

NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD

Thursday, April 20, 2017
Medora Room, State Capitol
Bismarck, North Dakota

Representative Keith Kempenich, Chairman, called the meeting to order at 4:00 p.m.

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

Others present: Senator Joan Heckaman, New Rockford
See [Appendix A](#) for additional persons present.

It was moved by Senator Klein, seconded by Representative Kreidt, and carried on a voice vote that the minutes of the December 5, 2016, 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 ([Appendix B](#)) regarding the status and asset allocation of the budget stabilization fund. He said since its inception, \$572.5 million has been deposited into the budget stabilization fund, investment income has totaled \$78.9 million, and distributions and withdrawals from the fund have totaled \$577.9 million, resulting in net assets of \$73.5 million as of February 28, 2017. He said the market value of the fund as of February 28, 2017, was approximately \$73.7 million. He said, due to general fund revenue shortfalls, the Retirement and Investment Office (RIO) has transferred \$505 million from the budget stabilization fund to the general fund during the 2015-17 biennium. He said as of March 31, 2017, \$5.9 million remains in the fund.

Mr. Hunter presented information ([Appendix C](#)) regarding the budget stabilization fund investment performance. He said for the current fiscal year-to-date through December 31, 2016, the budget stabilization fund had a net return of .48 percent compared to a policy benchmark return of .18 percent loss. He said for the 5-year period ended December 31, 2016, the total fund net return was 1.90 percent compared to a policy benchmark return of .62 percent. He said actual net returns have exceeded the policy benchmark return by approximately \$30 million for the 5 years ended December 31, 2016.

Mr. Hunter provided a copy of the budget stabilization fund investment policy statement ([Appendix D](#)). He said RIO began transferring the Bank of North Dakota Match Loan CD Program to the legacy fund in October 2016 and completed the transition by January 31, 2017. The asset allocation of the budget stabilization fund is 100 percent short-term fixed income and cash.

STATUS OF THE LEGACY FUND

At the request of Chairman Kempenich, Mr. Hunter presented information ([Appendix E](#)) regarding the status and asset allocation of the legacy fund. He said from inception through February 28, 2017, \$3.799 billion has been deposited into the legacy fund. He said income retained in the fund totaled \$574.1 million, and net assets of the fund as of February 28, 2017, totaled \$4.373 billion. He said, while net earnings in the fund totaled \$574.1 million from inception through February 28, 2017, investment earnings, as defined by North Dakota Century Code Section 21-10-02, totaled \$382.7 million, all of which will become part of the principal of the fund.

In response to a question from Chairman Kempenich, Mr. Hunter said RIO requires approximately 60 to 90 days after the end of the fiscal year to audit reports and determine actual investment earnings. He said information regarding actual investment earnings of the legacy fund for the 2017-19 biennium should be available by September 30, 2019.

In response to a question from Mr. Hardmeyer, Ms. Sharp said 2017-19 biennium legacy fund investment earnings are not available, and will not be transferred to the general fund, until the end of the 2017-19 biennium. She said, because RIO will not know the actual amount until after the biennium closes, the Office of Management and Budget will use information available to closely estimate the investment earnings and provide for the transfer of an estimated earnings amount before the biennium closes at the end of July.

In response to a question from Senator Klein, Mr. Hunter said the original 2017-19 biennium investment earnings estimate of \$160 million, as defined in Section 21-10-12, was based on \$4 billion of assets earning 2 percent for 2 years and coincidentally earnings for fiscal years 2015 and 2016 totaled approximately \$160 million. He said, considering the legacy fund earned \$153 million in the first 8 months of the current fiscal year, earnings of \$200 million during the 2017-19 biennium is possible. However, he cautioned that earnings history is not a guarantee of future earnings.

Ms. Kelly L. Schmidt, State Treasurer, said tax deposits into the legacy fund are made 2 months after the revenue is earned. She said because the last deposit of the biennium is made in August, the earnings calculation could be delayed.

In response to a question from Chairman Kempenich, Ms. Sharp said all revenue sources included in the revenue forecast are based on estimates. She said estimating the earnings available for transfer to the general fund is not any different than other revenue forecasts used to build the budget.

In response to question from Mr. Hardmeyer, Mr. Hunter said the assets of the legacy fund are managed for the long term if the Legislative Assembly budgets based on a \$200 million earnings transfer from the legacy fund during the 2017-19 biennium, the asset allocation of the fund would not change.

In response to a question from Senator Klein, Mr. Hunter said the earnings are calculated at the end of the biennium.

In response to a question from Chairman Kempenich, Mr. Hunter said because tax revenues continue to be deposited into the fund, the new revenues could be used to make the transfer to the general fund. He said maintaining several months of cash deposits will allow for RIO to manage the process and minimize transaction fees.

At the request of Senator Klein, Mr. Hunter presented a summary ([Appendix F](#)) of legacy fund investments by asset class as of February 28, 2017, and fund performance as of December 31, 2016. He said, based on unaudited reports, the legacy fund has earned 7.89 percent over the 8 months ended February 28, 2017, compared to a policy target benchmark of 6.5 percent. He said the unaudited return for the year ended December 31, 2016, was 4.8 percent compared to a target return of 3.5 percent. He said over the 5-year period ended December 31, 2016, the return was 3.6 percent compared to a target return of 2.6 percent. He said the lower returns over the last 5 years are due to the initial policy of fixed income investments.

Mr. Hunter provided a copy of the legacy fund investment policy statement ([Appendix G](#)). He said policy statement revisions, approved by the State Investment Board in July 2016, provided for the transfer of Bank of North Dakota certificates of deposit (CDs) from the budget stabilization fund to the legacy fund. He said the fund's investment in Bank of North Dakota CDs totaled \$76.7 million as of February 28, 2017. He said there are no recommendations for revision of the investment policy statement, but he suggested an asset liability study to review the asset allocation. He said the study could be completed in 2017.

Mr. Hunter also provided information ([Appendix H](#)) regarding legacy fund investment fees and expenses and State Investment Board client assets under management. He said investment management fees and expenses increased to .36 percent in fiscal year 2016 from .33 percent in fiscal year 2015, as the approved asset allocation strategy was implemented. He said performance fees remained flat at approximately .06 percent. He said the use of active management paid minimal returns for the legacy fund in fiscal year 2016 as the fund paid \$12.8 million in fees to earn 1.06 percent, and only outperformed the policy benchmark by .05 percent, or \$1.8 million.

Chairman Kempenich said the next meeting will be in June 2017.

It was moved by Senator Klein, seconded by Representative Kreidt, and carried on a voice vote that the meeting be adjourned.

No further business appearing, Chairman Kempenich adjourned the meeting at 4:42 p.m.

Sheila M. Sandness
Senior Fiscal Analyst

ATTACH:8