

## NORTH DAKOTA LEGISLATIVE MANAGEMENT

## Minutes of the

**LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD**

Wednesday, June 15, 2016  
Harvest Room, State Capitol  
Bismarck, North Dakota

Representative Keith Kempenich, Chairman, called the meeting to order at 9:00 a.m.

**Members present:** Representatives Keith Kempenich, Gary Kreidt; Senators Jerry Klein, George Sinner; Citizen Members Eric Hardmeyer, Ryan Rauschenberger, Pam Sharp

**Others present:** Allen H. Knudson, Legislative Budget Analyst and Auditor, Legislative Council  
See [Appendix A](#) for additional persons present.

**The motion made by Senator Klein and seconded by Representative Kreidt at the December 2, 2015, meeting was considered and carried on a voice vote that the minutes of the June 15, 2015, meeting be approved as distributed.**

**It was moved by Senator Klein, seconded by Senator Sinner, and carried on a voice vote that the minutes of the December 2, 2015, meeting be approved as distributed.**

**STATUS OF THE BUDGET STABILIZATION FUND**

At the request of Chairman Kempenich, Mr. David J. Hunter, Executive Director and Chief Investment Officer, Retirement and Investment Office, presented information regarding the status and asset allocation of the budget stabilization fund. Mr. Hunter said since its inception, \$567.4 million has been deposited into the budget stabilization fund, investment income has totaled \$77.7 million, and distributions from the fund have totaled \$64.3 million, resulting in net assets of \$580.8 million as of April 30, 2016. He said the market value of the fund as of March 31, 2016, was approximately \$579.9 million. He said the asset allocation of the fund is 100 percent short-term fixed income and Bank of North Dakota certificates of deposit (CDs).

Mr. Hunter presented information ([Appendix B](#)) regarding the budget stabilization fund investment performance. He said for the current fiscal year-to-date the budget stabilization fund had a net return of 1.02 percent compared to a policy benchmark return of .98 percent. He said for the 1 year period ended March 31, 2016, the total fund net return was 1.37 percent compared to a policy benchmark return of 1.08 percent.

Mr. Hunter said the Retirement and Investment Office (RIO) anticipates transferring approximately \$8 million of budget stabilization fund investment earnings to the general fund in June 2016.

In response to a question from Chairman Kempenich, Mr. Hunter said the majority of investments within the budget stabilization fund are accessible and the fund could be liquidated within a 1- or 2-week timeframe.

In response to a question from Chairman Kempenich, Mr. Darren Schulz, Deputy Chief Investment Officer, Retirement and Investment Office, said he does not anticipate any penalties would be incurred if the budget stabilization fund is liquidated.

In response to a question from Mr. Hardmeyer, Mr. Hunter said he is not yet aware of a specific date for the transfer of funds from the budget stabilization fund to the general fund. Mr. Hunter said RIO will work with the Office of Management and Budget (OMB) to establish the proper plan and timeframe for the eventual transfer.

Due to the eventual transfer from the budget stabilization fund to the general fund, Mr. Hunter said, the remaining balance in the budget stabilization fund will be insufficient to support the Bank of North Dakota Match Loan CD Program. He said prior to the transfer, RIO will request a change to the investment policy statement of the budget stabilization fund. He said the policy change will remove reference to the Bank's Match Loan CD Program. He said RIO will continue to maintain the expected risk and return goals of the budget stabilization fund until the transfer of funds is complete, at which time RIO suggests investing legacy fund money into the Bank's Match Loan CD Program.

Ms. Kelly Schmidt, State Treasurer, stated the eventual transfer of the investment in the Bank's Match Loan CD Program from the budget stabilization fund to the legacy fund will be an accounting transaction between two State Investment Board funds and no actual dollars will be moving.

In response to a question from Chairman Kempenich, Ms. Sharp said OMB does not anticipate transferring the balance in the budget stabilization fund to the general fund until the last 6 months of the 2015-17 biennium. Ms. Sharp said the funds are committed, but will not be transferred until needed for general fund cash flow purposes.

Representative Kreidt expressed concern regarding delaying action to change the investment policy statement. If circumstances change, he said, the transfer could occur before the advisory board has an opportunity to consider changing the investment policy statement. He suggested changing the policy now.

**It was moved by Representative Kreidt, seconded by Ms. Sharp, and carried on a roll call vote that the advisory board recommends that due to the eventual transfer of funds from the budget stabilization fund to the general fund, as ordered by the Governor, the investment policy statement for the budget stabilization fund be amended at that time to remove reference to the investment in the Bank of North Dakota Match Loan CD Program.** Representatives Kempenich and Kreidt, Senators Klein and Sinner, Mr. Hardmeyer, Mr. Rauschenberger, and Ms. Sharp voted "aye." No negative votes were cast.

### STATUS OF THE LEGACY FUND

At the request of Chairman Kempenich, Mr. Hunter presented information regarding the status of the legacy fund. Mr. Hunter said from inception through April 30, 2016, \$3.485 billion has been deposited into the legacy fund. He said income retained in the fund totaled \$250.3 million, and net assets of the fund as of April 30, 2016, totaled \$3.735 billion. He said the market value of the fund as of April 30, 2016, was approximately \$3.735 billion.

Mr. Hunter presented information ([Appendix C](#)) regarding the legacy fund investment performance. He said for the current fiscal year-to-date the legacy fund had a net return of -.55 percent compared to a policy benchmark return of -.60 percent. He said for the 1 year period ended March 31, 2016, the total fund net return was -.33 percent compared to a policy benchmark return of -.78 percent.

Mr. Hunter said while the return on the legacy fund has not been as favorable as expected, the legacy fund has had better returns than the market from a passive investment perspective. He said as the policy benchmark, which is based on the legacy fund's strategic asset allocation of 50 percent equity, 35 percent fixed income, and 15 percent diversified real assets, has been consistently lower than the actual returns for the legacy fund. He said while the legacy fund has not met its long-term strategic allocation goal of 6.4 percent, the fund has generated a 2.57 percent return since the inception of the fund, which is more than the standard inflation rate of 2 percent. He said if the legacy fund can outperform passive market benchmarks, he believes the long-term strategic allocation goal of 6.4 percent can be obtained.

Mr. Hunter presented information regarding the actual returns within each asset class of the legacy fund during fiscal year 2016. As of March 31, 2016, the real estate asset class had performed the most favorably, with an actual return of 12.40 percent. The asset classes that performed the least favorably were the small cap equity class, which had an actual return of -7.54 percent and the international equity asset class, which had an actual return of -5.80 percent.

In response to a question from Mr. Hardmeyer, Mr. Hunter said the strategic asset allocation for the legacy fund was established and implemented in August 2013. Mr. Hunter said historically, the typical approach is to reevaluate the asset allocation every 3 to 5 years.

In response to a question from Senator Klein, Mr. Hunter said that while discussions could begin during this year, he suggested reevaluating the current strategic asset allocation in 2017.

In response to a question by Senator Sinner, Ms. Sharp said the legacy fund's constitutional provisions state that investment earnings of the legacy fund beginning in July 2017 will be transferred to the general fund at the end of each biennium. Ms. Sharp said the constitutional provisions do not address the earnings that have accumulated prior to July 2017. She said the State Treasurer has asked for an Attorney General's opinion regarding the allowable use of the fund's earnings that accrued prior to July 2017.

In response to a question from Mr. Hardmeyer, Ms. Schmidt anticipates receiving the Attorney General's opinion in approximately 1 month. She said she will share the Attorney General's opinion with the Legacy and Budget Stabilization Fund Advisory Board, as well as the Budget Section.

Mr. Hunter said investment fees for the legacy fund could increase from 27 to 33 basis points to approximately 40 to 45 basis points. He said this is due to the legacy fund becoming more fully implemented into its 6.4 percent target return allocation.

Due to the eventual transfer of funds from the budget stabilization fund to the general fund, Mr. Hunter said the budget stabilization fund will not have sufficient funds to support the Bank's Match Loan CD Program. As a result, he said, RIO suggests the legacy fund invest in the Bank's Match Loan CD Program. He said the legacy fund investment in the Bank's Match Loan CD Program should be limited to \$200 million, or 5 percent of the legacy fund balance, whichever is less and receive a minimum of 1.75 percent annual return. He presented a proposed change to the legacy fund investment policy statement to reference the Bank's Match Loan CD Program as an authorized investment in the fixed income allocation of the legacy fund.

**It was moved by Mr. Hardmeyer, seconded by Mr. Rauschenberger, and carried on a roll call vote that the advisory board recommends the investment policy statement for the legacy fund be amended to authorize, as part of the fund's fixed asset allocation investment portfolio, up to \$200 million, or 5 percent of the legacy fund balance, whichever is less, to be invested in the Bank's Match Loan CD Program when the budget stabilization fund's investment in this program ceases.** Representatives Kempenich and Kreidt, Senator Klein, Mr. Hardmeyer, Mr. Rauschenberger, and Ms. Sharp voted "aye." No negative votes were cast.

Chairman Kempenich said he anticipates the next meeting of the Legacy and Budget Stabilization Fund Advisory Board to be in December 2016 during the organizational session of the Legislative Assembly.

No further business appearing, Chairman Kempenich adjourned the meeting at 10:56 a.m.

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Levi Kinnischtzke  
Fiscal Analyst

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Sheila M. Sandness  
Senior Fiscal Analyst

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