

## **LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD - STATUS REPORT TO THE BUDGET SECTION DECEMBER 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 George Sinner), the Director of the Office of Management and Budget 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 was no transfer to the budget stabilization fund at the end of the 2013-15 biennium. However, in June 2015 approximately \$23 million was transferred from the budget stabilization fund to the general fund, of which approximately \$11 million was principal and \$12 million was earnings, to reduce the balance in the budget stabilization fund to approximately \$574 million or 9.5 percent of 2015-17 biennium 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. Unaudited investment returns, net of fees, have averaged 2.28 percent during the 5 years ended June 30, 2015, compared to a policy benchmark of .42 percent. Unaudited fund performance for the year ended June 30, 2015, net of fees, was 1.86 percent compared to a policy benchmark of .75 percent. Market value of the fund as of September 30, 2015, was \$575.7 million, of which \$10 million (2 percent) is invested in cash equivalents, \$91 million (16 percent) is invested in certificates of deposit at the Bank of North Dakota, and \$474.7 million (82 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 September 30, 2015, prepared by the Retirement and Investment Office (RIO) is attached as [Appendix A](#).

The Legacy and Budget Stabilization Fund Advisory Board requested information regarding the potential effects of revenue shortfalls during the 2015-17 biennium on the budget stabilization fund, including the effect of funds available in the foundation aid stabilization fund on amounts withdrawn from the budget stabilization fund. The Office of Management and Budget has indicated an estimated revenue shortfall of \$300 million would not require an allotment or a transfer from the budget stabilization fund because the 2013-15 biennium ending general fund balance was approximately \$130 million higher than estimated and the Legislative Assembly budgeted for a \$211 million 2015-17 biennium ending general fund balance. However, an estimated revenue shortfall of \$600 million would likely result in a 2.5 percent allotment and a transfer from the budget stabilization fund in excess of \$100 million. Any general fund allotment of state school aid, transportation aid, and special education aid provided to the Department of Public Instruction would be offset by a transfer from the foundation aid stabilization fund.

### **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 and fully implemented as of January 2015:

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- 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.

Prior to July 1, 2015, pursuant to Section 15-08.1-08, if the unobligated balance of the strategic investment and improvements fund (SIIF) exceeded \$300 million at the end of any month, 25 percent of any revenues received for deposit in SIIF in the subsequent month was 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 (2015) 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. Deposits into the legacy fund from its inception through September 2015 total \$3.26 billion as follows:

<b>Month of Deposit</b>	<b>Tax Revenue Deposit</b>	<b>Transfers From the Strategic Investment and Improvements Fund</b>	<b>Total Legacy Fund Deposit</b>
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
April 2015	38,706,412		38,706,412
May 2015	41,626,258		41,626,258

Month of Deposit	Tax Revenue Deposit	Transfers From the Strategic Investment and Improvements Fund	Total Legacy Fund Deposit
June 2015	46,839,874		46,839,874
July 2015	53,878,193		53,878,193
August 2015	52,445,900		52,445,900
September 2015	46,082,947		46,082,947
Total	\$2,910,796,135	\$347,881,057	\$3,258,677,192

Net assets of the legacy fund as of June 30, 2015, were \$3,325,835,711, and market value was \$3,328,600,152. Information regarding market value of the legacy fund by asset class as of June 30, 2015, prepared by RIO is attached as [Appendix B](#). Since its inception unaudited investment returns on the legacy fund, net of fees, have averaged 3.24 percent compared to a policy benchmark of 2.33 percent. Unaudited fund performance for 1 year as of June 30, 2015, net of fees, was 3.31 percent compared to a policy benchmark of 2.56 percent.

Based on the May 2015 legislative forecast the balance in the legacy fund on June 30, 2017, is estimated to total \$4.3 billion. The projections were based on average daily oil production of 1.1 million barrels per day and oil prices increasing from \$42 to \$53 per barrel. The Legacy and Budget Stabilization Fund Advisory Board requested information regarding the potential effects of lower oil prices on the legacy fund. Legislative Council staff compared the May 2015 legislative forecast to a "what if" scenario for the legacy fund. The "what if" scenario was based on actual oil tax revenue collections and allocations for the biennium to date through November 2015 and forecasted amounts from December 2015 through the remainder of the biennium, based on the following:

- Oil prices increasing from \$29.80 to \$36.56 (\$16 less than the May 2015 legislative forecast);
- Oil production decreasing from 1.16 million barrels per day to 1 million barrels per day by the end of the first fiscal year and remaining at 1 million barrels per day for the second year of the biennium; and
- No impact from the "large trigger" because the provisions of the "large trigger" did not become effective.

Based on the "what if" assumptions deposits into the legacy fund would be an estimated \$211.9 million less than what was included in the May 2015 legislative forecast. Lower deposits would be offset slightly by the 2013-15 biennium ending legacy fund balance exceeding the forecast by \$28.8 million. The ending balance in the legacy fund as of June 30, 2017, under the "what if" scenario, is estimated to be \$4.1 billion, \$183.1 million less than the May 2015 legislative forecast.

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