

# Legislative Budget Hearing

Utah School & Institutional Trust

Fund Office

January 2016

# Agenda

- Who we are
- Our current challenges
- Budget discussion
- Appendix - Solutions to our challenges

# Introduction

## School & Institutional Trust Funds Office

- “The office is an independent state agency within the executive branch and is not a division of any other executive branch department.” 53D-1-201 (2)
- Formed in 2015 to institutionalize the investment management of the permanent school fund or school trust fund
  - \$2 billion in assets
  - 11 additional land trust funds also managed by SITFO

Utah State University  
Deaf School  
Institute for the Blind  
State Industrial School  
Normal Schools

Public Buildings  
Reservoirs Fund  
Utah State Hospital  
School of Mines  
University of Utah

# Introduction - Funding

## **School & Institutional Trust Funds Office**

“The director shall deposit into the account an amount of money from the earnings from trust fund assets equal to the annual appropriation that the Legislature makes to the office, to pay for the office’s operating costs.” 53D-1-203

- Self-funding
  - Operations are funded through the trust, not the taxpayers

# Introduction - Governance

## **School & Institutional Trust Funds Office**

The Board of Trustees consists of the State Treasurer (Chairperson) and four additional members. 53D-1-301

- Non-partisan
- Expertise in institutional management
- Outstanding professional qualifications pertinent to the prudent investment of trust fund money

# Introduction - Staff

## **School & Institutional Trust Funds Office**

The staff consists of three persons:

- Director, Chief Investment Officer
- Senior Investment Analyst
- Administrative Analyst

Advisory and consultant relationships underway:

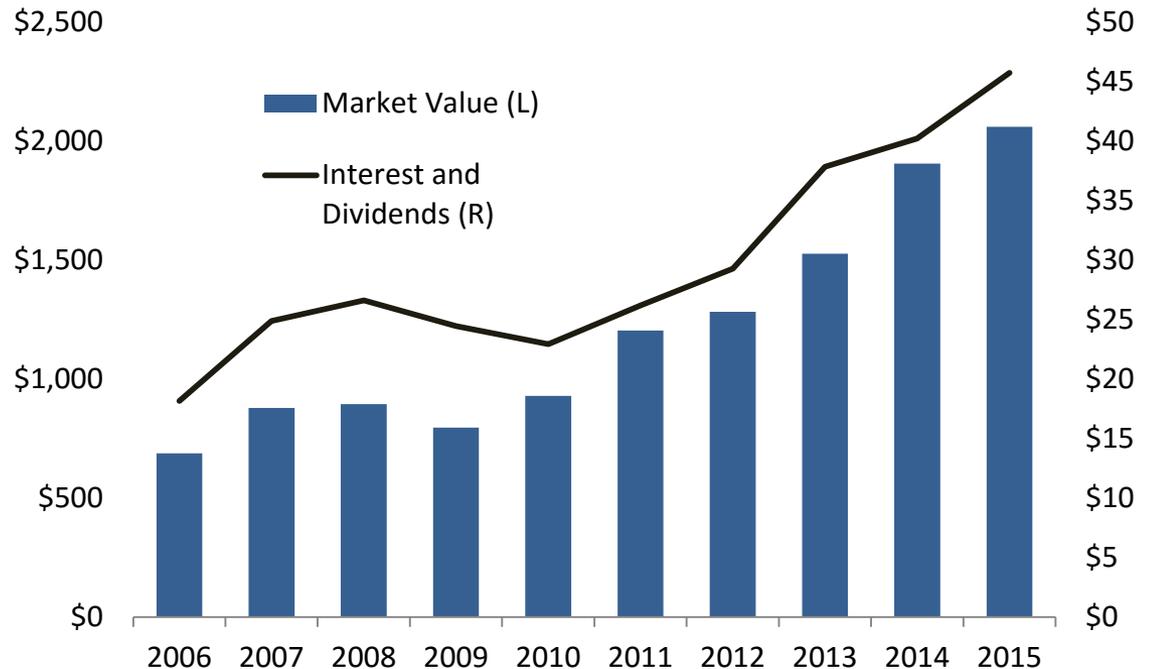
- Investment consultant and advisors
- Custodian bank
- Research vendors
- Risk management

# Previous State of Affairs

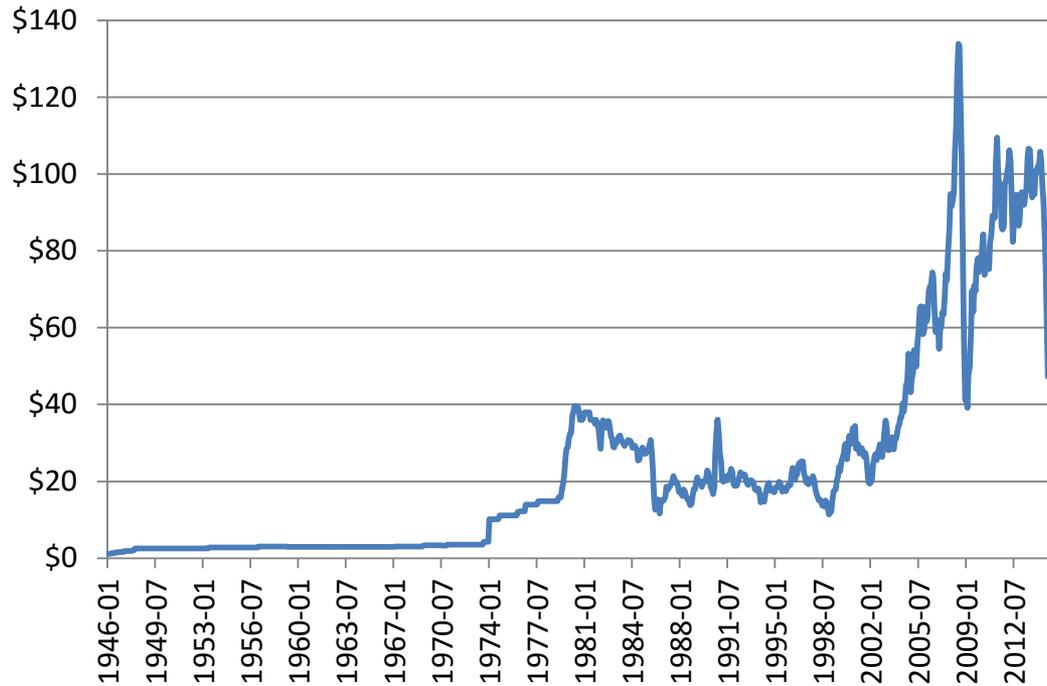
1995 to present:

- Portfolio grew to \$2bn
  - Primarily SITLA contributions
  - Important element of “growth tilt”

Contributions from Land Assets:	\$1,401M
Contributions from Investment Activities:	\$653M
Average Annual Distribution:	\$17M
2015 Distribution:	\$45M



# Challenges - Contributions

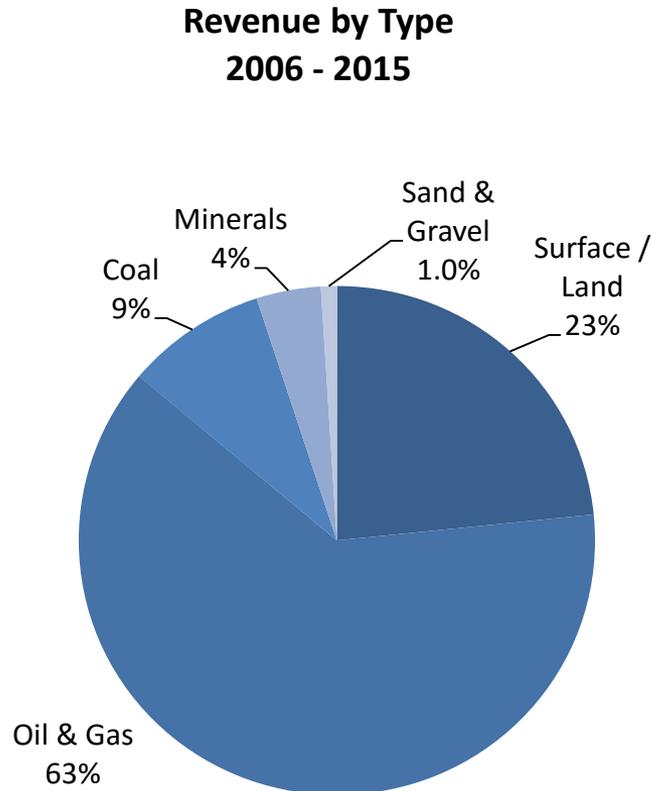


## Challenge:

- Price of oil is volatile, historical average is low

Historical Prices	Oil
1946 – 2015	\$23.52
1995-2015	\$53.11
Max	\$133.88
Min	\$1.17

# Challenges - Contributions



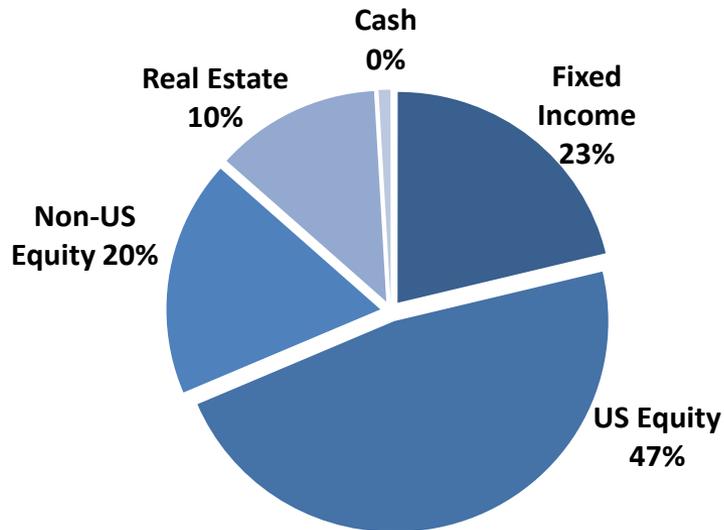
## Challenge:

- Major contributor is oil & gas
- Nature of land based assets is limiting

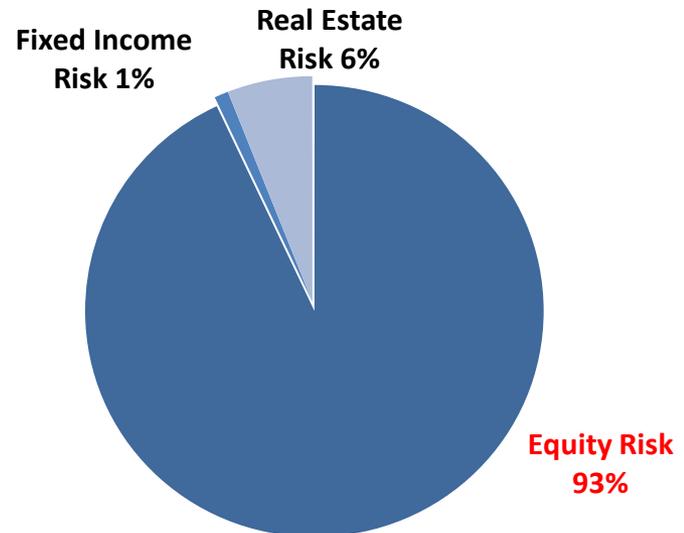
	20 Years (\$)	20 Years (%)	2010 - 2015 (\$)	2010 - 2015 (%)
<b>Avg</b>	\$ 70	10%	\$ 89	5%
<b>Min</b>	\$ 9	4%	\$ 72	4%
<b>Max</b>	\$ 128	20%	\$ 116	7%

# Challenges – Portfolio

**School Fund**  
Asset Allocation



**School Fund**  
Risk Allocation



## Challenge:

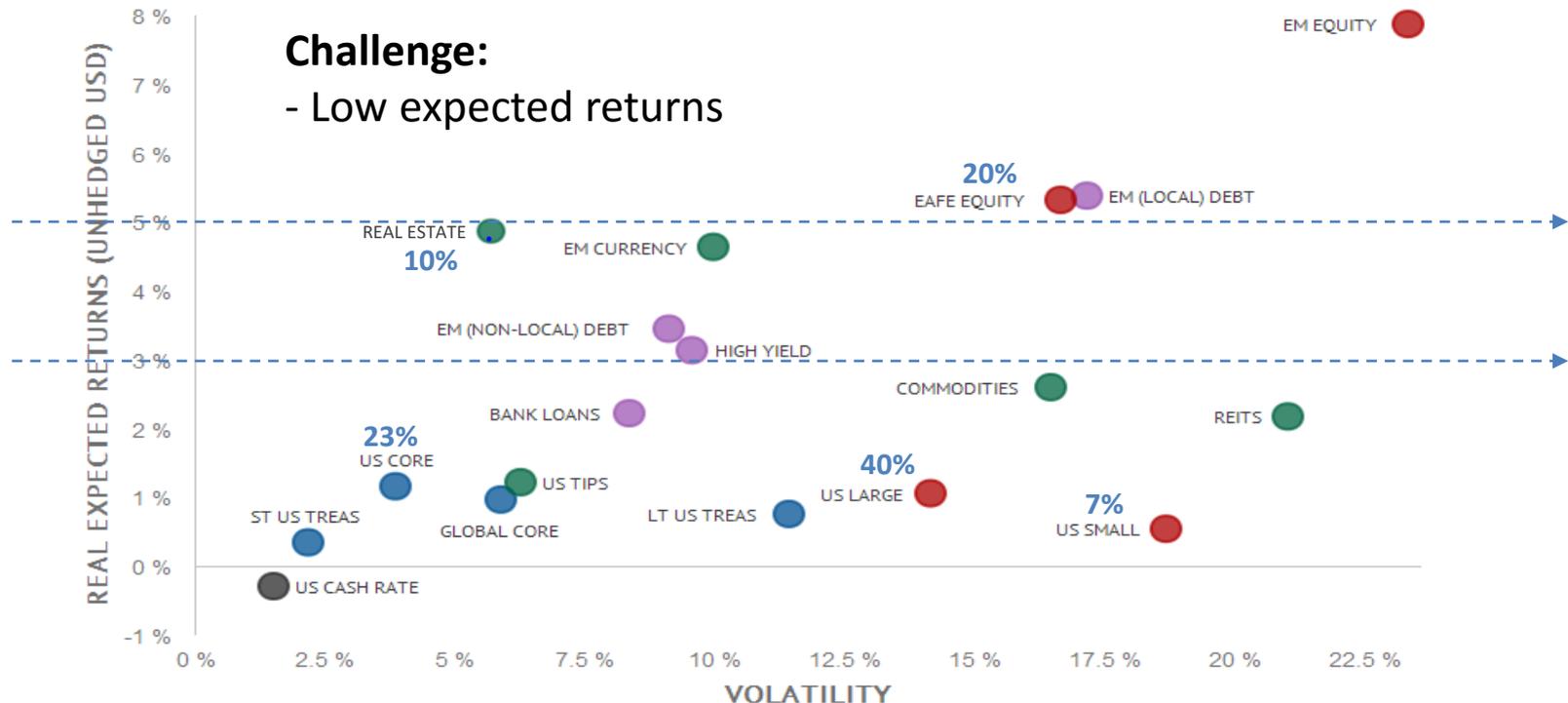
- 90%+ of the risk generated by equity
- Not well diversified
- Low distributions

# Challenges - Portfolio

## REAL 10-YEAR EXPECTED RISK & RETURN



Geometric expected returns for core asset classes show mainstream stocks and bonds suffering from low real yields and anemic growth. Opportunities for return do exist for investors willing to go beyond mainstream assets.



As of 12/31/2015. Source: These expected returns are calculated by Research Affiliates LLC using data provided by MSCI Inc., Bloomberg, and Barclays. Volatility is measured as standard deviation. These forecasts are forward-looking statements based upon the reasonable beliefs of RA and are not a guarantee of future performance. This content is not investment or tax advice or an offer, sale or any solicitation of any offer to buy any security, derivative or any other financial instrument. Any use of the above content is subject to and conditioned upon the user's agreement with all important disclosures, disclaimers and provisions found at [www.researchaffiliates.com/Pages/Legal.aspx](http://www.researchaffiliates.com/Pages/Legal.aspx). In the event the above content is provided or modified by a third-party, Research Affiliates LLC fully disclaims any responsibility or liability for such content. ©2016 Research Affiliates, LLC. All rights reserved.

If target return 7% (inflation adjusted 4%) ...need to diversify.

# Challenges - Distributions

1995 to present:

- Current distribution policy based on 19<sup>th</sup> century practices (“income only”)
- Conundrum of balancing “growth” and “income” is constraining

## Challenge:

- Low yields
- Inefficient, inequitable distribution policy

Historical and Current Yields	Stocks	Bonds
1890-1995	↓ 4.68%	↓ 4.73%
1995-2015	1.83%	4.15%
2011-2015	↓ 2.06%	↓ 2.13%
2015	2.11%	1.88%

# Challenges – Summary

- Are the previous sources of growth sustainable?
- Is the portfolio diversified?
  - Risk managed?
  - Future returns?
- Is the distribution policy optimal?
  - Does it allow for portfolio diversification?
  - Does it allow for risk management?
  - Does it allow for intergenerational equity?

# Forward Looking

## 2016 – Improvement efforts underway

- Distribution policy changes
- Portfolio diversification
- World class advisory relationships

# Budget - FY16 & FY17

	FYTD	as %	FY16	as %	FY17	as %
AA Personnel Services	\$178,614	21%	\$463,855	54%	\$597,427	69%
CC Travel/Out of State	\$1,220	0%	\$17,250	2%	\$42,500	5%
DD Current Expense	\$88,325	10%	\$289,495	33%	\$160,814	19%
EE Data Processing Current Expense	\$1,014	0%	\$15,500	2%	\$47,000	5%
GG Capital Expenditure	\$18,054	2%	\$40,000	5%	\$5,000	1%
TOTAL INCOME	\$865,000	100%	\$865,000	100%	\$865,000	100%
TOTAL EXPENSE	\$287,227	33%	\$826,100	96%	\$852,741	99%
DIFFERENCE	\$577,773	67%	\$38,900	4%	\$12,259	1%

*School Trust Funds Management Account  
Appropriation*

# Budget - Highlights

FY16 Significant one-time expenses incurred for office set up:

- Professional services
- Office furniture
- Technology

FY17 (Pro-forma) Expected significant ongoing expenses:

- Personnel (69%)
- Office management (incl. rent) (6%)
- Travel (due diligence) (5%)
- Technology (5%)

<b>AA Personnel Services</b>	<b>FYTD</b>	<b>as %</b>	<b>FY16</b>	<b>as %</b>	<b>FY17</b>	<b>as %</b>
	<b>\$178,614</b>	<b>21%</b>	<b>\$463,855</b>	<b>54%</b>	<b>\$597,427</b>	<b>69%</b>
5101 Regular Salaries & Wages	\$109,662.52	13%	\$303,594.90	35%	\$387,864.00	45%
5110 Leave Paid	\$11,891.16	1%	\$20,000.00	2%	\$30,000.00	3%
5120 Miscellaneous Earnings	\$23.54	0%	\$50.00	0%	\$100.00	0%
5140 Compensatory/Excess Time Eamed (FLSA Exempt & Non-E	\$1,004.80	0%	\$2,000.00	0%	\$2,500.00	0%
5160 Sate Retirement	\$26,782.68	3%	\$65,606.95	8%	\$77,650.00	9%
5170 FICA/Medicare	\$8,588.17	1%	\$20,700.00	2%	\$24,223.00	3%
5180 Health, Dental, Life & Long-Term Disability Insurance	\$12,215.51	1%	\$30,000.00	3%	\$47,571.81	5%
5190 Unemployment & Workers Compensation Insurance	\$1,131.03	0%	\$3,200.00	0%	\$4,138.55	0%
5199 Compensatory/Excess Time Eamed Benefits (FLSA Exempt	\$301.44	0%	\$500.00	0%	\$1,000.00	0%
5300 Sate Leave Pool	\$7,013.62	1%	\$18,203.52	2%	\$22,379.80	3%

<b>CC Travel/Out of State</b>	<b>\$1,220</b>	<b>0%</b>	<b>\$17,250</b>	<b>2%</b>	<b>\$42,500</b>	<b>5%</b>
6054 Out of State Travel-Maximum Auto Mileage Rate	\$0.00	0%	\$250.00	0%	\$500.00	0%
6055 Out of State Travel-Meal Reimbursement	\$68.00	0%	\$2,000.00	0%	\$2,000.00	0%
6057 Out of State Travel-Transportation Costs	\$1,152.34	0%	\$15,000.00	2%	\$40,000.00	5%

<b>DD Current Expense</b>	<b>\$88,325</b>	<b>10%</b>	<b>\$289,495</b>	<b>33%</b>	<b>\$160,814</b>	<b>19%</b>
6115 Human Resource Services	\$0.00	0%	\$1,800.00	0%	\$3,500.00	0%
6126 Wireless Communication Service	\$0.00	0%	\$2,700.00	0%	\$3,000.00	0%
6132 Communication Services	\$0.00	0%	\$1,640.00	0%	\$1,500.00	0%
6136 Postage & Mailing	\$0.00	0%	\$1,000.00	0%	\$500.00	0%
6137 Professional & Technical Services-Non-medical	\$26,739.94	3%	\$95,505.00	11%	\$15,600.00	2%
6138 Attorney Fees	\$0.00	0%	\$3,500.00	0%	\$10,000.00	1%
6161 Rental of Land & Buildings	\$11,757.00	1%	\$31,350.00	4%	\$47,964.00	6%
6166 Parking Space Rent & Bus Pass Cost	\$0.00	0%	\$2,000.00	0%	\$2,000.00	0%
6181 Office Supplies	\$15.00	0%	\$25,000.00	3%	\$10,000.00	1%
6182 Printing & Binding	\$0.00	0%	\$2,500.00	0%	\$3,000.00	0%
6185 Books & Subscriptions	\$0.00	0%	\$3,000.00	0%	\$3,000.00	0%
6186 Photocopy Expenses	\$0.00	0%	\$1,000.00	0%	\$1,000.00	0%
6187 Small Office Equipment Less Than \$5000	\$0.00	0%	\$2,500.00	0%	\$1,000.00	0%
6188 Office Furnishings Less Than \$5000	\$26,528.73	3%	\$50,000.00	6%	\$5,000.00	1%
6189 Other Small Equipment & Supplies Less Than \$5000	\$0.00	0%	\$2,500.00	0%	\$1,000.00	0%
6257 Risk Management Insurance & Bonds	\$0.00	0%	\$2,000.00	0%	\$2,000.00	0%
6260 Purchasing Card Current Expenses	\$2,890.50	0%	\$20,000.00	2%	\$40,000.00	5%
6271 Reception & Meeting Costs	\$0.00	0%	\$3,000.00	0%	\$3,000.00	0%
6274 Membership Dues	\$0.00	0%	\$2,500.00	0%	\$750.00	0%
6276 Conventions, Seminars, Workshops & Comittees	\$0.00	0%	\$4,000.00	0%	\$6,000.00	1%
6277 Employee Relocation Expense	\$10,000.00	1%	\$15,000.00	2%	\$0.00	0%
6282 Employee Educational Assistance	\$0.00	0%	\$5,000.00	1%	\$1,000.00	0%
6300 Dept of Technology Services Telecommunication Charges	\$10,393.41	1%	\$12,000.00	1%	\$0.00	0%

<b>EE Data Processing Current Expense</b>	<b>\$1,014</b>	<b>0%</b>	<b>\$15,500</b>	<b>2%</b>	<b>\$47,000</b>	<b>5%</b>
6467 Data Processing ardware Less Than \$5000-Desktop Compu	\$0.00	0%	\$5,000.00	1%	\$1,500.00	0%
6469 Data Processing Hardware Less Than \$5000-Laptop/Noteb	\$0.00	0%	\$6,000.00	1%	\$1,000.00	0%
6471 Data Processing Hardware Less Than \$5000-Peripherals	-\$47.95	0%	\$500.00	0%	\$500.00	0%
6472 Data Processing Software Less Than \$5000	\$0.00	0%	\$0.00	0%	\$40,000.00	5%
6500 Dept of Technology Services-Data Processing Charges	\$1,061.89	0%	\$4,000.00	0%	\$4,000.00	0%

<b>GG Capital Expenditure</b>	<b>\$18,054</b>	<b>2%</b>	<b>\$40,000</b>	<b>5%</b>	<b>\$5,000</b>	<b>1%</b>
6702 Office Furniture & Equipment	\$18,054	2%	\$40,000.00	5%	\$5,000.00	1%

<b>TOTAL INCOME</b>	<b>\$865,000</b>	<b>100%</b>	<b>\$865,000</b>	<b>100%</b>	<b>\$865,000</b>	<b>100%</b>
<b>TOTAL EXPENSE</b>	<b>\$287,227</b>	<b>33%</b>	<b>\$826,100</b>	<b>96%</b>	<b>\$852,741</b>	<b>99%</b>
<b>DIFFERENCE</b>	<b>\$577,773</b>	<b>67%</b>	<b>\$38,900</b>	<b>4%</b>	<b>\$12,259</b>	<b>1%</b>

# Appendix – Biographies

## **Ryan Kulig - Administrative Analyst**

*Ryan is an administrative analyst at the State of Utah's School and Institutional Trust Fund Office (SITFO). Ryan manages the operations of the office and has oversight of portfolio administration, as well as contributing to the investment analysis. Prior to joining SITFO in 2016 he worked for Sax Angle Partners, a long/short equity hedge fund, where he specialized in fundamental and technical analysis of equity investment opportunities. His expertise focused on evaluating the merits of investment strategies across a diverse range of industries. His background stems from performing financial analysis of federal grant activity for non-profit and for profit organizations with the advisory practice at MRK Advisors, a boutique consulting firm. Prior to that, Mr. Kulig conducted technical research and analysis as an intern with the advisory practice at KPMG, LLP. Mr. Kulig earned his Bachelor of Business Administration in Global Business with an Emphasis in Finance and a Minor in Economics from the University of Portland.*

## **Nathan Barnard, CFA - Senior Investment Analyst**

*Nathan joined the Utah School and Institutional Trust Fund Office (SITFO) in 2016 as a senior investment analyst. His responsibilities include portfolio management and research. Prior to joining SITFO, he spent two years at Leader Capital as a fixed income portfolio analyst acting as back-up portfolio manager for their fixed income strategies. At Leader Capital, he conducted economic, fixed income market and individual credit research to develop executable investment ideas and themes. Prior to joining Leader Capital, he worked for RVK, Inc., an institutional investment consultant, for six years where he held analyst roles in portfolio analytics and later in manager research. As a Manager Research Analyst for RVK, his coverage universe included all fixed income managers across durations/maturities, qualities, sectors and regions. Nathan has a Bachelor of Science in Business Administration from the University of Colorado – Boulder where he majored in finance. He is a CFA charterholder and a member of the CFA Society of Portland.*

## **Peter Madsen - Director, Chief Investment Officer**

*Peter Madsen joined in September 2015 as the new agency was just getting off the ground. Peter has been in the investment management industry since 1999. His career includes global investing on behalf of large institutional clients such pension funds, endowments, including permanent school fund experience from another state. Peter holds a Bachelor of Arts degree from the University of Utah in International Political Economy and Russian. He also holds a Master of Business Administration degree, with an emphasis on International Finance, from the Middlebury Institute of International Studies.*

# Appendix – Distribution Policy

## Best practice:

- Reflection of the specific needs and the overall portfolio potential
  - Needs = Cost of pencils, # of pencils
  - Potential = Size and growth of portfolio

# Appendix – Distribution Policy

## Industry standards:

- Well diversified portfolio can sustain 4-5% distributions
- Inflation adjusted growth of the principal
- Intergenerational equity

Overall Average	4.80%
Private	6.32%
Human or Social	4.86%
Community	4.57%
Cultural or Arts	4.46%
Education (non-higher ed)	4.18%
College or University	4.08%
Faith-based	3.91%
Environmental	3.65%

\*Must be able to avail oneself of broadest opportunity set and take moderate levels of risk

# Appendix – Distribution Policy

**Yale's approach:** Spending is calculated by taking a weighted average comprising 80% of the prior year spending and adjusting it for inflation, and 20% of the amount that results from applying the spending rate to the market value.

**Stanford's approach:** The calculation is weighted 60% on the actual payout from the prior year and 40% on the spending rate.

# Appendix – Distribution Policy

***“Needs Based” Factor:*** *Cost of pencils (inflation) + # of pencils (enrollment).*

***“Stability/Ability” Factor:*** *4% of 12 quarter average of portfolio market value*

***Subject:*** *to a cap of 4% over a 12 quarter moving average*

*50% (1+“Needs Based Factor” x Previous Year Distribution)*

*+*

*50% (4% x “Stability Factor”)*

*Subject to a cap of 4% against a 12Qtr Moving Average of Portfolio Value*

# Appendix – Distribution Policy

In practice:

- Estimations using “optimistic” and “pessimistic” scenarios
- The difference and the trigger effect

Optimistic

Date	“Historical Policy”	“New Policy”
2016	\$46.97	\$78.25
2017	\$48.85	\$84.33
2018	\$50.80	\$88.66

Pessimistic

Date	“Historical Policy”	“New Policy”
2016	\$46.97	\$78.25
2017	\$42.27	\$80.94
2018	\$38.05	<del>\$79.55</del> \$78.16*

\*4% cap triggered

# Appendix – Distribution Policy

Our goal: Meet needs of current and future beneficiaries, by reflecting full portfolio potential

Current: 2.5%

Target: ~ 4%

How?

- Modify distribution policy
- Diversify portfolio