



Final Minutes
Endowment Fund Investment Regular Board Meeting
May 19, 2015

A regular meeting of the Endowment Fund Investment Board (Board) was held in the Board Conference Room at 816 W. Bannock Street, Ste. 301, Boise, Idaho on May 19, 2015. Chairman M. Dean Buffington called the meeting to order at 9:40 a.m. and recognized that a quorum was present.

Member's Present:

Dean Buffington, Chairman
Gavin Gee
Representative Neil Anderson
Warren Bakes
Tom Kealey
Gary Mahn
Sue Simmons
Richelle Sugiyama
Senator Chuck Winder

Staff Present:

Larry Johnson
Chris Halvorson
Laurel Fritz
Judy Shock

Legal Counsel:

Julie Weaver

Member's Absent:

Guests:

Janet Becker-Wold, Callan
Duff Daniels, WCM
Ray Houston, LSO (9:50-10:50)
Scott Phillips, SCO (10:50-11:30)
Cameron Arial, Zions (11:00-11:30)
Michael Keith, Piper Jaffray (11:00-11:30)
Stephanie Bonney, MSBT (11:00-11:30)
Rhet Hulbert, Clearwater (12:05-2:00)
Don Streett, Clearwater (12:05-2:00)

Hard copies of board materials were mailed and delivered six days prior to the scheduled board meeting and a meeting notice was posted on the door of the EFIB office beginning May 12, 2015.

Board Meeting Minutes: February 11, 2015

Mr. Bakes made a motion that the minutes of the February 11, 2015 regular meeting be approved as submitted. The motion was seconded by Mr. Gee and approved unanimously.

Recent Endowment Fund Results

Mr. Halvorson reported on performance for April and May month-to-date.

Capital Market Assumptions

Mr. Johnson covered various estimates of the equity risk premium, most of which show that equities are likely to outperform bonds over the next four-seven years. The year-forward outlook from HCWE Inc., based on expectations for inflation and growth, shows no clear direction in equities vs. bonds. The expected long-term return for the total endowment portfolio remains in the 6.5% range, or 4.0% net of inflation and fees.

Ray Houston arrived at 9:50 a.m.

Fund Performance – 1st quarter (Janet Becker-Wold, Callan)

Endowment Fund: The endowment portfolio posted a 2.0% return for the quarter ended March 2015, 10 basis points below its benchmark. Relative to public fund peers, the fund ranked in the 47th percentile for the quarter, 31st percentile for the year ended March 2015 (26th percentile for the year relative to endowments and foundations) and 4th percentile for the last 10 years.

State Insurance Fund: The SIF portfolio posted a 1.57% return for the quarter ended March 2015, 4.84% for the year, and 4.94% for the last five years. The fund outperformed its target for the quarter, the year, and the last five years.

Compliance Reports: Ms. Becker-Wold reviewed the managers who are behind their median and index for the last three years. She concluded that, at this time, there is no reason these managers will not be able to perform as expected in the future.

Break - 10:40-10:50

Scott Phillips arrived at 10:50 a.m.

Ray Houston departed at 10:50 a.m.

Real Estate Implementation Plan

Mr. Johnson proposed an implementation plan for Real Estate, based on the decision of the EFIB at the February meeting to incorporate \$150 million of private Real Estate into the endowment fund portfolio:

- Initial list of candidates provided by Callan in early June
- Due diligence on the candidates by EFIB staff in June
- Finalists to be interviewed and selected by the Executive Committee in mid-July
- Investment plan (source of funding) approved by the EFIB at the August 11 meeting
- Finals presentation and selection by the Executive Committee in mid-August

In response to a question, about whether the Department of Land's potential disposition of its approximately \$25 million commercial property portfolio and its \$150 million of remaining residential cabin sites would impact the implementation of a commercial real estate mandate for the endowment funds. Mr. Johnson explained that adding the new assets to the fund would be independent of the Department of Land's activities. It is consistent with the implementation plan in Callan's Asset Allocation and Governance Review approved by the Land Board last December which directed the EFIB to consider, among other things, investment in a diversified real estate pool.

Ms. Becker-Wold added that Callan recommends this allocation be invested over 4-8 quarters to recognize the benefits of vintage year diversification and to accommodate the market cycle.

Ms. Becker-Wold also followed up on the board's earlier request to consider whether an investment in listed REITS would be an appropriate holding place for any uninvested allocation to private Real Estate. She said that Callan does not recommend using listed REITS. The asset allocation work done for the Land Board and the overall endowment incorporated assumptions for private, US real estate, not listed real estate. She presented analysis which shows that listed real estate has equity-like volatility and relatively high correlation with equities and therefore does not achieve the diversification benefits of private real estate. Callan recommends that assets earmarked for the private real estate allocation remain invested in the existing endowment portfolio until called by a manager for investment in private Real Estate.

Cameron Arial, Michael Keith and Stephanie Bonney arrived at 11:00 a.m.

Mr. Johnson recommended the EFIB authorize staff, with the consent of the Attorney General's office, to retain a legal advisor with expertise in real estate investment agreements. The advisor, with support from staff and Ms. Weaver, would review the agreements of potential open-ended real estate operations the Investment Board will be considering.

The EFIB discussed the characteristics of investing in private Real Estate, including its potential return stream, appraisal-based valuation of capital gains and losses, delays in investments and redemptions, and limited partnership legal structures. The EFIB instructed Mr. Johnson to update the Land Board, at its June meeting, on the implementation plan and also provide an overview of the investment characteristics of private Real Estate.

Mr. Mahn made a motion to authorize EFIB staff, with the assistance and approval of the Attorney General's office, to retain a specialized Real Estate attorney with an expected FY 2016 operating cost of no more than \$25,000. The motion was seconded by Ms. Simmons and approved by a vote of 8-1, with Rep. Anderson voting "nay".

Rhet Hulbert and Don Streett arrived at 12:05 p.m.

School Bond Credit Enhancement Program

Mr. Johnson indicated that staff has conducted a review of the school bond program and tentatively proposes the following changes:

- Increase the Public School Fund's overall commitment to the program from \$200 million to \$300 million
 - Increases the bond principal which can be guaranteed from \$800 million to \$1.2 billion
- Raise the maximum available to any one district from \$20 million to \$30 million

These changes would benefit the larger school systems and increase the Public School endowment's earnings from guaranty fees. Mr. Johnson indicated the changes would not significantly impair the endowment's liquidity, since the fund has grown significantly since the original limits were put in place in 2000. Also, substantial capacity would remain for small districts, who tend to obtain a higher rate of savings from the Credit Enhancement program and the state's guaranty program.

Mr. Johnson explained that implementing these changes would require amendments to statutes. Ideally, these would be finalized at the EFIB's August meeting to allow them to be thoroughly vetted by the Governor's staff and other stakeholders prior to introduction in the next legislative session.

Mr. Bakes made a motion that Staff work with the State Treasurer's office and the Legislature on proposing the increases from \$200 million to \$300 million (overall Public School Fund's overall commitment) and raise the maximum available to any one school district from \$20 million to \$30 million. The motion was seconded by Mr. Gee and approved unanimously.

Lunch served 12:15 p.m.

Land Board Distribution Policy

Mr. Johnson presented an estimate of FY 2017 Endowment Distributions, assuming the fiscal year had ended in March. Total distributions rise 9.6% to \$61.9 million from \$56.5 million in FY 2016 and \$52.0 million in FY 2015. These amounts are preliminary, pending final fund results for the fiscal year and receipt of an updated forecast of land revenues from the Department of Lands.

The Public School Fund has a deferred capital gain in its Permanent Fund of over \$110 million, but this is not required to be formally recognized as income to reserves until FY 2016. If it were considered now, that would boost Public School distributions from an estimated \$35.6 million to \$44 million. The board discussed the pros and cons of recognizing the gain early and asked staff to provide further analysis of this option at the August meeting.

Mr. Johnson also stated that the Land Board's Asset Management Plan requires the EFIB to review the Distribution Policy annually and recommend whether any changes are appropriate. Staff does not recommend any changes at this time, pending better understanding of the impact of the transfer of endowment land property sale proceeds to the Permanent Funds. Staff plans to present a preliminary analysis of this impact at the August meeting.

Mr. Kealey made a motion to recommend to the Land Board that no changes be made to the current Distribution Policy. The motion was seconded by Mr. Mahn and approved unanimously.

Capitol Permanent Endowment Distribution

Ms. Fritz presented the Capitol Permanent Endowment Fund distribution recommendation. She indicated that staff evaluated the sustainability of the current 5% policy using two scenarios with future annual fund returns of 6.8% and 0.0%. She stated that per the current 5% policy, \$1,276,000 is sustainable, for the upcoming distribution on July 1, 2015, assuming that land income begins to recover by 2018.

Representative Anderson made a motion that a distribution of \$1,276,000 be made from the Capitol Permanent Fund to the Maintenance Reserve on July 1, 2015. The motion was seconded by Mr. Gee and approved unanimously.

Investment Consultant to DEQ

Mr. Johnson reviewed an email from Curt Fransen, Director of DEQ, regarding the recommendation of the Investment Board to retain an outside consultant for the Bunker Hill Water Treatment Endowment. Mr. Fransen said that DEQ does not believe it would be a necessary to incur the cost to hire an independent investment consultant at this time because DEQ has not been able to identify a significant difference between the investment objectives of the general Endowment Fund and the current needs of Bunker Hill. He added that this should be re-evaluated when DEQ takes over operation of the treatment plant and begins expending monies from the Bunker Hill Endowment.

The EFIB discussed the benefits of in-depth investment analysis, beyond what EFIB staff can perform, on the suitability of the endowment asset mix for the Bunker Hill endowment. They asked staff to consider the impact on Bunker Hill of adding Real Estate to the fund asset mix, especially as it impacts liquidity, and discuss this with DEQ.

Clearwater Equitization Overlay Program

Mr. Hulbert presented an overview of the daily equitization and rebalancing process that Clearwater manages for the endowment fund. The process turns excess cash, on a daily basis, into the economic equivalent of stocks and bonds through the use of futures. Over the long run, it has contributed a modest return while reducing overall portfolio risk as the process keeps the fund close to its target allocation. It costs about \$100,000 per year to run this strategy and, on average, the fund has earned about \$400,000 per year since inception.

Mr. Hulbert confirmed Clearwater's commitment to continue to provide this product and to seeking other clients.

Rhet Hulbert and Don Streett departed at 2:00 p.m.

EFIB Staff Reports

Mr. Halvorson reviewed the performance reports of the Parks and Recreation endowments. Fiscal year-to-date through April 2015, Trail of Coeur d'Alene's and Ritter Island are up 3.7%. From inception in July 2014 through March 2015, the Bunker Hill Water Treatment endowment is up 1.9%. From inception in October 2014, the Fish & Game Stewardship endowment is up 1.8%, and the Fish & Game Trust endowment is up 1.8%.

Ms. Shock reported on the Expenses vs. Budget thru April 2015, Quarterly Financial Statements, Coverage Ratio and the YTD Land Revenues.

Mr. Johnson reported on Housing Starts, Inland Lumber Price, Stumpage Price, and the Gift Log.

Mr. Johnson reviewed the quarterly report on the School Bond Credit Enhancement Program. A school district in Wilder was issued a guaranty during the first quarter of 2015. The total under guaranty stands at \$470.2 million. He mentioned that, at one point, the amount guaranteed was near \$800 million, but it dropped primarily because large districts refinanced their bonds, but were unable to continue with an endowment guaranty due to the imposition of the \$20 million per district limit. He also reviewed the annual letter and report from the Superintendent's office, stating that the school district participating in the School Bond Guarantee program will be able to adequately meet their bond servicing requirements in FY 2015. Further, EFIB staff carried forward the analysis into FY 2016 and found no evidence that suggests any district will have difficulty making timely payments.

Mr. Johnson reviewed the Gift Log and discussed Upcoming Issues for the August 2015 board meeting. The EFIB requested that Callan's year-end performance reports incorporate information on total endowment assets, land and fund.

Executive Session

Representative Anderson made a motion that the board enter Executive Session pursuant to *Idaho Code §67-2345, for the purpose of discussing (1) (b) personnel issues*. Mr. Gee seconded the motion and the board approved unanimously. The board went into Executive Session at 2:15 p.m.

The roll call vote was as follows:

Chairman Dean Buffington – Aye

Vice Chairman Gavin Gee - Aye

Representative Anderson – Aye

Warren Bakes - Aye

Tom Kealey – Aye

Gary Mahn - Aye

Susan Simmons – Aye

Richelle Sugiyama - Aye

Senator Winder - Aye

Guests present during Executive Session:

Julie Weaver

Mr. Halvorson, Ms. Fritz, Mr. Johnson and Ms. Shock departed at 2:15 p.m.

Per the Board's request, Mr. Johnson returned at 2:25 p.m.

At 2:30 p.m., a motion to return to regular session was made by Ms. Simmons, seconded by Mr. Gee and approved unanimously.

Chairman Buffington thanked the Compensation Chair, Ms. Simmons and her committee for their diligence in developing the personnel review of the Manager of Investment.

Ms. Simmons reported on numerous stakeholder contacts made by the Compensation committee in preparation for the annual review.

The EFIB discussed the goals of the agency and asked Ms. Simmons to add an objective that staff should develop, in conjunction with the Land Board and the Department of Lands, an efficient audit process that incorporates both the land and the fund. The EFIB also recommended that the objective of retaining law firms to monitor securities litigation be given lower priority.

Ms. Simmons made a motion to approve the salary matrix as proposed by Mr. Johnson, subject to approval by DFM. Subject to approval of the Governor's office, Mr. Johnson will receive a salary increase of 3.0% and a \$2,000 bonus for FY 2015. Salary increases would be effective May 24. The motion was seconded by Mr. Bakes and approved unanimously.

Adjournment

There being no further business to come before the Board, Ms. Simmons made a motion to adjourn, which was seconded by Mr. Gee and passed unanimously.

The meeting adjourned at 2:35 p.m.