19.1081.01000

FISCAL NOTE
Requested by Legislative Council
01/14/2019

Bill/Resolution No.: HB 1504

1 A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2017-2019 Biennium		2019-2021 Biennium		2021-2023 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues	$(83,000,000)	$83,000,000	$(15,000,000)	$15,000,000		
Expenditures						
Appropriations						

1 B. **County, city, school district and township fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

	2017-2019 Biennium	2019-2021 Biennium	2021-2023 Biennium
Counties			
Cities			
School Districts			
Townships			

2 A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

House Bill 1504 creates a legacy earnings fund and calls for a transfer from the general fund if the amount of legacy fund earnings transferred to the general fund in accordance with section 26 of article X of the ND Constitution is greater than 5% of the four-year average value of the legacy fund.

B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

HB 1504 calls for a transfer of funds from the general fund to the new legacy earnings fund. This transfer would only occur if the earnings from the legacy fund deposited into the general fund in accordance with section 26 of article X of the ND Constitution are greater than 5% of the four-year average value of legacy fund assets. The amount of the transfer would be equal to the difference between the original transfer of legacy fund earnings into the general fund and the calculated 5% average value.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

HB 1504 contains an emergency clause which, if passed, would make this new language effective for the legacy fund transfer scheduled to occur at the end of the '17-'19 biennium.

2017-2019 Biennium:
The revised executive forecast for '17-'19 estimates $300M in legacy fund earnings will be transferred to the general fund at the end of the biennium. In addition, the average fiscal year-end legacy fund balance for the most recent four years is roughly $4.34B. Using 5% of the $4.34B ($217M), and comparing it to the $300M estimate of earnings, this bill would require roughly $83M be transferred from the general fund into the newly created legacy earnings fund.

2019-2021 Biennium:
The current executive forecast is estimating another $300M in earnings to be transferred into the general fund for the 2019-2021 biennium. Using actual fiscal year-end balances of the legacy fund for FY 2017 and FY 2018 as well

as estimated balances for FY 2019 and FY 2020, the estimated four-year average value of the fund would be about $5.69B. Comparing 5% of this average ($285M) to the estimated amount of legacy fund earnings to be transferred to the general fund ($300M), the required transfer from the general fund to the new legacy earnings fund is estimated to be roughly $15M for the 2019-2021 biennium.

B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation or a part of the appropriation is included in the executive budget or relates to a continuing appropriation.*

Name: Ryan Skor

Agency: Office of State Treasurer

Telephone: (701)328-2643

Date Prepared: 01/18/2019

2019 HOUSE FINANCE AND TAXATION COMMITTEE

HB 1504

2019 HOUSE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1504
1/28/2019
31573

☐ Subcommittee
☐ Conference Committee

Committee Clerk: Mary Brucker

Explanation or reason for introduction of bill/resolution:

A bill relating to the legacy earnings fund and transfers of legacy fund earnings; and to declare an emergency.

Minutes:

Attachments 1-2

Chairman Headland: Opened hearing on HB 1504.

Representative Kempenich: Introduced bill. Distributed written testimony, see attachment #1. This is trying to fix a problem we're having with the legacy fund and pre-spending the earnings. It takes two years to get the numbers we're using. We're trying to guess out 24 months of earnings. It sets up a process of how to calculate what we can or should use out of the earnings. It's sets up a four-year process with a four-year average of the balance of the fund and then five percent. If you use $6 billion and 5% then $300 million is what we'd have available. It sets up a fund in the treasurer's office. The idea is to see if we can get a little more interest off the money. By the Constitution it would have to go into the general fund but it would be a timing issue. The bill isn't changing how we do things today, it's just if we pre-spend. The handout shows we're $306 or $307 million but this isn't including December so we'll have to see what that shows. That's the problem with doing this is that we're dealing with things that don't have a fixed number to it. This is an attempt to give us better management of the fund. It will be growing but it will give us a better idea of what we should be pre-spending out of the legacy fund.

Chairman Headland: It looks like at the end of September there was $306 million available?

Representative Kempenich: October actually. The end of September is when it was run but the end of October is what the $306 million is. In November we were about $342 million but December wasn't kind to us so it dropped back. These figures run about two months behind. June 30 is the end of our fiscal year so we won't know what the earnings are until the end of September. That's where it creates some problems with proposals that have been out this biennium because it's two years out before the actual money shows up. We can manage it until June 30 but if the legislature decides to spend 100% of what's forecasted and something happens it's problematic to meet the demands on it. This bill tries to set up a

percentage. We've allocated the funds with a goal of earnings at 6-6.5% so at 5% that would give us a little margin to make sure we meet that.

Chairman Headland: We used $200 million to get out of last biennium and this biennium. If this number were to hold true that only leaves $100 million allowable to be spent. Anything above that we'll be spending next biennium's earnings.

Representative Kempenich: This would work really well if we didn't pre-spend it because then we would have had $300 million plus September and just guessing at a couple months. Now we're guessing where the earnings are going to be at in this fund 24-28 months for the next biennium.

Chairman Headland: Further testimony in support?

Kelly Schmidt, State Treasurer: Distributed written testimony, see attachment #2. Ended testimony at 10:01.

Representative B. Koppelman: Is anything over 5% going into a special fund?

Kelly Schmidt: Correct.

Representative B. Koppelman: When and how would that special fund money be accessible to the legislature?

Kelly Schmidt: There needs to be a few mechanics added to this bill. My hope is to have a conversation with the chairman, the committee, and the sponsor of the bill to get some of those mechanics in. We have to follow the constitution which requires the transfer.

Representative B. Koppelman: Is the idea of this bill to delay when the legislature spends the money? How does that square with this over 5% in this other fund? I'm trying to figure out how those two pair together.

Kelly Schmidt: He's trying to smooth the earnings so we'd take the smoothing piece and deposit it into this fund. When the actual calculation of earnings is completed at the end of a biennium the difference would be adjusted after that. This would help with eliminating the creeks and valleys in the market, setting the dollars aside for a budget opportunity so you all would know what was going to be available to you based on that smoothing. Then an adjustment would be made at the end of a biennium relating to what the actual earnings would be. We do it all the time in state government relating to forecasting in dollars ending fund balances and making biennial adjustments.

Chairman Headland: Is there further testimony in support? Is there opposition? Seeing none we will close the hearing on HB 1504.

2019 HOUSE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1504
2/5/2019
32216

☐ Subcommittee
☐ Conference Committee

Committee Clerk: Mary Brucker

Explanation or reason for introduction of bill/resolution:

A bill relating to the legacy earnings fund and transfers of legacy fund earnings; and to declare an emergency.

Minutes:

Attachment 1

Chairman Headland: I would like to have the State Treasurer come up and explain what this bill is supposed to do.

Kelly Schmidt, State Treasurer: Distributed testimony, see attachment 1. This bill is set to accomplish a couple things; by smoothing what would be set aside for earnings of the legacy fund we would be taking away some of the risk from market volatility making it easier when dollars become available so it would be easier to budget from those dollars. Instead of having to look at the estimates and the peaks and valleys this would smooth that off. This is something that is done in Washington and Colorado. Please refer to the handout for examples. If you take an average market value of the legacy fund going back to 2014 and take 5% of that we'd be at $196 million or take 4% of the three-year average market value as Colorado does we'd be at $187 million. This bill would set these dollars aside, put them in the legacy earnings fund, and we would be able to then use that dollar amount going forward into the next legislative session.

Chairman Headland: How would this impact the last bill we just passed?

Kelly Schmidt: There is so much discussion on the legacy fund earnings. We've been working very hard in discussion on how we're going to reduce market volatility when looking at earnings from the legacy fund and how we can reduce pre-spending of legacy fund earnings that were done this current biennium to the tune of $200 million. My concern as Treasurer is that if we get to a point where we are pre-spending earnings from the legacy fund to the tune of $1 billion we just can't do that in the treasury. Cash flowing $1 billion out of the general fund and giving a 0% two-year loan we just can't do. This bill is an attempt to try and take away the risk of market volatility and the risk of pre-spending. Since you already passed the bill that just went out I'm going to stand with Representative Dockter because I love that bill. The reason I love that bill is because you've made a decision on what you would like to see happen to the legacy fund earnings. As being someone who has to set an

asset allocation to determine how we're going to invest those earnings and to know that there is a plan because there hasn't been one. We have to invest based on certain dollar amounts being spent every two years including a portion of the principle. I would agree with you that it would be difficult to do one versus the other. Setting aside these dollars into the earnings fund would just hold the money in order for us to use the earnings that had been set aside there for the opportunity to work down those tax.

Representative B. Koppelman: If we use these methods it takes $100 million off the table to be spent in the legacy fund. We're expecting this year, including the $200 that was pre-spent, to have $300 total.

Kelly Schmidt: Right now it's $336 million as of December 31.

Representative B. Koppelman: If we use this method today there would only be $196 million available.

Kelly Schmidt: That's correct depending on the dates you would use. As the fund goes up so is this dollar amount because we would be taking the overall balance and the lower balance would fall off. The lowest year would fall off because the fund is always going to continue to grow.

Representative B. Koppelman: We'll still have another June 30 before this calculation is final so presumably there will be maybe $6 billion on that reading and then the $2.2 billion would fall off the five year rolling average so then it might be $220 million but it still won't be $330 some million as it would otherwise be without a smoothing. Representative Kempenich is trying to take some of that money off the table from gambling on the fringes and going with what a safe estimate is.

Kelly Schmidt: I would agree however, there wouldn't be $300 million available because you spent $200 million of it.

Representative B. Koppelman: If we use this we would have zero left based on what was pre-spent as opposed to having $120 million like some are suggesting with our current process. My concern with the bill we just passed is if we used a method like this it would probably delay the effect of income tax relief.

Kelly Schmidt: I agree with that. I don't believe it was the intent of the legislative body to pre-spend $200 million as was done last legislative session.

Chairman Headland: That puts an interesting perspective on this bill for me. I don't know that we should pass both but I'm not completely wanting to dismiss this so maybe a study should be looked at during the interim.

Representative Dockter: We could do a hog house and put it in as a study.

Chairman Headland: I think that is something I would want to agree with. I don't want to take it off the table what we've already passed by passing something else that would impact that.

Representative Dockter: Could we have our intern write up a study?

Chairman Headland: We're already smoothing common schools trust fund.

Kelly Schmidt: Yes and that's where this idea came from.

Chairman Headland: So actually is there a need to study it?

Kelly Schmidt: As it relates to the set aside fund, if this bill were to move forward it would need some amending just to put in the mechanics of what we want to do with the set aside fund. We need to make sure it's marrying it up with the constitutional provision that has already been relating to the legacy fund. I think it merits a study if for the sake of conversation.

Chairman Headland: Or we could find out if there was a possibility of delaying because with the last bill when we get into future biennium we're only taking 50 percent. In theory this smoothing could be set aside out of the other 50 percent.

Representative B. Koppelman: If we pretend your bill that we just passed had passed last session, so there wasn't that $300 million provision and we were starting with $300 million because we hadn't pre-spent it, your 50% income tax reduction would now be $100 million instead of being $150 million. So I don't think we can do it.

Chairman Headland: That's right.

Representative B. Koppelman: Do we need this because we're in the habit of pre-spending? If we're going to pre-spend going into the future, then this would make sense but if we're not going to pre-spend then we're never going to overspend because we'll know what we have six months before we get here to spend it.

Chairman Headland: I would agree with that.

Representative B. Koppelman: MADE A MOTION FOR A DO NOT PASS

Representative Dockter: SECONDED. I think we need to keep it a legacy so whatever we can do to study it I'm for.

Chairman Headland: Does everybody understand what we're doing with the do not pass and why?

ROLL CALL VOTE: 12 YES 2 NO 0 ABSENT
MOTION CARRIED

Representative B. Koppelman will carry this bill.

2019 HOUSE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1504
2/6/2019
32313

☐ Subcommittee
☐ Conference Committee

Committee Clerk: Mary Brucker

Explanation or reason for introduction of bill/resolution:

A bill relating to the legacy earnings fund and transfers of legacy fund earnings; and to declare an emergency.

Minutes: No attachments

Chairman Headland: I'd like to address this bill. I had a couple conversations and I think there was an idea we should possibly consider. Could I get a motion to reconsider our actions whereby we passed out this bill?

Representative Fisher: MADE A MOTION TO RECONSIDER OUR ACTIONS

Representative B. Koppelman: SECONDED

VOICE VOTE: MOTION CARRIED

Representative B. Koppelman: I'm the carrier of this bill. One of the reasons we defeated this bill dealing with the smoothing of the revenues was because we all support the long term income reduction that we passed out of the committee. This would cut our tax reductions by a third if we use this method so we did a do not pass. If want to preserve the integrity of what the chairman's bill does, we should hog house this bill into a bill that said we believe the legacy fund money shouldn't be spent until the biennium following its realization. Last session we spent legacy money in hopes we would get more. This would say that once we know we have $300 million then you can consider spending it. Not only would it better protect the fund but it would allow us to earn additional interest on that money as we go between the one biennium and the following legislative session's effective dates.

Chairman Headland: In talking with the bill sponsor he liked the idea. As a committee, do you think we can come up with the right language and send it up to Council so they can fix it. We'll stand at ease so we can figure out this language.

Representative B. Koppelman: In this bill we'd like to hog house amend it into a bill that would direct the legislative assembly that we would not spend legacy fund earnings until after

their recognized in the fund. We want to make sure we don't mess up the income tax buy down bill, HB 1530, with this language.

Emily Thompson, Legislative Council: So this is taking 50% of the legacy fund earnings transferring it into the general fund and you want to hog house this bill?

Chairman Headland: Representative B. Koppelman will you explain how you want HB 1504 to read?

Representative B. Koppelman: The intent of the new HB 1504 we'd like to hog house amend it to monies that are deposited into the general fund could not be appropriated until after the date they are received in the general fund. This was stop the practice of pre-spending in the legislative session prior. They deposit the money on the last date of the biennium, June 30. We don't want to mess up HB 1530 with this language.

Allan Knudson, Legislative Council: This bill was initially trying to stabilize the money in the general fund. One concern is you don't know how much you're going to get until the last day. Because it is transferred into the general fund it can be spent anytime throughout the biennium because it is part of general fund revenues for that biennium. One option you have is if you take out the part about in excess of a four-year average value legacy fund. As soon as the money comes into the general fund it gets transferred to the legacy earnings fund or if you want the two to be compatible you could transfer all the earnings into this income tax rate reduction fund. It would be nice to have them both work out of the same funding. The main thing is to have the treasurer transfer the money out of the fund right away because then you wouldn't be able to spend it until you know what's there and it would be there for the next legislative session to spend. If you keep it in the general fund you can't say that you can't spend it until it's there because you can't commit a future legislature, they can do what they want. If you get it out of the general fund into a special fund, then you can have a little more control over when you can spend it.

Chairman Headland: Last session when we used $200 million of anticipated earnings, those earnings were not in the general fund yet?

Allan Knudson: That's correct.

Chairman Headland: I think Representative B. Koppelman is asking for is that we don't spend future earnings after this in the prior biennium. Is there a way we can write that into something without it effecting these other bills?

Allan Knudson: It would just be legislative intent that the legislature doesn't spend the money until it's actually there.

Chairman Headland: Does that work for what you want to do?

Representative B. Koppelman: Maybe but something he said might work better. If we were to strike on line 10, "in excess of 5% of a four-year average value of legacy fund assets" and on line 12 we strike "the average value of the legacy fund assets must be determined by using the assets ending value for the recent four fiscal years." We could add "on June 30 of

the following biennium the treasurer shall transfer that money back to the general fund." Then the new earnings would go into the sinking fund and be off limits for general fund spending and last year's earnings would go back to the general fund. Wouldn't that achieve the same thing?

Allan Knudson: It would but it might miss up this bill because you're taking all the earnings. Unless you just took 50% of the earnings to this fund and the other 50% in the other fund.

Representative B. Koppelman: We could do that.

Chairman Headland: That takes it away from any legislator ability to try and get what they believe their legacy project would be, doesn't it?

Representative B. Koppelman: It would take the 50% off the bill you're suggesting. I don't think it would take anybody's projects off. They would have to base their projects on money that was already recognized and not future dollars.

Representative Hatlestad: When do you make that money available?

Representative B. Koppelman: June 30 of the following biennium is when 50% of the money would go back to the general fund.

Allan Knudson: You could do it the next year instead because then it would be available earlier in the biennium.

Chairman Headland: The more we go on the more I feel would impact the bill. I wonder if we shouldn't let the bill die like we were going to do. I'll certainly listen to what you have to say.

Representative B. Koppelman: If we're this close the rest of the process would handle minor tweaks to the language as long as the intent in there. We could make the motion and pass the bill.

Representative Steiner: MADE A MOTION FOR A DO NOT PASS

Vice Chairman Grueneich: SECONDED

Representative Steiner: This is a big policy decision. Before we make that major of a policy decision we should have a lot more testimony and input. We're changing the intent of the smoothing. It could be good policy but I don't feel comfortable voting for it in a rush. This concept could be attached to another vehicle as long as everybody else is comfortable.

Representative Hatlestad: I don't disagree but we could pass it as projected then the Senate gets the bill. We lock up the earning money until a time when we know what we're doing.

Chairman Headland: My initial thought in bringing this back was to write something into legislative intent but now we're creating this other bucket and it's gotten too complex.

ROLL CALL VOTE: 11 YES 3 NO 0 ABSENT

MOTION CARRIED

Representative B. Koppelman will carry this bill.

Date: 2-5-19
Roll Call Vote #: 1

2019 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1504

House Finance and Taxation Committee

☐ Subcommittee

Amendment LC# or Description:

Recommendation:
☐ Adopt Amendment
☐ Do Pass ☑ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐

Motion Made By Rep. Koppelman Seconded By Rep. Dockter

Representatives	Yes	No	Representatives	Yes	No
Chairman Headland	✓		Representative Eidson	✓	
Vice Chairman Grueneich	✓		Representative Mitskog		✓
Representative Blum	✓				
Representative Dockter	✓				
Representative Ertelt		✓			
Representative Fisher	✓				
Representative Hatlestad	✓				
Representative Kading	✓				
Representative Koppelman	✓				
Representative Steiner	✓				
Representative Toman	✓				
Representative Trottier	✓				

Total (Yes) 12 No 2

Absent 0

Floor Assignment Rep. Koppelman

If the vote is on an amendment, briefly indicate intent:

Date: 2-6-19
Roll Call Vote #: 1

2019 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1504

House Finance and Taxation Committee

☐ Subcommittee

Amendment LC# or Description: _____

Recommendation:
☐ Adopt Amendment
☐ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☒ Reconsider ☐ _____

Motion Made By Rep. Fisher Seconded By Rep. Koppelman

Representatives	Yes	No	Representatives	Yes	No
Chairman Headland			Representative Eidson		
Vice Chairman Grueneich			Representative Mitskog		
Representative Blum					
Representative Dockter					
Representative Ertelt					
Representative Fisher					
Representative Hatlestad					
Representative Kading					
Representative Koppelman					
Representative Steiner					
Representative Toman					
Representative Trottier					

Total (Yes) _____ No _____

Absent _____

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

Voice Vote = Motion carried

Date: 2-6-19
Roll Call Vote #: 2

2019 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1504

House Finance and Taxation Committee

☐ Subcommittee

Amendment LC# or Description:

Recommendation:
☐ Adopt Amendment
☐ Do Pass ☑ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐

Motion Made By Rep. Steiner Seconded By Rep. Grueneich

Representatives	Yes	No	Representatives	Yes	No
Chairman Headland	✓		Representative Eidson	✓	
Vice Chairman Grueneich	✓		Representative Mitskog	✓	
Representative Blum	✓				
Representative Dockter	✓				
Representative Ertelt		✓			
Representative Fisher	✓				
Representative Hatlestad	✓				
Representative Kading		✓			
Representative Koppelman	✓				
Representative Steiner	✓				
Representative Toman		✓			
Representative Trottier	✓				

Total (Yes) 11 No 3

Absent 0

Floor Assignment Rep. Koppelman

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1504: Finance and Taxation Committee (Rep. Headland, Chairman) recommends **DO NOT PASS** (11 YEAS, 3 NAYS, 0 ABSENT AND NOT VOTING). HB 1504 was placed on the Eleventh order on the calendar.

2019 TESTIMONY

HB 1504

APPENDIX B

LEGACY FUND
Statement of Net Position
As of 9/30/2018

Legacy Fund balances and returns are posted on RIO's website at each month-end.

	As of 9-30-18	As of 6-30-18
ASSETS:		
INVESTMENTS (AT FAIR VALUE)		
GLOBAL EQUITIES	$ 2,944,414,308	$ 2,766,036,036
GLOBAL FIXED INCOME	2,037,448,765	1,929,981,907
GLOBAL REAL ASSETS	828,654,190	805,149,765
INVESTED CASH (NOTE 1)	52,443,540	54,793,877
TOTAL INVESTMENTS	5,862,960,803	5,555,961,585
RECEIVABLES		
DIVIDEND/INTEREST RECEIVABLE	23,155,064	21,357,528
MISCELLANEOUS RECEIVABLE	5,840	14,495
TOTAL RECEIVABLES	23,160,904	21,372,023
OTHER ASSETS		
INVESTED SECURITIES LENDING COLLATERAL (NOTE 2)	25,627,173	24,284,177
OPERATING CASH	162,350	208,349
TOTAL ASSETS	5,911,911,230	5,601,826,134
DEFERRED OUTFLOWS OF RESOURCES		
DEFERRED OUTFLOWS RELATED TO PENSIONS	244,618	271,634
LIABILITIES:		
SECURITIES LENDING COLLATERAL (NOTE 2)	25,627,173	24,284,177
ACCOUNTS PAYABLE	15,050	71,703
ACCRUED EXPENSES	470,495	497,792
INVESTMENT EXPENSE PAYABLE	1,150,895	1,150,895
TOTAL LIABILITIES	27,263,613	26,004,567
DEFERRED INFLOWS OF RESOURCES		
DEFERRED INFLOWS RELATED TO PENSIONS	9,183	9,183
NET POSITION:		
HELD IN TRUST	5,884,883,052	5,576,084,018
TOTAL NET POSITION	$ 5,884,883,052	$ 5,576,084,018

These financial statements are preliminary, unaudited and subject to change. 11/5/2018

LEGACY FUND
Statement of Changes in Net Position
For the Month Ended 9/30/2018

	Month Ended 9-30-18	Year-to-Date
ADDITIONS:		
INVESTMENT INCOME		
GAIN ON SALE OF INVESTMENTS	$ 53,377,218	$ 161,741,886
LOSS ON SALE OF INVESTMENTS	52,373,438	123,736,320
NET GAINS (LOSSES) INVESTMENTS	1,003,780	38,005,566
NET APPREC (DEPREC) MARKET VALUE	(28,471,285)	57,529,586
NET CHANGE IN FAIR VALUE OF INVESTMENTS	(27,467,505)	95,535,152
INTEREST, DIVIDEND & OTHER INVESTMENT INCOME	12,496,702	27,819,296
	(14,970,803)	123,354,448
LESS INVESTMENT EXPENSES	-	2,200,473
NET INCOME FROM INVESTING ACTIVITIES	(14,970,803)	121,153,975
SECURITIES LENDING INCOME	48,020	197,384
SECURITIES LENDING EXPENSES	9,594	39,444
NET SECURITIES LENDING INCOME	38,426	157,940
NET INVESTMENT INCOME	(14,932,377)	121,311,915

EARNINGS AVAILABLE

Section 26 of Article X of the Constitution of North Dakota dictates that earnings of the Legacy Fund accruing after June 30, 2017, shall be transferred to the general fund at the end of each biennium. Earnings accrued prior to June 30, 2017, become part of the principal of the fund.

NDCC 21-10-12 defines "earnings" for the purposes of Section 26, Article X as "net income in accordance with generally accepted accounting principles, excluding any unrealized gains or losses."

As of the date of these financial statements, the principal balance of the Legacy Fund is $ 5,094,951,361

As of the date of these financial statements, earnings of the Legacy Fund eligible for transfer to General Fund at the end of the biennium is $ 306,513,586

#1 HB 1504 1-28-19 P-1

pdf-notes for iPad

Legacy Fund – Actual Performance vs Policy Benchmark

Net Returns Exceed Policy Benchmark – Periods Ended 9/30/18

	Quarter Ended 9/30/2018	1 Yr Ended 9/30/2018	3 Yrs Ended 9/30/2018	5 Yrs Ended 9/30/2018	Risk 5 Yrs Ended 9/30/2018	Risk Adj Excess Return 5 Yrs Ended 9/30/2018
Total Fund Return - Net	2.16%	6.04%	9.19%	6.31%	4.11%	0.52%
Policy Benchmark Return	2.19%	5.51%	8.00%	5.28%	3.75%	
					OK	

1. **For the 1-Year Ended 9/30/2018**, the Legacy Fund earned a **Net Return of 6.04%** exceeding the Policy Benchmark of 5.51% and creating **Excess Return of 0.53%.** Actual net returns exceed the Policy Benchmark by **$25 million for the 1-year ended 9/30/2018** (e.g. $5 billion x 0.50% = $25 million).
2. **For the 5-Years Ended 9/30/2018,** the Fund earned a **Net Return of 6.31%** exceeding the Policy Benchmark (of 5.28%) and creating **Excess Return of 1.03%.** Actual returns exceed Policy by **$150 million for the 5 years ended 9/30/2018** (e.g. $3 billion x 1.0% = $30 million x 5 years = $150 million).
3. **The above benchmark returns were achieved while adhering to approved risk levels.**

The Policy Benchmark is 50% Equity, 35% Bonds and 15% Real Assets (including Real Estate and Infrastructure).

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Note: All amounts are preliminary, unaudited and subject to change including estimates of excess returns.

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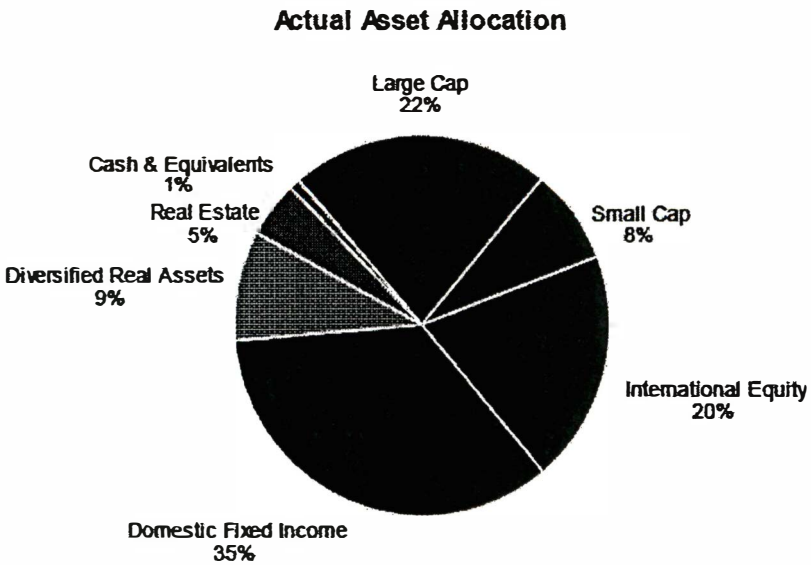
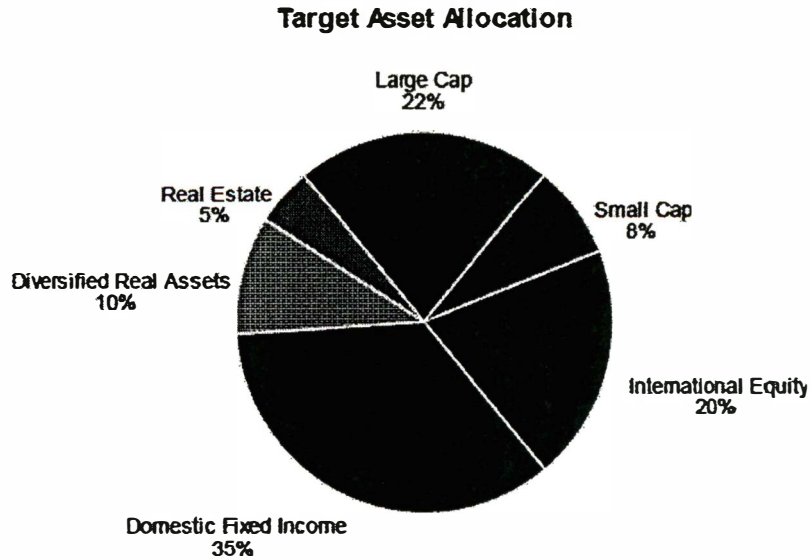
Legacy Fund

Actual Allocations are within 1% of Target as of Sep. 30, 2018





Asset Class	$000s Actual	Weight Actual	Target	Percent Difference	$000s Difference
Large Cap	1,315,453	22.3%	22.0%	0.3%	20,507
Small Cap	474,473	8.1%	8.0%	0.1%	3,584
International Equity	1,160,993	19.7%	20.0%	(0.3%)	(16,230)
Domestic Fixed Income	2,050,114	34.8%	35.0%	(0.2%)	(10,026)
Diversified Real Assets	549,288	9.3%	10.0%	(0.7%)	(39,324)
Real Estate	283,299	4.8%	5.0%	(0.2%)	(11,007)
Cash & Equivalents	52,496	0.9%	0.0%	0.9%	52,496
Total	5,886,116	100.0%	100.0%		

Callan notes that "Allocations are well within target ranges. The Legacy Fund's rebalancing benefits from significant monthly cash inflows which allow RIO to tightly control exposures to liquid asset classes."

Policy Benchmark = 22% Russell 1000, 8% Russell 2000, 20% MSCI World ex US, 35% Bloomberg Aggregate, 10% SIB DRA, 5% NCREIF.

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ND Legacy Fund
Summary of Deposits, Earnings and Net Position
As of September 30, 2018

	Deposits	Total Net Earnings	Net Increase/ (Decrease)	Ending Net Position	Earnings as defined in NDCC 21-10-12
FY2012	**396,585,658**	2,300,225	398,885,883	398,885,883	**2,571,475**
FY2013	**791,126,479**	4,216,026	795,342,505	1,194,228,388	**15,949,089**
FY2014	**907,214,971**	113,153,662	1,020,368,633	2,214,597,021	**50,033,655**
FY2015	**1,011,343,040**	99,895,650	1,111,238,690	3,325,835,711	**95,143,905**
FY2016	**434,853,950**	45,851,680	480,705,630	3,806,541,341	**65,326,673**
FY2017	**399,501,134**	479,595,256	879,096,390	4,685,637,731	**207,814,875**
Totals	**3,940,625,232**	745,012,499	4,685,637,731	4,685,637,731	**436,839,672**
					Transferrable Earnings
FY2018	**529,870,755**	**360,575,532**	**890,446,287**	**5,576,084,018**	**242,859,840**
FY2019 *	***187,615,702***	***121,183,332***	***308,799,034***	***5,884,883,052***	***63,653,746***
		481,758,864			306,513,586
Life-to-date Totals	**4,658,111,689**	**1,226,771,363**	**5,884,883,052**	**5,884,883,052**	**743,353,258**

** FY2019 amounts are preliminary and unaudited.*

All earnings prior through 6/30/17 became part of principal.

The Legacy Fund approached $5.9 billion at Sep. 30, 2018. Net Investment Income exceeded $1.2 billion since inception including $481 million in Fiscal 2018-19. Earnings as defined by NDCC 21-10-12 approximated $306 million for the 15 months ended September 30, 2018.

NDCC 21-10-12 defines "earnings" as net income in accordance with generally accepted accounting principles excluding any unrealized gains or losses.

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North Dakota

State Of North Dakota
Office of State Treasurer
Kelly L. Schmidt, State Treasurer

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Kelly Schmidt, State Treasurer

In Support of HB 1504

House Finance & Tax

Rep. Craig Headland, Chair

Rep. Jim Grueneich, Vice-Chair

January 28, 2019

Mr. Chairman and members of the committee, I support the concept and intent created by HB 1504 to smooth the earnings of the Legacy Fund.

The Treasurer has two roles which relate to this bill, one as a member of the State Investment Board and fiduciary of the Legacy Fund and two, as sole fiduciary of the general fund.

The smoothing of Legacy Fund earnings will reduce the risk of market volatility when calculating earnings and the budgeting of those earnings. This practice is used with the Common School Trust Fund (CSTF). Distributions from the CSTF are based upon the growth in value of the trust's assets over time. Biennial distributions from the trust must be 10% of the five-year average value of the trust assets. This bill would provide for the same smoothing practice. It would be 5% (Legacy) rather than 10% (CSTF).

As fiduciary of the General Fund, I have concerns relating to the pre-spending of Legacy Fund earnings. This fund is different than most forecasted revenue in a few ways:

1. Legacy Fund deposits come from 100% oil, a volatile commodity.
2. Increased market volatility exposure due to the earnings definition found in NDCC 21-10-12 which contains "gains or losses", rather than a definition of interest and dividends.
3. Additional risk is added due to the timing of the deposit. If we wait to use earnings, there will be 18 months of earnings history prior to a legislative session. If we don't wait, we are guessing what the capital markets will do over an extended period to provide earnings through the future biennium.

Example: 2019-21 Legacy Fund projects approved this session will be cash flowed from the general fund and reimbursed to the general fund at the end of fiscal year 2021.

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The 2017 Legislative Assembly appropriated $200M of Legacy Fund earnings to balance the 2017-2019 biennial budget. These earnings were pre-spent, the general fund will not be made whole until the earnings deposit is made in July 2019 (estimate). We have been loaning $200M from the general fund at 0% interest.

As the Legacy Fund grows, so will the earnings. It is my hope will in some day see $1B in earnings. However, pre-spending and the need to cash flow at that level would be impossible. It is my hope this bill could also address the pre-spending of Legacy Fund earnings.

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State Of North Dakota
Office of State Treasurer
Kelly L. Schmidt, State Treasurer

HB 1504

House Finance and Tax

Follow up information

Kelly Schmidt, State Treasurer

Examples of Legacy Fund Spending Policy: Wyoming spending policy 5% of the 5-year average market value. ND Common Schools Trust Fund 10% of the 5-year average. Colorado 4% of the3-year average. The distribution amount would increase as the principle grows and reduce market volatility.

Legacy Earnings Fund (smoothing) Example: (in HB 1504)

5% of the 5- year average market value (Wyoming, one-third of their general fund budget is financed from this fund)

June 30, 2018 - $5,576,084,018
June 30, 2017 - $4,685,637,731
June 30, 2016 - $3,806,541,341
June 30, 2015 - $3,325,835,711
June 30, 2014 - $2,214,597,021

Average - $3,921,739,164 x 5% = **$196,086,958**

4% of the 3 -year average market value (Colorado)

June 30, 2018 - $5,576,084,018
June 30, 2017 - $4,685,637,731
June 30, 2016 - $3,806,541,341

Average - $4,689,421,030 x 4% = **$187,576,841.20**

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