



Board Members

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Larry Johnson, CFA, CPA
Manager of Investments

Monthly Report to the Board of Land Commissioners
Since the February 15, 2011 Land Board Meeting thru March 8, 2011

Investment performance thru February 28, 2011

Month: **2.7%** Fiscal year: **22.6%**

Status of endowment fund reserves

For all endowments, estimated reserves as of January 2011 were at least **5 times** the size of the approved FY2011 distributions, except for **Public School**, which is at **3 times** the regular distribution (after current reserves are reduced by the special distribution in FY2011).

Significant actions of the Endowment Fund Investment Board

Meetings: The Investment Board met February 17 and approved a motion to recommend that the Land Board **increase the distribution rate for the State Hospital South endowment** fund (see attached).

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

At the April meeting, EFIB staff will present responses to **questions regarding the Distribution Policy** raised at the December 2010 Land Board meeting by the Superintendent and the Attorney General.



INVESTMENT REPORT

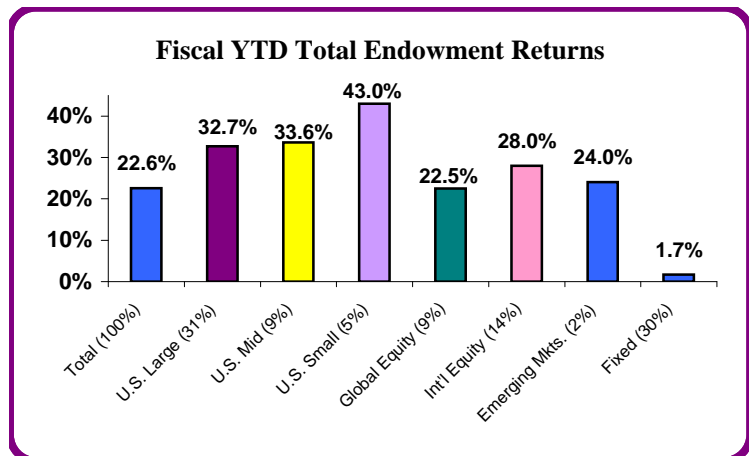
Preliminary Report (gross of fees & certain income accruals)

February 28, 2011

Current Value of the Fund	\$	1,254,291,536
Investment Change in Market Value FYTD	\$	222,596,176
Net Contributions FYTD	\$	(7,334,916)
Fiscal Year-to-Date Returns		22.6%
Month-to-Date Returns		2.7%

	<u>Feb-11</u>	<u>Fiscal Year to Date</u>	<u>Last Five Years</u>
Total Fund	2.7%	22.6%	5.9%
Benchmark	2.4%	21.7%	4.4%
Total Fixed	0.4%	1.7%	5.9%
Benchmark	0.3%	1.5%	5.8%
Total Equity	3.5%	31.4%	4.8%
Benchmark	3.4%	31.4%	3.3%
Domestic Equity	3.9%	33.9%	4.8%
Russell 3000	3.6%	31.8%	3.2%
Global Equity	2.1%	22.5%	Global Equity
MSCI ACWI	2.9%	29.9%	MSCI ACWI
Int'l. Equity	3.4%	28.0%	Int'l. Equity
MSCI ACWI ex-US	2.6%	29.5%	MSCI ACWI ex-US

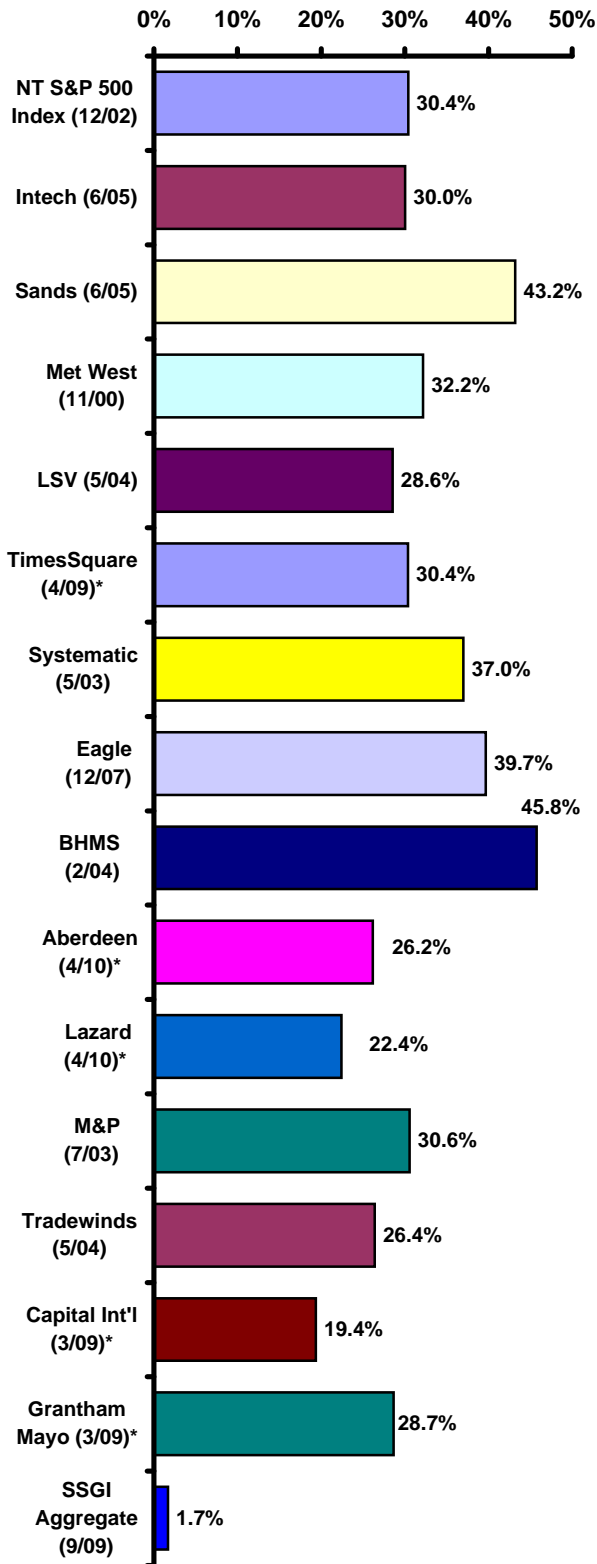
	<u>Mkt Value</u>	<u>% Alloc</u>
Domestic Equity	\$ 579.3	46.2%
Large Cap	\$ 404.5	32.3%
Mid Cap	\$ 116.9	9.3%
Small Cap	\$ 57.8	4.6%
Global Equity	\$ 116.9	9.3%
Int'l Equity	\$ 207.1	16.5%
Fixed Income	\$ 339.0	27.0%
Cash	\$ 12.1	1.0%
Total Fund	\$ 1,254.3	100.0%



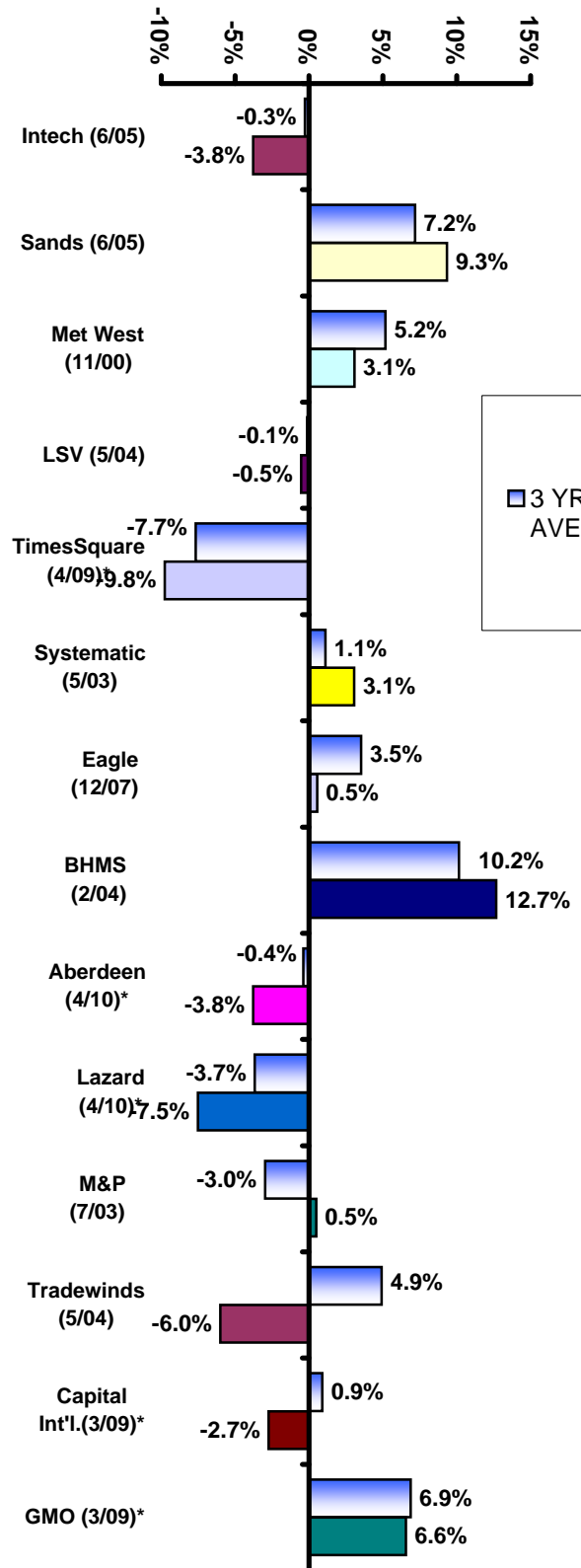
Endowment Fund Staff Comment:

The fund was up 2.7% for the month, 0.3% over benchmark. The Russell 3000 index was up 3.6%, Russell Midcap up 3.8%, and Russell 2000 (small cap) up 5.5%. International equities (MSCI ACWI ex-US) were up 2.6% for the month, and Emerging Markets off 1.0%. Growth outperformed value and domestic outperformed international equity. Bonds, as measured by the BC Aggregate index, were up 0.2% and TIPS were up 1.0%. Seven of 14 active managers beat their benchmark. On a Fiscal Y-T-D basis, the fund is up 22.6%, 0.9% over benchmark. Seven 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.

STATE BOARD OF LAND COMMISSIONERS
March 15, 2011
Regular Agenda

SUBJECT

Increase the long-term distribution rate for State Hospital South based on the outlook for sustainable land revenues and fund returns.

BACKGROUND

Currently, Land Board Policy sets distributions from the State Hospital South endowment at approximately 5% of the Permanent Fund (3 year average). However, since the endowment's Permanent Fund has kept pace with inflation and population growth (the only endowment to do so), the EFIB has stated that, in its opinion, a higher distribution rate for State Hospital South might be prudent if there were confidence that future land revenues would remain near historical levels. In January, the Department of Lands completed a long term land revenue forecast that predicts SHS land revenues, even in the "low" scenario, will be higher in the next ten years than they were for the ten years ended 2010.

BASIS FOR RECOMMENDATION

The Department of Lands estimates that the State Hospital South endowment will generate land income, net of management expenses, equivalent to at least 7.7% of its total endowment fund over the next ten years. In addition, the EFIB estimates that the fund, over the long term, will earn at least 3.0% annually, net of fees. This results in a minimum reasonable income forecast of 10.7% annually. If 5.0% is retained to offset estimated inflation and population growth, the fund could distribute the remainder, 5.7% of the total fund, on a sustainable basis. 5.7% of the total fund is equivalent to 7.0% of the Permanent Fund, a 2 percentage point increase from the 5.0% rate used today.

However, if the distribution rate were immediately increased to 7.0%, the Earnings Reserve for the endowment would fall to 4.3 years, materially below the Land Board's policy of 5 years. To maintain 5 years of reserves, the distribution rate can only be increased to 6.0%. When reserves grow enough to support a 7.0% rate, the EFIB will consider recommending an additional increase in the distribution rate.

Any increase in distributions for FY2012 approved at this meeting may come too late for consideration by the legislature during its current session. However, the Department of Health and Welfare could, in the next legislative session, either seek a supplemental appropriation for State Hospital South to spend the additional funds in FY2012 or obtain authorization to spend them in FY2013.

RECOMMENDATION

Modify the Land Board's Distribution Policy to permanently increase the distribution rate for the State Hospital South Endowment to 6.0% of the three-year average of the Permanent Fund and, for FY2012, increase the approved distribution to \$2,301,600 from \$1,917,600.

BOARD ACTION

Secretary of State Ysursa moved approval of the Endowment Fund Investment Board's recommendation to increase the distribution from the current 5% to 6% of the three-year average which would increase the distribution from \$1,917,600 to \$2,301,600. Attorney General Wasden seconded the motion. Governor Otter further clarified that the motion is for year 2012 only and that the motion does not include 2013 and beyond at 7%. The motion carried on a vote of 5-0.

ATTACHMENT

1. Presentation on the Distribution Rate for State Hospital South



Distribution Rate for State Hospital South

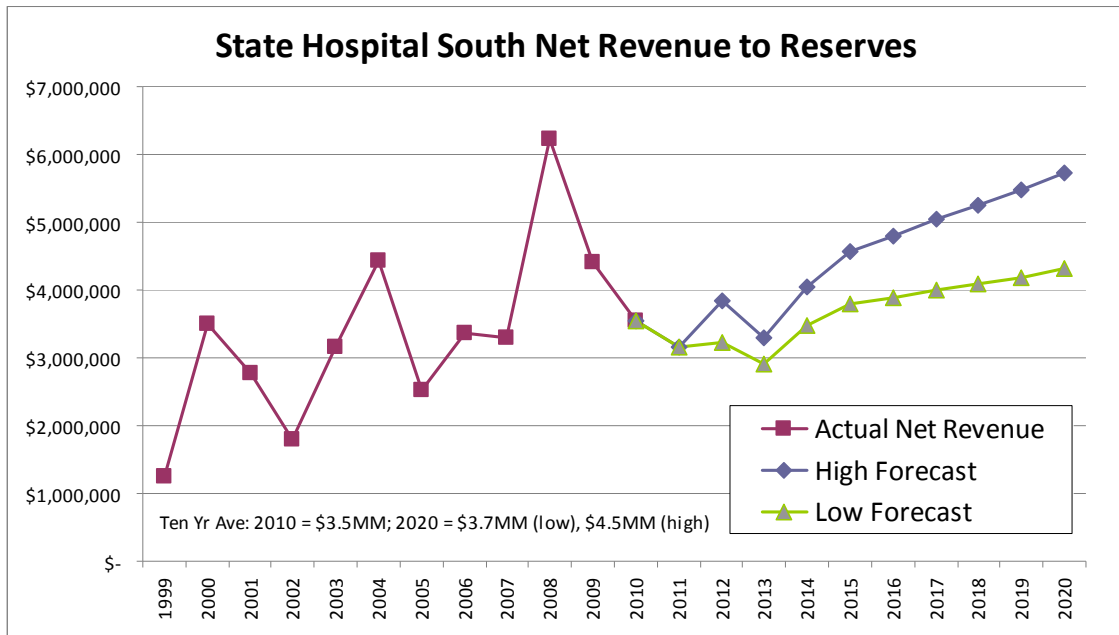
March 15, 2011 Land Board Meeting

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Conditions necessary before increasing the 5% Distribution Rate

- The EFIB believes it is prudent to consider adjusting the 5% distribution rate for endowments which:
 - Have reached target levels in their reserve fund (5 years) and permanent fund (inflation + population growth since year 2000)
 - Have above average expected land revenues
- In January, the Dept. of Lands completed a 10-year revenue forecast, with high and low scenarios for State Hospital
 - Results imply an increase in the distribution rate to as high as 7% would be sustainable, even in weak markets
 - But, reserves are not yet sufficient to support 7%

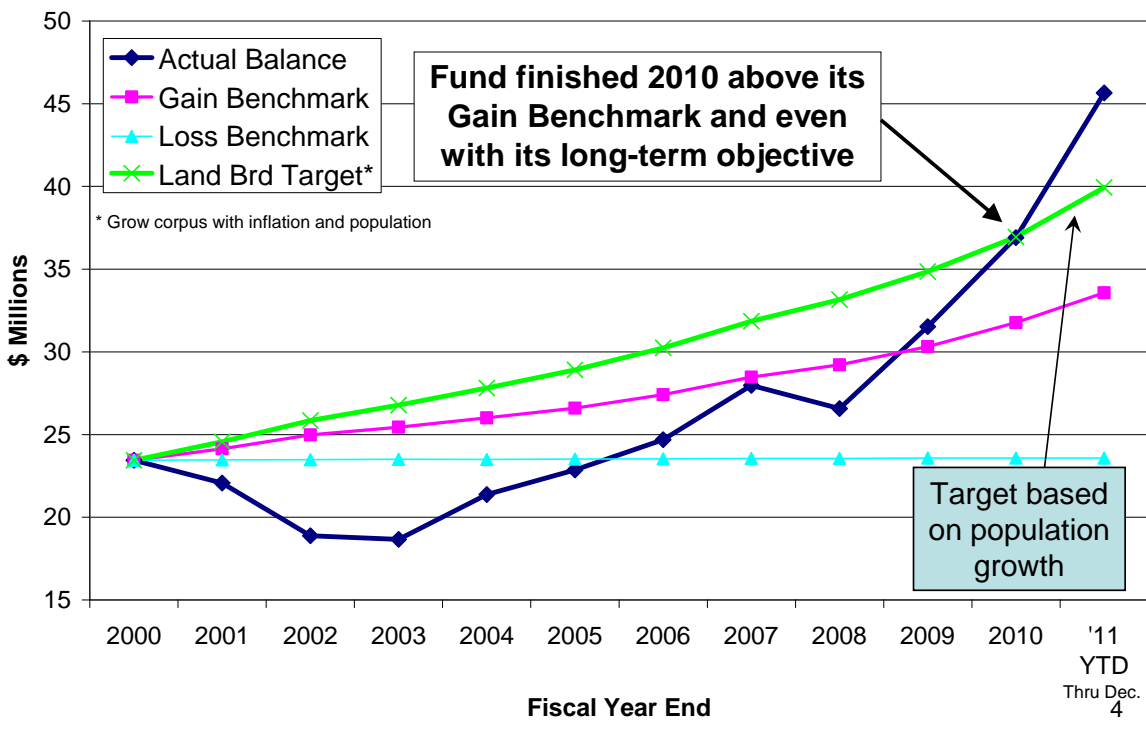
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Low forecast: Timber harvest grows as planned, but prices do not recover from current levels, gradual growth in real estate income

High forecast: Timber prices return to historical average

State Hospital South Permanent Endowment Fund Actual Balance vs. Benchmarks -- 2000 to 2011



Prudent Distribution Rate Based on Expected Income

**State Hospital South
Forecast of Revenues Available
2011-2020 -- Two Scenarios**

	<u>Base Case*</u>	<u>Low Case**</u>
Expected Net Fund Return	6.8%	3.0%
Expected Land Revenue	8.5%	7.7%
Total Fund Earnings	15.3%	10.7%
Inflation & Popul. Growth	(5.0%)	(5.0%)
Available for Distribution	<u>10.3%</u>	<u>5.7%</u>
<i>Current Distribution Rate</i>		
% of Total Fund	4.0%	4.0%
% of Permanent Fund	5.0%	5.0%

* Base case: median land revenues, fund returns

** Low case: "low" land rev., 10th percentile fund returns

- If both fund and land revenues prove disappointing over the next 10 years, State Hospital's sustainable distribution rate would be 5.7% of the Total Fund (7% of the Permanent Fund)
 - Maintains reserves and Perm Fund at targeted levels

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Prudent Distribution Rate Based on Reserve Level

In December, State Hospital had \$11.5 million in reserves, which equals:

- 6 years at previously approved 2012 distribution of \$1.9 million
- 4.3 years if distribution rate goes to 7%
- 5 years if distribution rate goes to 6%

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Recommendation

- Recommend that the Land Board increase the distribution rate for State Hospital South from 5% to 6% for FY2012 and beyond
 - 20% (\$380,000) increase from \$1.92 million to \$2.30 million
 - Sustainable based on a conservative income forecast
 - Maintains 5 years of reserves
 - When reserves grow to 5 years at a 7% distribution rate (by August?), the EFIB will revisit whether a recommendation to move to 7% for FY2013 and beyond would be appropriate