

LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD - STATUS REPORT TO THE BUDGET SECTION JUNE 26, 2019

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 Jim Dotzenrod), 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.

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. The asset allocation of the budget stabilization fund is 97.7 percent short-term fixed income and 2.3 percent in cash and equivalents. Unaudited investment returns, net of fees, have averaged 1.64 percent during the 5 years ended March 31, 2019, compared to a policy benchmark of 1.16 percent. Unaudited fund performance for the year ended March 31, 2019, net of fees, was 3.13 percent compared to a policy benchmark of 3.02 percent. Market value of the fund as of March 31, 2019, was \$117 million. Information regarding market value of the budget stabilization fund by asset class as of March 31, 2019, prepared by the Retirement and 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 and fully implemented as of January 2015:

- 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.

In November 2017, the Legacy and Budget Stabilization Fund Advisory Board recommended RIO contract with Callan Associates, Ltd., to conduct an asset allocation study of the legacy fund. The Legacy and Budget Stabilization Fund Advisory Board received a report dated May 19, 2018, regarding Callan Associates, Ltd., asset allocation and spending study for the legacy fund. The study recommended no change to the asset allocation of the legacy fund. The Legacy and Budget Stabilization Fund Advisory Board recommended SIB continue the same asset allocation of the legacy fund.

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. Oil and gas tax revenue deposits into the legacy fund from its inception through May 2019 total \$5.1 billion as follows:

Biennium/Month of Deposit	Oil and Gas Tax Revenue Deposit	Transfers from the Strategic Investment and Improvements Fund	Total Legacy Fund Deposit
2011-13 biennium	\$1,066,602,716	\$121,109,425	\$1,187,712,141
2013-15 biennium	1,691,786,379	226,771,632	1,918,558,011
2015-17 biennium	834,355,082		834,355,082
2017-19 biennium to date:			
July 2017	35,319,357		35,319,357
August 2017	31,803,135		31,803,135
September 2017	33,461,246		33,461,246
October 2017	37,219,660		37,219,660
November 2017	37,478,583		37,478,583
December 2017	44,430,941		44,430,941
January 2018	46,242,886		46,242,886
February 2018	50,310,643		50,310,643
March 2018	57,061,632		57,061,632
April 2018	45,701,476		45,701,476
May 2018	51,993,032		51,993,032
June 2018	58,848,164		58,848,164
July 2018	62,538,186		62,538,186
August 2018	58,099,513		58,099,513
September 2018	66,978,003		66,978,003
October 2018	62,090,447		62,090,447
November 2018	68,832,365		68,832,365
December 2018	70,826,949		70,826,949
January 2019	49,277,747		49,277,747
February 2019	37,809,020		37,809,020
March 2019	48,261,533		48,261,533
April 2019	47,794,328		47,794,328
May 2019	56,102,590		56,102,590
Total	\$4,751,225,613	\$347,881,057	\$5,099,106,670

The market value of the legacy fund as of March 31, 2019, was \$6.21 billion. Information regarding market value of the legacy fund by asset class as of March 31, 2019, prepared by RIO is attached as [Appendix B](#). Unaudited fund performance for the year ended March 31, 2019, was 2.58 percent compared to a target return of 3.74 percent. Over the 5-year period ended March 31, 2019, the return was 5.58 percent compared to a target return of 4.92 percent. Net earnings in the fund totaled \$1.35 billion from inception through April 30, 2019, including \$900.8 million of realized earnings based on the definition of earnings in Section 21-10-12. The constitutional measure which created the legacy fund was silent with regard to legacy fund earnings from inception through June 30, 2017; however, a November 2016 Attorney General's opinion stated those earnings should become part of the principal of the legacy fund and may only be expended by the Legislative Assembly with a two-thirds vote. Therefore, earnings accruing through the end of the 2015-17 biennium became part of the principal of the legacy fund. Earnings after June 30, 2017, as defined in Section 21-10-12, must be transferred to the general fund at the end of the 2017-19 biennium and are available for expenditure during the 2017-19 biennium.

The Legislative Assembly, in Section 11 of House Bill No. 1015 (2017), estimated \$200 million of earnings will be transferred from the legacy fund to the general fund at the end of the 2017-19 biennium. However, the legislative revenue forecast, approved by the 2019 Legislative Assembly, includes \$300 million of legacy fund earnings for the 2017-19 biennium. 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 2017-19 biennium closes at the end of July 2019. As of April 30, 2019, earnings of the legacy fund eligible for transfer to the general fund at the end of the 2017-19 biennium is \$464 million.

The balance in the legacy fund as of June 30, 2017, was \$4.686 billion and is estimated to be \$6.389 billion (prior to the transfer of earnings to the general fund) as of June 30, 2019.

ATTACH:2