

SCHOOL TRUST INVESTMENT TASK FORCE

Minutes

April 17, 2013

Attending: Jennifer Johnson, Elizabeth Tashjian, David Hemingway, Sterling Jenson, Rich Cunningham, and David Damschen, Task Force Members. Bruce Williams, Margaret Bird, Tim Donaldson, Paula Plant, USOE. Tracy Miller, PTA. Jill Flygare, GOPB. Betsy Ross, Allen Rollo, Treasurer's Office. Kim Christy, SITLA.

Excused: Kent Misener.

Future Task Force Meetings

April 24, 12-2 PM

May 7, 12-2 PM

Welcome and Introduction

Kim Christy, Deputy Director of SITLA, spoke to the Task Force about the SITLA structure. Kim served as a policy analyst for the 2 year Task Force in the early 1990s which recommended the paradigm which led to the creation of SITLA. The fiduciary role had been substantially blurred. The Board of Trustees was set up to make sure the quasi-independent administration was focused on generating revenue, and ensure autonomy, accountability, and collaboration. Tim Donaldson showed the Task Force the data on where the land revenue has come from the last decade. 50-65% of annual income has been due to oil and gas, 5-15% has come from coal, with surface and development revenue accounting for the remainder. Land exchanges and future land revenue prospects were discussed.

Flow Chart

Margaret Bird presented showing the flow of money. The trust lands is a self-funded operation, and net income from the trust lands goes to the permanent school fund, with the interest and dividends annually distributed out to the schools.

Overview of the Utah Treasurer's Office

David Damschen distributed copies of the State School Fund Report, which is delivered annually to the Education Interim Committee. The Real Estate Investment Policy and Investment Policy Statement were also distributed. Dave discussed the history of the legislation that has moved forward the investment opportunities for the fund. Dave explained that the policies are developed in consultation with the Investment Advisory Committee and the Callan consultants. The Investment Advisory Committee members and Treasurer's staff were discussed, with backgrounds shared. Rep. Cunningham clarified that the Treasurer is not bound by the policy statement nor the advice of the Investment Advisory Committee. The Legislature has concern over advisory committees which lack teeth and may not be able to fully bring their expertise to bear on operations.

The Treasurer's Office has a long term philosophy in favor of passive management, due to efficient market theory, the additional costs of active management, and Ed Alter's past experience with Utah Retirement Systems. The time horizon on the fund is measured in centuries. Dave explained past practices and policies regarding rebalancing. Active management would require additional staff. There was discussion as to whether enhanced

index funds are better classified as passive or active. Dave explained the CAFR report and the state audit.

The Office is their own custodian on the funds in their control. There are significant risks to that, especially as active management becomes more common. There is a sweet spot somewhere, Mr. Damschen said, where those permanent changes are appropriate and active management becomes more attractive. The Treasurer's Office believes they are the custodian by Constitution, but is in the process of requesting proposals for outside custodians on other funds within their control.

Overview of the Idaho Endowment Fund Investment Board

Larry Johnson, Manager of Investments for the Idaho Endowment Fund Investment Board, presented an overview of the Idaho structure for the investment of their \$1.4 billion land grant trust fund. The land board consists of statewide elected officials, and they are over the endowment fund board, though they have delegated investment decisions for most of the past decade. The endowment fund board has 9 members, 6 of which are investment professionals. They hire and fire a Manager of Investments, who is 1 of a staff of 4. Their internal costs are approximately half a million dollars per year, paid out of the fund.

In Idaho, there is a complex structure for distributing earnings. This was the result of a huge decline in distributions that came with the 2000-03 downturn. Idaho had been distributing 8-9%, about \$70 million a year. Since that time, an earnings reserve fund is built up, to lower volatility. Mr. Hemingway stated that earnings should be sent to the beneficiaries and he does not like reserve funds. Larry said that formulas are important as a starting point, but the fiduciary needs to have discretion to adjust. That fiduciary flexibility is critical in bad times. In Arizona their formula is hard-wired in the Constitution, and that resulted in \$0 distributed when it was most needed. Elizabeth Tashjian said that 5-6% distributions seems aggressive. Larry explained that because it is a 5 year pool, and hence tends to lag the market gains, it usually ends up being more like 4%.

Mr. Johnson emphasized that he is required by statute to have an annual external audit. He said the expertise is lacking in the State Auditor's Office to appropriately audit their operations. They have two outside entities measuring performance, and their legal, IT, payroll, HR, and other functions are performed at cost by other entities in state government.

Larry explained that transparency is the key. Even "a clunky governance structure" can be overcome if the process is transparent and inclusive of all stakeholders. Sunshine is the best disinfectant. Allen Rollo asked whether Idaho has considered broadening asset classis. Larry said that Idaho has not yet, in part because they have had superior results with active management on 86% of their equity portfolio.

Adjourned 2:00 p.m.