August 9, 2001 **BOARD MATTER NO. 52**

ACTION: Spending Policy Change Recommendations

AUTHORITY: W.S. 9-4-713

ALTERNATIVE: Approve or establish alternative recommendation

ANALYSIS:

During the 2000 Legislative Session, Wyoming State Statute 9-4-713 was created which establish an investment earnings spending policy for the Permanent Mineral Trust Fund and the Common School Permanent Land Fund. In compliance with this statute, the State Treasurer must provide, annually not later than September 30 each year, in consultation with the State Loan and Investment Board, a recommendation to the Select Committee on Capital Financing and Investments regarding modifications to the spending policy for the Permanent Mineral Trust Fund and the Common School Permanent Land Fund.

When this legislation was adopted, it established a spending policy for fiscal years 2001 through 2004 setting spending at a specific dollar rate contrasting with previous periods where income produced was spent every fiscal year. At the same time the spending policy was adopted, a new asset allocation environment was set for the State recognizing that if it did not increase exposure to higher returning asset classes such as equities, the permanent funds would not keep pace with projected spending and maintain their value in real terms, net of inflation, over the long-term. The new equity limit adopted was 55%, a revision from the previous level of 25%.

In discussions with both the Board and the Select Committee, a further future development was discussed to provide an even more workable solution to setting state spending levels. That development was a suggestion to move to a spending policy that is determined based on a pre-determined percentage of a moving asset value. Most endowments and foundations have adopted such policies for the purposes of:

- Maintaining real value of assets over time;
- Supporting the spending needs of the organization;
- Growing the assets in real terms.

In setting spending rates for long-term institutions, consideration is given to the needs of the institution supported, desire to inflation-proof the asset base, and goals for growth of assets in real terms net of spending.

Considering these issues, many such institutions have chosen spending rates of 4.0% to 6.0% implemented using an average market value approach of typically 12 quarters (three calendar years using quarterly market values to further smooth market fluctuations). Institutions have determined these levels by exercises in which they look for a spending rate, that in combination with expected inflation (we currently use 3.0%) will allow their assets to grow in real terms. Using simple mathematics, this results in an expected return of approximately 8.0% for 5% spending rates, and 9.0%for 6% spending rates.

Based on statutory dictating spending levels for the Permanent Mineral Trust Fund as an example, Wyoming is spending about 8.0% of assets (using a five year rolling average market value). Over time, assuming the asset allocation intended for the permanent funds is implemented as planned and the investments provide an investment return consistent with our long-term projections, we estimate that spending levels will decrease to approximately 7.2% by 2004 and 5.9% by 2007. If the portfolio is expected to return 7.9% in the long-term, it is apparent that the State in the near-term will be spending above levels required if inflation-proofing is desired in the near-term. However, if spending remains at levels similar to those passed in statute (9-4-713), over time, the investment program will eventually be able to support spending and inflation proofing.

August 9, 2001 **BOARD MATTER NO. J2**

(CONTINUED)

The State Treasurer in consultation with R.V. Kuhns and Associates and the Investment Work Group is recommending the following actions be considered by the Select Committee on Capital Financing and Investments:

- Change the spending policy to a percentage of assets calculation;
- Adopt a five year rolling average market value approach for purposes of spending;
- Beginning with the spending levels outlined in current statute, begin setting a spending rate that gradually decreases over time to a sustainable rate of 5.0%. This gradual step-down process can be implemented by decreasing spending rates by 0.5% per year until sustainable levels are achieved.

DIRECTOR'S RECOMMENDATION: Information Only - No Board Action Required

RVK
R.V. Kuhns & Associates, Inc.

Wyoming State Treasurer's Office
Spending Policy Change Recommendations
July 26, 2001

Background
In fiscal year 2000, a spending policy was adopted for the next two biennium setting spending at a specific dollar rate contrasting with previous periods where income produced was spent every fiscal year. At the same time the spending policy was adopted, a new asset allocation environment was set for the State recognizing that if the it did not increase exposure to higher returning asset classes such as equities, the permanent funds would not keep pace with projected spending and maintain their value in real terms, net of inflation, over the long-term. The new equity limit adopted was 55%, a revision from the previous level of 25%.

Spending Policies of Other Long-term Institutions
In discussions of both the Board and Select Committee on Capital Finance and Investments, a further future development was discussed to provide an even more workable solution to setting State spending levels. That development was a suggestion to move to a spending policy that is determined based on a pre-determined percentage of a moving asset value. Most endowments and foundations have adopted such policies for the purposes of:

- Maintaining real value of assets over time;
- Supporting the spending needs of the organization;
- Growing the assets in real terms.

In setting spending rates for long-term institutions, consideration is given to the needs of the institution supported, desire to inflation-proof the asset base, and goals for growth of assets in real terms net of spending.

Considering these issues, many such institutions have chosen spending rates of 4.0% - 6.0% implemented using an average market value approach of typically 12 quarters (3 calendar years using quarterly market values to further smooth market fluctuations). Institutions have determined these levels by exercises in which they look for a spending rate, that in combination with expected inflation (we currently use 3.0%) will allow their assets to grow in real terms. Using simple mathematics, this results in an expected return of approximately 8.0% for 5% spending rates, and 9.0% for 6% spending rates.

Recommendations for Wyoming

Based on statutory dictated spending levels for the Permanent Mineral Trust Fund as an example, Wyoming is spending about 8.0% of assets (using a 5 year rolling average market value). Over time, assuming the asset allocation intended for the permanent funds is implemented as planned and the investments provide an investment return consistent with our long-term projections, we estimate that spending levels will decrease to approximately 7.2% by 2004 and 5.9% by 2007. If the portfolio is expected to return 7.9% in the long-term, it is apparent that the State in the near-term will be spending above levels required if inflation-proofing is desired in the near-term. However, if spending remains at levels similar to those passed in statute (number?), over time, the investment program will eventually be able to support spending and inflation-proofing.

We recommend the following actions be considered:

- Change the spending policy to a percentage of assets calculation;
- Adopt a 5 year rolling average market value approach for purposes of spending;
- Beginning with the spending levels outlined in current statue, begin setting a spending rate that gradually decreases over time to a sustainable rate of 5.0%. This gradual step-down process can be implemented by decreasing spending rates by 0.5% per year until sustainable levels are achieved.

From: Pat Arp
To: Biggio, Larry; Garland, Sharon; Stephenson, Gary; Teter, Carolyn
Date: 7/30/01 9:24AM
Subject: Re: Deputies Group

Larry,

Nicely done. I went back through my notes but found nothing that you missed. So I think the Operational Standards you drafted are fine. Thanks for the work.

I spoke with Andrea this morning about her coordination with our ITD folks. They are all here on Wednesday of this week and will meet then. Andrea will have their issues list to us in priority order by Thursday (the 2nd). That is a week prior to the meeting with A&I E-portal folks on the 9th so that should work.

As for questions for Frank: These are somewhat separate from the e-portal but integral to planning for technology issues.
1. Regarding transition to one standard for e-mail, will A&I ask for enterprise funding or will there be a charge back, or both? I believe in the document Frank gave to the OGC there was a statement that A&I would ask for enterprise funding and there was also language about charge back. IS the plan to obtain enterprise funding to convert to one system and then charge agencies for specific services or ongoing costs? If so, agencies will need to know this soon for budget planning purposes.
2. I have heard talk of using left over Y2K monies for a number of projects - further e-portal building, the business application pilot etc. I'd like to ask Frank to give that more consideration and then specifically designate where those funds will go so we can better advise the OGC what monies they might want to request of the legislature for the things they want to accomplish.

Larry, that's it from me for now.
Pat

>>> Larry Biggio 07/27/01 03:39PM >>>
Good Afternoon: Attached are some preliminary thoughts about our group and its role and operations from yesterday afternoon. Please give me your thoughts. Thanks you.

9-4-713. Investment earnings spending policy - permanent funds.

(a) The purpose of this section is to establish a spending policy for earnings on permanent fund investments to provide, in descending order of importance:

(i) Consistent, sustainable flow of earnings for expenditure over time;

(ii) Protection of the corpus of the permanent funds against inflation; and

(iii) To the extent practicable, increases in earnings available for expenditure to offset the effects of inflation.

(b) There is created within the earmarked revenue fund the permanent Wyoming mineral trust fund reserve account. The state treasurer shall transfer funds from this account to the general fund as necessary to ensure that the spending policy amount specified in subsection (d) of this section is available for expenditure annually during each fiscal year. As soon as possible after the end of each of the fiscal years beginning on and after July 1, 2000, revenues in this account in excess of seventy-five percent (75%) of the spending policy amount in subsection (d) of this section shall be credited to the permanent Wyoming mineral trust fund.

(c) The earnings from the permanent Wyoming mineral trust fund under W.S. 9-4-204(n) during each of the fiscal years beginning July 1, 2000, and July 1, 2001, in excess of the spending policy established in subsection (d) of this section are appropriated from the general fund to the permanent Wyoming mineral trust fund reserve account. The appropriation shall be credited to the fund as soon as practicable after the end of the fiscal year but no later than ninety (90) days after the end of the fiscal year.

(d) The annual spending policy for the permanent Wyoming mineral trust fund is as follows for the fiscal year (FY) specified:

(i) FY 2001 - One hundred nineteen million dollars ($119,000,000.00);

(ii) FY 2002 - One hundred twenty-three million dollars ($123,000,000.00);

(iii) FY 2003 - One hundred twenty-four million dollars ($124,000,000.00);

(iv) FY 2004 - One hundred twenty-four million dollars ($124,000,000.00).

(e) Annually, not later than September 30, during and after 2001, the state treasurer, in consultation with the state loan and investment board, shall provide a recommendation to the select committee on capital financing and investments regarding modifications to the spending policy in subsection (d) of this section. The recommendations shall be consistent with the purposes specified in subsection (a) of this section. The select committee on capital financing and investments shall annually submit a recommendation to all members of the legislature before the convening of the session regarding modifications to this spending policy.

(f) There is created within the earmarked revenue fund the common school permanent fund reserve account. The state treasurer shall transfer funds from this account to the common school account within the permanent land income fund as necessary to ensure that the spending policy amount specified in subsection (h) of this section is available for expenditure annually during each fiscal year. As soon as possible after the end of each of the fiscal years beginning on and after July 1, 2000, revenues in this account in excess of seventy-five percent (75%) of the spending policy amount shall be credited to the common school account within the permanent land fund.

(g) There is annually appropriated from the general fund to the common school permanent fund reserve account an amount determined under this subsection. The amount shall be computed and calculated by the state treasurer. The amount shall be equal to the extent to which earnings from the common school account within the permanent land fund under W.S. 9-4-204(k) exceed the spending policy established in subsection (h) of this section for that fiscal year. For purposes of calculating earnings from the common school account within the permanent land fund under this subsection, earnings transferred to the corpus of the common school account pursuant to W.S. 9-4-305(b) shall not be included. Earnings transferred to the common school account under W.S. 9-4-305(b) shall not be included when determining spending policy under subsection (h) of this section. The appropriation shall be credited to the account as soon as practicable after the end of the fiscal year but no later than ninety (90) days after the end of the fiscal year.

(h) The annual spending policy for the common school account within the permanent land fund is as follows for the fiscal year (FY) specified:

(i) FY 2001 - Sixty-six million dollars ($66,000,000.00);

(ii) FY 2002 - Sixty-eight million dollars ($68,000,000.00);

(iii) FY 2003 - Seventy-two million dollars ($72,000,000.00);

(iv) FY 2004 - Seventy-five million dollars ($75,000,000.00).

(j) Annually, not later than September 30, during and after 2001, the state treasurer, in consultation with the state loan and investment board, shall provide a recommendation to the select committee on capital financing and investments regarding modifications to the spending policy in subsection (h) of this section. The recommendations shall be consistent with the purposes specified in subsection (a) of this section. The select committee on capital financing and investments shall annually submit a recommendation to all members of the legislature before the convening of the session regarding modifications to this spending policy.

From: "Fred Parady" <fparady@wyoming.com>
To: "Sharon Garland" <SGARLA@state.wy.us>
Date: 7/19/01 11:41AM
Subject: Re: Public Finance Meeting/St. Loan & Investment Bd meeting

Sharon:

Thanks for the update - and for all the hard work that went into that great meeting in Mammoth!

I had hoped to join Cynthia on the 23rd, but am unable to do so, so thanks for the agenda and discussion, both were helpful.

I would like to include the a discussion of the review of spending policy in our committee meeting on the 8th.

See you soon!

One other item - I get into my work email daily, so you may want to use fparady@ocichemical.com.

Thanks!

Fred

On Mon, 16 Jul 2001 17:51:41 -0600
"Sharon Garland" <SGARLA@state.wy.us> wrote:
> Fred, Cynthia asked that I send you a copy of the agenda for the
> meeting we will be having next Monday, July 23, with the State's
> independent public finance advisor, Keith Curry from Public Financial
> Management, Inc. (PFM). The purpose of this meeting is to introduce
> him to the various concepts that will place a significant demand on
> the State's financial resources including School Capital
> Construction, State Facilities & University Capital Construction and
> other state and local entity finance needs. She thought that you
> might be in town for the night show on Sunday evening, July 22 and if
> so would invite you to attend the meeting on Monday. If that works
> with your schedule, we would love to have you join us.
>
> Second, Dave Gruver also asked that I contact you concerning the
> State Loan & Investment Board meeting taking place on August 9. I
> had previously indicated to Dave that the Board would not be acting
> upon any investment items at its Aug. 9 Board meeting. However,
> since we held the investment meeting in Yellowstone, there are two
> items that we do plan to present to the Board at their Aug 9 meeting.
> Becky Gratsinger from R.V. Kuhns is currently preparing a draft
> sub-policy on alternative investments for inclusion in the state's
> master investment policy and will be presenting it to the investment
> work group within the next two weeks. The work group plans to review
> the new sub-policy with Becky, making any necessary revisions and
> preparing a final version to be presented to the State Loan and
> Investment Board on August 9 for final approval. The second item the
> investment work group will be working on with Becky to be presented
> to the Board on August 9 is a recommendation for updating the

> spending policy.
>
> As Becky will be giving an educational session (primer) at the Select
> Committee on August 8 which will include discussion about
> alternative investments in her Asset Allocation presentation and will
> also include a presentation on the spending policy, I do not think it
> is necessary for the Select Committee to attend the Board meeting on
> the 9th, although they are certainly welcome to do so.
>
> On the spending policy, the state statutes indicate that the State
> Treasurer, in consultation with the State Loan and Investment Board,
> shall provide a recommendation to the Select Committee any
> modifications to the policy. In order to comply with this provision,
> we plan to prepare a Board matter with our recommendation seeking the
> Board's approval on Aug. 9. We can provide a copy of this Board
> matter to the Select committee on Aug. 8. If the Board approves our
> recommendation, we will send a formal letter of recommendation from
> the State Treasurer to the Select Committee prior to Sept. 30. The
> Select Committee can thenact upon the Treasurer's recommendation at
> it's next meeting, which I understand from Dave will probably be in
> October.
>
> If this meets your approval, we will proceed in this manner. If you
> have any questions on either of these matters, don't hesitate to
> contact me.
>
> Sharon
>

August 9, 2001 **BOARD MATTER J - 3**

ACTION: Acknowledgment of Annual Conflict of Interest Disclosure

AUTHORITY: SL&IB Master Investment Policy § 3.4

ANALYSIS:

In compliance with W. S. 6-5-118, the State Loan and Investment Board adopted a provision within the Master Investment Policy (Section 3.4, "Conflict of Interest Disclosure") which requires:

> "members of the State Loan and Investment Board and those staff who invest public funds or have the authority to decide how such funds are invested shall disclose any pecuniary benefit received or personal interest in any entity providing investment related services to the State or in any security or other investment made by the State. This disclosure shall include any property with a value of $20.00 or more, transportation and lodging, and food, drink or entertainment with a value of $100.00 or more annually. Such disclosure shall comply fully with the provisions of WS 6-5-118, shall be in addition to the quarterly reports required under this Section and shall be made a part of the minutes of the State Loan and Investment Board."

Per a telephone conversation with staff from the Department of Audit, the following individuals have duly filed an annual report on conflict of interest/disclosure as required. These reports are on file with the Department of Audit.

Governor Jim Geringer
Secretary of State, Joe Meyer
State Auditor, Max Maxfield
State Treasurer, Cynthia Lummis
State Superintendent of Public Instruction, Judy Catchpole
Glenn Shaffer, Chief Investment Officer, Treasurer's Office
Sharon Garland, Deputy State Treasurer
Diana Walter, Investments Accountant, Treasurer's Office
Kenneth Rolfsness, Investments/Distribution Accountant, Treasurer's Office
Karla Semler, Investment Analyst, Treasurer's Office
Barbara Patterson, Financial Analysis Supervisor, Treasurer's Office

DIRECTOR'S RECOMMENDATION:

The Director recommends that formal acknowledgment be made a part of the minutes of this meeting that the individuals listed above have satisfied the requirements of Section 3.4 of the Master Investment Policy Statement by filing their annual report on conflict of interest/disclosure forms with the Department of Audit.

BOARD ACTION: