

MINUTES

MONTANA HOUSE OF REPRESENTATIVES 54th LEGISLATURE - REGULAR SESSION

JOINT SUBCOMMITTEE ON NATURAL RESOURCES

Call to Order: By **CHAIRMAN ROGER DEBRUYCKER**, on February 3, 1995, at 10:00 a.m. in Room 402 of the State Capitol.

ROLL CALL

Members Present:

Rep. Roger DeBruycker, Chairman (R)
Sen. Thomas F. Keating, Vice Chairman (R)
Sen. Judy H. Jacobson (D)
Sen. Loren Jenkins (R)
Rep. John Johnson (D)
Rep. William R. Wiseman (R)

Members Excused: none

Members Absent: none

Staff Present: Roger Lloyd, Legislative Fiscal Analyst
Florine Smith, Office of Budget & Program
Planning
Debbie Rostocki, Committee Secretary

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:

Hearing: Department of Commerce
- Board of Investments
- Montana Health Facilities Authority
Executive Action: Department of Commerce
- Montana Science & Technology Alliance
- Board of Investments
- Montana Health Facilities Authority
Department of Fish, Wildlife and Parks

HEARING ON Department of Commerce Department Overview

Mr. Roger Lloyd, Legislative Fiscal Analyst (LFA), gave a brief overview of the department's budget. As a result of early retirements, the department paid out \$167,800 of unfunded costs. They chose to finance some of these costs over a ten-year period, for an unpaid obligation of over \$90,000.

Mr. Jon D. Noel, Director of the Department of Commerce, then gave his overview. An organizational chart was passed out. **EXHIBIT 1** The Management Services Division, Economic Development Division and the Business regulatory Services Division have had their administrative positions removed and now report directly to the director's office. This was done in order to reduce the cost of running the department. They have either proposed or endorsed eliminating or transferring positions in the Coordinator of Indian Affairs office (department-suggested transfer to the Governor's office), the Local Government Audit and Systems Bureau, the Milk Control Bureau (proposed to be transferred to the Department of Livestock if it is not eliminated) and the Professional and Occupational Licensing (POL) Bureau. The department has suggested eliminating a number of the POL licensing boards although it has made no formal recommendations.

Economic development is the department's highest priority and most general fund dollars are spent in this area. Professional and occupational licensing would be the first activity which the department could do without. This is the only department in state government for which there is no general fund appropriation for management services in the director's office. Everything in those budgets is charged out to the other activities.

There are some aspects of the Reinventing Government Task Force recommendations that would "lose some things into the department" and which don't show up on the chart, including a couple of the occupational licensing activities which are currently in other agencies. Consolidating of these activities would enable the department to get better leverage over support staff. A bill has been introduced which would move some of the grant and loan programs out of the Department of Natural Resources and Conservation (DNRC) into the department of Commerce Community Development Bureau.

CHAIRMAN ROGER DEBRUYCKER asked if the Hard Rock Mining Impact Board (currently part of the Department of State Lands' budget) was one which could be moved to this department. **Mr. Noel** replied that this board makes grants and loans only but does not regulate hard rock mining. This is also true of the Coal Board.

HEARING ON Department of Commerce
Board of Investments

Mr. Lloyd gave a brief overview of the budget for the Board of Investments. There were no LFA issues with this budget.

Mr. Carroll South, Executive Director of the Board of Investments, then gave an overview. **EXHIBIT 2** The state's constitution mandates that a unified investment program be developed for the state. With the exception of \$23.6 million that has been allocated to the Board of Science and Technology

from the Coal Trust, the Board of Investments is statutorily responsible for investing all state funds.

The Board operates two very successful Build Montana loan programs: the In-State Investment Program, a program through which the Board makes loans to commercial ventures in the state from up to 25% of the permanent coal trust fund, and a second program which sells bonds and uses the proceeds to make loans to local governments for a variety of purposes. In the past ten years there has not been one default by a local government under this program.

In the late 1980's the state discovered there was a \$375 million liability on the old Workers' Compensation fund. Bonds have been issued in the amount of \$142 million in 1991 and an additional \$32.5 million had to be issued in the last year to pay off the old fund liability. These bonds will be paid back by the payroll tax.

The Board's portfolios have grown by nearly \$1 billion (Att. A, **EXH. 2**) in the past two years. The figures showing total invested funds represent actual book values (amortized cost) and not market values. The actual increase in the total fund is graphically displayed: in the past two years growth has far exceeded any previous increase. Much of the reason for this is the pensions are now on an actuarially sound footing. In addition, the new state fund is now operating in a fiscally responsible manner. He pointed out that the line on the graph of total invested funds depicts the amount of actual return (and not the total rate of return) which is put into the Statewide Budgeting and Accounting System (SBAS) and is available to spend. It peaked in the 1980's and has been going down since. The line on the graph of total invested funds represents the actual dollar value of the income. The Public Employees' Retirement (PERS) and Teachers' Retirement (TR) funds are the two largest funds invested out of the total fund. Graphs are broken out by asset allocation.

Following the theory that one should not put all their eggs in one basket, the kinds of investments made are diversified and within each category it is ensured there is no one investment which comprises too large a portion of the total portfolio. In the past several years the Board has been diligently building up the equity exposure of the pensions. Montana is far below almost every other state (and even further below corporate pensions) in terms of the amount allocated to equity. Historically, equities have always grown more rapidly than fixed income investments and this is what makes equity allocations very important. As a percent of the total, equity investments have gone up consistently in the last six years.

Attachment B (**EXH. 2**) gives a "snapshot" of who owns the money the state invests. The state insurance fund, which only began in 1991, had a book value at the end of FY 94 of \$337 million.

In retrospect, choosing the State Street Bank and Trust as the state's custodial bank was a very good decision: the lengthy "RFP" selection process was a success. Part of the agreement with this bank is that it will provide the state with its securities accounting system. Online access to the State Street Bank allows the state to do all of its securities accounting directly on the bank's mainframe in Quincy, Massachusetts. The fee paid for this service is \$425,000 per year but is more than offset by the securities lending income that the bank generates to the state.

The Board is not requesting any additional accounting staff in spite of the billion dollar portfolio increase. This is due to the fact that the department has been able to automate activities. This is a result of the Legislature's generous equipment appropriation two years ago. When **Mr. South** began his duties with the Board, accountants were reconciling an internal accounting system with SBAS.

Tape No. 1:B:000

To perform the reconciliation hard copy reports were being taken from SBAS and the internal accounting systems and entered on spreadsheets to find the differences. Now numbers are being downloaded directly from the State Street system into the reconciliation worksheets and the same is being done with SBAS. The Board was able to do the SBAS programming as a result of the Legislature's appropriating contracted services funds for this.

He stressed the importance of being able to utilize contracted services. A local law firm is contracted with for all the Board's investment-related legal activities. The cost is \$104 per hour. During FY92 and FY93 the Board was involved in a class-action lawsuit with other pension funds against the May Company because the Board felt they inappropriately called their high coupon bonds. Several thousand dollars' worth of legal services dollars were used. The money was recovered from the May Company and was put into the Board's account, but the spending authority was necessary.

The Board is currently contracting with its local lawyer regarding the State's involvement with the "Orange County Note." Not only does the Board want to make sure it has enough spending authority for legal services but it wants to ensure it has enough money for programming. It is **Mr. South's** desire and intent to continue to automate the Board of Investments.

One of the reasons for the request for an additional administrative clerk is because of the laborious, cumbersome file system the state presently has in the in-state investment program and residential mortgages. The problem with reorganizing files is that a different person does it every time and they have to start over from scratch. The Board's goal is to contract for however long it takes to straighten up the files, possibly up to two years.

Because of their size, the pensions (Att. A, **EXH. 2**) are very difficult to diversify. One component of diversification is the residential mortgage package. (The Board serves as a secondary lender in the mortgage market.) In 1972, mortgages comprised about 25% of the PERS funds and this is now down to about 4%. They are also decreasing in real dollars. One reason for this is because the Board has not had the staff to adequately perform "due diligence" when it examines the mortgages for sale. To prevent staff from being overworked the Board has actually priced itself out of the market. The Board believes it should increase the asset allocation to residential mortgages. The mortgage analyst being requested will help in this regard.

The equipment request is related to the Board's ongoing needs to maintain and adapt its computer hardware and software to accommodate changes made at the State Street Bank end of the connection.

SEN. KEATING wanted to know if the Board is limited in the types of equities it can invest in. **Mr. South** said there are no limitations on the share of the pension that can be invested in equity but there are some restrictions which have to do with how much of any one company they can own.

SEN. KEATING wanted to know if the Board had an estimate on the amount of return on equities for 1994. **Mr. South** replied that on a total rate of return, which considers market price, they did much better in equities than they did on fixed income. (Book value vs. market value would indicate a "paper loss.") He added that he didn't think there was a fixed income portfolio in the nation that wasn't down for that year. As interest rates go up the value of bonds go down. The derivatives the Board has are only in the two large pension funds but they only comprise one to two percent of the total.

SEN. JENKINS wanted to know what the Board's loan rate was under its In-state Investment Program. **Mr. South** said the average coupon on the entire portfolio was 7.22%. The advantage the state gives the borrowers is it is willing to fix the rate for fifteen years, which banks are unwilling to do. In addition, the Board is permitted to reduce the rate by 2.5% if enough jobs are created.

Regarding equity risks, while the return is higher, the risk is also higher. **Mr. South** pointed out this is why diversification is favored. The ideal pension plan is anywhere from 45-50% equities.

In response to **SEN. JENKINS**, **Mr. South** said there had been a general election vote which would have permitted the Board to invest the Coal Trust fund in equities (which did not pass) and there will be a bill in this legislature to permit the board to invest the State Fund in equities. That fund is a growth fund and it needs to grow. He said it would not be desirable,

however, to invest any of the trusts in equities, which provide a lower level of real dollar return. While having money from the trust fund in equities would increase the fund, available income for use from the general fund would be reduced.

Mr. South went into further detail regarding the definition of "equity." The Board has a common stock pool as well as a convertible pool. The latter buys preferred stock and convertible debentures, which are also considered to be equity investments. In addition the Board has some alternative equities which is a leveraged buyout program, and venture capital.

SEN. JENKINS wanted more details regarding the Board's investments in Orange County, California. **Mr. South** said the Board purchased \$25 million of Orange County "Teeter notes." Teeter was the name of a California legislator who introduced a bill to permit large counties to develop a program by which they provided cash to all of the local government entities within the county up to the amount of the actual mill levy. Orange county itself assumed the responsibility of collecting delinquent taxes.

The kind of notes the Board purchased were Teeter notes. The first pledge of revenue was the delinquent taxes and the second pledge was the investment pool of Orange County. The Board feels it was "terribly misled" by S & P and Moody's, because they both gave these Orange county notes the highest investment rating. Board of Investment policy requires that only investment-grade securities can only be purchased. At the present time, the notes are not in default. The interest payment for December 1994 was six days late in arriving. This was not Orange County's fault, however, because they now have to ask the bankruptcy judge to release the money to pay the interest. This interest payment was deposited into the short-term investment pool and was allocated on the day it was received. On February 2, the bankruptcy judge released the February money and the Board should receive its interest payment any day. Orange county is not in default and the Board is 100% certain it will receive the \$25 million that is due June 30. The other alternative would be, if they remain current on their interest payments, they would approach the bondholders to "roll it over" for another ten or twelve months.

Orange County cannot afford to default on their bonds because they have to issue bonds. If a bond is once defaulted on and it is reissued the interest rate is 15-16%. Contrary to what may have been rumored, this money is not a derivative, it is a municipal note. Montana just issued (for cash flow purposes) \$71 million in similar kinds of notes.

SEN. JENKINS asked for clarification regarding what a derivative is. **Mr. South** said the basic definition of derivative is a security held whose performance is totally dependent upon other factors. An example of a simple derivative would be a "inverse floater"; i.e., instead of having a fixed income coupon on it there is a floater that provides that as interest rates go up in

the market your interest rates go down, and vice versa. Derivatives are sometimes used in small components for "hedging."

The most "serious" kind of derivatives are fairly recent and are called collateralized mortgage obligations (CMO's). Basically brokers take a "plain vanilla" security, with underlying assets comprised of a pool of mortgages. This is a very volatile asset because it is tied to interest rate fluctuations. If interest rates go down rapidly, people refinance and the pool is depleted. CMO maturity dates can be extended by several years because of the payback of the underlying assets. The most complex security derivative is where the investor not only has the underlying assets of the mortgages but the principal due is separated from the interest due: one broker sells the principal part while another broker sells the interest side.

Some local governments in Montana are heavily invested in CMO's. In a short period of time they have seen their maturity dates go from three years to fifteen years. Even though they are backed in terms of principal, the only way to get it is to hold them until the maturity date. If operating cash has been invested on the assumption that they will roll over every few years and the market changes, operating cash will not be forthcoming. Some of the CMO's held by the local governments are presently only worth 45 cents on the dollar, some less than that. While they are used by most money managers to hedge, it is risky to have a large portion of one's portfolio invested in them.

CHAIRMAN DEBRUYCKER wanted to know why the Board was suing Orange County if they were confident they were going to get their money. **Mr. South** clarified they were not suing, just being assertive. They have written numerous legal letters to the bankruptcy judge and the credit committees. The Board is attempting to become a member of the credit committee.

CHAIRMAN DEBRUYCKER wanted to know why interest on the total invested funds (Att. A, **EXH. 2**) appeared to be a lower percentage rate than the PERS and TR rates. **Mr. South** explained that the total invested funds included a representation of STIP, which is a money market fund and its interest rate is fairly low.

CHAIRMAN DEBRUYCKER wanted to know if the Board was held at a flat interest rate on the Coal Tax trust fund and the School Trust fund. **Mr. South** replied the law clearly states that the school trust fund has to be in fixed income.

SEN. JENKINS wanted to know what the annual rate of return was on the school trust fund. **Mr. South** said it was about 8.5% in 1994.

Tape No. 2:A:000

He added this is the actual return on the invested balances that is put into SBAS and is available for the general fund. The total rate of return, however, is something completely different. The total rate of return on the fixed income portfolio for 1994 was actually less than "0." What this means is that at the end

of the year the price was down more than the income received. In other years the rate has been as high as 12 or 13%.

EXECUTIVE ACTION ON Department of Commerce
Board of Investments

Motion: SEN. THOMAS KEATING moved to accept Present Law (PL) Adjustments No. 4, 5, 6 and 7 on p. C-188; SEN. JACOBSON seconded the motion.

Discussion: SEN. KEATING had a general question regarding the funding mechanisms for the Board of Investments. Mr. South explained there are two different accounting entities. The large one is for the investments. A charge up to the appropriated amount is made against each of the funds they invest. The Bond Program is funded by the spread between what the Board pays the bondholders and what the borrowers pay the Board.

SEN. KEATING wanted to know what percentage of the investment return was spent on administration. Mr. South explained how basis points were used to quantify costs. For FY94 their cost for investing \$4.8 billion was 4.4 basis points or 4.4/100 of 1%. This includes the custodial bank contract. If the money management aspect is separated out the cost was 3.5 basis points. The cost is going down every year because the portfolio grows much faster than the budget.

Vote: The question was called for and the motion carried unanimously.

Motion/vote: SEN. KEATING moved to accept New Proposals No. 1 and 2 on p. C-189; SEN. JACOBSON seconded the motion. The motion carried unanimously.

EXECUTIVE ACTION ON Department of Commerce
Montana Science & Technology Alliance

Discussion: Mr. Lloyd explained that there had been a number of FTE changes within the department but the net change was "0." One of the programs that lost FTE was this one: two FTE were moved to the Montana Promotion Division.

Ms. Ann Welz, Executive Director of the Alliance, pointed out that the Grade 16 assessment and development position mentioned in the LFA narrative at the bottom of p. C-182 was actually a grade 9. SEN. JENKINS wanted to know, if two FTE were moved from this division to the Montana Promotion Division, why only one FTE was showing as leaving this division. Mr. Lloyd explained that the executive budget sometimes makes changes in present law as well as in the base budget. Two years ago the program had seven FTE and now it has five. One was taken out of the base and the funding was removed as well.

In response to **SEN. KEATING**, **Mr. Noel** stated there is no appropriation of the coal tax trust involved in this budget. This Alliance, like the Board of Investments, has investment authority over \$25.8 million. **SEN. KEATING** wanted to know how much of this amount was actually loaned out. **Mr. Noel** said all of the "R & D" portion, about \$8 million, is gone. In the seed capital fund they have uncommitted funds of about \$5.5 million that could be loaned out.

SEN. KEATING wanted to know if this program overlapped with the Build Montana Program. **Mr. Noel** said there was no overlap: the Build Montana Program is loaning only where there is hard security.

In response to **SEN. KEATING**, **Mr. Noel** said that if the authority over the uncommitted funds were to be removed, this would be like telling the world, "we don't have any money to invest, don't bother sending us proposals." He added that nine out of ten of the proposals they receive are not pursued because they are not appropriate and do not have potential for a return on the investment. After getting a business plan drawn up, that one out of ten businesses comes back to the Board with a recommendation regarding continuing due diligence, etc. Typically the Alliance makes a commitment for a sum of money which is given out in disbursements. However, Alliance staff remains involved in doing due diligence over these committed funds.

The funding source for administrative costs is payback and interest on investments. \$250,000 of that is the payback on the loans to the University System R & D Program. Beyond that there is some payback from Gateway, Western Energy and others. There is royalty income on the latter two entities but other than that there is little other royalty income. **SEN. KEATING** suggested that this is more of a proprietary fund than a state special revenue fund.

Motion/vote: **SEN. KEATING** moved to accept PL No. 4; **REP. WISEMAN** seconded the motion. The motion **carried** unanimously.

HEARING ON Department of Commerce
Health Facilities Authority

Mr. Lloyd gave an overview of the Authority's budget. The Authority is asking for an increase of \$34,000 in FY96 and \$17,000 in FY97, the bulk of which is in contracted services and Board of Investments support.

Tape No. 2:B:000

Mr. Jerry Hoover, Executive Director of the Health Facilities Authority, then spoke. He passed around a copy of some information on the Authority. **EXHIBIT 3** In 1984 the Legislature created the Health Facilities Authority.

There are two new programs in the Authority. The Direct Loan Program is aimed at very small health facilities who ordinarily

could not borrow money at the rates under this program under any circumstances.

The Master Loan Program provides loans for investment-grade facilities that cannot get investment-grade ratings because of their small size. (Currently the rating agencies will not rate a facility under 250 beds.) There are only four facilities like this in Montana. The Authority has issued loans for a hospital in Libby, a nursing home in Billings and a hospital in Sidney under this program at an interest rate of 6.25% over 20 years. This is the kind of financing they do to maintain health care in the smaller communities.

The Authority's costs, in terms of the volume of business it does, is very small. He then reviewed the LFA issues (p. 2, **EXH. 3**).

Regarding Board of Investment (BOI) support, in 1990 the Authority's FTE were reduced from three to one. They relocated with the BOI and began to purchase services. There was a big increase in the first few years. However, for the last three years the Authority has "trended" somewhere between \$40,000-\$45,000. Excess funds for the purchase of BOI services are reverted. He stressed that this is an enterprise fund. The Authority has to earn the money to spend it.

SEN. KEATING wanted to know if many of the 6.25% bonds were sold in-state. **Mr. Hoover** replied that they use in-state underwriting in banking firms. They sell all of the serial bonds (with maturity rates from one to ten years) in the state. They loan to all of the facilities in the state, not just the small ones. Regarding future expectations of demands, **Mr. Hoover** expected most to come from the smaller facilities in communities with less than 10,000 people.

EXECUTIVE ACTION ON Department of Commerce
Montana Health Facilities Authority

Motion/vote: **SEN. JENKINS** moved and **REP. WISEMAN** seconded to accept PL Adjustments No. 4, 5 and 7 on p. C-181. The motion carried unanimously.

Discussion: **SEN. JENKINS** didn't see any reason for an increase in BOI support (PL No. 6). **Mr. Hoover** said the responsibility to continue to monitor loans would continue to grow. They definitely need something in the neighborhood of \$40,000 to remain at the current level. **SEN. JACOBSON** wanted to know how the Authority determined how to pay the BOI. **Mr. Hoover** said the BOI bills him for the cost of their committed time.

Motion/vote: **REP. WISEMAN** moved to accept PL Adjustment No. 6; **SEN. KEATING** seconded the motion. The motion carried unanimously.

EXECUTIVE ACTION ON Department of Fish Wildlife and Parks

Discussion: CHAIRMAN DEBRUYCKER said the committee had neglected to close the section on the Department of Fish, Wildlife and Parks (FWP) budget and entertained a motion to do so.

Motion/vote: SEN. KEATING moved and SEN. JENKINS seconded the motion to close the section on FWP. The motion carried unanimously.

Discussion: CHAIRMAN DEBRUYCKER then directed the committee to turn to pages C-160-161, the budget for the Montana Promotion Division. Mr. Lloyd stated that since it appears the statutory appropriation for the bed tax will remain intact, most of this budget is already appropriated. The question is whether or not the committee wants to hear this program and reappropriate it in HB 2. There are some private funds which the committee could appropriate if it saw fit. SEN. JACOBSON submitted she felt it was important to hear this budget. Even though the appropriation is statutory and the division was fairly autonomous, legislators are still responsible for explaining to constituents what the bed tax is providing for. At least the Legislature should hear what the Division's plans are. There was general agreement to hear the budget.

Mr. Andy Poole, Deputy Director of the Department of Commerce, added that ever since the bed tax was instituted, they have come before the Legislature to explain the program and they intend to continue this.

Mr. Noel distributed copies of the Department of Commerce Biennial Report for FY94-94. EXHIBIT 4

ADJOURNMENT

Adjournment: 11:45 a.m.



ROGER DEBRUYCKER, Chairman



DEBBIE ROSTOCKI, Secretary

RD/dr

The meeting was recorded on two 60-minute audiocassette tapes.

DEPARTMENT OF COMMERCE

EXHIBIT 1
DATE 2/3/95 #2

ADMINISTRATION

TOURISM

ECONOMIC DEVELOPMENT

LOCAL GOVERNMENT ASSISTANCE

BUSINESS REGULATORY SERVICES

MONTANA LOTTERY

OFFICE OF CONSUMER AFFAIRS

MANAGEMENT SERVICES DIVISION

MONTANA PROMOTION DIVISION

BOARD OF INVESTMENTS

ECONOMIC DEVELOPMENT DIVISION

COORDINATOR OF INDIAN AFFAIRS

FINANCIAL INSTITUTIONS DIVISION

PERSONNEL

TOURISM SERVICES

ACCOUNTING & FISCAL MANAGEMENT

TOURISM INDUSTRY DEVELOPMENT

SCIENCE & TECHNOLOGY ALLIANCE

REGIONAL DEVELOPMENT

LOCAL GOVT. AUDIT & SYSTEMS BUREAU

HORSE RACING BUREAU

DATA PROCESSING

FILM INDUSTRY PROMOTION SERVICES

BOARD OF HOUSING

TRADE

CENSUS & ECONOMIC INFORMATION CENTER

WEIGHTS & MEASURES BUREAU

BUDGET & FINANCE

MARKETING

HEALTH FACILITIES AUTHORITY

SMALL BUSINESS DEVELOPMENT CENTERS

SECTION 8 HOUSING BUREAU

MILK CONTROL BUREAU

Administrators Eliminated

Programs Eliminated or Moved

RECRUITMENT & BUSINESS FINANCE

COMMUNITY DEVELOPMENT BUREAU

PROFESSIONAL & OCCUPATIONAL LICENSING BUREAU

HARD ROCK MINING IMPACT BOARD


BUILDING CODES BUREAU

COAL BOARD

MEMORANDUM

Montana Board of Investments
Department of Commerce
555 Fuller (406) 444-0001

To: Natural Resources Subcommittee Members

From: Carroll South
Executive Director 

Date: February 2, 1995

Subject: 1997 Biennium Budget

Board Duties - Except for \$23.6 million of the Permanent Coal Trust allocated to the Board of Science and Technology, the Board is required to invest all state funds. All funds are invested by Board staff, except for a small amount allocated to alternative investments.

The Board manages two equity investment pools and one short-term investment pool, in which local governments may invest at their discretion. On June 30, 1994, the Board invested funds for 265 separate accounts, which included 183 state accounts and 82 local government accounts. Local governments had invested \$264.7 million in the short term pool as of June 30, 1994.

The Board makes loans to Montana business under the In-State Investment Program. As of December 31, 1994, 286 loans totalling \$67.4 million were outstanding. During fiscal 1994, the Board funded \$18.2 in new loans.

The Board sells bonds and lends the proceeds to local government entities for a variety of purposes. As of December 31, 1994, loans totalling \$28.5 were outstanding. Due to growth in the program, additional bonds totalling \$7.5 million were sold in June, 1994.

At the request of the legislature, the Board issued bonds/notes on two occasions to fund the Workers' Compensation "old fund" debt.

Portfolio Growth - Since the Board's current operating budget was set, the book value of funds invested by the Board has increased \$972.8 million. Attachment A depicts the book value growth of total funds and the two major pension funds since the Board's creation in 1972 through 1994.

Attachment B shows the market values of major fund types invested by the Board and lists individual accounts as of June 30, 1994. The nine pension funds comprised 55.9 percent of the total, while various trust funds accounted for 19.8

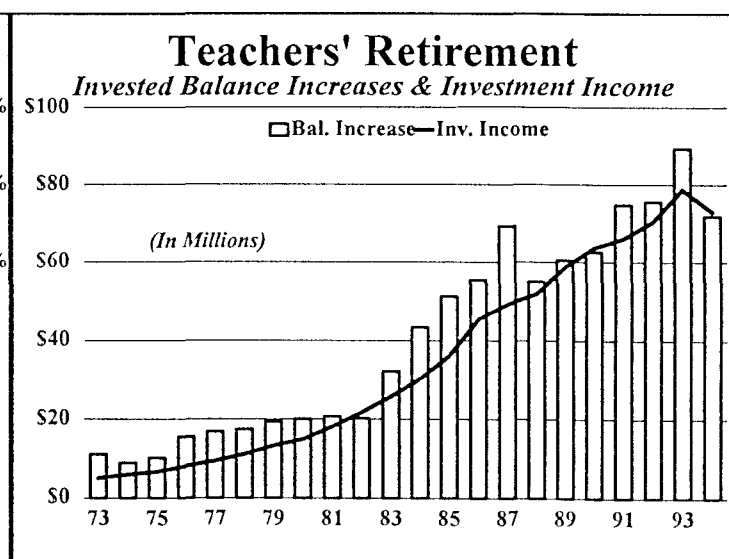
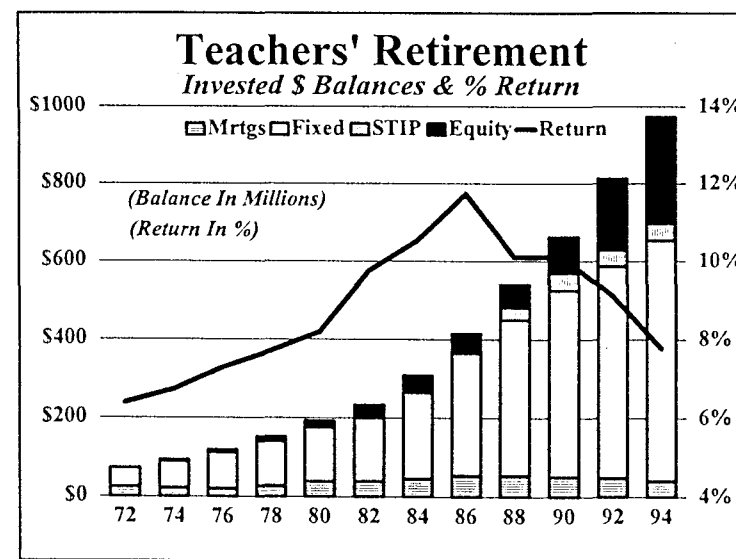
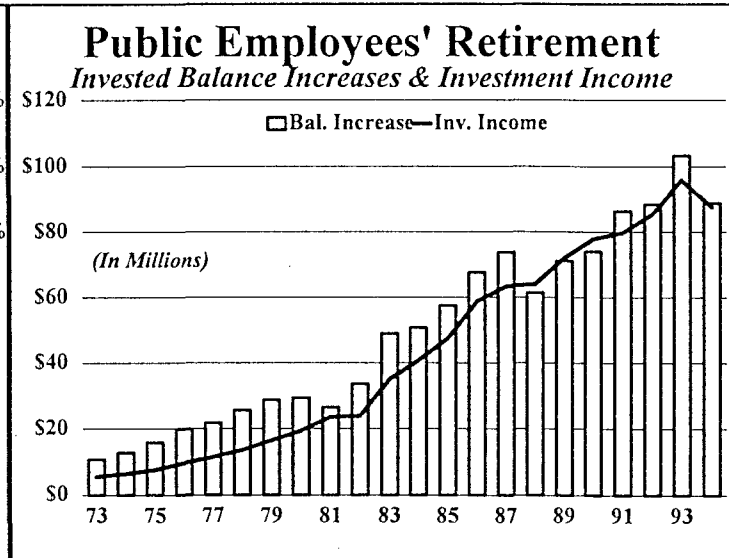
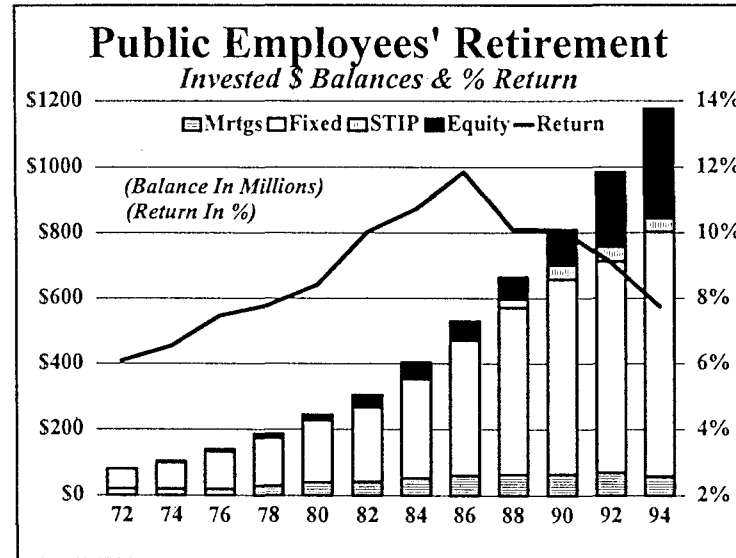
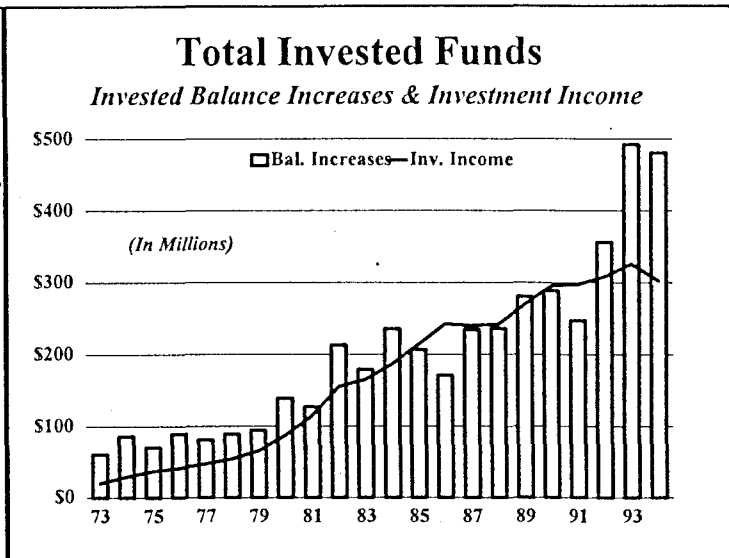
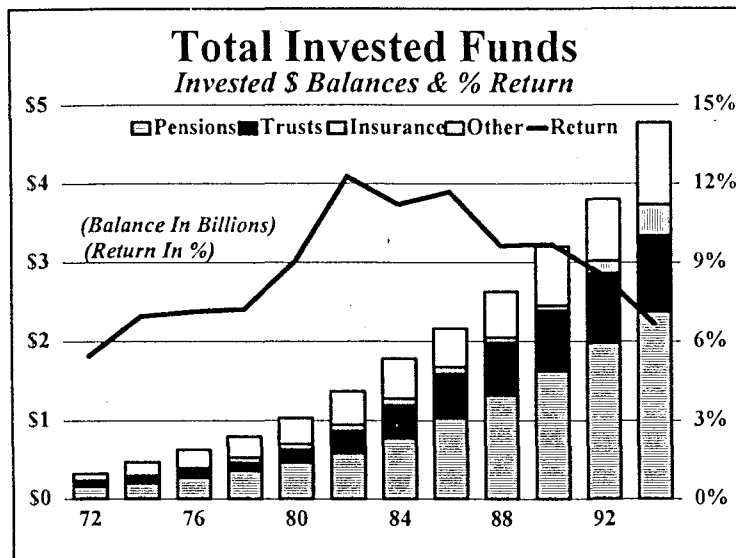
percent of the total. Insurance funds, primarily the State Fund, comprised 8.0 percent of the total.

Board Operations - The Board employs 28 employees, which includes 15 investment staff, three bond staff, and 10 accounting and support staff. During fiscal 1994, the Board's charge for investing funds was 4.4 basis points on the market value of invested funds, which includes costs for the custodial bank. When custodial bank costs are excluded, the cost was 3.5 basis points.

The Board selected State Street Bank and Trust as its custodial bank on December 31, 1993. State Street provides Board staff leased line access to the bank's main frame securities accounting system. State Street also lends securities held by the Board and returns 75 percent of the income to the Board. Securities lending income received by the Board far exceeds the custodial fee paid to State Street.

In addition to the accounting activities Board staff carry out on the State Street main frame, they also make daily entries on the State Wide Budgeting and Accounting System (SBAS) and must reconcile the two accounting systems on a monthly basis.

ATTACHMENT A

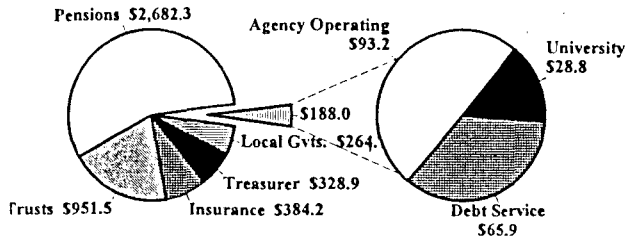


ATTACHMENT B

Total Invested Funds By Source

\$4.80 Billion Market Value At Year-End 1994

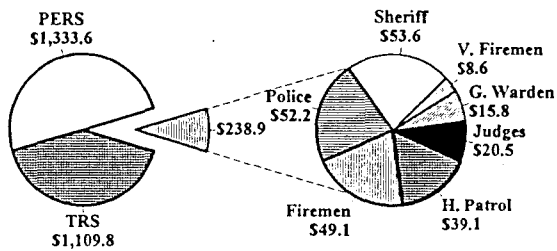
(In Millions)



Pension Funds At Market Value

\$2.68 Billion Total At Year-End 1994

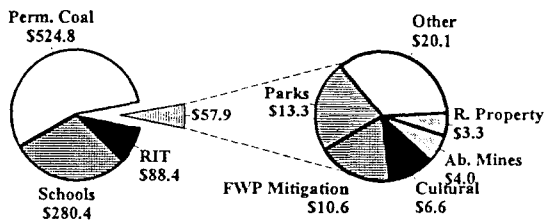
(In Millions)



Trusts At Market Value

\$951.51 Million Total At Year-End 1994

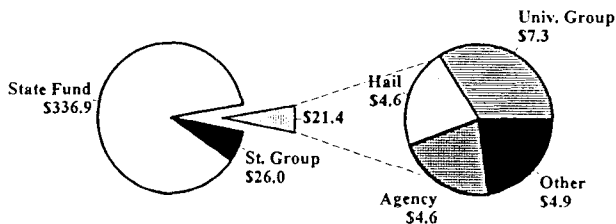
(In Millions)



Insurance Funds At Market Value

\$384.23 Million Total At Year-End 1994

(In Millions)



Total Invested Funds By Source

Source	Amount	% Total
Public Employees' Retir.	\$1,333,621,602	27.79
Teachers' Retirement	1,109,824,754	23.12
Permanent Coal Trust	508,709,198	10.60
State Compensation Fund	336,850,553	7.02
Treasurers Fund	328,903,245	6.85
Trust & Legacy	280,406,942	5.84
Local Governments STIP	264,715,700	5.52
State Agency Operating	90,809,203	1.89
Resource Indemnity Trust	88,442,237	1.84
Sheriffs Pension	53,563,112	1.12
Police Pension	52,171,810	1.09
Firemen Pension	49,135,083	1.02
Debt Service STIP	49,080,600	1.02
Highway Patrol Pension	39,124,368	0.82
Higher Education STIP	27,841,600	0.58
Group Benefit Insurance	25,996,450	0.54
Judges Pension	20,473,040	0.43
Treasure State Endowment	16,050,584	0.33
Game Warden Pension	15,833,709	0.33
Insurance STIP	14,863,100	0.31
Parks Coal Tax Trust	13,307,837	0.28
Other Trusts STIP	12,166,600	0.25
Payroll Bond Debt Service	10,622,715	0.22
FWP Mitigation	10,598,454	0.22
Vol. Firemen Pension	8,565,276	0.18
Cultural Coal Trust	6,633,776	0.14
DNRC Debt Service	6,237,874	0.13
Agency Insurance	4,587,290	0.10
Abandoned Mine Trust	4,040,669	0.08
Wildlife Habitat Trust	3,641,322	0.08
FWP Real Property Trust	3,254,348	0.07
Weed Control Trust	2,521,495	0.05
Subsequent Injury	1,933,356	0.04
Board Of Housing	1,695,000	0.04
Rock Creek Mitigation	1,245,606	0.03
Higher Education MTCP	971,590	0.02
Health Facilities Authority	714,351	0.01
Other Trusts MTCP	493,919	0.01
Total	\$4,799,648,369	100.00

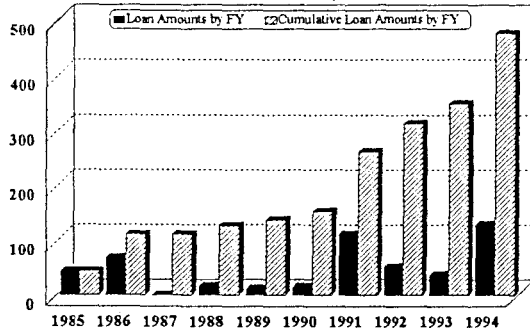
MONTANA HEALTH FACILITY AUTHORITY

PROGRAM FACTS:

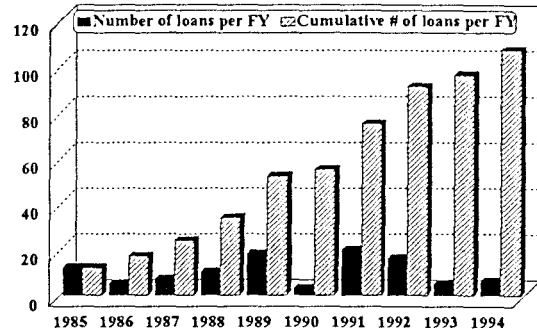
A. 1984-1994

Loan Amounts by Year

(in millions)



Number of Loan Transactions



Total Bond Issuance: \$477,203,000
Total Cost Savings: \$65,165,000

Total Number of Loans: 107
Total Number of Facilities: 70

Fiscal Years (90-94)

Avg. Annual Growth: 42.77%

Avg. Annual Growth: 12%

B. 1994-95 Biennium

Total Bond Issuance: \$145,735,000
Total Pooled Loans: 5,620,000
Interest Rate Savings: 14,331,718

Growth: 44%
Growth: 27%
Savings: 10%

New Programs:

Direct Loan Program - Provides loans from Authority funds for eligible projects which are limited to \$50,000 and a loan term of five years.

Master Loan Program - In conjunction with the Board of Investments, provides access for multiple borrowers on a pooled basis.

BUDGET FACTS:

<u>Fiscal</u> <u>Year</u>	<u>Total</u> <u>Expenditures</u>	<u>BOI</u> <u>Support</u>	<u>Fees/</u> <u>Audits</u>	<u>Program Costs</u> <u>as a</u> <u>% of Bonds</u>
1990	112,827	19,785	0	.115
1991	105,479	26,990	0	.056
1992	121,685	42,470	0	.051
1993	130,718	44,021	0	.055
1994	136,686	40,352	16,553	.038

Average

Growth: 3.11%

22.29%

DISCUSSION OF LFA ISSUES:

1. **Contracted Services:** Last biennium this committee agreed to contingently budget \$30,081 for expenses associated with the payment of bond issuance and financial advisory fees to the Department of Administration, and to conduct external audits of bond trustees. These expenses totaled \$16,553 in FY94. Unexpended funds were reverted.

The Authority proposes a continuation of the contingency funding agreed upon by the committee last session, including a reduction of \$16,936 in FY97 which is a result of its decision to conduct trustee audits once rather than twice each biennium. However, if the committee further reduces the biennium budget by \$16,528 each year, it effectively eliminates the biennium budget allocation for trustee audits, as well as the FY97 allocation for financial advisory and bond issuance fees paid to the Department of Administration.

The overall outcome is an elimination of a component the Authority's fiduciary responsibility to its bond investors, and a 50 percent reduction in the allocation for payment of Department of Administration fees. These fees pay a portion of the costs incurred by the state for its financial advisor and Comprehensive Annual Financial Report.

2. **Board of Investment Support:** The BOI support is in lieu of two FTE rather than one, as well as expenses associated with supplies, rent, travel and indirect costs. The expenditure growth trend parallels the growth in loan transactions and bond issuance volume, as portrayed in the earlier graphs and tables. Unexpended funds were reverted.

EXHIBIT

~~3~~ 4

DATE

2/3/95

HB

Montana Department
of Commerce
**BIENNIAL
REPORT
FY 1994/1995**

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HOUSE OF REPRESENTATIVES
VISITOR REGISTER

NAT. RESOURCES SUB COMMITTEE

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Jon Neal	Fpprof Commerce	✓	
Aldy Pool	Commerce	✓	
Jerry Hoover	Commerce	✓	
Bob Charlton	Commerce	✓	

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