

## NORTH DAKOTA LEGISLATIVE MANAGEMENT

## Minutes of the

**LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD**

Monday, June 16, 2014  
Roughrider Room, State Capitol  
Bismarck, North Dakota

Representative Keith Kempenich, Chairman, called the meeting to order at 1:00 p.m.

**Members present:** Representatives Keith Kempenich, Gary Kreidt; Senators Jerry Klein, Carolyn C. Nelson; Citizen Members Eric Hardmeyer, Pam Sharp

**Member absent:** Citizen Member Ryan Rauschenberger

**Others present:** Joe Morrisette, Tax Department Designee, Bismarck  
See [Appendix A](#) for additional persons present.

**It was moved by Senator Klein, seconded by Mr. Hardmeyer, and carried on a voice vote that the minutes of the November 5, 2013, 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, provided information ([Appendix B](#)) regarding the status and asset allocation of the budget stabilization fund. Mr. Hunter said in August 2013, approximately \$181 million was transferred from the general fund to the budget stabilization fund. He said since its inception, \$567.4 million has been deposited into the budget stabilization fund; investment income has totaled \$57.1 million; and distributions from the fund have totaled \$33.8 million, resulting in net assets of \$590.7 million as of April 30, 2014. He said the asset allocation of the budget stabilization fund is 100 percent short-term fixed income and Bank of North Dakota certificates of deposit. He said because the budget stabilization fund is a reserve fund, assets are invested in short-term (1-year to 3-year) fixed income securities to protect the fund from long-term interest rate risk.

In response to a question from Chairman Kempenich, Mr. Hunter said most of the assets of the budget stabilization fund are managed by Babson Capital and JP Morgan at costs that range from 10 to 14 basis points, based on unaudited fund performance.

Mr. Hunter provided information ([Appendix C](#)) regarding the returns of the budget stabilization fund. Since the fund's inception, he said, unaudited investment returns, net of fees, have averaged 2.34 percent compared to a policy benchmark of 1.66 percent. He said unaudited fund performance for one year as of March 31, 2014, net of fees, was 1.48 percent compared to a policy benchmark of .33 percent.

Mr. Hunter provided information ([Appendix D](#)) regarding the market value of budget stabilization fund assets. He said market value of the fund as of April 30, 2014, was \$590.9 million, of which \$19.4 million (3.3 percent) is invested in cash equivalents, \$106.9 million (18.1 percent) is invested in certificates of deposit at the Bank of North Dakota, and \$464.6 million (78.6 percent) is invested in short-term fixed income securities with Babson Capital and JP Morgan.

**STATUS OF THE LEGACY FUND**

Mr. Hunter provided information ([Appendix E](#)) regarding the status of the legacy fund. He said from inception through April 30, 2014, \$1.933 billion has been deposited into the legacy fund. He said income retained in the fund totaled \$75.1 million, and net assets of the fund as of April 30, 2014, totaled \$2 billion.

Mr. Hunter provided information ([Appendix F](#)) regarding monthly deposits to the fund from September 2011 through April 2014, the legacy fund strategic asset allocation, and the distribution of actual and estimated deposits from July 2013 through January 2015. He said in August 2013, the Retirement and Investment Office began implementing a new policy allocation plan approved by the State Investment Board over an 18-month period using existing managers within the insurance trust. He said the target policy allocation includes 30 percent broad United States equity, 20 percent broad international equity, 35 percent fixed income, 10 percent diversified real estate, and

5 percent core real estate. He said as of April 30, 2014, the asset allocation of the fund includes 32 percent short-term fixed income, 21 percent broad United States equity, 15 percent broad international equity, 26 percent fixed income, 1 percent diversified real estate, and 5 percent core real estate. He said the short-term fixed income currently included in the asset allocation represents funds remaining to be transferred to target asset types.

In response to a question from Mr. Hardmeyer, Mr. Hunter said increases in monthly deposits to the legacy fund relate to increased oil and gas tax collections. He said the estimates do not include additional funding transfers from the strategic investment and improvements fund (SIIF) to the legacy fund. He said it is likely the total market value as of January 31, 2015, will exceed the current estimate of \$2.7 billion.

In response to a question from Senator Nelson, Mr. Darren Schulz, Deputy Chief Investment Officer, State Investment Board, said when the asset allocation transition plan was first implemented, funding transfers were deposited alternately with equity and fixed income managers. He said recently the \$71 million monthly transfer from short-term fixed income and new deposits are deposited with managers based on targeted allocations.

In response to a question from Mr. Hardmeyer, Mr. Hunter said the assets of the legacy fund can be separated from other pooled assets at any time.

Mr. Hunter provided information ([Appendix G](#)) regarding the returns of the legacy fund. Since its inception, he said, unaudited investment returns on the legacy fund, net of fees, have averaged 2.54 percent compared to a policy benchmark of 1.42 percent. He said unaudited fund performance for one year as of March 31, 2014, net of fees, was 3.93 percent compared to a policy benchmark of 2.92 percent.

In response to a question from Chairman Kempenich, Mr. Hunter said the legacy fund is not estimated to reach returns of 6.5 percent until the target policy allocation is fully implemented. He said he is confident the target policy allocation will be implemented as planned by January 31, 2015.

Mr. Hunter provided information ([Appendix H](#)) regarding the market value of legacy fund assets invested with each manager. He said market value of the fund as of April 30, 2014, was \$2,009,264,825. He said investment management fees range from 15 to 20 basis points, based on unaudited fund performance.

In response to a question from Chairman Kempenich, Mr. Hunter said managers are evaluated on a case-by-case basis based on long-term performance and the portfolio management team. He said funds could be moved in three to four months if there was a need, but a change could be made even quicker if a significant problem arose. He said there are no concerns with current managers.

Ms. Kelly L. Schmidt, State Treasurer, said if the unobligated balance of 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. She anticipates SIIF will exceed \$300 million in June 2014, and a portion of SIIF revenues will be transferred to the legacy fund beginning in July. She anticipates the transfers from SIIF to the legacy fund will continue through the remainder of the biennium.

Representative Kreidt asked Ms. Schmidt to inform the advisory board of monthly transfer amounts to the legacy fund.

Chairman Kempenich said mineral resources are finite, and as long as the state is meeting its current obligations, the excess should be saved to meet future needs.

The Legislative Budget Analyst and Auditor said the Government Finance Committee has been assigned a study regarding possible uses of the legacy fund. He said the committee has recommended a bill draft to the Legislative Management to provide that earnings transferred from the legacy fund to the general fund after 2017 be immediately transferred back to the legacy fund to become part of the principal of the fund.

## **ADVISORY BOARD DISCUSSION AND STAFF DIRECTIVES**

In response to a question from Senator Nelson, Mr. Hardmeyer said a bipartisan group of 25 to 30 individuals has been formed to solicit input from communities across the state regarding possible uses for the legacy fund earnings.

In response to a question from Senator Klein, Mr. Hardmeyer said some of the ideas presented to the group include funding existing initiatives, K-12 education, and higher education. He said other ideas include changing the asset allocation of the fund to allow for infrastructure financing. He said there are those who would believe the funding should be retained for future use, but others are concerned that delaying the use of the funding too long could result in an effort to approve an initiated measure to use the funds for a certain purpose.

In response to a question from Chairman Kempenich, Mr. Hunter said fiscal year 2014 financial information should be available in October 2014. The Legislative Budget Analyst and Auditor said the advisory board does not report to the Legislative Management but may report to the Budget Section in December 2014.

Chairman Kempenich said the next advisory board meeting will likely be in November 2014.

No further business appearing, Chairman Kempenich adjourned the meeting at 2:02 p.m.

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Sheila M. Sandness  
Senior Fiscal Analyst

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