

LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD - STATUS REPORT TO THE BUDGET SECTION JUNE 16, 2015

The Legacy and Budget Stabilization Fund Advisory Board was created by 2011 Senate Bill No. 2302--codified as North Dakota Century Code Section 21-10-11. The advisory board is established for the purpose of developing recommendations for the investment of funds in the legacy fund and the budget stabilization fund to present to the State Investment Board (SIB). The advisory board is to report at least semiannually to the Budget Section.

Pursuant to Section 21-10-11, the Legacy and Budget Stabilization Fund Advisory Board is comprised of two members of the House of Representatives appointed by the House Majority Leader (Representative Keith Kempenich and Representative Gary Kreidt), two members of the Senate appointed by the Senate Majority Leader (Senator Jerry Klein and Senator Carolyn C. Nelson), the Director of the Office of Management and Budget (OMB) or designee, the President of the Bank of North Dakota or designee, and the Tax Commissioner or designee. Section 21-10-11 provides that a Chairman be selected by the advisory board. The advisory board selected Representative Keith Kempenich to serve as Chairman and Senator Jerry Klein to serve as Vice Chairman.

BUDGET STABILIZATION FUND

The Legacy and Budget Stabilization Fund Advisory Board continues to receive updates regarding the status and returns of the budget stabilization fund. Based on 2015-17 biennium general fund appropriations, there will not be a transfer to the budget stabilization fund at the end of the 2013-15 biennium. However, OMB plans to transfer an estimated \$22.7 million from the budget stabilization fund to the general fund at the end of the 2013-15 biennium to reduce the balance in the budget stabilization fund to \$572.5 million or 9.5 percent of 2015-17 general fund appropriations. Interest earned on the fund is deposited in the general fund because the balance in the fund is at the maximum allowed under Section 54-27.2-01. The asset allocation of the budget stabilization fund is 100 percent short-term fixed income and Bank of North Dakota certificates of deposit. Since the fund's inception, unaudited investment returns, net of fees, have averaged 2.36 percent compared to a policy benchmark of 1.57 percent, and unaudited fund performance for one year as of March 31, 2015, net of fees, was 2.04 percent compared to a policy benchmark of .82 percent. Market value of the fund as of March 31, 2015, was \$595.1 million, of which \$7.3 million (1.2 percent) is invested in cash equivalents, \$102.8 million (17.3 percent) is invested in certificates of deposit at the Bank, and \$485 million (81.5 percent) is invested in short-term fixed income securities with Babson Capital and JP Morgan. Information regarding market value of the budget stabilization fund by asset class as of March 31, 2015, prepared by the Retirement Investment Office (RIO) is attached as [Appendix A](#).

LEGACY FUND

In 2011 the Legacy and Budget Stabilization Fund Advisory Board selected a legacy fund asset mix that it recommended to SIB. The State Investment Board accepted the recommendation of a portfolio that consisted of 100 percent short-term fixed income investments managed by two managers--Babson Capital and JP Morgan. In September 2012, SIB selected a consultant--R.V. Kuhns & Associates, Inc.--to conduct an asset allocation and spending policy study for the legacy fund. R.V. Kuhns & Associates, Inc., considered the primary mission of the legacy fund, which is to preserve the real, inflation-adjusted purchasing power of the money deposited into the fund. In April 2013, the advisory board recommended the following asset allocation mix for the legacy fund, which was approved by SIB:

- Broad United States equity - 30 percent;
- Broad international equity - 20 percent;
- Fixed income - 35 percent;
- Core real estate - 5 percent; and
- Diversified real assets - 10 percent.

The Retirement and Investment Office consulted with Callan Associates Inc. and R.V. Kuhns & Associates, Inc., to develop a transition timeline, and SIB approved a transition plan to fully implement the new policy allocation over a period of 18 months through the use of existing managers within the insurance trust. The transition plan, initiated in August 2013, included depositing, pro rata to the new asset classes, all new money

17.9004.01000

combined with a gradual transfer (\$71 million per month) of funds out of short-term fixed income. As of January 2015, the new asset allocation plan was fully implemented.

Pursuant to Section 15-08.1-08, if the unobligated balance of the strategic investment and improvements fund (SIIF) exceeds \$300 million at the end of any month, 25 percent of any revenues received for deposit in SIIF in the subsequent month must be deposited instead into the legacy fund. During the 2013-15 biennium, SIIF exceeded \$300 million beginning in June 2014 and 25 percent of revenues were transferred to the legacy fund from July 2014 through March 2015. House Bill Nos. 1176 and 1377 removed the provisions directing the deposit of 25 percent of revenues into the legacy fund rather than SIIF if the SIIF balance exceeds \$300 million beginning July 2015. A summary of monthly deposits to the legacy fund from September 2011 through March 2015 prepared by RIO is attached as [Appendix B](#). Deposits into the legacy fund from its inception through March 2015 total \$2.98 billion as follows:

Month of Deposit	Tax Revenue Deposit	Transfers From the Strategic Investment and Improvements Fund	Total Legacy Fund Deposit
September 2011	\$34,311,020		\$34,311,020
October 2011	32,666,664		32,666,664
November 2011	33,217,752		33,217,752
December 2011	36,470,942		36,470,942
January 2012	40,086,657		40,086,657
February 2012	42,775,292		42,775,292
March 2012	45,333,698		45,333,698
April 2012	42,276,824		42,276,824
May 2012	44,835,258		44,835,258
June 2012	44,611,553		44,611,553
July 2012	49,749,192		49,749,192
August 2012	43,464,073		43,464,073
September 2012	45,425,341		45,425,341
October 2012	53,869,764		53,869,764
November 2012	57,588,723		57,588,723
December 2012	60,838,521		60,838,521
January 2013	54,982,692		54,982,692
February 2013	57,830,728	\$21,442,938	79,273,666
March 2013	62,299,929	24,641,387	86,941,316
April 2013	57,078,037	23,471,883	80,549,920
May 2013	65,856,565	26,507,127	92,363,692
June 2013	61,033,491	25,046,090	86,079,581
July 2013	65,809,822	26,581,015	92,390,837
August 2013	64,370,737		64,370,737
September 2013	76,184,497		76,184,497
October 2013	78,609,984		78,609,984
November 2013	78,485,734		78,485,734
December 2013	74,578,510		74,578,510
January 2014	69,929,468		69,929,468
February 2014	69,581,856		69,581,856
March 2014	69,458,394		69,458,394
April 2014	72,333,974		72,333,974
May 2014	81,701,649		81,701,649
June 2014	79,589,331		79,589,331
July 2014	88,319,151	23,492,658	111,811,809
August 2014	89,840,261	27,318,132	117,158,393
September 2014	92,997,837	21,600,134	114,597,971
October 2014	86,826,687	25,662,832	112,489,519
November 2014	84,354,826	28,953,305	113,308,131
December 2014	77,843,898	27,278,909	105,122,807
January 2015	70,401,034	25,185,786	95,586,820
February 2015	54,147,416	19,260,193	73,407,609
March 2015	39,248,769	1,438,668	40,687,437
Total	\$2,631,216,551	\$347,881,057	\$2,979,097,608

The market value of the legacy fund as of March 31, 2015, was \$3,194,769,809. Information regarding market value of the legacy fund by asset class as of March 31, 2015, prepared by RIO is attached as [Appendix C](#). Since its inception, unaudited investment returns on the legacy fund, net of fees, have averaged 3.42 percent compared

17.9004.01000

to a policy benchmark of 2.55 percent. Unaudited fund performance for one year as of March 31, 2015, net of fees, was 5.72 percent compared to a policy benchmark of 5.39 percent.

Based on actual oil and gas gross production tax and oil extraction tax revenue allocations through February 2015 and estimated allocations for the remainder of the 2013-15 biennium, based on the March 2015 revised revenue forecast, the balance in the legacy fund on June 30, 2015, is estimated to total \$3.3 billion. Based on the March 2015 revised revenue forecast and final legislative action, the balance in the legacy fund on June 30, 2017, is estimated to total \$4.3 billion. The updated projections are based on average daily oil production of 1.1 million barrels per day and oil prices increasing from \$42 to \$53 per barrel.

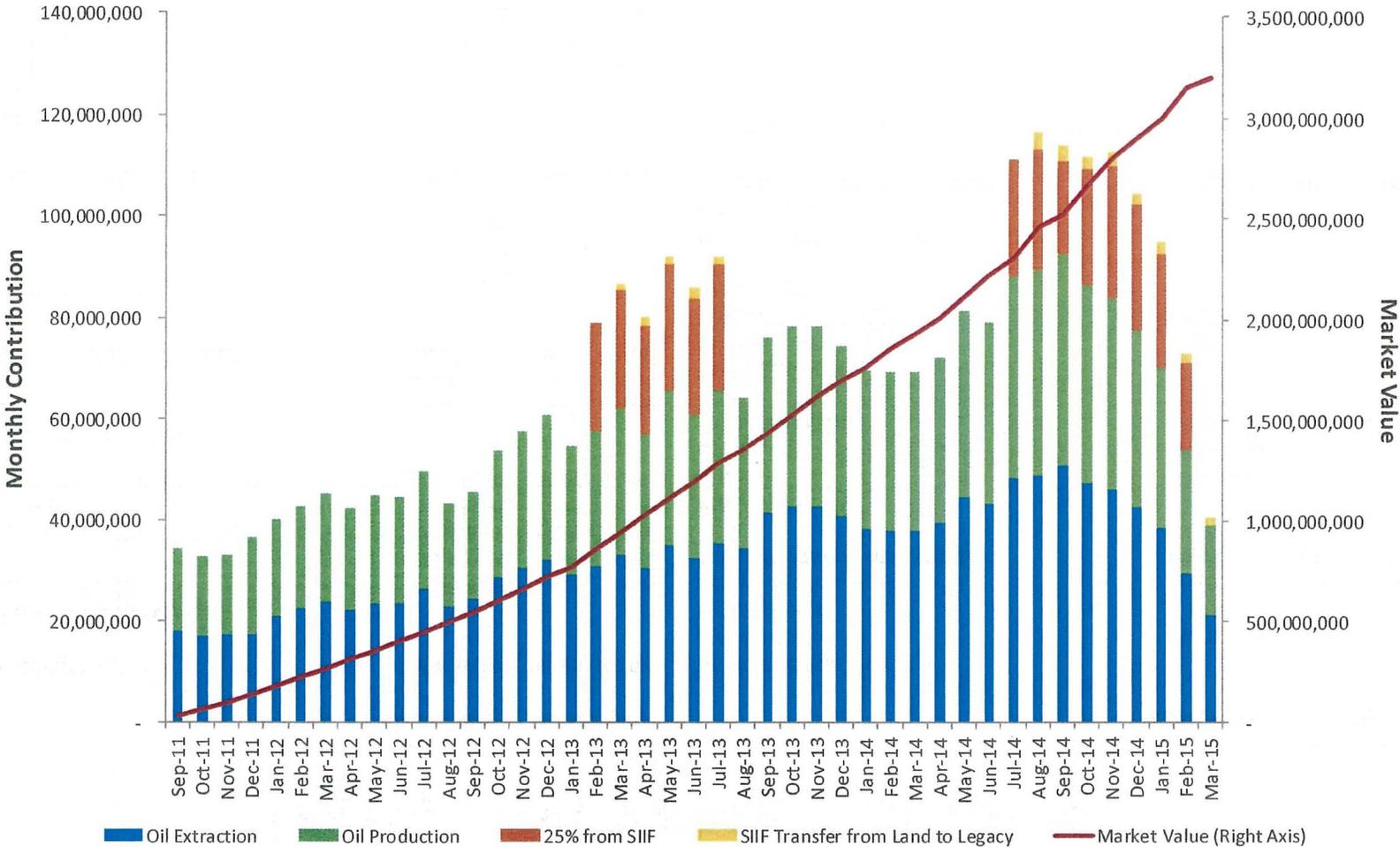
ATTACH:3

Budget Stabilization Fund Manager Structure

	3/31/2015 Market Value	Actual Weight	Policy Weight
TOTAL BUDGET STABILIZATION FUND	595,135,716	100.0%	100.0%
<i>BANK OF NORTH DAKOTA CDs</i>	<i>102,767,901</i>	<i>17.3%</i>	<i>17.3%</i>
CASH EQUIVALENTS			
Northern Trust	7,336,677	1.2%	1.2%
<i>TOTAL CASH EQUIVALENTS</i>	<i>7,336,677</i>	<i>1.2%</i>	<i>1.2%</i>
SHORT TERM FIXED INCOME			
Babson Capital	244,224,152	41.0%	40.7%
JP Morgan	240,806,986	40.5%	40.7%
<i>TOTAL SHORT TERM FIXED INCOME</i>	<i>485,031,138</i>	<i>81.5%</i>	<i>81.5%</i>

NOTE: Monthly market values are preliminary and subject to change.

Legacy Fund Monthly Contributions and Total Market Value



Source: Office of North Dakota State Treasurer

Note: Amounts are preliminary, unaudited and subject to change.

Legacy Fund Manager Structure

	3/31/2015		Allocation			3/31/2015		Allocation	
	Market Value	Actual	Policy	Market Value		Actual	Policy		
TOTAL LEGACY FUND	3,194,769,809	100.0%	100.0%		DIVERSIFIED REAL ASSETS				
LARGE CAP DOMESTIC EQUITY					Western Global TIPS	231,391,136	7.2%	7.6%	
Los Angeles Capital (Growth)	215,038,068	6.7%	6.6%		Grosvenor CIS II	1,968,559	0.1%	0.1%	
LSV	211,420,771	6.6%	6.6%		JP Morgan (Infrastructure)	75,000,000	2.3%	2.3%	
Los Angeles Capital (Enhanced Core)	141,616,596	4.4%	4.4%		TOTAL DIVERSIFIED REAL ASSETS	308,359,695	9.7%	10.0%	
Clifton Group	140,324,506	4.4%	4.4%		REAL ESTATE				
TOTAL LARGE CAP DOMESTIC EQUITY	708,399,941	22.2%	22.0%		JP Morgan	84,506,477	2.6%	2.5%	
SMALL CAP DOMESTIC EQUITY					Invesco	74,554,166	2.3%	2.5%	
Research Affiliates	86,309,721	2.7%	4.0%		TOTAL REAL ESTATE	159,060,643	5.0%	5.0%	
Clifton	176,833,203	5.5%	4.0%		CASH EQUIVALENTS				
TOTAL SMALL CAP DOMESTIC EQUITY	263,142,924	8.2%	8.0%		Northern Trust (1)	39,796,990			
INTERNATIONAL EQUITY					TOTAL CASH EQUIVALENTS	39,796,990	1.2%	0.0%	
Capital Group	254,045,516	8.0%	8.0%		<i>90 Day T-Bill</i>				
LSV	256,497,055	8.0%	8.0%		SHORT TERM FIXED INCOME				
DFA	64,291,680	2.0%	2.0%		Babson Capital	295,646	0.0%	0.0%	
Vanguard	65,735,413	2.1%	2.0%		TOTAL SHORT TERM FIXED INCOME	295,646	0.0%	0.0%	
TOTAL INTERNATIONAL EQUITY	640,569,665	20.1%	20.0%						
FIXED INCOME									
Western Asset	349,582,566	10.9%	11.4%						
Prudential	86,860,421	2.7%	2.8%						
PIMCO (DISCO)	40,878,015	1.3%	1.3%						
PIMCO (BRAVO II)	15,141,639	0.5%	0.5%						
Declaration (Total Return)	86,638,228	2.7%	2.7%						
State Street	148,512,691	4.6%	4.9%						
Wells Capital	347,530,745	10.9%	11.4%						
TOTAL FIXED INCOME	1,075,144,306	33.7%	35.0%						

NOTE: Monthly returns and market values are preliminary and subject to change.