



Board Members

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Monthly Report to the Board of Land Commissioners

Since the May 18, 2010 Land Board Meeting thru June 8, 2010

Investment performance thru May 31, 2010 (preliminary)

Month: **-5.2%** Fiscal year: **18.9%**

Status of endowment fund reserves

For all endowments, estimated reserves as of April were at least **4 times** the size of the approved FY2010 distributions, except for Public School, which is at **2.5 times** the regular distribution after current reserves are reduced by the approved \$22 million special distribution for FY2011. Starting with the actual April balance and projecting forward based on the latest land revenue forecast and assuming no fund gain or loss, the coverage ratio for **Public School is expected to be around 2 times at the end of FY2012.**

Significant actions of the Endowment Fund Investment Board

Meetings: The EFIB had a regular meeting May 18 and decided to formally **recommend that the Land Board, at its August meeting, use the current policy** in setting budgeted distributions for FY2011. The EFIB discussed the four requests made by the Superintendent of Public Instruction at the May Land Board meeting and developed a work plan to address those items. However, most of the effort is contingent on whether a long-term land revenue forecast is available for each individual endowment. If a long-term forecast is practical, it will take some time to complete the forecast and analyze its impact on the distribution rate and the level of reserves.

The EFIB expects to be **ready by the December meeting to present options** for adjusting the distribution rate and the level of reserves. The EFIB believes this delay is necessary to prudently consider any changes to the Distribution Policy. However, it is unlikely that any change would decrease budgeted distributions, so the EFIB is optimistic that this delay will not be materially disruptive to the FY2011 budget process.

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

None.

Work Plan for the Requests by the Superintendent

1. *Should we request that the Legislature change the law that deals with how Permanent Fund interest and dividends flow?*

The EFIB recommends no change in the law. The current statute appropriately addresses several important issues. EFIB staff is preparing a write up on the rationale for retaining the current statute for review by Land Board at its July meeting.

2. *Look at each of the endowments individually and make an individual recommendation for the level of reserve needed, based on current law and based on changing the law to allow Permanent Fund interest and dividends to continue flowing to the reserve.*

A key determinant of the level of reserves is the rate of distribution (currently 5% of the Permanent Fund). For example, if we spend a higher %, this increases the risk of a cash flow shortfall, which requires more years of reserves. Therefore, the EFIB recommends that consideration of the level of reserves be deferred until the distribution rate is confirmed (see next question).

3. *Reexamine the way we calculate distribution amounts, to consider a more comprehensive approach that looks at the performance of the whole endowment, not just one piece of it.*

A comprehensive approach requires that the EFIB and the Land Board understand the long-term outlook for net land revenue for each endowment. The Department of Lands is examining its systems and data to assess the level of accuracy in revenue forecasting. Since the majority of net land revenue is from timber harvest, near term forecasts (3-5 years) are more easily determined based on volume under contract by endowment. Any estimate of revenues beyond 3-5 years would be based on methodologies similar to those used to predict the stock market. Once Lands completes their analysis, the EFIB will be in a much better position to evaluate distribution policy options which more directly consider the performance of the land base.

4. *Once an endowment fills its reserves, ensure that we weight equally the interests of current and future beneficiaries, as required by our policy on controlling for inflation and population growth.*

In calculating the effect that transfers have on distributions, EFIB staff has adjusted its methodology to ensure that the current beneficiary gets full benefit in the next year's distribution from any transfer (i.e. in most cases, the distribution promptly goes up by 5% of the amount transferred to the Permanent Fund).

Proposed Timeline

July 20 Land Board Meeting

EFIB staff presents the rationale behind the current statute dealing with income transfers after an endowment reaches its Gain Benchmark. Land Board decides whether to recommend changes in the statute.

Department of Lands presents three year forecast of net revenues by endowment and provides their conclusion on long-term forecasts of timber revenues for each individual endowment.

August 11 EFIB Meeting

EFIB reviews Department of Lands three year forecast and, based on the current Land Board Distribution Policy (5% of the Permanent Fund, 5 years of reserves), recommends FY2011 distribution levels and transfers to the Permanent Fund.

August 17 Land Board Meeting

Land Board approves transfers and FY2011 distributions based on current policy. Transfers to the Permanent Fund for State Hospital South would not be implemented until completion of work on potential adjustments to the distribution rate (December)

September 21 Land Board Meeting

Department of Lands presents long-term net revenue forecast by endowment (if possible).

November 16 EFIB Meeting

EFIB reviews options to modify Distribution Policy, including adjusting distribution rates and reserve levels based on long-term land revenue forecasts (if possible) and updated analysis by Callan of required reserves by individual endowment.

December 21 Land Board Meeting

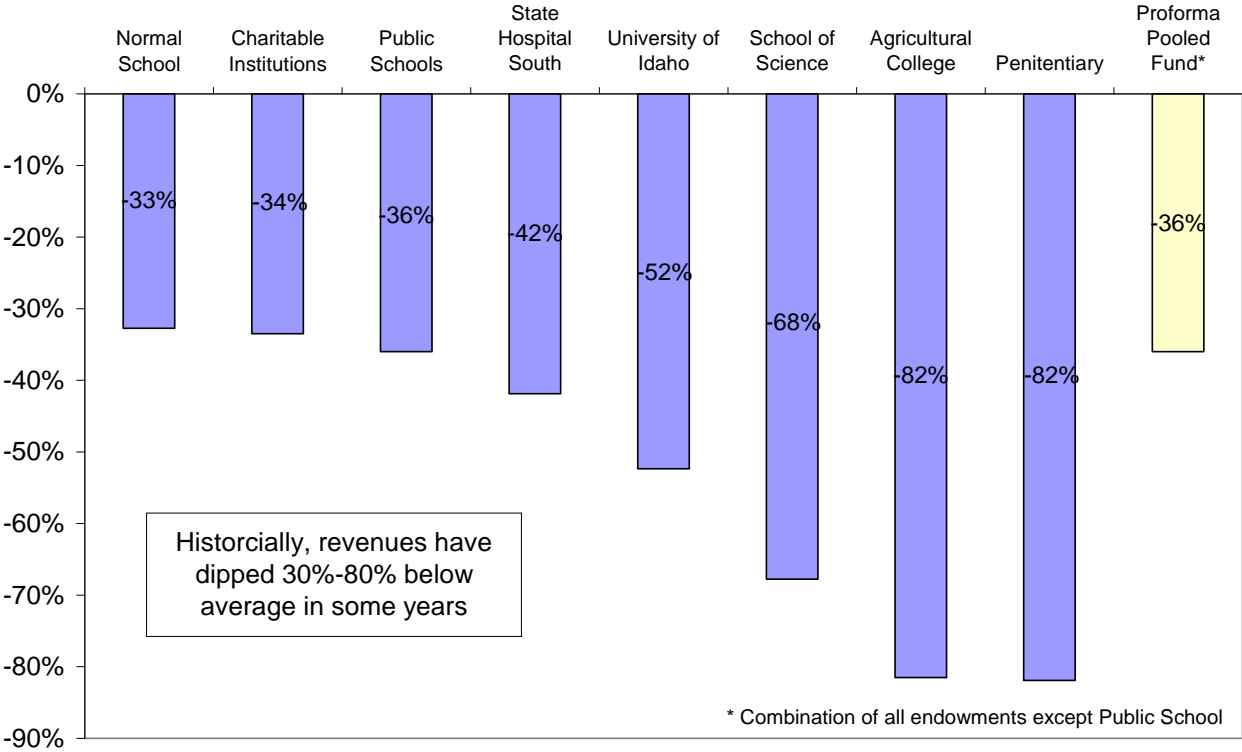
Land Board considers options to revise Distribution Policy.

Potential change in legal structure

The Land Board's legal counsel is considering whether to develop a plan to consolidate the lands and funds of all endowments (except Public School) into a single pooled fund. This would reduce administration costs and, most importantly, significantly reduce the volatility of timber revenue for those endowments. If this pooling takes place, then the distribution rate and the target level of reserves would need to be established for this larger, more stable pool of assets.

On a pooled basis, the smaller endowments would have about the same downside revenue risk as the Public School endowment (compare the "Public Schools" and "Pooled Fund" bars on the graph on the next page).

Lowest Land Revenue Year as a % of Average Land Revenues by Endowment -- FY2001 to FY2010





INVESTMENT REPORT

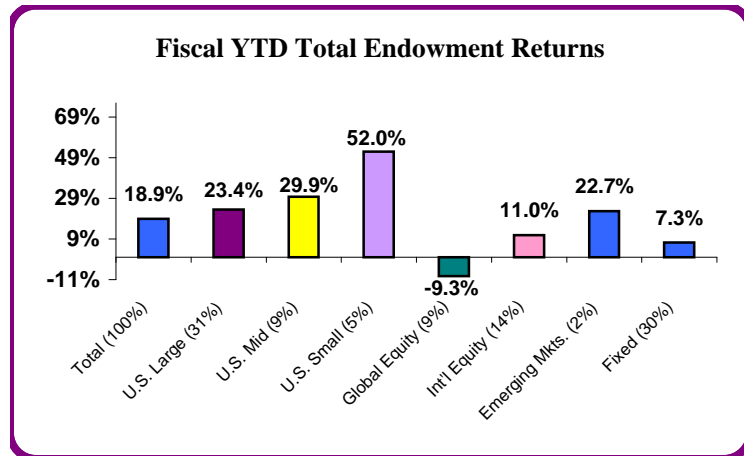
Preliminary Report (gross of fees & certain income accruals)

May 31, 2010

Current Value of the Fund	\$	1,062,155,227
Investment Change in Market Value FYTD	\$	171,589,925
Net Contributions FYTD	\$	(26,946,143)
Fiscal Year-to-Date Returns		18.9%
Month-to-Date Returns		-5.2%

<u>May-10</u>		<u>Fiscal Year to Date</u>		<u>Last Five Years</u>	
Total Fund	-5.2%	Total Fund	18.9%	Total Fund	4.5%
Benchmark	-5.7%	Benchmark	16.7%	Benchmark	2.8%
Total Fixed	0.7%	Total Fixed	7.3%	Total Fixed	5.4%
Benchmark	0.8%	Benchmark	7.8%	Benchmark	5.3%
Total Equity	-7.7%	Total Equity	23.5%	Total Equity	3.3%
Benchmark	-8.4%	Benchmark	20.6%	Benchmark	1.2%
Domestic Equity	-7.5%	Domestic Equity	27.5%	Domestic Equity	2.7%
Russell 3000	-7.9%	Russell 3000	22.8%	Russell 3000	0.8%
Global Equity	-9.3%	Global Equity		Global Equity	
MSCI ACWI	-9.3%	MSCI ACWI		MSCI ACWI	
Int'l. Equity	-8.9%	Int'l. Equity	11.0%	Int'l. Equity	5.8%
MSCI ACWI ex-US	-10.5%	MSCI ACWI ex-US	11.9%	MSCI ACWI ex-US	2.4%

	<u>Mkt Value</u>	<u>% Alloc</u>
Domestic Equity	\$ 530.0	49.9%
Large Cap	\$ 371.2	34.9%
Mid Cap	\$ 103.7	9.8%
Small Cap	\$ 55.1	5.2%
Global Equity	\$ 45.1	4.2%
Int'l Equity	\$ 173.0	16.3%
Fixed Income	\$ 303.7	28.6%
Cash	\$ 10.3	1.0%
Total Fund	\$ 1,062.2	100.0%

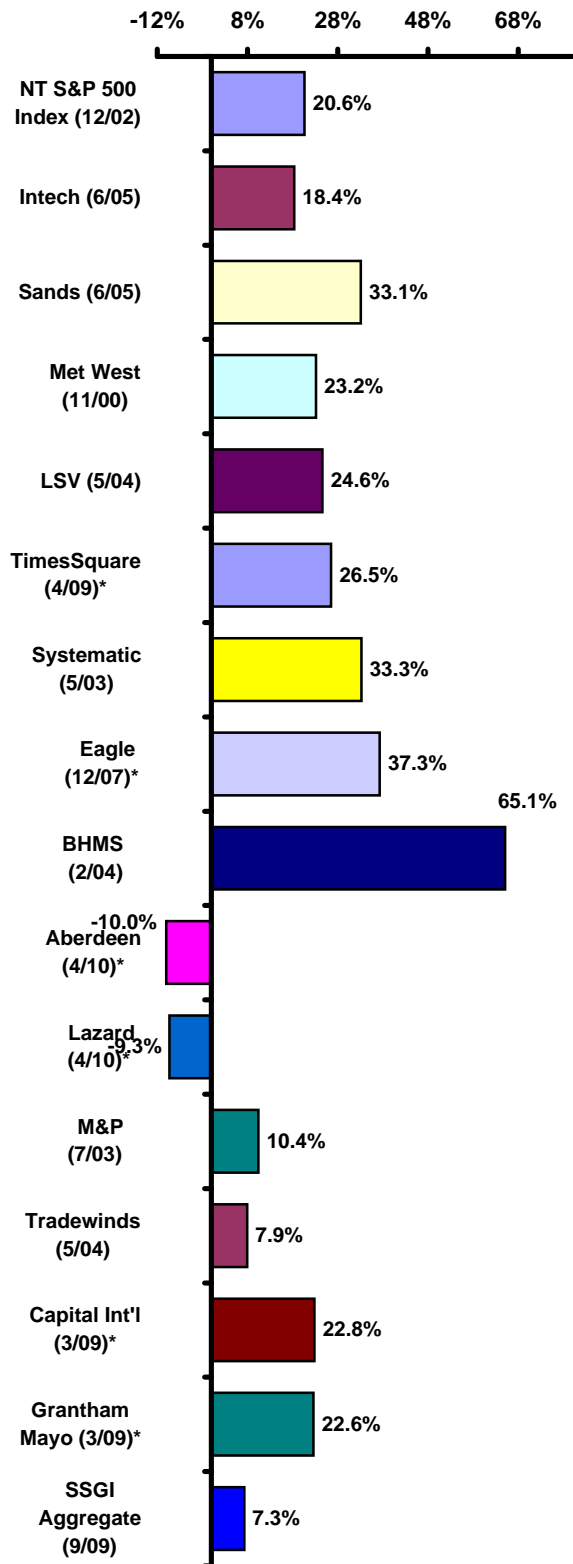


Endowment Fund Staff Comment:

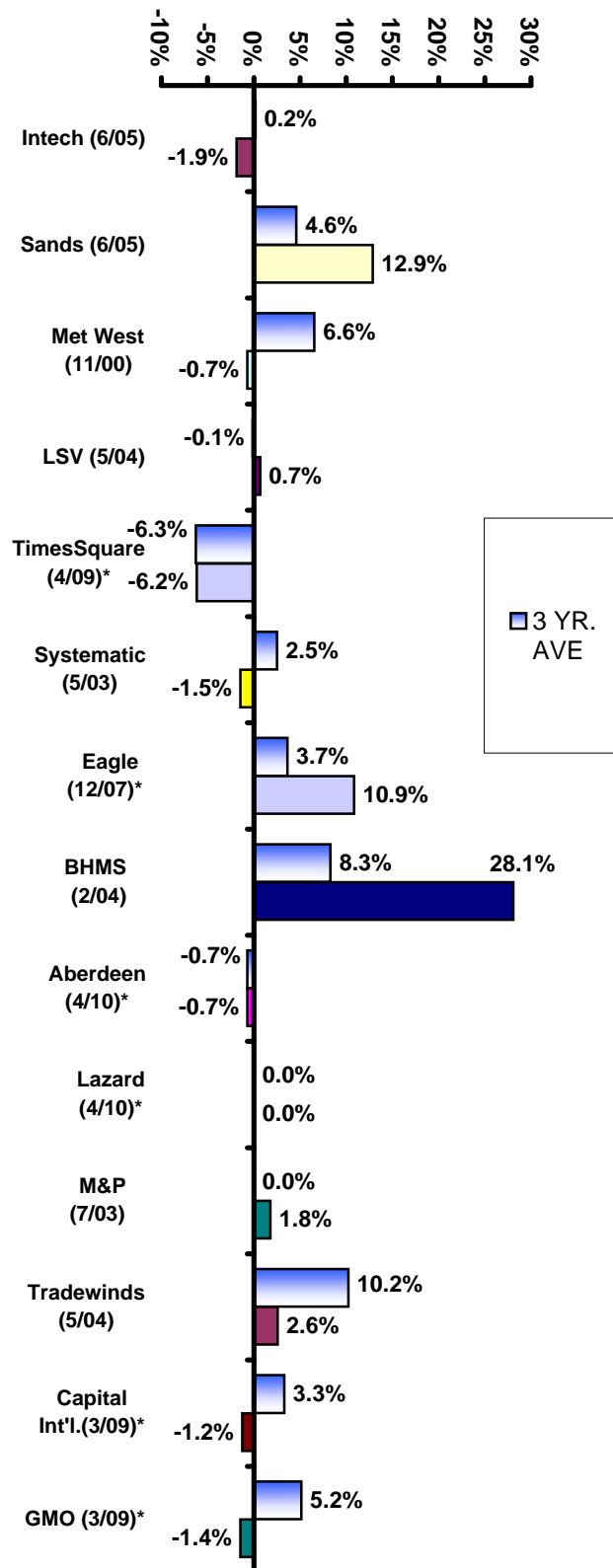
The fund was down 5.2% for the month, 0.5% better than benchmark. The Russell 3000 index was down 7.9%, Russell Midcap down 7.3%, and Russell 2000 (small cap) down 7.6%. International equities (MSCI ACWI ex-US) were down 10.5% for the month, and Emerging Markets down 8.8%. Growth outperformed value this month and domestic outperformed international equity. Bonds, as measured by the BC Aggregate index, were up 0.8% and TIPS were down slightly. Nine of 14 active managers beat their benchmark.

On a Fiscal YTD basis the fund is up 18.9%, 2.2% over benchmark. Six of 14 active managers are ahead of their benchmark.

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.