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

**Members present:** Representative Keith Kempenich, Gary Kreidt; Senators Jim Dotzenrod, Jerry Klein; Citizen Members Eric Hardmeyer, Joe Morrissette, Ryan Rauschenberger

**Others present:** Representative Corey Mock, Grand Forks, member of the Legislative Management 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 November 28, 2017, meeting be approved as distributed.

**OIL AND GAS TAX REVENUE UPDATE**

At the request of Chairman Kempenich, the Legislative Council staff presented a memorandum entitled Oil and Gas Tax Revenues Monthly Update regarding an update on oil production and prices, oil and gas tax revenue collections, and oil and gas tax revenue allocations for May 2018 and for the biennium to date.

In response to a question from Representative Kreidt, Mr. Ryan Rauschenberger, Tax Commissioner, said North Dakota oil prices are generally discounted $4 to $5 compared to West Texas Intermediate oil prices due to transportation costs.

**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 of the budget stabilization fund, including investment performance, the fund balance, and the investment policy statement. Mr. Hunter said the budget stabilization fund had a net return of 0.35 percent compared to a policy benchmark return of 0.22 percent for the 1-year period ended March 31, 2018. He said the fund had a net return of 1.31 percent compared to a policy benchmark return of 0.62 percent for the 5-year period ended March 31, 2018. He said the market value of the fund was $38.3 million on March 31, 2018. He said the budget stabilization fund received a $62 million transfer on May 21, 2018, which is not reflected in the market value of the fund. He said The asset allocation of the budget stabilization fund is 97 percent short-term fixed income and 3 percent cash and equivalents.

**STATUS OF THE LEGACY FUND**

At the request of Chairman Kempenich, Mr. Hunter presented information (Appendix C) regarding the status of the legacy fund, including investment performance, the fund balance, and investment management fees. Mr. Hunter said the legacy fund had an overall net return of 10.2 percent compared to a policy benchmark return of 8.3 percent for the fiscal year to date through March 31, 2018. He said net earnings for the fiscal year to date through March 31, 2018, totaled $313.8 million, including $171.6 million of realized earnings pursuant to the definition of earnings in North Dakota Century Code Section 21-10-12, and $142.2 million of unrealized gains. He said the market value of the fund was $5.38 billion on March 31, 2018. He said the actual asset allocations of the legacy fund are within 1 percent of the target allocations reflecting the investment policy benchmark of 50 percent equity investments, 35 percent fixed income, and 15 percent real assets. He said investment management fees for the legacy fund totaled $14.6 million in fiscal year 2017, or 0.34 percent of the average market value of the fund's assets. He said the Legislative Assembly, in Section 11 of 2017 House Bill No. 1015, estimates $200 million of earnings will be transferred from the legacy fund to the general fund at the end of the 2017-19 biennium. He said as of March 31, 2018, earnings of the legacy fund eligible for transfer to the general fund at the end of the 2017-19 biennium total $171.6 million.

In response to a question from Senator Klein, Mr. Hunter said total earnings for the period July 1, 2011, through March 31, 2018, are $1.058 billion and realized earnings are $608.5 million.
In response to a question from Mr. Hardemeyer, Mr. Hunter said benchmarks are determined using an industry-wide index (such as S&P 500) depending on the type of asset for each asset class and using a weighted average to determine an overall benchmark. He said benchmarks are reported net of management fees.

In response to a question from Mr. Hardemeyer, Mr. Hunter said with current oil production levels and oil prices, the Retirement and Investment Office estimates $50 million to $60 million in monthly oil and gas tax revenue allocations will be deposited into the legacy fund.

Mr. Paul Erlendson, Senior Vice President, Callan LLC, presented the findings of its asset allocation and spending study of the legacy fund (Appendix D). He said the study reviewed asset mix alternatives, the potential returns, and the associated level of risk. He said the current target has a median annual expected return of 5.8 percent with a 95th percentile return for a loss of 10.9 percent. He said the spending policy of the legacy fund determines the investing policy of the fund. He said the principal balance of the fund is intended for inter-generational use and the investment income is eligible for short-term distribution. He said based on the current policy for the legacy fund, no change in asset allocation is recommended.

In response to a question from Mr. Hardmeyer, Mr. Erlendson said as part of the study, a "worst case" scenario was reviewed with the assumption that 7.5 percent (15 percent per biennium) of principal would be spent and earnings at 3 percent per year would also be spent from the legacy fund. He said this spending rate is much higher than most endowments or permanent funds and a super majority of the Legislative Assembly would be required to spend at that rate. He said this assumption was used only for the purposes of the study.

In response to a question from Representative Mock, Mr. Erlendson said the study compared a scenario of spending income only to a scenario of spending income and 5 percent of principal.

In response to a question from Mr. Morrissette, Mr. Erlendson said the assumed total rate of return was 6 percent and the rate of return for eligible investment income was 3 percent.

Senator Klein said he believes the current asset allocation policy of the legacy fund provides the best rate of return considering the rate of risk.

It was moved by Representative Kreidt, seconded by Mr. Hardmeyer, and carried on a roll call vote that the advisory board accept the report provided by Callan LLC, regarding the asset allocation and spending study of the legacy fund. Representatives Kempenich and Kreidt; Senators Dotzenrod and Klein; and Citizen Members Hardmeyer, Morrissette, and Rauschenberger voted “aye.” No negative votes were cast.

In response to a question from Representative Mock, Ms. Kelly Schmidt, State Treasurer, said more frequent transfers of realized earnings to the general fund would be beneficial, but would require a constitutional change.

At the request of Chairman Kempenich, Mr. Hardmeyer explained a concept for leveraging the legacy fund by providing funds for the infrastructure loan program at the Bank of North Dakota. He said the state could issue $500 million of bonds with the proceeds being deposited into the infrastructure loan program at the Bank. He said the bonds would be repaid using earnings of the legacy fund and the payments on infrastructure loans would be retained in the loan program for making more loans. He said $50 million to $55 million of legacy fund earnings would be needed each biennium to repay $500 million of bonds over 20 years.

In response to a question from Representative Kreidt, Mr. Hardmeyer said the bonds could be issued by the Public Finance Agency, the proceeds would be deposited into the infrastructure loan program, but the payments would be made from the earnings of the legacy fund. He said the loans to political subdivisions would be at a lower rate, possibly 2 percent, for a term of 20 years.

It was moved by Mr. Hardmeyer, seconded by Senator Klein, and carried on a roll call vote that the advisory board recommends the State Investment Board maintain the current asset allocation of the legacy fund. Representatives Kempenich and Kreidt; Senators Dotzenrod and Klein; and Citizen Members Hardmeyer, Morrissette, and Rauschenberger voted “aye.” No negative votes were cast.

No further business appearing, Chairman Kempenich adjourned the meeting at 3:00 p.m.