Callan

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Alaska Mental Health Trust Authority

Inflation Proofing Discussion

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Fund Sponsor Consulting

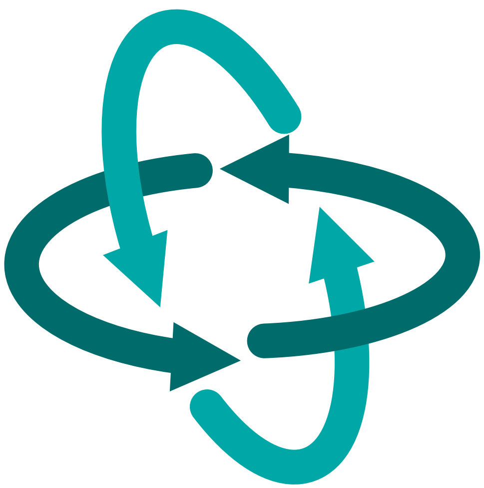
Introduction

Presenters

Steve Center, CFA

- 16th year with Callan, 27th year in the industry
- Senior Vice President, West Coast Consulting Team
- Callan shareholder
- Manager Search Committee member
- MBA, University of Washington
- BA, University of California, Irvine

Today's Agenda



Inflation Proofing Discussion

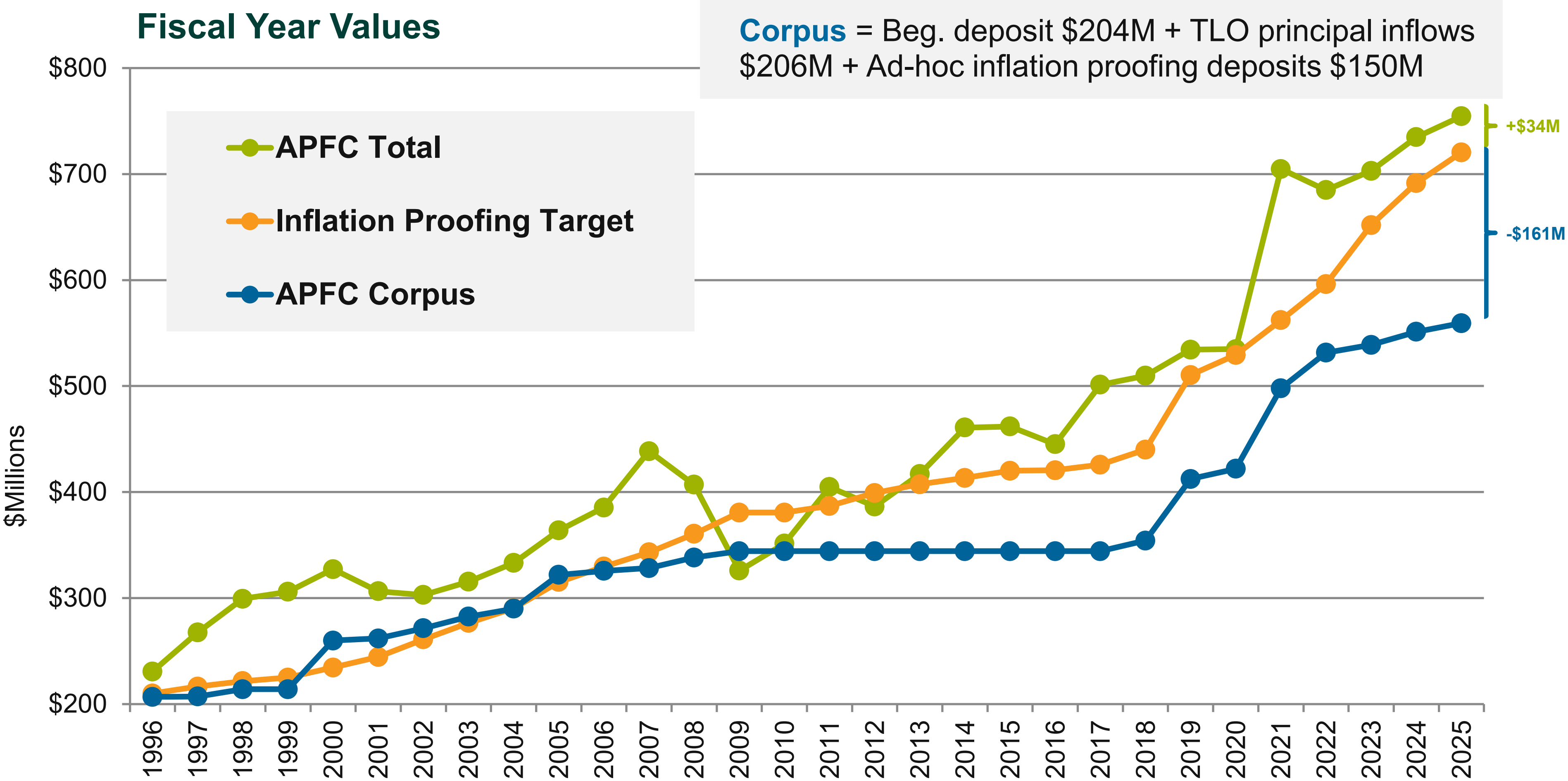
- Historical Status of the Trust
- Framework for Preserving Principal
  - Process for Reviewing the Trust's Real Value
  - Introduction of the Real Value Fund Ratio
  - Discussion of the Core Investment Philosophy for the Trust

Historical Status of the Trust

Data as of June 30, 2025

Historical Inflation Proofing

Through June 30, 2025, APFC Only



Inflation Proofing Target = Beg. deposit $204M + TLO principal inflows $206M + Inflation $311M

Corpus = Beg. deposit $204M + TLO principal inflows $206M + Ad-hoc inflation proofing deposits $150M

The Authority's APFC Corpus, which has fallen short of the Inflation Proofing Target ("IPT") since FY2006, was behind the IPT by the widest margin to date as of the end of FY2025 ($161 million)

The Authority's APFC Total market value was ahead of the IPT as of the end of FY2025 by $34 million and has been ahead of the Inflation Proofing Target in 27 of the 30 fiscal years

Source: APFC records and Callan calculations through June 30, 2025

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Framework for Preserving Principal

Inflation Proofing Versus Sustainable Spending Rate

The APFC Method Versus the Endowment Model

Inflation-Proofing

The APFC is legislatively required to conduct inflation-proofing appropriations from the Earnings Reserve Account ("ERA") to the Principal on an annual basis to protect the value of the Permanent Fund against inflation (AS 37.13.145 (c)).

- Annual transfers are made to inflation-adjust the Principal
- Effectively restricts spendable assets to the ERA balance

Endowment Model

Conversely, most endowments, foundations, and trusts focus on maintaining intergenerational equity by setting, and adhering to, a spending rate that does not exceed the asset pool's long-term expected real return (expected return above long-term expected inflation). This preserves the purchasing power of the asset pool through spending discipline.

For illustration, if a hypothetical trust has a long-term expected return of 7.3%, and inflation is projected to be 2.5%, the trust should not have a spending rate in excess of 4.8% (7.3% - 2.5% = 4.8%).

Source

AMHTA Approach to Inflation

Preservation of Purchasing Power

The Trust has a fiduciary responsibility to maintain intergenerational equity by preserving the long-term real purchasing power of Trust assets

Sustainable Spending Rate

The Trust has an approximate 10-year expected nominal return of 7.3%. By adopting an annual spending rate of 4.5%, which falls below the projected real return of 4.8% (assuming a 2.5% long-term inflation rate), the Board has set a spending rate that is expected to maintain the long-term purchasing power of the Trust.

Assessment of Inflation Status

Callan recommends conducting annual reviews of the value of the Trust's principal, adjusted for inflows and inflation, to determine real value of the Trust's principal

New Concept: Determination of Discretionary Capital

The Trust's overall value may potentially grow beyond its inflation-adjusted real value. By calculating a Real Value Funded Ratio ("RVFR"), representing the Trust's market value divided by the real value of the initial deposit and inflows, the Board can determine if the Trust has excess capital to invest in discretionary projects.

Establishment of a Process to Review the Trust's Real Value

Determine Discretionary Capital Availability, Ensures Intergenerational Equity

Review Projected Trust Returns and Inflation

Determine Sustainable Spending Rate

Maintain Budget Reserve Balance of 400% Annual Withdrawal

Determine Real Value Funded Ratio ("RVFR")

Assess Availability and Use of Discretionary Capital

The above process is designed to protect the long-term purchasing power of the Trust, ensuring intergenerational equity. Each step should be satisfied before advancing to the next step.

The Real Value Funded Ratio reviews the value of the Trust assets managed by APFC relative to the real value of the initial deposit and subsequent contributions. An illustration of the RVFR follows on the next slide.

Illustration of the Real Value Funded Ratio

$$RVFR = \frac{\$754M}{\$204M + \$206M + \$311M} = \frac{\$754M}{\$721M} = 1.05$$

The above illustrative Real Value Funded Ratio is based upon the following inputs:

- Fiscal Year-Ending Value of Assets Managed by APFC: $754M
- Beginning Deposit of $204M
- Principal Inflows of $206M
- Total Inflation Over Life of the Trust: $311M

  (uses observed annual CPI figures since inception)

Above calculation is for illustrative purposes only. Result rounded to the nearest hundredth.

Real Value Funded Ratio Decision Matrix

Less Than 1.00

The Trust’s value falls below the inflation-adjusted value of the corpus

Shortfall is carried forward

No discretionary investments considered

Between 1.00 and 1.10

The Trust’s value exceeds the inflation-adjusted value of the corpus

Maintain investment discipline, fund the 400% Budget Reserves balance

Above 1.10

The Trust’s value is more than 10% above the inflation-adjusted value of the corpus

Discretionary investments may be considered if Budget Reserve balance meets 400%

The Real Value Funded Ratio can be used to determine if the Trust’s assets are sufficient to consider discretionary investment opportunities. A 10% threshold effectively establishes a cushion against potential investment volatility.

Establishment of a Core Investment Philosophy

Preserve the Trust's Real Principal

↓

Establish a Sustainable Spending Rate

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Real Value Funded Ratio Review

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Evaluate Discretionary Capital Uses

1. **Real Purchasing Power**

   A primary fiduciary objective is to maintain the real purchasing power of the Trust. This will support intergenerational equity and serve as the backstop for all subsequent decisions.

2. **Sustainable Spending Rate**

   The Board sets a sustainable spending rate based upon the long-term expected return of Trust assets and the projected long-term inflation rate, not by past performance.

3. **Real Value Funded Ratio**

   The RVFR is a formula-driven assessment of the Trust's overall value relative to its inflation-adjusted basis. A RVFR above 1.0 means the Trust's investments with APFC exceed the inflation-adjusted total of contributions.

4. **Evaluation of Discretionary Opportunities**

   If the Real Value Funded Ratio is met, discretionary investments made with Trust assets may be evaluated. Such investments must compare favorably versus the projected long-term return and risk of APFC.

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