

## STATE BOARD OF LAND COMMISSIONERS

August 16, 2022

Regular Agenda

### Subject

Reclassification of the FY2022 Earnings Reserve Transfer of \$486,409,000 to exclude it from the Gain Benchmark

### Question Presented

Shall the Land Board approve reclassification of the FY2022 Earnings Reserve Transfer of \$486,409,000 to exclude it from the Gain Benchmark?

### Background

When the Idaho State Board of Land Commissioners (Land Board) met on August 17, 2021, it approved the transfer of \$486,409,000 from Earnings Reserve Funds into Permanent Funds. The endowment portfolio generated outstanding investment returns of 29.7% in fiscal year 2021 and the investment returns combined with revenue generated by the Idaho Department of Lands (Department) resulted in balances in Earnings Reserve Funds above target levels. This Earnings Reserve "surplus" was transferred into the Permanent Funds on September 1, 2021.

According to Idaho Code section 57-724, the Land Board has the option of adding such transfers to the Gain Benchmark (corpus of the Permanent Funds) or not adding the transfer to the Gain Benchmark. There is no compelling reason why excess earnings that accumulate in the Earnings Reserve Funds should become part of the corpus of the Permanent Funds and in fact most endowments have fund balances in excess of corpus. Funds not added to the Gain Benchmark can be used to make up for losses to the permanent fund during turbulent times in the financial markets and in periods of high inflation.

### Discussion

During fiscal year 2022, the endowment portfolio recognized investment losses of 13.0% and inflation of 7.2%. If the transfer of \$486,409,000 is treated as an addition to the Gain Benchmark, the balance of the Permanent Funds at the end of fiscal year 2022, will be \$445,925,356 below the Gain Benchmark. This creates challenges for the operation of the endowment portfolio because this deficit will need to be replenished by future investment gains before gains in excess of inflation can flow into the Earnings Reserve Funds. The longer the process of replenishment takes, the greater the risk that Earnings Reserves will not be sufficient to maintain stable beneficiary distributions. If the transfer of \$486,409,000 is not considered an addition to the Gain Benchmark, the Permanent Funds at the end of fiscal year

2022, will be \$40,483,644 above the Gain Benchmark. This approach dramatically reduces the risk that Earnings Reserves may be inadequate in the years ahead.

If this transfer is not added to the Gain Benchmark, it remains part of the Permanent Fund balance and is considered in the calculation of future beneficiary distributions. The beneficiaries are not penalized if the transfer is not included in the Gain Benchmark, however, the process and flow of funds between the Permanent Funds and Earnings Reserve Funds remains more fluid and fully operational. It is important to preserve this flexibility.

### **Recommendation**

Approve reclassification of the FY2022 Earnings Reserve Transfer of \$486,409,000 to exclude it from the Gain Benchmark.

### **Board Action**

### **Attachments**

1. FY2022 Gain Benchmark with Transfers
2. FY2022 Gain Benchmark without Transfers

<b>Gain Benchmark Summary With Transfers</b>						
<b>Endowment</b>	<b>Fiscal Year</b>	<b>Beginning Benchmark</b>	<b>Deposits</b>	<b>Reinvested Income</b>	<b>Inflation Impact</b>	<b>Ending Benchmark</b>
<b>Public School</b>	2001-2021	555,954,750	76,943,194	207,877,000	331,763,862	1,172,538,806
	2022	1,172,538,806	34,573,278	277,103,000	84,100,800	1,568,315,884
<b>Agricultural College</b>	2001-2021	14,787,041	62,101	12,643,000	9,105,051	36,597,193
	2022	36,597,193	0	10,885,000	2,624,948	50,107,141
<b>Charitable Institutions</b>	2001-2021	54,513,960	397,383	42,134,000	33,984,232	131,029,575
	2022	131,029,575	16,093	38,014,000	9,398,147	178,457,815
<b>Normal School</b>	2001-2021	47,258,942	24,810,495	28,656,000	29,804,633	130,530,070
	2022	130,530,070	6,461,533	34,934,000	9,362,320	181,287,923
<b>Penitentiary</b>	2001-2021	18,258,289	34,588	26,203,000	12,431,751	56,927,628
	2022	56,927,628	701	20,980,000	4,083,156	81,991,485
<b>School of Science</b>	2001-2021	54,836,451	418,547	34,732,000	32,712,282	122,699,280
	2022	122,699,280	46,686	39,675,000	8,800,653	171,221,619
<b>State Hospital South</b>	2001-2021	23,442,162	27,532,234	37,197,000	19,634,314	107,805,710
	2022	107,805,710	6,540,715	29,764,000	7,732,406	151,842,831
<b>University of Idaho</b>	2001-2021	42,442,536	297,021	39,170,000	26,568,355	108,477,912
	2022	108,477,912	5,970,599	35,054,000	7,780,620	157,283,131
<b>Total</b>				486,409,000		2,540,507,829

<b>Permanent Fund</b>	
<b>Balance 6/30/2022</b>	<b>Difference</b>
1,292,281,595	(276,034,289)
41,193,785	(8,913,356)
146,681,656	(31,776,159)
149,887,990	(31,399,933)
67,537,001	(14,454,484)
140,867,184	(30,354,435)
125,737,265	(26,105,566)
130,395,997	(26,887,134)
2,094,582,473	(445,925,356)

<b>Gain Benchmark Summary Without Transfers</b>						
<b>Endowment</b>	<b>Fiscal Year</b>	<b>Beginning Benchmark</b>	<b>Deposits</b>	<b>Reinvested Income</b>	<b>Inflation Impact</b>	<b>Ending Benchmark</b>
<b>Public School</b>	2001-2021	555,954,750	76,943,194	207,877,000	331,763,862	1,172,538,806
	2022	1,172,538,806	34,573,278	0	84,100,800	1,291,212,884
<b>Agricultural College</b>	2001-2021	14,787,041	62,101	12,643,000	9,105,051	36,597,193
	2022	36,597,193	0	0	2,624,948	39,222,141
<b>Charitable Institutions</b>	2001-2021	54,513,960	397,383	42,134,000	33,984,232	131,029,575
	2022	131,029,575	16,093	0	9,398,147	140,443,815
<b>Normal School</b>	2001-2021	47,258,942	24,810,495	28,656,000	29,804,633	130,530,070
	2022	130,530,070	6,461,533	0	9,362,320	146,353,923
<b>Penitentiary</b>	2001-2021	18,258,289	34,588	26,203,000	12,431,751	56,927,628
	2022	56,927,628	701	0	4,083,156	61,011,485
<b>School of Science</b>	2001-2021	54,836,451	418,547	34,732,000	32,712,282	122,699,280
	2022	122,699,280	46,686	0	8,800,653	131,546,619
<b>State Hospital South</b>	2001-2021	23,442,162	27,532,234	37,197,000	19,634,314	107,805,710
	2022	107,805,710	6,540,715	0	7,732,406	122,078,831
<b>University of Idaho</b>	2001-2021	42,442,536	297,021	39,170,000	26,568,355	108,477,912
	2022	108,477,912	5,970,599	0	7,780,620	122,229,131
<b>Total</b>			53,609,605	-		2,054,098,829

<b>Permanent Fund</b>	
<b>Balance 6/30/2022</b>	<b>Difference</b>
1,292,281,595	1,068,711
41,193,785	1,971,644
146,681,656	6,237,841
149,887,990	3,534,067
67,537,001	6,525,516
140,867,184	9,320,565
125,737,265	3,658,434
130,395,997	8,166,866
2,094,582,473	40,483,644