



Board Members

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Larry Johnson, CFA, CPA
Manager of Investments

Monthly Report to the Board of Land Commissioners
Since the July 20, 2010 Land Board Meeting thru August 10, 2010

Investment performance thru July 31, 2010 (preliminary)
Month and FYTD: 5.0%

Status of endowment fund reserves

For all endowments, estimated reserves as of June were at least **4 times** the size of the approved FY2011 distributions, except for Public School, which is at **2.2 times** the regular distribution (after current reserves are reduced by the special distribution in FY2011).

Starting with the actual June balance and projecting forward using the “low” land revenue forecast presented to the Land Board in July (and assuming no fund gain or loss), the coverage ratio for **Public School is expected to be around 1.8 times at the end of FY2012.**

Significant actions of the Endowment Fund Investment Board

Meetings: The EFIB is meeting August 11 to recommend, for the Land Board’s consideration, distributions and transfers for FY2012. As detailed in the attached, EFIB staff will be **recommending that endowment distributions be held essentially flat** (excluding the \$22 special distribution to Public School) **and that \$3.9 million be transferred** to the Permanent Funds from Earnings Reserves for the 4 endowments with more than five years of reserves.

Compliance/legal issues, areas of concern

Material deviations from Investment Policy or compliance guidelines for investment managers: None.

Material legal issues: None.

Changes in board membership or agency staffing: None.

Upcoming issues/events

The EFIB continues with its work plan to address questions raised by the Superintendent at the May and July Land Board meetings, with completion still scheduled for December.

As part of that work, the EFIB was asked to examine options to consider total expected endowment income, including land revenues, in establishing distributions. However, the EFIB will have a very limited ability to consider this issue because a long-term (ten years+) forecast of land income for each endowment, which is required to adequately address this

question, is not practical. While estimating expected land revenues over the short term (<5 years) is feasible due to current timber volume under contract and the existence of a detailed 5-year sale plan by endowment, the Department of Land's ability to produce a useful long-term (10 year+) revenue forecast is severely constrained by the uncertainty of timber harvests for the smaller endowments. The parcels selected for auction in the sale plan are based partly on the maturity of the timber stand, which is fairly predictable, but also on distress conditions in the forest at the time (insects, disease, fire, drought). Unpredictable shifts in these natural conditions result in decade-long deficits or surpluses of harvest for the smaller endowments, relative to what one would expect by forecasting harvest simply on current timber inventories and ages of the trees. Other complicating factors include economic and market fluctuations, industry changes, and shifts in management priorities. Therefore, developing a sufficiently reliable long-term revenue (10+ years) outlook for the smaller endowments is not practicable.



NO ACTION TAKEN
8/17/10



INVESTMENT REPORT

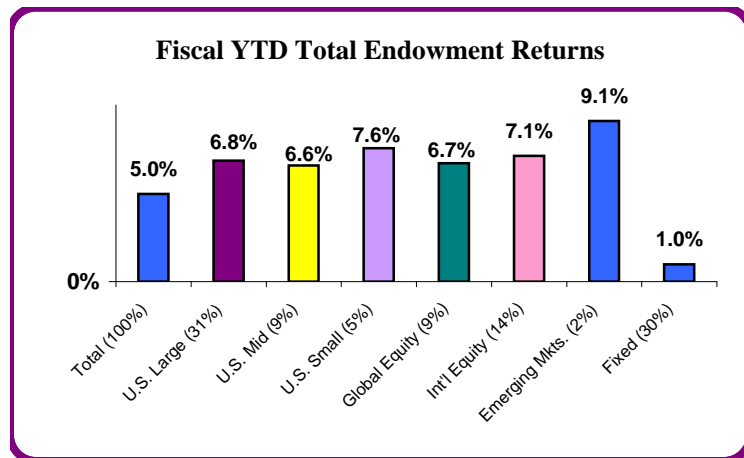
Preliminary Report (gross of fees & certain income accruals)

July 31, 2010

Current Value of the Fund	\$ 1,091,139,000
Investment Change in Market Value FYTD	\$ 54,300,305
Net Contributions FYTD	\$ (2,191,581)
Fiscal Year-to-Date Returns	5.0%
Month-to-Date Returns	5.0%

<u>Jul-10</u>		<u>Fiscal Year to Date</u>		<u>Last Five Years</u>	
Total Fund	5.0%	Total Fund	5.0%	Total Fund	4.2%
Benchmark	5.5%	Benchmark	5.5%	Benchmark	2.6%
Total Fixed	1.0%	Total Fixed	1.0%	Total Fixed	6.1%
Benchmark	1.1%	Benchmark	1.1%	Benchmark	6.0%
Total Equity	6.7%	Total Equity	6.7%	Total Equity	2.6%
Benchmark	7.4%	Benchmark	7.4%	Benchmark	0.7%
Domestic Equity	6.9%	Domestic Equity	6.9%	Domestic Equity	1.7%
Russell 3000	6.9%	Russell 3000	6.9%	Russell 3000	0.1%
Global Equity	6.7%	Global Equity	6.7%	Global Equity	6.0%
MSCI ACWI	8.1%	MSCI ACWI	8.1%	MSCI ACWI	6.0%
Int'l. Equity	7.1%	Int'l. Equity	7.1%	Int'l. Equity	6.0%
MSCI ACWI ex-US	9.0%	MSCI ACWI ex-US	9.0%	MSCI ACWI ex-US	3.0%

	<u>Mkt Value</u>	<u>% Alloc</u>
Domestic Equity	\$ 536.8	49.2%
Large Cap	\$ 377.4	34.6%
Mid Cap	\$ 105.1	9.6%
Small Cap	\$ 54.3	5.0%
Global Equity	\$ 46.8	4.3%
Int'l Equity	\$ 184.9	16.9%
Fixed Income	\$ 309.5	28.4%
Cash	\$ 13.1	1.2%
Total Fund	\$ 1,091.1	100.0%



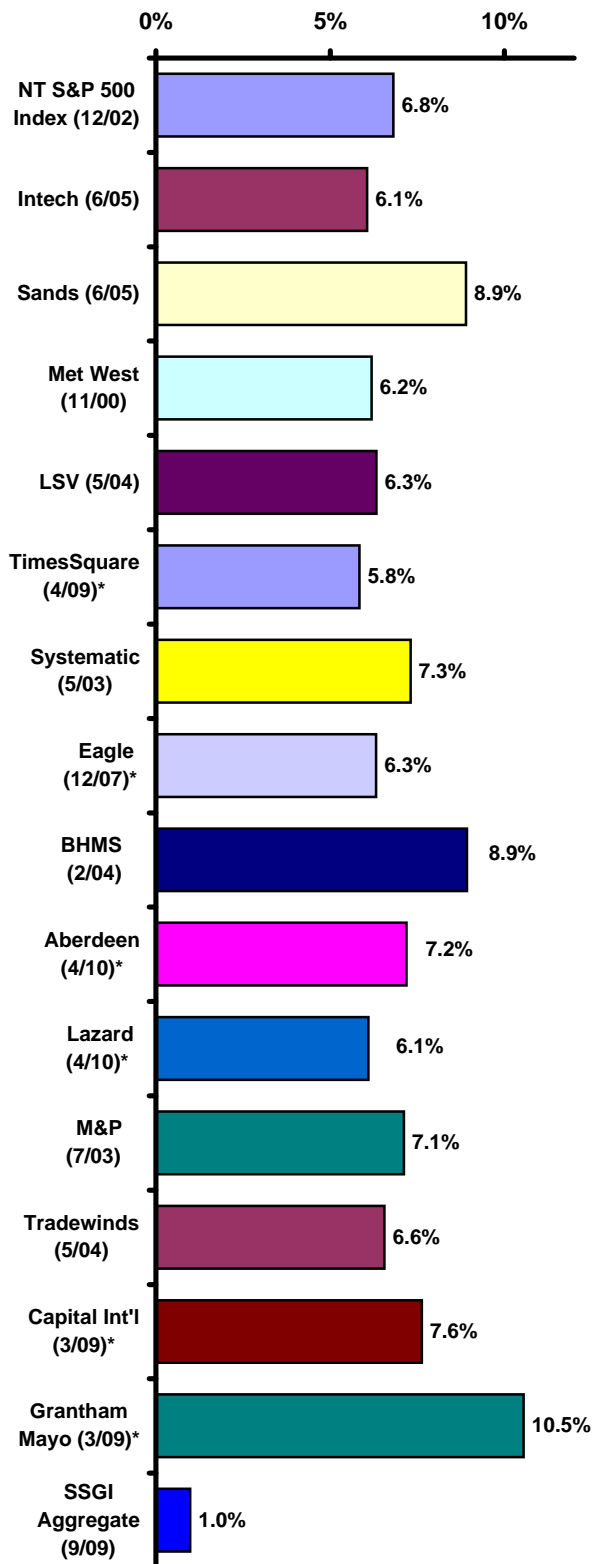
Endowment Fund Staff Comment:

The fund was up 5.0% for the month, 0.5% behind benchmark. The Russell 3000 index was up 6.9%, Russell Midcap up 7.2%, and Russell 2000 (small cap) up 6.9%. International equities (MSCI ACWI ex-US) were up 9% for the month, and Emerging Markets up 8.3%. Value outperformed growth and international outperformed domestic equity. Bonds, as measured by the BC Aggregate index, were up 1.1% and TIPS were up 0.1%. Four of 14 active managers beat their benchmark.

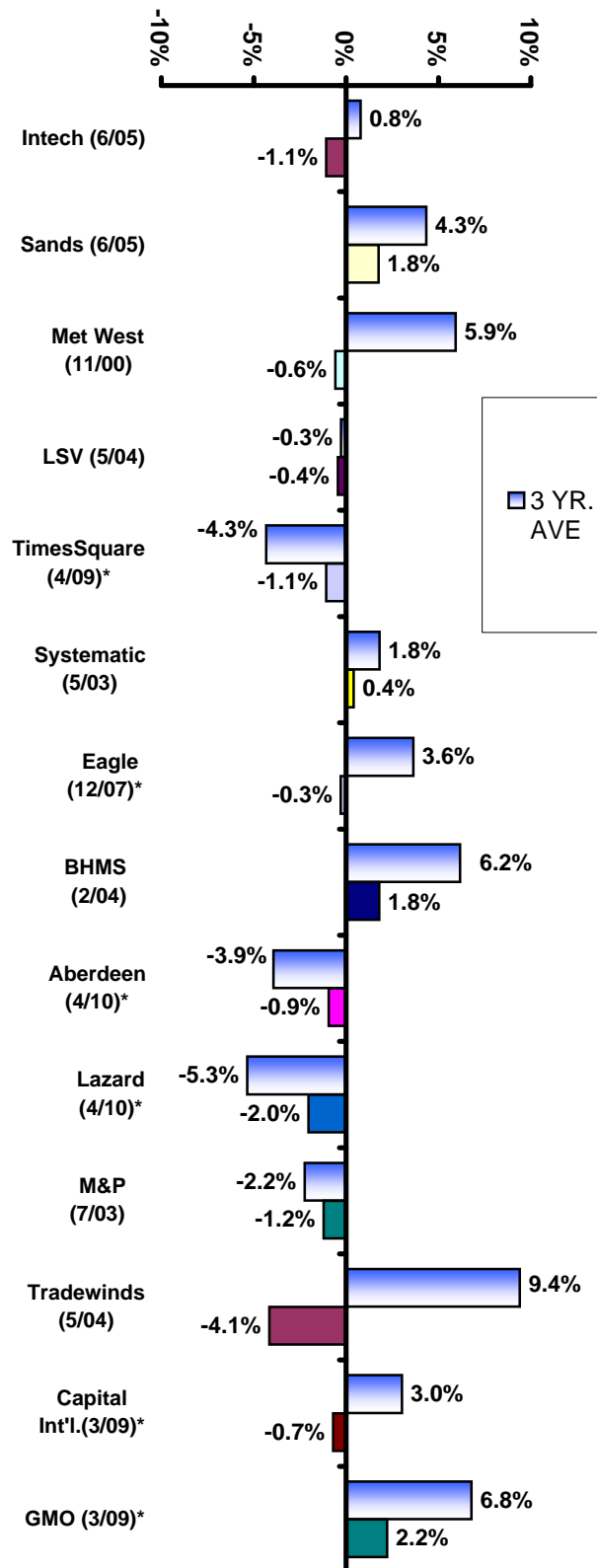


NO ACTION TAKEN
8/17/10

FYTD Manager Returns



FYTD Active Manager Relative Returns and 3-Yr. Annualized Relative Returns*



* ITD return used when manager has less than 3 years with EFIB.

STATE BOARD OF LAND COMMISSIONERS
August 17, 2010
Regular Agenda

SUBJECT

Approve distributions to endowment beneficiaries for fiscal year 2012 and transfers from Earnings Reserve to the Permanent Fund.

BACKGROUND

By statute, the Land Board is to determine the allocation of the Earnings Reserve Funds of the endowments – how much to distribute to beneficiaries, how much to transfer to the permanent fund, and how much to retain for future distributions.

If the Land Board approves fiscal year 2012 distributions this August, then beneficiaries can include them in their budgets due September 1, 2009.

BASIS OF RECOMMENDATION

The Endowment Fund Investment Board recommends that distributions be based on the Distribution Policy and Objectives as currently stated in the Land Board's Asset Management Plan. As shown in the table on the next page, this results in a 32% reduction in total distributions for fiscal year 2012 compared to fiscal year 2011. However, "regular" distributions (i.e. excluding the special \$22 million distribution to Public School), will rise slightly, by 0.6%.

Also, the Endowment Fund Investment Board recommends that \$3.9 million of Earnings Reserves for four endowments (Normal School, School of Science, State Hospital South and University) be transferred to their Permanent Funds effective September 1, since these endowments have more than five years of distributions in their reserves. Further, it is recommended that only the State Hospital transfer increase the Gain Benchmark of its fund, so as to increase the likelihood that the other three funds will reach their Gain Benchmarks in the future.

As explained in Attachment 1, the recommended distributions and transfers appear to be achievable and represent an appropriate balance between the interests of current and future beneficiaries, taking into account the current level of earnings reserves and past and expected future fund revenues.

The EFIB continues to analyze a number of suggestions and concerns related to Distribution Policy provided by the Superintendent at recent Land Board meetings. The EFIB plans to complete its analysis of these items by the December Land Board meeting. It is not anticipated that any options being considered would result in a reduction in the distributions or transfers being recommended to the Board now.

Table 1

	Distributions To Beneficiaries				Transfer To Permanent Fund**
	Approved FY2011	Proposed FY2012*	% Change*	\$ Change*	
Public School	53,292,400	31,292,400	-41.3%	(22,000,000)	-
Ag College	850,800	850,800	0.0%	-	-
Charitable Instit.	2,964,600	2,964,600	0.0%	-	-
Normal School	2,661,600	2,661,600	0.0%	-	323,000
Penitentiary	1,040,400	1,040,400	0.0%	-	-
School of Science	2,984,400	2,984,400	0.0%	-	368,000
State Hosp. South	1,663,200	1,917,600	15.3%	254,400	1,782,000
University	2,329,200	2,329,200	0.0%	-	1,461,000
	67,786,600	46,041,000	-32.1%	(21,745,600)	3,934,000

* Hold at FY2011 levels, except State Hospital South based on 5% of 3-year average Permanent Fund balance, adjusted for transfers from Earnings Reserve

** Amount of Earnings Reserve in excess of five years of the fiscal year 2012 distribution. State Hospital transfer will increase its Gain Benchmark while the remaining transfers will not.

All calculations subject to adjustment pending final audit of fiscal year 2010 results.

RECOMMENDATION

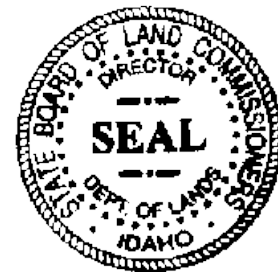
Approve the recommended distributions and transfers.

BOARD ACTION

A motion was made by Attorney General Wasden that the Board approve the recommendation of the Endowment Fund Investment Board that distributions be based on the distribution policy and objectives as currently stated in the Land Board’s Asset management Plan. Controller Jones seconded the motion. The motion carried on a vote of 4-0, with Secretary of State Yursa being absent from this vote.

ATTACHMENT

1. Background on Proposed Fiscal Year 2012 Distributions and Transfers



Background on Proposed Fiscal Year 2012 Distributions and Transfers

*For the August 17, 2010
meeting of the Board of
Land Commissioners*



Approved Priorities

The Land Board has adopted the following objectives/priorities for determining distributions:

1. Avoid reductions in total endowment distributions.
2. Maintain adequate Earnings Reserves to protect distributions from temporary shortfalls in fund returns and land revenues.
3. Grow distributions and permanent corpus faster than inflation and population growth.
4. State Distribution Policy in simple, broad terms. Treat all endowments the same unless there is a compelling reason to differentiate.

Source: Land Board Asset Management Plan 2

Review of Distribution Policy

The Land Board has adopted the following principles:

- Distribute approximately 5% of the value of the Permanent Fund each year,
 - Adjusted for reserves, transfers and other factors
- Maintain Earnings Reserves equal to five years of distributions
- Consider transferring any excess reserves back to the Permanent Fund each year

Source: Land Board Asset Management Plan 3

Summary: EFIB Staff Recommendations

(based on unaudited 6/30/10 balances)

- Strict application of the 5% of the Permanent Fund formula results in a 7% average reduction in distributions for FY2012 compared to FY2011
 - One endowment increases 15%
 - The decrease for the other seven violates the first priority – avoid reductions in total distributions
- Four endowments have less than the desired five years of reserves:
 - But, all four have sufficient reserves to support the current level of distributions without having to accept the reduction called for by the 5% formula
 - **Recommendation: Hold distributions at 2011 levels, except for the endowment (SHS) that increases 15% (and has five years of reserves)**
- Four endowments have excess reserves:
 - **Recommendation: Transfer \$3.9 million to their Permanent Funds**

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Current Situation

- Current year's approved distribution is safe – every fund has reserves in excess of 4 years, except Public School at 2.2 years
- \$89 million of timber presold as of June, 2010: Contracted income over the next 3 years
 - Caveat: Lumber prices and financial reserves must be sufficient to allow buyers to fulfill their contracts on time
- Net land revenue is expected to rise from \$21 million in FY2010 to \$24-33 million in FY2011 (Pub Sch: \$12 mil. in '10 to \$11-14 mil. in '11)
 - Lumber and timber prices have recovered modestly from multi-decade lows

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Addressing endowments with less than five years of reserves

The number 1 priority of the distribution policy is to avoid reductions, but:

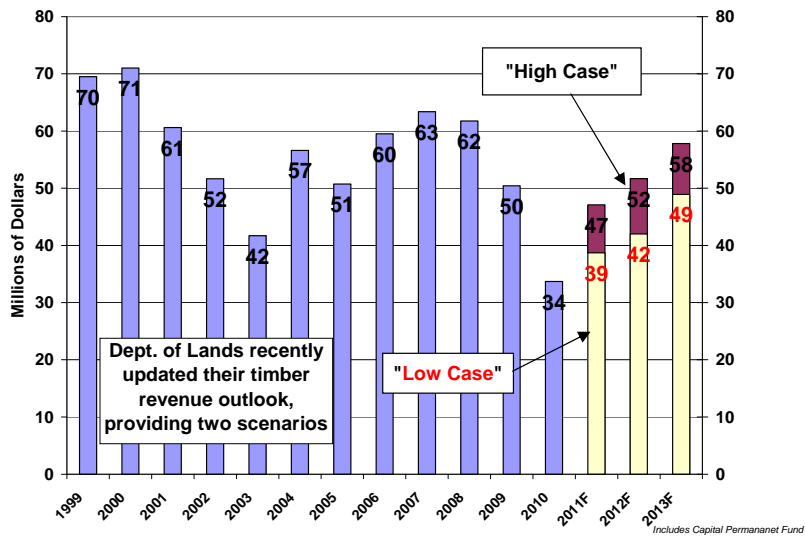
Is it prudent to hold distributions at current levels? Are we at risk of a significant reduction thru 2013 under a "reasonable" worst case scenario:

- Conservative timber revenue forecast
- 2% return on the endowment fund (no market appreciation)

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Timber Revenue Forecast

Completed July, 2010



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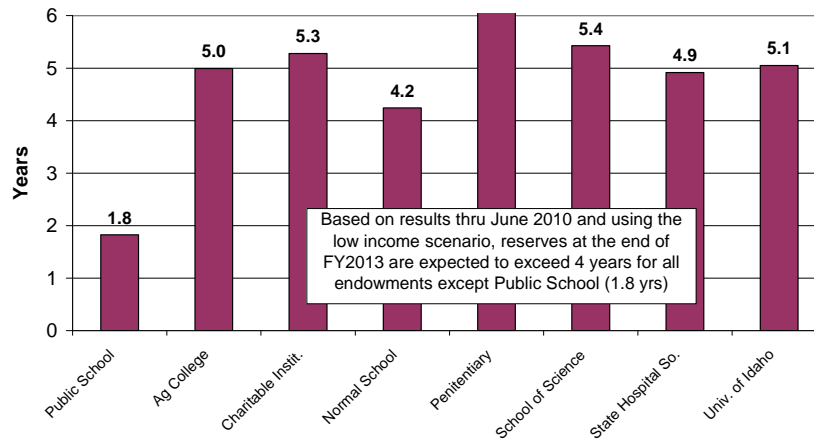
Conclusion

- No endowment exhausts its reserves by 2013 even in a "worst case", low land income scenario
- Therefore, it is prudent to maintain FY2012 distributions at current levels for endowments with less than five years of reserves
 - Assumes no special distribution for Public School in FY2012

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Even under the “Low” revenue case, 2013 coverage ratios are acceptable

Years of Distributions In Earnings Reserves
Forecast as at June 2013
Low Land Income, Zero Fund Market Appreciation Scenario

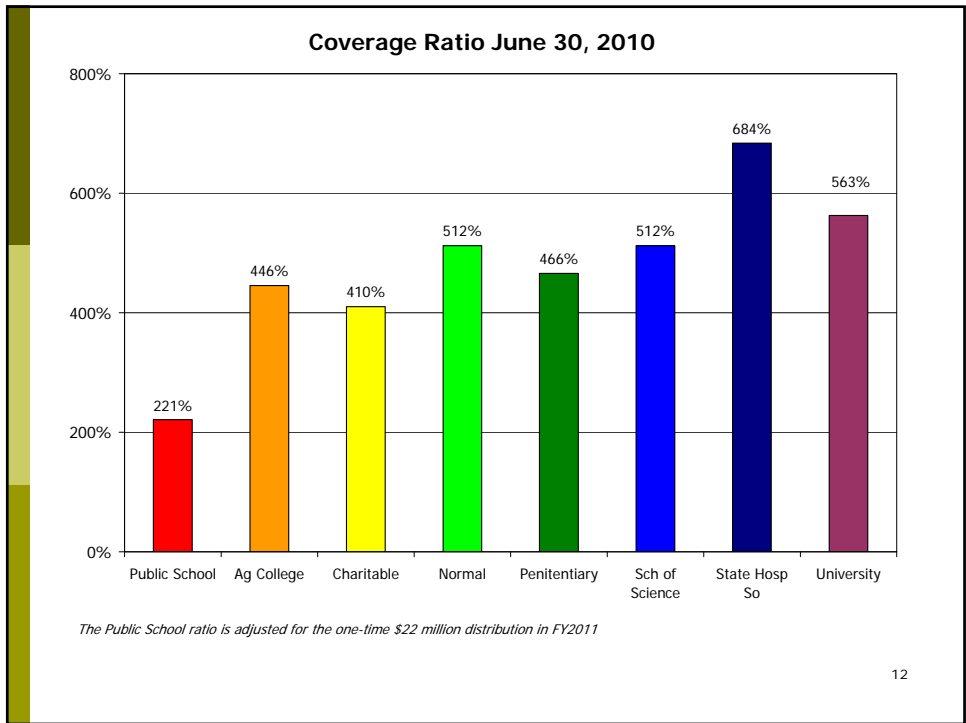


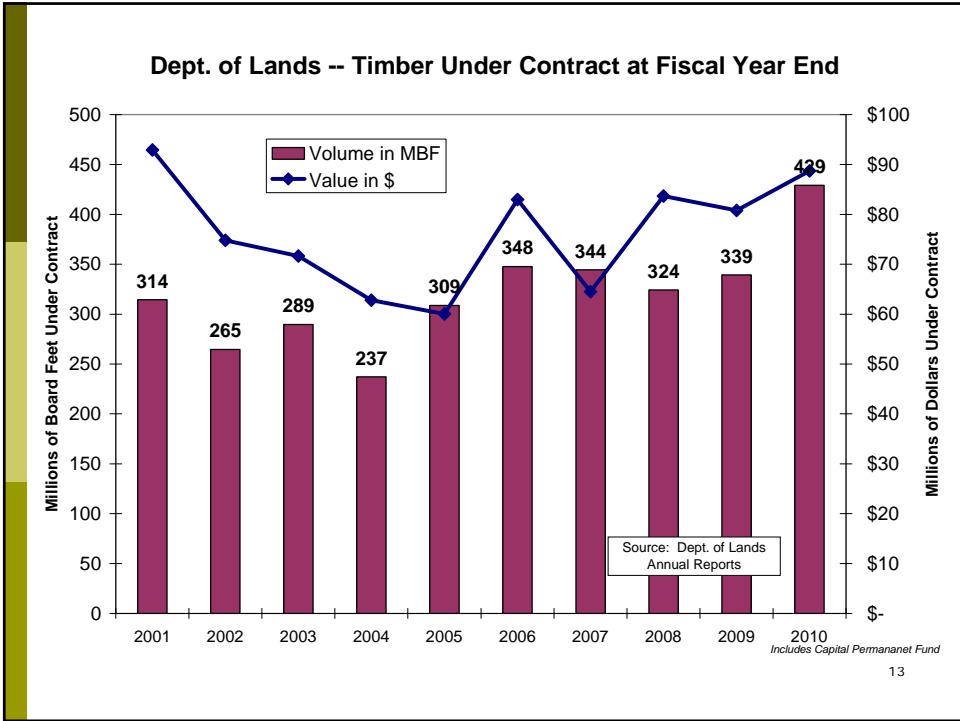
Caveats (potential for reductions)

- FY2013 coverage ratios under the “low” scenario are at acceptable levels for all endowments, except Public School
- A reduction in distributions in FY2013 or FY2014 is not likely, but may be necessary if, for example:
 - Future returns on the fund are negative
 - Additional hardship extensions are offered on existing timber contracts
 - A material number of existing timber contracts are abrogated by purchaser bankruptcies
 - Additional special distributions are authorized
 - Future timber prices fall below the level assumed in the “low” revenue scenario

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Appendix





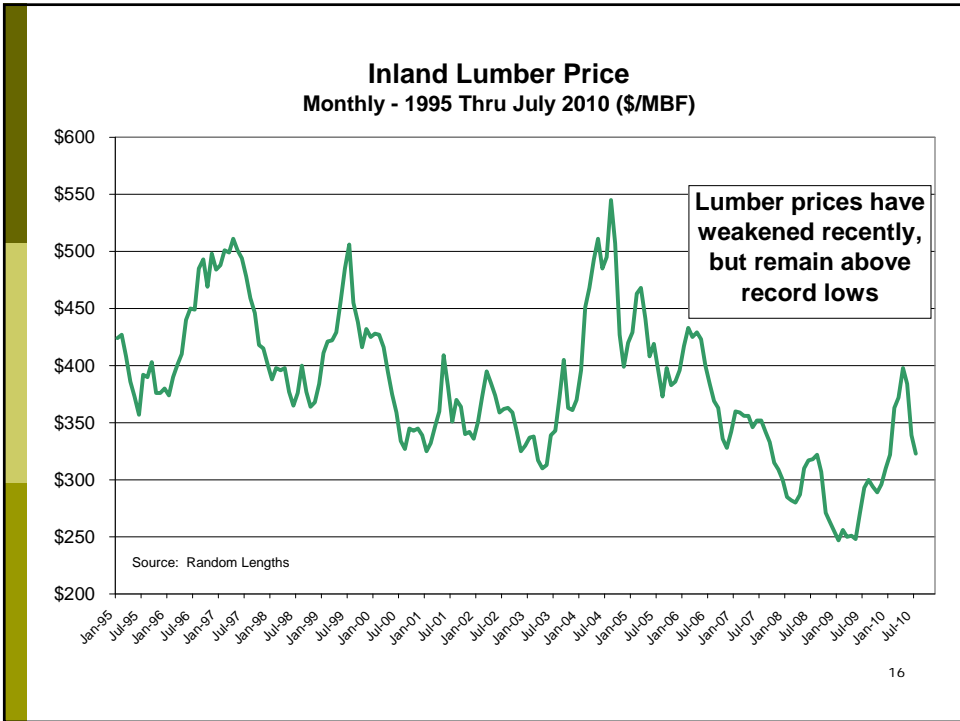
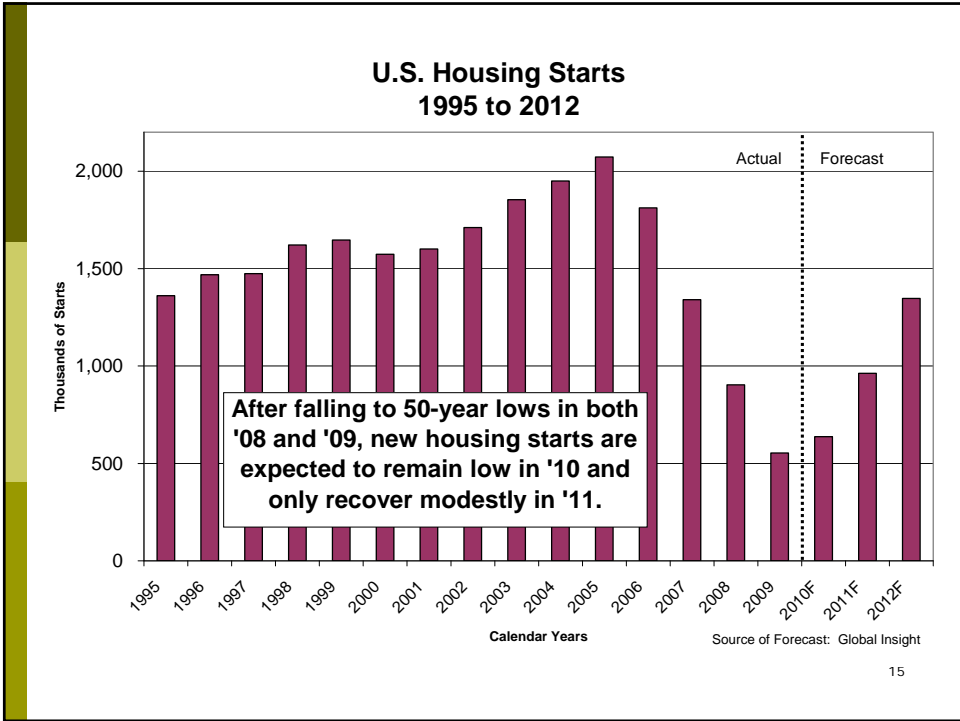
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“Low” forecast is a “reasonable” worst case scenario given high contracted volumes

**Net Endowment Land Revenues
Actual 2001-2010, "Low" Forecast 2011-2013**

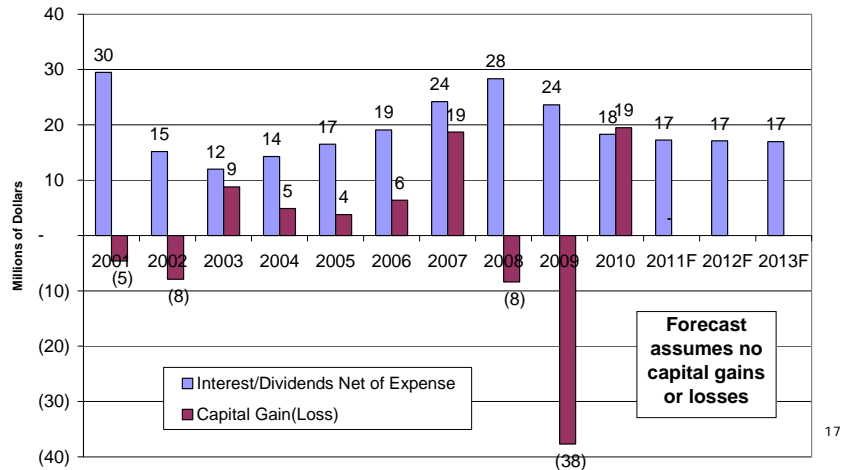


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“Low” forecast assumes no market appreciation in the fund

Net Endowment Fund Revenues
Actual 2001-2010, "Low" Forecast 2011-2013



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Transfers and the Gain Benchmark

- Four endowments have more than five years of reserves, so income is available to be transferred to and retained in the Permanent Fund
- The Land Board must indicate whether a transfer:
 - Increases permanent corpus (the Gain Benchmark) or,
 - Makes up past losses in purchasing power
- Since only one endowment (SHS) is above its Gain Benchmark, recommend that only its transfer increase its Benchmark

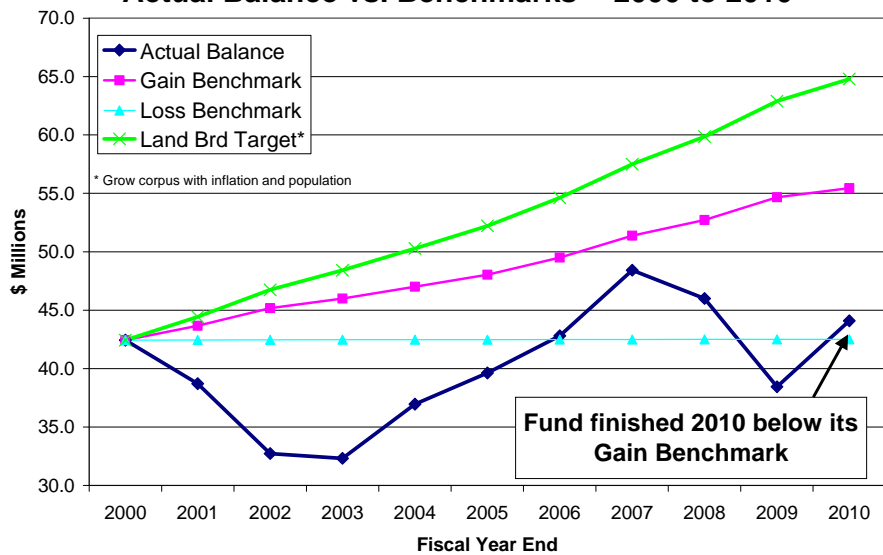
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Actual vs. Gain Benchmark At 6/10

	<u>\$MM</u>	<u>% of Perm. Fund</u>	<u>Proposed Transfer</u>	<u>Add Xfer to Gain Benchmark?</u>
State Hosp. South	5.1	13.9%	1.8	Yes
Penitentiary	(3.9)	(19.5%)		
Ag College	(3.2)	(19.6%)		
Public Schools	(168.5)	(22.1%)		
University	(11.3)	(25.7%)	1.5	No
Normal School	(13.6)	(27.5%)	0.3	No
School of Science	(17.1)	(31.2%)	0.4	No
Charitable Instit.	(17.0)	(31.4%)		
Total	(229.4)	(26.7%)	3.9	

- As of June 2010, only State Hospital had crossed its Gain Benchmark
- Recommendation: State Hospital transfer increases its Gain Benchmark, other transfers do not (i.e. they are applied to making up past losses in purchasing power)

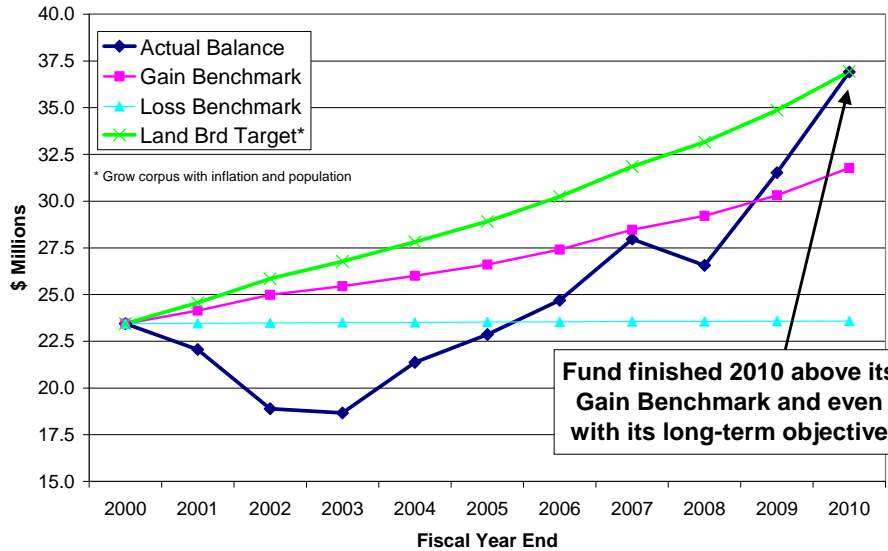
University of Idaho Permanent Endowment Fund Actual Balance vs. Benchmarks -- 2000 to 2010



Transfer will increase Actual Balance (blue line) but not permanent corpus (pink Gain Benchmark line)

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State Hospital South Permanent Endowment Fund Actual Balance vs. Benchmarks -- 2000 to 2010



Transfer will increase *both* Actual Balance (blue line) and permanent corpus (pink Gain Benchmark line)

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Recommended FY2012 Distributions/Transfers Based on June 2010 unaudited balances

EFIB staff recommendations: tan highlights

(\$ in millions)

	Total	Public School	Ag College	Charitable	Normal Schools	Penitentiary	School of Science	State Hospital South	University
Permanent Fund Value									
3-Year Average	849.2	575.9	16.1	53.9	48.8	19.8	54.3	36.6	43.8
Distribution % Per Policy	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
FY 2010 Distribution	45.7	31.3	0.9	3.0	2.7	1.0	3.0	1.5	2.3
FY 2011 Normal Distribution*	45.8	31.3	0.9	3.0	2.7	1.0	3.0	1.7	2.3
2012 Distribution									
5% formula, no xfer to Perm Fund	42.5	28.8	0.8	2.7	2.4	1.0	2.7	1.8	2.2
No reduction, with xfer to Perm Fund	46.0	31.3	0.9	3.0	2.7	1.0	3.0	1.9	2.3
% Change vs. 2011 Distribution									
5% formula, no xfer to Perm Fund	-7.3%	-8.0%	-5.6%	-9.0%	-8.4%	-4.7%	-9.0%	10.0%	-6.0%
No reduction, with xfer to Perm Fund	0.6%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	15.3%	0.0%
Years of Reserve (6/10)									
Adequate Years of Reserve (policy)	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
5% formula, no xfer to Perm Fund	3.9	3.2	4.7	4.5	5.6	4.9	5.6	6.2	6.0
No reduction, with xfer to Perm Fund	3.5	2.9	4.5	4.1	5.0	4.7	5.0	5.0	5.0
Earnings Reserve Balance (6/10)									
	165.3	91.1	3.8	12.2	13.6	4.8	15.3	11.4	13.1
Transfers to Permanent Fund	3.9	0.0	0.0	0.0	0.3	0.0	0.4	1.8	1.5
% of Earnings Reserve	2%				2%		2%	16%	11%

* Excludes a \$22 million one-time distribution from Public School. Adjusted for this item, years of Reserve at 6/10 with No Reduction falls to 2.2 years

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