

## NORTH DAKOTA LEGISLATIVE MANAGEMENT

## Minutes of the

**LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD**

Monday, December 5, 2016  
Medora Room, State Capitol  
Bismarck, North Dakota

Representative Keith Kempenich, Chairman, called the meeting to order at 3:30 p.m.

**Members present:** Representatives Keith Kempenich and Gary Kreidt; Senators Jim Dotzenrod and Jerry Klein; Citizen Members Eric Hardmeyer, Ryan Rauschenberger, and Pam Sharp

**Others present:** See [Appendix A](#) for additional persons present.

**It was moved by Representative Kreidt, seconded by Mr. Rauschenberger, and carried on a voice vote that the minutes of the June 15, 2016, 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, presented information ([Appendix B](#)) regarding the status and asset allocation of the budget stabilization fund. He said since its inception, \$567.4 million has been deposited into the budget stabilization fund, investment income has totaled \$83.6 million, and distributions from the fund have totaled \$72.9 million, resulting in net assets of \$578.1 million as of September 30, 2016. He said in June 2016 approximately \$8.6 million was transferred from the budget stabilization fund to the general fund. He said the market value of the fund as of September 30, 2016, was approximately \$578.3 million. He said, due to general fund shortfalls, the Retirement and Investment Office (RIO) transferred \$375 million from the budget stabilization fund to the general fund in October 2016 and approximately \$203.6 million remains in the budget stabilization fund. He said the asset allocation of the fund is 100 percent short-term fixed income and Bank of North Dakota certificates of deposit (CDs). However, he said RIO has begun to transfer the Bank of North Dakota Match Loan CD Program from the budget stabilization fund to the legacy fund.

Mr. Hunter presented information ([Appendix C](#)) regarding the budget stabilization fund investment performance. He said for the current fiscal year-to-date through September 30, 2016, the budget stabilization fund had a net return of .42 percent compared to a policy benchmark return of .01 percent. He said for the 5-year period ended September 30, 2016, the total fund net return was 2.03 percent compared to a policy benchmark return of .69 percent.

Mr. Hunter provided information ([Appendix D](#)) regarding changes to the budget stabilization fund investment policy statement related to investments in Bank of North Dakota CDs. He said policy statement revisions, approved by the State Investment Board in July 2016, provide for the transfer of Bank of North Dakota CDs to the legacy fund on or before July 1, 2017.

**STATUS OF THE LEGACY FUND**

At the request of Chairman Kempenich, Mr. Hunter presented information ([Appendix E](#)) regarding the status of the legacy fund. He said from inception through September 30, 2016, \$3.641 billion has been deposited into the legacy fund. He said income retained in the fund totaled \$426.4 million, and net assets of the fund as of September 30, 2016, totaled \$4.067 billion. He said the market value of the fund as of September 30, 2016, was approximately \$4.070 billion.

Mr. Hunter presented a summary ([Appendix F](#)) of legacy fund investments by asset class as of October 31, 2016. He said RIO began investing in short-term cash deposits with the Bank of North Dakota in September 2016 in order to enhance risk adjusted returns. He said \$29.6 million of the Bank's Match Loan CDs were transferred from the budget stabilization fund to the legacy fund in October. He said the Bank's Match Loan CD Program is limited to 5 percent of the legacy fund, which is approximately \$200 million based on the current balance in the fund. He said the Bank's Match Loan CD Program currently totals \$78 million. He said actual investment allocations are within 1 to 2 percent of target investment allocations.

In response to a question from Chairman Kempenich, Mr. Hunter said RIO's investment consultant contract allows for two projects each fiscal year. He said RIO could perform an asset liability study for the legacy fund at no added cost.

Mr. Hunter presented information ([Appendix G](#)) regarding the legacy fund asset allocation and performance, compared to policy benchmarks for the 1-, 3-, and 5-year periods ended September 30, 2016. He said the unaudited return for the year ended September 30, 2016, was 10.18 percent compared to a target return of 8.85 percent. He said over the 5-year period ended September 30, 2016, the return was 3.49 percent compared to a target return of 2.52 percent. He said, while net earnings in the fund totaled \$426 million through September 30, 2016, investment earnings, as defined by North Dakota Century Code Section 21-10-02, totaled \$288.6 million.

Mr. Hunter provided information ([Appendix H](#)) regarding changes to the legacy fund investment policy statement related to investments in Bank of North Dakota CDs. He said policy statement revisions, approved by the State Investment Board in July 2016, provide for the transfer of Bank of North Dakota CDs from the budget stabilization fund to the legacy fund on or before July 1, 2017. He said the Bank will be requested to guarantee a minimum 1.75 percent investment return; however, the minimum return requirement will be periodically reviewed in connection with the legacy fund's overall asset allocation.

Mr. Hunter also provided information ([Appendix I](#)) regarding:

- State Investment Board client assets under management;
- Net investment return summary;
- Investment consultants and professional service providers;
- State Investment Board members and processes;
- Retirement and Investment Office transparency enhancements;
- Chapter 21-10 relating to the State Investment Board; and
- Legacy fund highlights - September 30, 2016

Chairman Kempenich said the cost of bonding for funds during the 2017-19 biennium may be less than the cost of liquidating legacy fund assets. He requested RIO review the cost of accessing legacy fund earnings.

Mr. Hardmeyer said political subdivisions have suggested the legacy fund be used to provide political subdivision loans.

Chairman Kempenich said political subdivision loans from the legacy fund might be appropriate; however, the cost of dismantling fund investments to provide the loans must be considered. He said a political subdivision loan program might be structured similar to the Bank's Match Loan CD Program, but the risk of political subdivision loans would have to fit the risk reward acceptable for the legacy fund.

Senator Dotzenrod said a portion of the fixed income allocation of the legacy fund could be set up as a revolving loan fund.

Mr. Hunter said there is untapped capacity in the investment allocation available in the legacy fund for the Bank's Match Loan CD Program. He said currently approximately \$80 million of the \$200 million available for the Bank's Match Loan CD Program has been invested.

Chairman Kempenich said the advisory board will need additional information before making a recommendation regarding the use of legacy fund investments for political subdivision loans.

Senator Klein said constituents have expressed their desire for the Legislative Assembly to maintain the integrity of the fund.

Ms. Kelly L. Schmidt, State Treasurer, provided information regarding a recent Attorney General's opinion relating to legacy fund earnings accruing from the fund's inception through June 30, 2017. She said the constitutional measure which created the legacy fund was silent with regard to legacy fund earnings from inception through June 30, 2017; however, the 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. She said investment earnings of \$288.6 million through September 2016 and any additional earnings, as defined in Section 21-10-02, through the remainder of the 2015-17 biennium will become part of the principal of the legacy fund. She said earnings accruing after June 30, 2017, must be transferred to the general fund at the end of each biennium.

Ms. Schmidt expressed concern regarding cash flow challenges relating to the appropriation of legacy fund earnings during the 2017-19 biennium. She said, although the 2017-19 biennium legacy fund earnings will be available for appropriation, the earnings will not be deposited into the general fund until the end of the 2017-19 biennium. She said possible appropriations from the foundation aid stabilization fund and reductions in the balance of the highway tax distribution fund may add to the state's cash flow challenges in the next biennium.

Ms. Schmidt said moving funds from investment accounts has a cost. She suggested limiting transfers from the legacy fund to the extent possible.

**It was moved by Representative Kreidt, seconded by Senator Klein, and carried on a voice vote that the meeting be adjourned.**

No further business appearing, Chairman Kempenich adjourned the meeting at 4:23 p.m.

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Sheila M. Sandness  
Senior Fiscal Analyst

ATTACH:9