ms. MacKinnon added that she still has questions regarding the fees that are being paid to the external managers and whether or not the same type of performance results could be achieved elsewhere for a lower cost. She noted that the conversation may provide leverage in future negotiations with external managers to drive down the management fee.

Mr. Neff indicated that discussions will occur later in the meeting describing how AIDEA is moving away from the procurement style of engagement with external managers and into the more industry standard investment management agreement, which will open the dialog regarding considerations for fee reduction. Mr. Weitzner added that the Investment Manager's Agreement is included as one of the documents for this work session. He stated that Mr. Neff's background provides insight to the ways that the specific agreements with the external managers can be adjusted and that changes can be proposed.

Mr. Weitzner highlighted that Slide 11 shows that AIDEA has been a very good steward of the capital that was initially given by the State of Alaska. AIDEA has been looking at a fairly conservative investment approach and has maintained the capital for future investment and ongoing needs. There are continuing expectations of future projects that will be drawn from this capital. AIDEA has its specific mission and the investment analysis shows that AIDEA is managing its funds to achieve that mission.

Mr. Ford continued the presentation and showed a graphic that reiterated different points in time when fixed income portfolios delivered safety when the equity markets sold off. He understands that the mindset and foundation of the AIDEA investment policy containing 100% fixed income asset allocation may have lower returns than an equity allocation, but that the capital will be protected when markets sell off.

Mr. Neff indicated that the next two portions of the presentation will cover capital market assumptions and a hypothetical analysis. Mr. Ford discussed the graphic on Slide 14 shows the link between risk and return. As the expected return increases, the expected risk increases. He discussed a graphic that shows different asset allocations in 1991, 2006, and 2021 that are needed to achieve a 5% real return. The forward expectations of returns have decreased over time and portfolios have become more risky and more complex in order to meet the same return target.

Mr. Neff highlighted that the list shown on Slide 17 was generated internally by AIDEA and provided to Callan to perform the analysis shown on subsequent slides in the presentation. The list is non-exhaustive, but it is a good representation of companies that AIDEA has identified that have provided commentary or have outlined business practices or policies against Arctic drilling and development. Mr. Weitzner informed that this is responsive to the request from the previous Board meeting. Mr. Ford discussed the portfolio holdings of Barrow Hanley and Alaska Permanent Capital Management include corporate credit investments of banks. He noted that it is typically the banks that are found on AIDEA's restricted list. Approximately 7% of AIDEA's portfolio with Barrow Hanley is with 12 companies on the restricted list. These holdings total about $13.4 million.

Mr. Ford showed a hypothetical analysis of the results if those securities were excluded from the Barrow Hanley portfolio. Over the one-year period of time, the portfolio would have added 12 basis points in return. Over the three-year period of time, the portfolio would have added eight basis points in return. Mr. Ford commented that this is not a significant difference and the elimination of these holdings would not have harmed the portfolio. He discussed that going forward, there may be periods of time where banks will drive performance and will contribute to excess return. The results are dependent on the interest rate environment. Mr. Ford noted that discussions occurred with Barrow Hanley and it is possible for AIDEA to exclude the particular securities form their SMA. Barrow Hanley would then reinvest that portion across different credit sectors, perhaps including banks that are not on the restricted list.

Mr. Ford discussed that AIDEA's Alaska Permanent Capital Management account has identified seven banks securities on the restricted companies list, which is about 5.7% of the portfolio, totaling $10.5 million. The analysis of the attribution of these securities showed that they helped the performance by six basis points since the time of purchase. Mr. Ford noted that discussions occurred with Alaska Permanent Capital Management and it is possible for AIDEA to exclude the particular securities from their SMA. There were no questions. A brief at-ease was taken.

Mr. Neff continued the presentation. He expressed appreciation to Mr. Ford for his participation. Mr. Neff noted that the next section of discussion includes the red-lined version of the existing investment policy.

Ms. MacKinnon thanked Mr. Ford for Callan's presentation. She reiterated that many months ago during a financial review, the Board asked the question of Callan regarding which companies are within AIDEA's portfolios that no longer invest in Arctic oil and gas projects. She inquired of the Board if it would be helpful to request staff provide their perspective on the impacts and effects to the portfolio that would occur if AIDEA no longer invests in those companies. Mr. Neff explained that the analysis that Callan performed and presented is the answer to that request. He noted that additional discussion would need to occur with Department of Law as to whether or not the restrictions are able to be implemented.

Mr. Neff requested that Stefan Saldanha, Department of Law, provide additional comments. Mr. Saldanha explained that these portfolios are subject to the prudent investor rules. AIDEA has a fiduciary duty to manage the portfolio. Any restricted lists would have to be taken into consideration during the analysis. There could be a legal analysis and there could also be an analysis of the economic impacts from the oil and gas policies on Alaska's economy or maybe even the State government's budget.

Chair Pruhs requested that a legal analysis and an economic analysis be performed. There were no additional questions.

Mr. Neff continued the presentation and focused on the Investment Policy Statement. He explained that staff redesigned some of the characteristics of the existing Investment Policy Statement in order to give the portfolio and the external managers the ability to invest in securities that could help drive stronger risk-adjusted returns.

Chair Pruhs asked for clarification as to what document Mr. Neff is referencing. Mr. Neff indicated that Board members have been provided a separate document entitled Investment Policy Statement, Investment Policy for Outside Advisor. Mr. Neff reviewed the changes. He highlighted that the changes include replacing the word "contracts" with "Investment Management Agreement." At the bottom of page one, the change potentially allows for the credit quality of the portfolio's investments to be lowered on the rating spectrum in order to incorporate more yield associated with the asset class. The revision includes the higher part of the high yield market, instead of limiting the investments at the investment grade level. The weighted average credit quality of the portfolio will continue to be investment grade. Mr. Neff explained that the additional changes in the document define the new securities, describe how the average weighted quality of the portfolio should be reviewed, and outline the instructions for the underlying managers if the average weighted quality of the investments fall below investment grade.

Chair Pruhs asked if staff is proposing the draft to consider at a Board meeting. Mr. Neff agreed. Chair Pruhs suggested that Board members direct any questions to Mr. Neff. He anticipates that this consideration will be presented at the next Board meeting.

The question was asked regarding the method staff used to determine that benefits of BB- and BBB- credit quality. Mr. Neff informed that BB- represents the highest end of the high yield market. These are typically companies that are on the verge of investment grade, but are generating much higher yields from an investment perspective. The intent is to keep the investment quality high while obtaining more returns on a risk-adjusted basis. Mr. Neff discussed that duration is a measure of interest rate sensitivity to the portfolio. The fixed income portfolio has credit risk and interest rate risk. The credit risk of the portfolio is mitigated because of the high quality, which leaves interest rate risk. An additional proposal for the Board's consideration is ensuring the portfolio can benefit from a shorter duration in order to limit the long-term interest rate sensitivity.

Mr. Neff discussed that another proposal for the Board's review is moving from a contract engagement with the external managers to an investment management services agreement. Staff used some of the Alaskan sovereign wealth and pension fund investment management agreements as a guideline and foundation to the document. Mr. Neff noted that staff and the Department of Law have reviewed the document for the Board to consider as a step forward into migrating to an investment management services agreement and away from the current contractual arrangements.

Chair Pruhs asked if this agreement is through the procurement side. Mr. Neff agreed. Chair Pruhs noted that it would not need a Board action. Mr. Neff indicated that he is highlighting the information for the Board.

Ms. MacKinnon asked if Alaska's procurement code allows for AIDEA to make these recommended changes. She noted that Mr. Saldanha was nodding his head in agreement. She requested that Mr. Neff state the confirmation verbally. Mr. Neff agreed that he has discussed this arrangement with the Department of Law, specifically relating to AIDEA's procurement policy and Department of Law advised that it is something that AIDEA can move forward with. Ms. MacKinnon asked if the desire is to reduce the fees and to improve returns for Alaskans and AIDEA in order to continue to invest in Alaska. Mr. Neff agreed and noted that this will also give AIDEA the utmost flexibility in manager selection, retention and termination in order to benefit the long-term performance of the portfolio, as well as to benefit relationships with future external managers.

Mr. Neff concluded the prepared presentation by thanking the Board members. Chair Pruhs inquired as to today's reports on AIDEA's projects and AIDEA's loans. Mr. Neff requested to take a brief at-ease. There was no objection.

During the break, staff posted online for the public the document entitled "10-Year Development Project Asset Investments," and provided the document to Board members. Mr. Weitzner informed that this is the same information that has been provided previously to both the Senate and House Finance Committees under their request for AIDEA's 10-year investments in development project assets. He noted that additional information was provided to both Committees on the 10-year information for the Loan Participation Program.

Chair Pruhs commented that staff will first discuss AIDEA's projects and then discuss AIDEA's loan participation, in general. He noted that there is particular information regarding the loans that AIDEA cannot disclose to the public. Chair Pruhs advised that no discussion occurred during the break while the information was being uploaded to the website for the public. He requested that Mr. Weitzner begin review of the "10-Year Development Project Asset Investments" document.

Mr. Weitzner noted that this information is based upon a previous request regarding AIDEA's 10-year investments. The table provided lists the total asset base for direct project investments within the state of Alaska year-by-year from FY2011 through FY2020. This is under the programs of 44.88.172, the Economic Development Account, SETS, and Arctic Structure Development Fund. The information does not include the Enterprise Development Account, which is for the consumer finance loans. The 10-year progression of the asset base has grown from $383 million to $480 million. This is not representative of the total investment made in projects, but is reflective of the aggregate value after depreciation and amortization outlined in the financial statements.

Mr. Weitzner discussed the different changes that have occurred and are shown within the document. He walked through the example of MOC 1, LLC under the Investment in Preferred Interest in Operating Company heading until FY2018, after which point it is converted into a loan project and is shown under the heading Revolving Loan Fund Development Project-Loans. Mr. Weitzner indicated that in FY2021, it will move under another heading due to the foreclosure. Some of the assets undergo fluctuations between the types of investment in which they are categorized. They can move from an owned asset to a loan asset to a lease asset. Mr. Weitzner described the capital assets are AIDEA's direct investments in hard assets, including the Skagway Ore Terminal, the Healy Project, Ketchikan Shipyard, AIDEA's administration building, and Pentex. Overall, AIDEA is experiencing a continued growth in the underlying asset base direct investments, net of depreciation, amortization, divestitures, and acquisitions.

Chair Pruhs asked for the size of AIDEA's office building. Mr. Weitzner believes the building is 30,000 square feet, but will have to confirm and report back. Chair Pruhs asked if the replacement value of the building would be approximately $10 million. Mr. Weitzner discussed that staff has undertaken an assessment in the previous year, per the Board's direction, and he does not recall the valuation directly. He will report back with the information.

Mr. Fogle asked for the rate of return for AIDEA's externally managed investments for the past 10 years. Mr. Neff noted the 10-year annualized rate of return was not included within the prepared documents. He will provide the information. Mr. Fogle asked if Mr. Neff could provide an estimate today of the 10-year investment return and an estimate of the 10-year loan portfolio return.

Mr. Weitzner discussed that he believes the loan portfolio averages approximately 4.5%. The long-term fixed rate that AIDEA provides under the Loan Participation Program is based upon and benchmarked against the Federal Home Loan Band of Des Moines. The cost of operations is included in the calculation. He explained that as the 25-year US Treasury securities' rate of return has decreased, so has AIDEA's rate of return decreased because it is fixed to that rate. AIDEA's current fixed rate is about 3.55%. This reflects the blended rate in the Loan Participation Program portfolio of $460 million. The duration of the portfolio is approximately seven to 10 years.

Mr. Fogle asked if staff has recently conducted an analysis of the cost of operations. Mr. Weitzner agreed and noted that Mr. Neff completed the analysis. The information was published with the most recent benchmark for the Loan Participation Program and is approximately 20 basis points. Mr. Fogle requested that information is provided to the Board. Mr. Weitzner agreed. The March 2021 report indicates that the average rate of return of the total externally managed funds for five years is 2.8%, and for three years is 4.2%. Mr. Fogle asked how those returns compare with AIDEA's other legs of the total portfolio. Mr. Weitzner noted that he does not have the information in this specific report, but can provide the information.

Chair Pruhs commented that he hopes someone is taking notes regarding Mr. Fogle's requests.

Ms. MacKinnon believes that Mr. Fogle's questions are valuable with respect to a comparison analysis. She highlighted that the Board should not expect similar returns on different portfolios that carry different risks. Ms. MacKinnon wanted to be clear for the public that as the Board is reviewing the comparisons, it is for informational purposes to look deeper than the numbers, rather than determining that a low return is bad. Mr. Fogle agreed, and believes that additional discussion can include which legs of the portfolio are more risky and what weight should be given to each leg based on the level of risk.

Ms. Sande commented that she has read through previous AIDEA Board minutes from the last 10 years. This has helped her gain perspective of the different Boards and how they wrangled with the same conversation. Ms. Sande highlighted that the issues are complex. She hopes that members of the public will understand and appreciate these complexities, as the Board recognizes its mission to maximize the benefits to Alaskans and maintain funds for future projects and generations. Ms. Sande discussed that in her review of past minutes, she noticed that there seemed to be an emphasis on keeping one leg of the portfolio stool, the outside investment managers, secure and stable. She believes this was to mitigate the fluctuations that are expected with the other two legs of the portfolio; projects and loan participation. Ms. Sande feels this is a perfect year to discuss the variables with the loan participation since many of the loans are in distress due to the unexpected pandemic that has impacted everyone. She commented that the review of the past minutes provided her with perspective and assurance regarding previous policies and decisions to maintain secure investments in this leg of the portfolio, rather than take a more aggressive stance in the equity market.

Chair Pruhs gave the example that it may be challenging to have a certain rate of return within the projects leg of the portfolio stool because part of the mission is long-term employment. Every project stands on its own, and as Alaska benefits more and more from the project through long-term employment, the ability increases to reduce the cost of the projects through interest rates and direct participation. Chair Pruhs discussed that unexpected happenings could occur that could skew the risk portfolio in the projects leg. He commented that there is limited capacity to focus of different things. He views the investment leg of the portfolio stool as an area that he does not have to worry about as much because the attention is on the opportunities coming before staff and the Board. Much time is spent understanding the risks and the benefits of the opportunities, and what role AIDEA can play. Chair Pruhs noted the connection between resource allocation and risk management. He commented that today's rate of return or risk profile may be completely different in 18 months because of a couple of projects presented and AIDEA may be asked to take more risk. Chair Pruhs stated that he is not proposing a policy, but he is commenting on how he looks at opportunities when they are presented.

Ms. MacKinnon agreed with the Chair Pruhs' comments. She reflected on the slide presented by Callan showing an example of potential lost opportunity on the investments in the portfolio. Ms. MacKinnon discussed the option of having a third-party review all three portfolio categories to ensure that appropriate risk is being taken in each of the categories. She noted that Callan is overseeing the investment category of the portfolio to ensure the assets are staying in line with protection of the resource, which will be deployed in the future in Alaska. This direction is very different from the missions of the Permanent Fund Corporation, Alaska Railroad, or Alaska Housing Finance. AIDEA's focus is about business and economic opportunity. Ms. MacKinnon supports the suggestion of retaining a third-party to review all of AIDEA's portfolio components and provide advice and expertise.

Ms. MacKinnon discussed that the components of the portfolio include investment opportunities and revenue streams. She believes the portfolio has grown substantially because of the preservation of capital in the investments and the risk taken in the revenue streams. She asked if there is a calculation that can be used to determine the amount of equity risk that can be taken in the investment portfolio to mitigate the effects of inflation.

Mr. Weitzner commented that Mr. Neff discussed correlation between different indices and AIDEA's whole portfolio. Because Alaska is a resource-heavy state and because AIDEA invests specifically and only in Alaska, there is an inherent benefit to the extent that there is inflation. The benefit is felt by Alaska's principal businesses that are within the communities and the economy, and is therefore a benefit to AIDEA's Loan Participation Program and the utilization of AIDEA's commercial real estate sector and space.

Chair Pruhs gave the example that inflation that increases the price of oil benefits the state. Mr. Weitzner noted that mineral development benefits the state and benefits shipping and logistics within the state. He discussed that the downside is that there may be lower returns for Treasury securities.

Mr. Neff commented on the importance to review how equities have responded within the particular inflation and interest rate environment. Equities have been performing well during the downward trend of interest rates and benign inflation. Typically, inflation has a negative effect on equities. Mr. Neff discussed that going forward, the projections are that equities, at a 5% real return, show a 2.5 times historical risk, based on the historical volatility and the underlying interest rate environment. Mr. Neff noted that if inflation occurs for the right reason of an improving economic backdrop, then the State benefits. He discussed that the inflation that is occurring now in real estate and automobiles is transitory and does not tend to align with the economic backdrop.

Mr. Weitzner discussed that in the type of inflationary environment that improves Alaska's economy, the anticipation is that there is a larger need for AIDEA's investment into Alaska because that suggests that other private capital parties are expanding their operation and needing investments. This would result in an increased need to draw on the capital reserves and is a scenario that should be planned for.

Ms. MacKinnon concurred with and understood the previous comments. She reiterated the question regarding if there is an opportunity to take additional risk above a certain amount of dollars based on a formula that would relate to the other two portfolio revenue streams. Ms. MacKinnon provided a hypothetical scenario of a total of $900 million in asset revenue streams that was comprised of $300 million in investments, $300 million in projects, and $300 million in loan participation. She asked if the $300 million in the investment stream is the appropriate amount to weight against the risk of the other two asset streams. She asked if there was a formula in AIDEA's investment policy that would create additional opportunity under the investment stream, or does AIDEA believe that whatever the deposits can be each year is the right amount. She inquired if the policy AIDEA has enacted over the last 30 years is still supported. Ms. MacKinnon asked if AIDEA is holding the investment portfolio amount in a correct proportion compared to the other two portfolio legs. She requested additional information regarding whether or not the proportion has changed over the years, and if further review of the percentages should be studied to determine if the diversification of the investments should be altered.

Chair Pruhs suggested that the request should be to ask for the pros and cons.

Mr. Weitzner discussed that AIDEA determines and declares a dividend to the State's unrestricted general fund every year. Ms. MacKinnon noted the importance of reminding the public about how much AIDEA has paid in dividends to the State of Alaska. Mr. Weitzner informed that the dividend statute was enacted in 1997, and since then, AIDEA has declared and contributed close to $440 million in dividends to the State's unrestricted general fund. The declared dividend is paid over the following fiscal year in quarterly amounts.

Mr. Weitzner informed that each year when AIDEA declares the dividend to the State, the discussion regarding the correct level of asset allocation is undertaken. AIDEA provides a statement to the Legislature by January 10, following the declaration of the dividend, which gives that full basis and analysis of the assets for the future mission. Mr. Weitzner highlighted that the discussion will occur again in December.

Ms. Sande expressed the value of Ms. MacKinnon's comments and believes that one aspect that was not included in those discussions in the 1990's was the $82 billion in the Permanent Fund Dividend. This is very separate from AIDEA's mission and is another asset for Alaskans that was not there before. Ms. Sande expressed understanding that one reason AIDEA wants to keep the investment piece of the portfolio secure is to have money in reserve to be able to act and act quickly when investments arise that could benefit Alaskans, as AIDEA has done in the past and hopes to continue in the future. Ms. Sande discussed Chair Pruhs' point about a third-party evaluation and noted that perhaps an outside person would have a better perspective to evaluate and make an independent recommendation, rather than AIDEA staff or the Board members, who are immersed in the daily operations.

Chair Pruhs articulated his opinion that as the portfolio gets bigger, it is nice to have another set of eyes to review the three different legs of the portfolio. He requested staff discuss this option and report back to the Board highlighting the pros and cons for consideration and whether or not it makes sense to engage a third-party to ensure that AIDEA is not missing valuable opportunities for the organization.

Mr. Weitzner informed that included in the documentation provided to the Board for today's work session, are staff's recommended changes to the Investment Management Agreement regarding the contractual engagement with external managers, and staff's recommended changes to the Investment Policy. He discussed that the previous time that AIDEA's Board has reviewed the Investment Policy was when the fixed income investment policies were established with Resolution G01-14D in 2001. Mr. Weitzner agreed it is time to reexamine the definition of AIDEA's risk profile, while maintaining a conservative approach and conservative stewardship to the available capital reserve. He stated that AIDEA is a conservatively managed organization in the standpoint in how AIDEA is very good stewards of the capital and the investments that are made in Alaska.

Mr. Weitzner discussed that AIDEA has always recognized a net profit in the operations and profitable operations before expenses. This is in large contrast to what is seen in other development finance authorities and their missions. AIDEA has performed very well on that point and has been able to accumulate capital with its methods and processes. Mr. Weitzner noted that staff recommends adjusting the risk profile within the fixed income portion of the portfolio through the submitted amendments. He indicated that the original guideline was set at a conservative average weighting of AA across the portfolio. Staff believes that higher returns can be achieved without taking larger incremental risk by keeping with investment grade standards and averaging a BBB or BBB- across the portfolio.

Mr. Neff expressed his understanding that Chair Pruhs is requesting staff to review the current Investment Policy Statement and come back before the Board with any additional comments or questions. Mr. Neff reiterated the recommended changes that Mr. Weitzner highlighted. He added that the credit risk associated with those Investment Policy amendments is offset by the reduction in interest rate risk. This provides the ability to generate better returns on a risk adjusted basis.

Chair Pruhs requested additional discussion regarding AIDEA's dividend. He noted that the statute allows AIDEA to provide a dividend of 25% to 50% of the net profits. AIDEA is given the latitude to decide what percentage within that range will be the dividend amount. The decision is based on many factors, including the conditions of the day and the conditions of the State's finances. Through dividends, AIDEA has paid back the seed money that was given to AIDEA. Chair Pruhs discussed the option of providing a 25% dividend to the State since the seed money has been returned. The extra amount can then be deployed to investments in Alaska. He noted that this scenario depends on the conditions of the day, the price of oil, and other factors. He requested that the Board consider and discuss this option, regardless of the outside pressures. Chair Pruhs noted that the discussion includes the value of the portfolio. He reiterated the importance of having the discussion.

Ms. MacKinnon offered another perspective of what the Legislature might perceive regarding AIDEA and dividends. Just because the seed money has been returned to the State does not mean that the State does not still expect AIDEA to perform in return. It is not likened to owning a house or selling a house. The investment was made early and continued return is expected. AIDEA would not be in existence if the State had not established it. AIDEA has done an incredible job at returning the assets to the State. The State's legislators and governors have done a good job in letting AIDEA function and stand alone.

Ms. MacKinnon commented that there are assets under AIDEA's control that were installed by the State as the originator of AIDEA, including Bradley Lake, Ketchikan Shipyard, and the ore facility. She agreed that discussions should occur regarding what percentage between 25% and 50% should be returned as dividends to the State and that discussion will include the current economic conditions. She gave the example the she does not believe that AIDEA's dividend is as important to the State when oil prices are at $120 per barrel, compared to when oil prices are $40 per barrel and the State is running a billion dollars' worth of net losses.

Chair Pruhs commented that as a Board member, he has seen AIDEA declare dividends within the entire range from 25% through 50%. Each declaration had a different rationale for its percentage.

Ms. MacKinnon requested additional information from staff's perspective on the Investment Policy and why staff believes it is appropriate to manage liquidity by maintaining two years' worth of operational reserves and $80 million at the Municipal League. She mentioned that she does not know what types of investments are utilized at the Municipal League. Ms. MacKinnon asked for further explanation why the proposed rating from AA to BB- investments is the only adjustment recommended and if other beneficial investment modifications have been discussed with Callan. Mr. Neff informed that no additional discussions with Callan have occurred and that the issues would first be addressed with the AIDEA Board.

Ms. MacKinnon asked Mr. Neff to comment on the reasoning that two years' worth of operational capital is the right amount of cash to hold. Mr. Neff requested additional time to provide a response to the Board. Mr. Weitzner explained that the two-year amount was the internal policy established by the former Chief Financial Officer and has been maintained for this fiscal year. The amount reflects a level of comfort regarding liquidity issues within the organization. Mr. Weitzner informed that a new Chief Financial Officer, Dona Keppers, has joined staff and will be reviewing the two-year policy. Staff will provide more precise feedback regarding the reasons for the level of short-term liquidity. Mr. Weitzner understands that the amount is for immediate liquidity that could be used over the course of a year. He noted that the two-year amount was previous policy and he does not know the specific reason for the amount.

Ms. Sande responded to Chair Pruhs' comments regarding the dividend amount. She informed that she reviewed AS 44.88.088, which discussed the Legislature's intent related to the dividend program was meant for the financial integrity of AIDEA to remain secure so that the Authority can continue to fulfill its vital economic development mission for the State. The years that AIDEA moves forward and is unable to have the cash on hand to fulfill the mission, it is good to have the opportunity to pay less than 50% of the revenue as a dividend.

Chair Pruhs commented that a fundamental change that has occurred since the dividend requirement was established, is the substantial increase in the cost of project development. He gave the example of a $20 million project in 1997 could be an $80 million investment today. Chair Pruhs expressed that he is a proponent of building the balance sheet because when the opportunity arises and AIDEA does not have the balance sheet to participate or the opportunity is too big of a percentage of the balance sheet to participate, it will not take very long for projects to dismiss AIDEA as not having the funds or requirements to participate.

Chair Pruhs noted that he cannot expect the governor or the Legislature to inject additional liquidity, unless there is a specific supported project like Ambler where the State was investing in Roads to Resources. The cost of doing business has increased due to a variety of reasons, including products, studies, environmental reviews, and inflation. Chair Pruhs stated that he is not a proponent of a 25% dividend due to the current conditions. He thinks that from a long-term view and strategy standpoint, the Board needs to create a policy so that staff can do the best they can with the tools given.

Ms. Sande expressed the importance of building the balance sheet and discussing the work that is entailed. She communicated that each time she works with staff and with the Board, she feels a sense of pride as an Alaskan and as a representative of AIDEA whose work is conducted on behalf of Alaskans. Ms. Sande noted that she felt especially proud when she reviewed past Board minutes, year after year, showing how Alaskan communities have come together to work on behalf of Alaskans. She highlighted that AIDEA has supported its operating expenses through its revenue in addition to providing benefits to Alaskans through dividends, the loan participation program, and supporting jobs and businesses.

Chair Pruhs commented that he does not feel that 100% of the focus should be on the dollar amount because it is just as important that people have been employed because of the investments made.

Ms. Sande discussed that she believes when people are critical of AIDEA and call it a State agency, that it is important to make the distinction that the Legislature was very clear in statute to separate AIDEA from the State. The revenue and funds of AIDEA are meant to be separate from the State of Alaska in the same way that AIDEA's liabilities are not the State's liabilities. She is impressed with AIDEA's team.

Mr. Fogle wanted to recap what he is requesting from this meeting. His understanding of the three legs of the portfolio stool is that the investments are the least risky, the loan section is the next level of risk, and the project section is the riskiest leg of the portfolio. Mr. Fogle requested that staff develop a strategic plan that outlines the risk tolerance for each leg of the portfolio, the desired rate of return for each leg of the portfolio, and a design for implementation. He noted that currently the return for loans and projects are approximately the same, but projects are riskier and should have a higher upside return relative to the risk. Mr. Fogle noted that staff can follow-up with the BAS Committee on the strategic plan and ways to move forward without the loss of opportunity costs.

Mr. Weitzner agreed to follow-up on Mr. Fogle's request. He clarified that the private capital sources coinvesting with AIDEA in Alaska are achieving the benchmark returns that are sought for infrastructure development. Alaska is no different in needing to address its unique local investment issues. Mr. Weitzner noted that the broader portfolio includes several assets that AIDEA has been tasked with managing from a fiduciary position that may not have the same types of returns. Mr. Weitzner agreed that the Investment Policy that was established in 2001 and needs to be updated.

Mr. Weitzner asked if the approach can include engagement on the Investment Policy, not exclusively for the external money managers, but looking at ways to define components of investments that are to be handled by external managers and other components. Additionally, staff would make recommendations that direct investment assets with a higher risk profile would ultimately have a higher return requirement. Staff would recommend definitions of the risk parameters for the other portfolios as well.

Ms. MacKinnon inquired as to the external money manager fees. Mr. Neff indicated that the blended rate for the externally managed capital on a dollars-out calculation is 16 basis points annually. The individual manager annual fee is 21 basis points for Barrow Hanley and 11 basis points for Alaska Permanent Capital. Ms. MacKinnon commented that Department of Revenue's fee last summer was at four basis points to manage that type of capital. She believes their fee has increased during the new fiscal year. Ms. MacKinnon believes that AIDEA is paying a higher price to the external managers for managing the money very conservatively, as opposed to having the money managed internally either with the Department of Revenue, McKinley Capital, or another entity. She requests that staff discuss the current fees in their review process and include a fee recommendation in the report and full recommendation to the Board.

Mr. Weitzner noted for the record that Alaska Permanent Capital, whose fee is at 11 basis points, is an Alaska-managed fund and is a benchmark for an Alaskan operation. Staff has not benchmarked anything with McKinley Capital. Ms. MacKinnon expressed appreciation for the clarification and believes that it is exceptional that Alaska is managing at a lower fee with similar returns. Mr. Neff informed that the two external managers have different returns and the fee schedule for Alaska Permanent Capital (APC) is lower because of the portfolio construction and the associated return scenario. Mr. Weitzner commented that there are incremental differences.

He noted that Ms. MacKinnon is correct in that there are not fundamental differences in the returns, but there are issues relative to duration and other components in the way that they are managed. Mr. Neff added that there has been an increase in return versus the two managers to justify the incremental fee base. He referenced an email provided by Ms. MacKinnon on June 7 where it appears that Barrow Hanley's net returns have exceeded APC by 1.58% on a one-year annualized basis, by 91 basis points on a three-year annualized basis, and by about 50 basis points on a five-year annualized basis. These returns are net of fees.

Ms. MacKinnon requested that staff and the Board review the reason Barrow Hanley's fees are higher. Mr. Neff commented that AIDEA's average fee is in an appropriate range, but he does believe there is an opportunity to have a discussion regarding reducing fees in the current interest rate environment. He noted that other components need to be considered when reviewing external investment managers, such as the availability of separately managed accounts or a pooled strategy. Ms. MacKinnon stated that the Department of Revenue has a variety of pooled investment options that are easily managed that staff can review as an option to the current strategy.

Mr. Fogle asked if there will be a monthly or quarterly update from staff on the progress of the Investment Policy, investment decisions and the strategy of the three-legged portfolio stool. Chair Pruhs believes that the discussion regarding the draft changes to the investment strategy for fixed income that were provided today will occur at the next Board meeting. He suggested that updates, including the fee structure evaluation, could occur on a quarterly basis, along with the current quarterly reports.

Mr. Weitzner expressed his understanding of some the issues that have been discussed today are issues that normally arise when staff is reviewing the assets to ultimately report and make recommendations to the Legislature. The ongoing discussion includes looking at the asset base, how investments are made, and the definition and utilization of additional capital.

Ms. MacKinnon commented that she believes that the money managers' contracts expired a year ago and were extended by a year. Mr. Neff indicated that AIDEA is currently on expiration with Barrow Hanley, which is why the Investment Management Agreement was presented. He believes the APC contract ends in October or November. Ms. MacKinnon discussed that staff provided an earlier document that was advisory. She asked if her understanding is correct that staff has the ability to go into the agreement versus coming before the Board for formal approval. Mr. Neff explained that the document was for informational purposes to ensure the Board understood that staff is moving forward in the direction outlined regarding the review of the procurement policies and the Investment Management Agreement. Ms. MacKinnon expressed support for the changes and believes they will benefit AIDEA. She hopes staff moves forward and is able to negotiate a deal with the external money managers that staff believes is beneficial to the organization as a whole.

Mr. Weitzner explained the benefits of the agreements provide AIDEA with considerably more flexibility.

Vice-Chair Karl expressed appreciation for the discussion and for all of the work that staff has conducted in considering options and providing information.

Commission Anderson echoed the comments. She believes this discussion is timely and she looks forward to seeing what staff has to present at the next Board meeting.

Chair Pruhs indicated that there will be policy action items at the next Board meeting. He hopes that the answers from today's questions can be disseminated to the Board members.

Ms. MacKinnon asked if the practice to evenly divide the investment assets between two different external portfolio managers is a policy, and if so, should that policy be reviewed. She commented that it may not be beneficial to the organization to maintain the 50/50 allocation of resources if there is a manager that is performing at a better level for a more reasonable rate. Mr. Neff agreed that suggestion needs to be part of the holistic review, especially considering staff's proposed amendments to the Investment Policy.

Mr. Fogle expressed appreciation to Mr. Neff for assembling the restricted list for the investments. He believes it is important for Alaskans. Mr. Fogle noted that Alaska was brought into the Union because of its resource development opportunities. He believes that as a financial arm in Alaska, AIDEA should be leading the charge to express that the big banks do not dictate what is done in Alaska. Mr. Fogle is in favor of adding the restricted list to the investment parameters that the external managers follow. Mr. Neff agreed to incorporate the restricted list into staff's analysis.

Ms. MacKinnon restated that AIDEA has requested the Department of Law to conduct a legal analysis of instituting the investment restricted list, in addition to the request for staff to conduct an economic analysis to understand the possible implications to the State.

Mr. Kendig commented that he looks forward to seeing the new contracts and will be paying attention to the fees.

7. DIRECTORS COMMENTS

7A. Next regularly scheduled AIDEA Board Meeting: Wednesday, September 22, 2021

Mr. Weitzner informed that the next regularly scheduled AIDEA Board meeting is Wednesday, September 22, 2021.

8. BOARD COMMENTS

Commissioner Anderson informed that she has a conflict on September 22, and will not attend the meeting.

Mr. Fogle indicated that he has a conflict on September 22, and will not attend the meeting.

Chair Pruhs requested that Mr. Weitzner poll the Board to determine an alternative meeting date. Mr. Weitzner agreed to work with the Board to establish a day that keeps with the Wednesday schedule.

Chair Pruhs expressed his sincere appreciation to Board members and to staff for two days of hard work and good discussion. He looks forward to future discussions and decisions that support the aligned goal to benefit Alaskans. Chair Pruhs suggested that these robust work sessions on investment policy occur on a more frequent basis, perhaps every four years, rather than the previous 20-year span.

9. ADJOURNMENT

There being no further business of the Board, the AIDEA work session meeting adjourned at 12:11 pm.

Alan Weitzner, AIDEA Executive Director
Secretary