



Alaska Industrial Development and Export Authority

BOARD MEETING MINUTES

Wednesday, October 23, 2019

Anchorage, Alaska and Phoenix, Arizona

1. CALL TO ORDER

Chair Pruhs called the meeting of the Alaska Industrial Development and Export Authority to order on October 23, 2019, at 10:08 a.m. 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, Department of Commerce, Community, and Economic Development [DCCED]); Albert Fogle (Public Member); Bill Kendig (Public Member); Greg Samorajski (Deputy Commissioner, Department of Revenue [DOR]); and John Springsteen (Deputy Commissioner, DCCED) arrived at 3:00 p.m.

Members present via teleconference: Julie Sande (Public Member).

3. ROLL CALL: STAFF, PUBLIC

AIDEA Staff present: Tom Boutin (CEO/Executive Director); Curtis Thayer (Executive Director AEA); Chris Anderson (Commercial Finance Director); Brenda Applegate (Chief Financial Officer [CFO]); Mark Davis (Chief Infrastructure Development Officer); Alan Weitzner (Chief Investment Officer, Project Finance & Asset Management [PFAM]); Jen Bride (Financial Systems Analyst); Terence Cato (Information Systems Director); Yulia Ellsworth (Assistant CFO/Controller); Leona Hakala (Loan Officer); Geoffrey Johns (PFAM Investment Officer); Karsten Rodvik (External Affairs Officer); Jeff San Juan (Infrastructure Development Finance Officer); Lex Sargento (Chief Procurement and Contracting Officer); Linda Senn (Human Resources Director); Sam Tappen (Infrastructure Development Officer); Sherrie Siverson (Executive Assistant); Krin Kempainen (Administrative Assistant); and Aimee Sudbeck (Administrative Assistant).

Public present: Dan Britton and Steven Haagenon, (Interior Gas Utility [IGU]); Shawn Florio (HDR); Jerry Juday (Department of Law); Colby Lawrence (Gateway Hotel/Major Marine Tours); Ted Leonard and John Moosey (Mat-Su Borough); Sunny Morrison (Accu-Type Depositions); Thomas Tougas (Four Seasons Marine Svcs. Corp.).

Public present via teleconference: James Brooks (Alaska Daily News); Alex Ford and Gordon Weightman (Callan); Tim Redder (First National Bank of Alaska [FNBA]); Patrice Lee, Mike Miller, Pam Throop, and Gary Wilken (IGU); Cindy Cartledge (Jermain Dunnagan & Owens [JDO]); Alan Bailey (Petroleum News)

4. AGENDA APPROVAL

Tom Boutin requested Item 7D. Resolution No. G17-19A Approving a Navision System Upgrade with Server Upgrade be moved to after Item 7F. The agenda was approved as amended.

5. PUBLIC COMMENTS

There were no public comments.

6. PRIOR MINUTES - September 18, 2019

The minutes from September 18, 2019 were approved as presented.

7. NEW BUSINESS

7A. Presentation - Interior Gas Utility, Interior Energy Project

Mr. Boutin introduced Dan Britton and Steve Haagenson, and requested they provide the IGU presentation. Chair Pruhs expressed appreciation to all IGU representatives in attendance, especially former AIDEA Board member Gary Wilken. Mr. Britton explained the Interior Energy Project's (IEP) goals include bringing low cost energy to as many residents and businesses in Interior Alaska as quickly as possible, helping to stabilize the economy, and helping to improve air quality.

Mr. Britton provided a brief history of the project and the background of natural gas in Fairbanks since 1998. Currently, IGU is the single utility in Fairbanks. In 2013, SB23 was signed into law, which established the IEP and provided AIDEA with the financing package to develop the supply and delivery of additional natural gas supplies to the interior and expand the service capabilities. In 2015, the project was taken back to the Legislature for authorization to move away from liquefaction on the North Slope and back to the Cook Inlet as an option, at which time HB105 was signed into law. Pentex Alaska Natural Gas Company was purchased by AIDEA in 2015. IGU purchased Pentex from AIDEA in 2018. AIDEA subsequently approved the finance agreement and passed the project plan resolution allowing expenditure of additional funding and continued advancement of the project.

Mr. Britton explained Fairbanks does not have pipeline gas available. Liquefaction is the alternative that was chosen. The liquefied natural gas (LNG) facility in Point MacKenzie, Titan 1, has been in continuous operation since 1998. The current transportation fleet contains 17 specialized trailers. There are no pup trailers at this time. The trucks and drivers are contracted with Big State Logistics. IGU participated with Alaska Railroad on a pilot project to transport LNG in ISO containers. This option is potentially viable and will continue to be considered in the future as demand increases. Mr. Britton discussed the active work on two storage facilities upgrades in Fairbanks and North Pole.

Mr. Britton stated approximately 140 miles of new buried distribution pipeline was constructed in Fairbanks and North Pole. The pipes in Fairbanks are gasified and currently serve 1,150 customers. The pipes in North Pole are under nitrogen pressure and are awaiting the LNG facility. This is the first phase of the distribution expansion. Conversion to gas in North Pole will be a significant benefit to the air quality issue. Mr. Britton explained the processes of turning the LNG back into gas before it enters the buried distribution pipeline.

The customer conversion program will provide incentive and ease to the process to ensure a high level of demand on the system. The Borough has a federal clean airshed grant that contains a woodstove exchange program. The conversion of wood stove to natural gas is the priority in the program and provides the highest reduction in air emissions. The Borough recognizes the importance gas plays in combating the air quality issue and in the success of the IEP. The Borough is reviewing additional options to assist in conversion. IGU has not requested any new construction code changes in North Pole regarding furnace requirements be required.

Mr. Britton answered questions during the presentation. The IGU 20-year capital plan and proforma utilizes a study completed by AIDEA, which includes the base case of 35% of accessible customers will convert to natural gas within 10 years. The upper end base case considers a 50% customer conversion rate. Eielson Air Force Base currently receives its heat and power from a combined coal-fired facility. The military bases are likely to review conversions in the future. Fort Wainwright has just begun an EIS process for their combined heat and power plant. It will likely take five to 10 years for a decision to be made.

Mr. Britton provided an update on the status of the project. A front-end engineering and design (FEED) study has begun to expand the current Point Mackenzie LNG facility by an additional 100,000 gallons per day. RFPs were issued for the liquefaction, pretreatment, storage tanks, unloading racks and power generation. The level of interest was high. A notice of intent is expected to be issued soon. Previous analysis regarding the possibility of an expansion facility in Houston, Alaska, proved to be unsound and inoperative.

Mr. Britton explained the next stage is to take the project to a 65% engineering design to get to a plus/minus 10% on the budget. The decision will be made to either take the project to 100% engineering before contracting the work or to engage in a design build for the remaining piece. The feed work is scheduled to be completed by the end of 2019. Mr. Britton discussed the necessary ongoing financing needs to move forward with the liquefaction project.

Mr. Britton gave a detailed description of the construction of the double-walled 5.25 million-gallon capacity tank. The tank is expected to be in service prior to January 1, 2020 to qualify for State of Alaska storage tax credits of up to \$15 million for this project. The tax credits were established as part of the Cook Inlet Recovery Act and exploration incentives. The investment in the tank is approximately \$56 million. The tank allows for an additional 50% of customers to be added to service.

Mr. Britton showed and described pictures of the plant components, including the offload skid, the boil-off gas compressors, the vaporizers, and the multipurpose building. Time lapse videos of the tank construction can be found on the IEP website. Mr. Britton discussed the ground loop cooling system to maintain frozen ground for the life of the facility.

Mr. Britton continued the presentation reviewing the North Pole storage project of 150,000-gallon capacity. The purchase of 20 acres closed in September. Groundwork construction began October 1, 2019. The pad is being brought up to grade to be ready for construction in the spring. The site infrastructure work is out for bid contracting. Golden Valley has provided a commitment in concept, indicating publically they are committed to using gas in their facility, with the caveat of acceptable pricing. Mr. Britton showed and described the rendering of the project. He explained IGU has contracted with MAP Consulting to contact potential gas suppliers to solidify a gas supply for the next tranche of the project. The current demand is approximately 90% commercial and 10% residential.

Mr. Britton reviewed the status of the financing activities. The original \$125 million of SETS funds is expected to be fully drawn by the first quarter of 2020. AIDEA and IGU recently executed an additional \$10 million of financing, allowing the North Pole project to move forward installing mains and service lines. As part of the IEP, there is up to \$150 million of bond availability through AIDEA conduit revenue bonds. Credit presentations and site visits have been completed with Fitch as part of a planned bond issuance of \$60 million par value at the end of January 2020. Approximately \$50 million of the funds will be used for the liquefaction expansion and the remaining \$10 million will be used for additional services, meters and minor distribution system infill work. Hilltop Securities is the financial advisor. The bond council is Foster and Pepper. The underwriter team is led by Bank of America Merrill Lynch.

Mr. Britton delineated the next steps of the project. The natural gas conversion program will continue to advance. The implementation of the combined utility integration and transition plan is ongoing. The master schedule will be updated as policy developments arise. Liquefaction feed work will be finalized. Negotiations are advancing for the natural gas feedstock availability for the next level of supply. Public relations and marketing strategies are advancing.

A member asked the question regarding the price to connect Southcentral to the Interior with a pipeline. Mr. Britton noted the answer varies depending on who responds. His perspective is most gas pipeline projects average about \$2 million to \$3 million a mile, for an approximate cost of \$1 billion or more to complete that transmission line connection. Up until the IEP, around \$60 million of private investment has been spent on Interior natural gas. The monies spent related to the IEP include a capital appropriation of \$57 million and the \$125 million that will be expended within the next year.

Mr. Britton conveyed a safety message to ensure calls to 811 occur before any digging commences. All Alaska gas utilities conduct free locates. Loss time personnel incidents have transpired in the past. No fires or explosions have resulted related to natural gas release. The safety record is excellent. There is a high level of safety code requirements for LNG systems.

Chair Pruhs inquired as to the level of engagement by the three government entities that allow IGU to be a utility. Mr. Britton believes the entities are very engaged, supportive, and participate actively. Quarterly updates and presentations are provided. All project revenues will be reinvested in the project. The IGU enabling ordinance does not allow for any excess revenues to be dividend-back to the Assembly for other uses. Mr. Haagenson explained the Board is comprised of seven members. Three members are appointed; one by Fairbanks, one by North Pole, and one by North Star Borough. Four members are elected by the public.

Chair Pruhs inquired if the existing operating utility supports positive cash flow. Mr. Britton agreed there is a positive cash flow contribution. The capital improvements and replacements are being covered by operating cash flow. There have been challenges with the warm weather reducing the heating degree days by 20%. All key management staff and key operational personnel have been maintained. Retention is at a high level. New positions created include a director of operations and a conversion customer service manager.

Vice-Chair Karl congratulated the IGU Board on retaining Mr. Britton for a three-year extension and for creating a successful gas utility in Fairbanks.

Mr. Haagenson invited AIDEA Board members and staff to Fairbanks for a tour of the project. Chair Pruhs expressed appreciation to the former AIDEA Executive Director Ted Leonard for laying the foundation for IGU. He thanked IGU for the presentation and for the IGU Board members' participation.

7B. Loan Resolution No. L19-11 Seward Wildlife Cruises, LLC

Mr. Boutin requested Chris Anderson present on Loan Resolution No. L19-11. Mr. Boutin stated staff recommends the approval of the \$8.1 million loan participation with the borrower Seward Wildlife Cruises, LLC and co-borrower Gateway 82, LLC. The guarantors are Four Seasons Marine Services Corporation, Thomas and Mary Tougas, and TMT Trust. AIDEA has reached its interest rate floor. This 90/10 loan participation request is slightly higher at 3.41% fixed for 25 years. FNBA is participating at an approximate variable blended rate of 4.2% for 20 years.

Ms. Anderson explained the use of the proceeds would pay off FNBA's construction loan and closing costs. The project is the 80-room Seward Gateway Hotel located in Seward. There are 30 construction jobs affiliated with the project and 35 new jobs created. The project will be professionally managed by Mr. Tougas and Kyle Nuckols, who manage a sister property, Harbor 360 Hotel. The entities will share maintenance, front desk and housekeeping staff. AIDEA would take a first deed of trust position on the property. The project was appraised at \$12,382,000 for the real estate and \$918,000 for furniture, fixtures, and equipment (FF&E), providing a 73% loan-to-value, well within AIDEA's guidelines.

Ms. Anderson reported the projected net operating income for 2019 provides the debt service coverage of 1.95:1. AIDEA's minimum is 1.25:1. There are no known environmental issues. The tourism base in Seward continues to grow with over 100 cruise ships scheduled for the 2019

season. The combination of tour busses, train passenger and road travelers have made Seward a destination throughout the summer. The new hotel will also contract with Alaska Travel Borough in Anchorage, providing sales, marketing, and reservation support.

Ms. Anderson described the strengths as new construction, experienced management, and a strong market demand. The perceived weaknesses include the seasonal operations and non-flagged hotel. The portfolio diversification as of June 30, 2019 for the Gulf Coast region would increase from 4.32% to 6.09% with this loan. In the Gulf Coast region, 54.35% of participated loans are attributed to tourism, and would increase to 68.13%. AIDEA has 11.3% of its total statewide portfolio in the tourism industry, which would increase to 12.93%. Completion of the hotel is scheduled for May 1, 2020. AIDEA will inspect the hotel at its completion and before the loan is funded. Staff recommends the loan for approval.

Vice-Chair Karl inquired if the lender would still have completed the project if this reasonable loan was not available from AIDEA. Tim Redder, FNBA, agreed and commented FNBA did approve the construction and permanent financing for this project.

Chair Pruhs asked Ms. Anderson to provide a list at the next Board meeting of all the hotels and locations AIDEA has financed.

Commissioner Anderson inquired regarding how the hotel will contract with the cruise industry. Ms. Anderson stated the facility is seasonal and will be open from the second week of May until the third week of September. Thomas Tougas, Four Seasons Marine Svcs Corp., explained the hotel will primarily contract through Premier, Alaska Tour and Travel, and Alaska Travel Borough. He explained the flagging benefit is diminishing because of the use of customer ratings from independent agencies like Trip Advisor. The cruise ship industry is approximately 22% of the hotel business. The biggest market in the summer is visiting friends and relatives (VFR).

Deputy Commissioner Samorajski asked Mr. Tougas to characterize the motivation for seeking AIDEA's participation in the loan. Mr. Tougas explained he purchased the land 18 years ago and has been making payments since, while waiting for the demand and the financing to be appropriate. He noted AIDEA's financing opportunities are attractive. Mr. Tougas informed he is on the Board of Directors of FNBA and could have received a loan through FNBA, but decided to pursue financing with AIDEA because of the general condition of interest rates, the stability of the fixed rate, and the term of the loan. Criterion Construction out of Anchorage is the contractor.

MOTION: Mr. Kendig moved to approve Resolution No. L19-11 Seward Wildlife Cruises, LLC. Motion seconded by Vice-Chair Karl.

The motion was approved with members Pruhs, Karl, Anderson, Fogle, Kendig, Samorajski, and Sande voting yea.

7C. Resolution No. G19-21 Predevelopment Work on Potential Access Road Projects

Mr. Boutin explained Resolution No. G19-21 is a request for two predevelopment budget items which are proposed to be funded out of the Authority's Economic Development Fund, AS 44.88.172. The first predevelopment work is for an additional \$718,000 for the Ambler Mining District Industrial Access Project (AMDIAP).

Mr. Boutin requested the second predevelopment work be discussed in detail first. It is for Phase I funding of \$50,000 for West Susitna Access Road (WSAR). This represents a quarter of the funding, of which other funders are involved in the remaining amount. The urgency is to complete field work this fall. Mr. Boutin introduced Mat-Su Borough representatives Ted Leonard and John Moosey, who are available for comment and questions. The origination of the access is from Alaska Department of Transportation Road to Resources. Mr. Boutin stated projects of this kind are central to AIDEA's statutory directive and monies are available within the Authority's Economic Development Fund.

Chair Pruhs requested Mr. Moosey provide a background of the project for Board members. Mr. Moosey explained the State of Alaska has invested a substantial amount of work on the Road to Resources under a previous Administration to cross the Little Susitna River and Susitna River to access the tremendous identified resources. The Mat-Su Borough Assembly has set aside earnings of \$1.5 million to create access across Little Susitna River. The work on the ground, including digital data and ground truthing, will have value and will be available for public use.

Mr. Moosey expressed interest in the project's consideration of a corridor to Port MacKenzie. He described the opportunities and structure of Port MacKenzie resources. Mr. Moosey indicated any action and activity for the project would be economically beneficial. Resources include timber, hard rock, coal leases, and copper. Currently, the transportation costs to get the resources to market are not economically feasible. A third of the Mat-Su Borough's land is on the west side of the Susitna River with no access. The majority of the land on the west side of the river is State property, with some federal lands adjacent.

Mr. Moosey stated the Marine Corps has been invited to conduct training at Port MacKenzie, which offers the necessary amount of available land and water. Mr. Moosey believes it would be ideal to have a Marine base in this area to mirror JBER.

Alan Weitzner described the three corridors that will be considered: the Port Mackenzie Route (PMR), an East-West Route (EWR), and the South Route (SR). Mr. Weitzner noted a north route was reviewed and deemed not feasible.

Chair Pruhs inquired if the ultimate access road, unlike the Ambler Road or Red Dog Road, will be open to the public. Mr. Moosey explained the access road is anticipated to be open to the public with safety restrictions. Mr. Weitzner indicated the preliminary discussions involve different components being public versus resource use. The access corridors defined to the Little Susitna River were always viewed as public access. Chair Pruhs noted he would have difficulty supporting a road project that did not provide public access.

Mr. Leonard expressed appreciation to AIDEA and staff for their efforts on this project to promote economic development for this area. The Mat-Su Borough, particularly Mr. Moosey, is the lead entity on this predevelopment work. To the extent the resolution is being proposed and the MOU is developed, the work is being conducted and coordinated through AIDEA. The efforts to consistently and effectively move the project forward is paramount.

Chair Pruhs requested staff provide the presentation and update on the Ambler Road project. He reminded members there is no Record of Decision for the Ambler Road project. Mr. Boutin requested Mark Davis provide the update. Mr. Davis explained staff is seeking authorization to spend, if necessary, up to \$718,000 to progress the AMDIAP to the final EIS stage. The funding could be used for the outlined budget allocations responding to requests from the Bureau of Land Management (BLM) including a subsistence committee, cultural resources management report (CRMP), responses to public comments, incorporating public comments, as well as a compensatory mitigation plan with the U.S. Army Corps of Engineers (USACE), who has expedited the Clean Water Act process. The comment period for the draft EIS process closes on October 29, 2019.

Commissioner Anderson inquired if it is worthwhile to wait on approving the budgeted authorization until the next Board meeting after the public comment period has expired. Mr. Davis explained there is a timing factor to be considered regarding BLM in their desire to issue a Record of Decision in early 2020. Commissioner Anderson agrees a decision at the December Board meeting does not allow sufficient time to move forward. She understands some of the requested funds are for items that are normally included in the initial EIS planning, but were inadvertently omitted. Commissioner Anderson inquired as to the mechanism of recouping finance costs once the project is underway. Mr. Davis stated the finance plan model will follow the Red Dog model and includes rolling the costs of all permitting into the cost of the project, of which the State gets repaid and AIDEA gets repaid.

Chair Pruhs inquired if a full budget, beyond the requested \$718,000, is available to be provided to the Board. Mr. Davis stated the current budget request will take the project through the permitting for the 404 process and the 106 process to get to the Record of Decision. The EIS is near completion. There are three possible routes. The final route has not been agreed upon by the land owners. The design and construction phases will occur afterward the route is established. Chair Pruhs expressed concern with the request for funds when the specifics of the requirements are unknown.

Mr. Davis noted the CRMP is conducted as part of National Environmental Policy Act (NEPA). The amount budgeted reflects the contractor's hard bid. The compensatory mitigation plan budget number is solid based on USACE and DOWL's assessment. The anti-degradation report budget item for DEC is a water quality report and the cost is based on an estimate from DNR. The additional travel expenses budgeted are based upon BLM's expectation of three more flights at \$6,000 each.

Chair Pruhs noted the memorandum does not include the amount of funds spent to-date, the balance of funds remaining in the State appropriation, and the expected amount to be spent in the future. Chair Pruhs conveyed support for the project, but reticence regarding this particular ask in relation to the overall project.

Jeff San Juan stated \$26.2 million has been spent since the inception of the project to-date. These are total funds appropriated by the Legislature. Brenda Applegate explained there is approximately \$32,000 of uncommitted and unencumbered State funds remaining out of the 2014 and 2015 State appropriations of \$17 million. Mr. Davis noted half of the State appropriations were spent by Department of Transportation (DOT) before AIDEA took over the project. Mr. Davis believes it is possible to expend approximately \$800,000 in additional costs before firm commitments are reached. Mr. Boutin believes the final phases of the project after firm commitments will consist of a blend of AIDEA general obligation and revenue bonds and AIDEA cash, for an amount greater than \$25 million, but less than \$50 million.

Chair Pruhs requested confirmation the total best estimate of the remaining budget to get the project to firm commitments includes today's budget amount of about \$700,000 and an additional \$800,000, for a total of approximately \$1.5 million. He believes it is prudent and professional for staff to provide the Board with a best estimate final budget based on staff's expertise and historical knowledge. Mr. San Juan confirmed the \$1.5 million budget number is fair. Chair Pruhs indicated the Board also has the option of not approving any funds above the \$700,000 to get to a Record of Decision. Additional monies do not have to come out of AIDEA's revolving fund. AIDEA could notify the State that additional monies need to be appropriated in order to continue moving forward on the AMDIAP.

Mr. Kendig requested a delineated line item budget of the remaining \$800,000 be provided to Board members as soon as possible. He suggested an Ambler Update be added as a regular agenda item for each meeting. Vice-Chair Karl cautioned the Board the estimated \$1.5 million additional budget is not a steadfast amount because there is no level of precision available. He believes AIDEA is the only entity who can move forward with this project on behalf of Alaskans.

Commissioner Anderson requested staff provide a high level line item budget consisting of total project funds expended to-date and future anticipated funds. This will be the baseline for ongoing budget discussions. She believes the additional \$25 million to \$50 million is too big of a spread and some level of detail needs to be included to support the budget claim. Deputy Commissioner Samorajski agreed and indicated this meeting is the first time he has heard the projected budget claim of \$25 million to \$50 million. Chair Pruhs agreed, and noted the long-term budget is a separate step than the budget request today.

Mr. San Juan believes staff has many of the answers about which the Board is inquiring. He recommended the Board schedule a special session meeting to discuss the specifics of the Ambler Project and its budget or create a subcommittee to conduct a deeper dive. Chair Pruhs reiterated the importance of staff providing the Board with a line item budget and the importance

of staff's effort to track and report on that projected budget. Mr. Davis discussed the next step after the Record of Decision, per statute, is to present the Board with a finance plan.

Mr. Boutin advised of the high likelihood of litigation during these continued phases. Chair Pruhs asked if AIDEA pays for litigation costs. Mr. Davis stated under NEPA, if a suit is brought forward, it would be against the lead federal agency, BLM. However, there are other legal fees in the normal course of negotiations and achieving firm commitments. Vice-Chair Karl commented on the likelihood of AIDEA needing to utilize counsel in the event a suit is brought against BLM. Mr. Boutin stated there is no way of forecasting the legal actions that could be brought against this project.

Chair Pruhs inquired if it is possible for the Board to separate Resolution No. G19-21 into two resolutions; one focusing on the Phase I funding of \$50,000 for WSAR and the second focusing on the AMDIAP. He noted the projects are completely different and believes it is appropriate to have standalone resolutions for each. Deputy Commissioner Samorajski agreed. Chair Pruhs requested resolutions in the future are separated based on project-specific information. Mr. Boutin agreed.

MOTION: Mr. Kendig moved to approve Resolution No. G19-21 Predevelopment Work on Potential Access Road Projects. Motion seconded by Mr. Fogle.

Chair Pruhs reiterated the request for staff to bring a high level line item budget of the estimated \$1.5 million to get the project to the Record of Decision, an estimate of possible anticipated legal ramifications and fees, and a bullet point representation of the 172 finance plan.

The motion was approved with members Pruhs, Karl, Anderson, Fogle, Kendig, Samorajski, and Sande voting yea.

Ms. Sande stated during the earlier break, there were several people online that requested their attendance be placed on the record (Ms. Throope and Ms. Lee).

7E. Presentation - AIDEA's Revolving Fund Investment Portfolio, Callan

Mr. Boutin invited Ms. Applegate, Gordon Weightman and Alex Ford of Callan to provide the investment portfolio presentation. Ms. Applegate stated Callan is AIDEA's investment advisor. Callan monitors the portfolio performance and provides the quarterly investment reports distributed within the Board packets. Today's presentation contains the fiscal year-end results of the investment portfolio. Mr. Weightman described his professional background and expressed appreciation to the Board for a 20-plus-year relationship with Callan. Mr. Weightman outlined the presentation will include a market update, the status of the fixed income environment, and particular information concerning AIDEA's assets and holdings. Mr. Weightman asked if the Board members have any additional specific requests regarding Callan's discussion today.

Deputy Commissioner Samorajski requested the manager fees be disclosed. Mr. Weightman informed there are two external investment managers running core investment grade bond

portfolios. Alaska Permanent Capital Management charges 13 basis points on assets. Barrow Hanley is based in Dallas, Texas, and charges 23 basis points on assets. Mr. Weightman stated the manager fees are competitive. Deputy Commissioner Samorajski inquired if the returns reported on pages 19 and 20 of the presentation are net of management fees or gross of management fees. Mr. Weightman informed the returns posted are gross of management fees because the returns are being compared against the gross returns of the peer group.

Mr. Weightman provided highlights regarding the economy. The overall metrics are good. The gross domestic product in the second quarter came in at 2%. Consumer spending has been healthy. Inflation has remained low at 1.7% over the last 12 months, which is well below the long-term average. This implies that producers and employers are experiencing difficulty in raising the costs of goods. Unemployment is healthy and historically low at 3.5%.

Mr. Weightman discussed the Federal Reserve has cut interest rates twice in 2019. A third interest rate cut is anticipated and priced in by the market to occur in October. On a global scale, over half of the world's government debt has an unprecedented negative yield, which means a \$100 bond will receive less than \$100 if held to maturity. The resulting investment behavior is a shift to chasing returns in riskier assets. Mr. Weightman noted anecdotally there are 30-year mortgages in Europe now with negative interest rates, which means the debt decreases even if no payments to the debt are made.

Mr. Weightman reported as of June 30, 2019, the total fund amount is approximately \$502 million, comprised of about \$99 million of internally managed U.S Treasury funds and \$403 million with the two external managers. Last year's return for the total fund was strong at 6.64%. Callan does not expect the current investment policy to continue achieving those types of returns, primarily due to the decline in interest rates. Going forward, the yield on the bond portfolios is about 2.5%. Absent any substantial moves in interest rates, 2.5% is the expected return over the next five years.

Chair Pruhs informed the Board will discuss investment strategies in the work session in December.

Mr. Weightman reviewed the rolling one-year returns over the last 20 years. The average return of the investment portfolio is 4.4% with core investment grade bonds. The graph shows a few years with negative returns and unrealized losses. The portfolio has outperformed the Bloomberg Aggregate benchmark the majority of the rolling one-year periods since 2003.

Mr. Ford described Alaska Permanent Capital Management as the more conservative of the two active external portfolios. This is shown with their slight underperformance compared to the benchmark in the returns for 1-year, 3-year, and 5-year periods. The strategy adds value over the benchmark longer-term over the 10-year and 15-year periods. Alaska Permanent Capital Management lags in performance compared to peers. This is to be expected because of the higher quality bias which is held in the portfolio with the intent to provide downside protection and preservation of capital.

Mr. Ford described Barrow Hanley as having a similar risk profile to Alaska Permanent Capital Management. The manager seeks to add value by finding undervalued bonds within the marketplace. This strategy has exceeded the Bloomberg Aggregate benchmark year-to-date, 1-year, 3-year, and since inception 6-year periods on a gross of fee basis. Net of fees, the strategy has been very close to its benchmark for the same periods, while maintaining a lower risk profile. Mr. Ford believes the external managers are performing in line with expectations and maintaining the goal of capital preservation.

Deputy Commissioner Samorajski commented his rough calculations reveal the portfolios paying approximately \$1 million in fees annually, while receiving almost no benefit. Over the last six years, Barrow Hanley is underperforming after the management fee of 23 basis points is subtracted. Alaska Permanent Capital has been underperforming generally for the last five years. Deputy Commissioner Samorajski stated the Treasury Department provides fund management services for State funds with no management fee. He noted the Department typically beats its benchmark by a couple of basis points. Deputy Commissioner Samorajski believes the Treasury Department would be available to offer the management services to AIDEA, which would provide a minimum savings of \$1 million a year. He recommended this option be discussed in advance of the December meeting.

Ms. Applegate believes the contracts with the two external managers expire in April 2020. Chair Pruhs agreed this topic should be included in the December work session. Commissioner Anderson requested an analysis be presented describing the number of additional employees this type of change would entail and any other financial impacts to the State. Deputy Commissioner Samorajski stated no additional employees would be necessary because of the similar ongoing fund management in the Department. He indicated Ms. Applegate could prepare remarks addressing those concerns.

Chair Pruhs noted two Board members have to leave between 2:00 and 3:00 p.m. He recommended the agenda order will be revised to address Item 7D. now, followed by Executive Session. There was no objection.

7D. Resolution No. G17-19A Approving a Navision System Upgrade with Server Upgrade

Ms. Applegate stated Resolution G17-19A is an amendment to the previously approved Resolution G17-19 in December of 2017, relating to the authorization for an upgrade to AIDEA and AEA's Enterprise financial software and servers. The history of the project is included in the Board packet memo.

The amendment requests include: a change in scope for an upgrade to the latest released MS version for the Navision Enterprise financial software; the purchase of new recommended servers to fully support, maintain, and improve the functionality for the lifecycle of the new software; the migration of the current SQL server to a new SQL server 2012, to reduce risk and vulnerability during the upgrade; and the implementation of the required MS license structure upgrade from concurrent users to named users.

Ms. Applegate noted the request of an additional \$240,000 in funding, above the originally authorized \$100,000, to allow for the increase in cost estimates, the onsite contractor support, and the purchase of the new server not included in the original budget.

Ms. Sande inquired as to the delay in the upgrade from the original 2017 resolution. Ms. Applegate explained the December 2017 resolution had an anticipated project start date of November 2018, and a completion date of June of 2019. During the interim, unanticipated staffing and workload issues occurred, and the change in technology to Version 13.3 was released. In hindsight, Ms. Applegate believes the staff's upgrade requests were premature. The server software will reach the end of its lifecycle in January 2020. IT is not currently out of compliance, but will be out of compliance during the migration to the new upgrade. Had the upgrade occurred as originally intended in 2018, IT would have remained in compliance. The decision not to implement the authorized upgrade was discussed internally and approved by Ms. Applegate and both previous executive directors of AIDEA and AEA. The opportunity cost for not implementing the upgrade as originally scheduled is approximately \$90,000. Ms. Applegate explained part of the additional costs is due to an increase in the vendor's fee for the upgrade. The upgrade to Version 13.3 will maintain a five-year life cycle.

Chair Pruhs requested Terence Cato discuss the security risk of the upgrade. Mr. Cato explained risk is inherent in any upgrade. Steps will be taken to mitigate the risk by installing a new interim server. The operating system and database system will be upgraded. The upgrade will take approximately 240 days.

Commissioner Anderson commented this resolution amendment seems reminiscent of the premature request in 2017. She suggested staff come back before the Board with a more fully developed budget and timeline of the procedure, as well as the identifiable associated risks.

MOTION: Mr. Kendig moved to table Resolution No. G17-19A. Motion seconded by Mr. Fogle. The motion to table Resolution No. G17-19A passed with no objection.

Commissioner Anderson believes more information is necessary. She requested staff return in December with a timeline of implementation, the costs, and associated risks.

7F. Executive Session: Mustang Development

MOTION: Mr. Fogle moved to enter into Executive Session to discuss confidential information relating the Mustang Development. Motion seconded by Mr. Kendig.

The Board entered Executive Session at 1:56 p.m. Participants included board members Dana Pruhs, Bernie Karl, Albert Fogle, Bill Kendig, Greg Samorajski, Julie Sande and John Springsteen. AIDEA staff and guests invited to join the session: Tom Boutin, Brenda Applegate, Alan Weitzner, Yulia Ellsworth, Geoff Johns, and guest Jerry Juday, and Mark Melchert.

The Board reconvened its regular meeting at 2:45 p.m. Chair Pruhs advised the Board did not take any formal action on matters discussed while in executive session.

8. DIRECTOR COMMENTS

Mr. Boutin stated his intent is to continue his practice of frequent email updates. Modifications to the updates can be made at the request of members.

Dashboard and Loan Reports, Project Matrices and Fact sheets, and the Continuing Education Calendar were included in the Board packet

The next regularly scheduled AIDEA Board meeting is Wednesday, December 4, 2019. There are two planned work sessions in December. One on December 4, 2019, prior to the Board meeting, and the second on December 5, 2019.

9. BOARD COMMENTS

Vice-Chair Karl expressed appreciation to Mr. Boutin for the efforts and information provided in the email updates.

Deputy Commissioner Samorajski agreed with Vice-Chair Karl's comments.

Mr. Kendig expressed appreciation to staff for their diligence. He requested the AIDEA and AEA agenda include an update from each of the Department heads to inform members of upcoming requests and happenings.

Ms. Sande inquired if it is possible to request that the Executive Directors of AIDEA and AEA provide feedback regarding areas the staff are currently following State process when the statute or regulation does not specifically require State process be followed. She is anecdotally aware that following State processes often neither seeks common sense, efficiency, nor cost reductions. Ms. Sande is interested in determining areas where it is possible to advocate for AIDEA following functions that are practiced in the private sector with the intent for AIDEA to make money. Mr. Boutin agreed to provide feedback.

Chair Pruhs expressed appreciation to staff and participants.

10. ADJOURNMENT

There being no further business of the Board, the AIDEA meeting adjourned at 2:50 p.m.



Tomas H. Boutin
Executive Director, Secretary
Alaska Industrial Development & Export Authority