

# JOINT BUDGET COMMITTEE



## INTERIM SUPPLEMENTAL BUDGET REQUESTS FY 2018-19

### DEPARTMENT OF TREASURY

JBC WORKING DOCUMENT - SUBJECT TO CHANGE  
STAFF RECOMMENDATION DOES NOT REPRESENT COMMITTEE DECISION

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## INTERIM SUPPLEMENTAL REQUESTS

### PUBLIC SCHOOL FUND INVESTMENT BOARD – FUND MANAGERS

	REQUEST	RECOMMENDATION
<b>TOTAL</b>	<b>\$300,000</b>	<b>\$300,000</b>
FTE	0.0	0.0
General Fund	0	0
Cash Funds	300,000	300,000
Federal Funds	0	0

**Does JBC staff believe the request satisfies the interim supplemental criteria of Section 24-75-111, C.R.S.?** **YES**  
 [The Controller may authorize an overexpenditure of the existing appropriation if it: (1) Is approved in whole or in part by the JBC; (2) Is necessary due to unforeseen circumstances arising while the General Assembly is not in session; (3) Is approved by the Office of State Planning and Budgeting (except for State, Law, Treasury, Judicial, and Legislative Departments); (4) Is approved by the Capital Development Committee, if a capital request; (5) Is consistent with all statutory provisions applicable to the program, function or purpose for which the overexpenditure is made; and (6) Does not exceed the unencumbered balance of the fund from which the overexpenditure is to be made.]

**Does JBC staff believe the request meets the Joint Budget Committee's supplemental criteria?** **YES**  
 [An emergency or act of God; a technical error in calculating the original appropriation; data that was not available when the original appropriation was made; or an unforeseen contingency.]

**Explanation:** JBC staff and the Department agree that this request is the result of an unforeseen contingency based on an unanticipated determination by the Office of the State Controller.

**DEPARTMENT REQUEST:** The Department requests \$300,000 cash funds spending authority for the Public School Fund Investment Board Pursuant to Section 22-41-102.5, C.R.S., line item.

**STAFF RECOMMENDATION:** Staff recommends that the Committee approve the request.

**STAFF ANALYSIS:** The Public School Fund, established as a trust for the public schools of the State from public lands set aside for this purpose, is valued at about \$4.3 billion. Approximately \$1.0 billion is in liquid assets and the balance is in land and mineral rights. Historically the fund was only allowed to invest its liquid assets in bonds. The Public School Fund Investment Board was established in S.B. 16-035 (The Public School Fund) to generate increased returns through investments in diversified assets. As bonds mature and convert to cash, the Investment Board invests in statutory allowable investments which include "only mutual funds, index funds, and any other instrument that is not a direct investment in a corporation."

To date, the Investment Board has diversified available liquid assets totaling \$200.0 million and has another \$100.0 million in cash immediately available to be invested in diversified assets. Cash assets are expected to increase by an additional \$80.0 million over FY 2018-19. This includes approximately \$33.0 million in earnings from the State Land Board, \$7.0 million in marijuana excise tax revenues, and \$40.0 million in maturing bond proceeds and principal payments.

The \$180.0 million total to be invested in FY 2018-19 could earn at least 2.0 percent more than the 1.8 percent it will earn in the Treasury Pool, where it resides until invested. The Treasury Pool is intended to be a highly liquid asset pool to provide for the daily cash needs of the State. The money

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in the Public School Fund is set aside in trust for perpetuity and does not need to be positioned for liquidity purposes. The higher return from investment in diversified assets could earn an additional \$3.6 million when annualized. The 10-year average rate of return on a portfolio of 70 percent global equities and 30 percent investment grade bonds is 5.47 percent; and represents the goal or benchmark return for the Investment Board's diversified assets.

The supplemental budget request was submitted as a result of an unanticipated determination by the Office of the State Controller. That determination was that fund management fees calculated on total assets under management and paid on a "net-return" basis should be included in and paid out of the annual appropriation for administrative expenses for the Public School Fund Investment Board (Investment Board) located in the Department of Treasury budget. The current appropriation for Investment Board expenses is \$500,000.

Representatives from the Investment Board, the State Land Board and the Department of Natural Resources (DNR) state that the administrative expenses line item was set at its current \$500,000 not anticipating that fund management fees would also be included or paid out of that appropriation. They state that it was assumed such fees would be treated simply as an annual net-return on investment, since such fees are not technically billed to and actively paid by an investor. Traditionally such fees are simply collected off-the-top annually, based on a percentage of assets under management, and a "net-return" is earned on the fund after management fees.

If all \$500,000 were used for fund management fees, this appropriation would provide for a 0.05 percent (or 5 basis points) fee on the \$1.0 billion total of liquid assets available in the Public School Fund. According to a 2017 study of fund fees by Morningstar, investors paid an average of 0.52 percent (or 52 basis points) for fund management. The Investment Board estimates fund management fees of 0.22 percent (or 22 basis points) for fund management fees.

Staff agrees that the determination by the Office of the State Controller appears to have been reasonably unanticipated at the time that S.B. 16-035 was contemplated and passed and that fund management fees were always anticipated as a part of the Investment Board's activities. Fund management fees calculated as a percentage of total assets under management are well understood in the world of financial investment.

Due to the nature of the fees annual growth due to the growth in assets under management, this line item will have to be adjusted annually in order to accommodate the increasing cost of fund management on a substantial and growing pool of assets. The representatives from the Investment Board, et al, have informed staff that they will be seeking legislation in the 2019 legislative session to clarify that such off-the-top, net-return, fund management fees should not be included in the annual appropriation, given their nature as a non-discretionary expense. Conceptually, staff supports such a clarification to eliminate the annual adjustments necessary for the non-discretionary nature of fund management fees.

At this time, the Investment Board projects that it will require an additional \$300,000 in the administrative expenses appropriation to cover the fund management fees on total assets invested for FY 2018-19. Staff agrees with the projection and recommends that the Committee approve the request.

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	FY 2017-18	FY 2018-19	Fiscal Year 2018-19 Interim Supplemental		
	Appropriation	Appropriation	Requested Change	Recommended Change	New Total with Recommendation

**DEPARTMENT OF THE TREASURY**

**Interim Supplemental - Public School Fund Investment Board – Fund Managers**

**Part XXII, Department of the Treasury**

*(3) Special Purpose*

Public School Fund Investment Board Pursuant to

Section 22-41-102.5, C.R.S.

	500,000	500,000	300,000	300,000	800,000
FTE	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
General Fund	0	0	0	0	0
Cash Funds	500,000	500,000	300,000	300,000	800,000
Reappropriated Funds	0	0	0	0	0
Federal Funds	0	0	0	0	0

**Totals**

DEPARTMENT OF THE TREASURY					
TOTALS for ALL Departmental line items	524,095,035	814,099,929	300,000	300,000	814,399,929
FTE	<u>32.9</u>	<u>32.9</u>	<u>0.0</u>	<u>0.0</u>	<u>32.9</u>
General Fund	151,447,545	400,329,817	0	0	400,329,817
Cash Funds	354,874,465	396,084,849	300,000	300,000	396,384,849
Reappropriated Funds	17,773,025	17,685,263	0	0	17,685,263
Federal Funds	0	0	0	0	0

Key:

"N.A." = Not Applicable or Not Available