

Who Manages ND's Wealth?

By: Tu-Uyan Tran – Fargo Forum 10/5/14

FARGO - Rancher Keith Kempenich laughed out loud when asked if he ever gets advice about money.

“Oh yeah, we do,” he said.

He runs the Box-K Ranch near Bowman, serves in the state House, and, a few times a year, chairs a board that decides how some of the state's billions in oil wealth is invested.

Sometimes, he said, people tell him the state needs to buy gold. Sometimes they tell him the state should pay residents an oil dividend like Alaska does. And sometimes, it's investment advisers looking for business.

“My attitude is this is a long-term deal,” Kempenich said. “You don't need to be the fastest one, but you need to be steady.”

North Dakota has been in the investment game for more than a century, starting with the trust lands established at statehood to support schools and colleges. But it's only since the latest oil boom began that the state's really been a major player.

The state Legacy Fund, a lock box for a portion of the state's oil-tax wealth that was created in 2010, is now worth about \$2.2 billion. The state Department of Trust Lands, which leases out North Dakota's oil-bearing property, has about \$4.6 billion – an increase of about 350 percent from fiscal year 2009, when the boom was just beginning.

And that doesn't include another \$7.2 billion in pensions and various other investment funds.

Making sure all that money is invested soundly on behalf of taxpayers and would-be pensioners is a complex task that involves dozens of state officials such as Kempenich and dozens more consulting firms around the nation.

Running the funds

Two agencies are largely responsible for investing North Dakota's wealth in the financial markets. The Retirement and Investment Office has most of it, including the Legacy Fund. The Department of Trust Lands has the rest.

At the top of the organizational chart for each agency is a governing board. The RIO is governed by the 11-member State Investment Board with Lt. Gov. Drew Wrigley as chairman, while Trust Lands is governed by the five-member Land Board, with Gov. Jack Dalrymple as chairman.

One difference with the State Investment Board is it carries out but does not generally set investment goals. The goals are set by boards overseeing individual funds, such as Kempenich's Legacy Fund board or the teachers' pension board.

Both the RIO and Trust Lands have financial experts who act as “managers of managers,” meaning they manage private-sector investment managers who do most of the actual investing. Some management firms, such

as Goldman Sachs and JPMorgan, are well-known. Others, such as InvestAmerica in Cedar Rapids, Iowa, are low-key.

The real action happens at that level, where stocks of individual companies, some still not publicly traded, and shares in real estate and infrastructure projects are bought and sold. How well North Dakota's investments perform depends on the skill of those investment managers.

Key investment players

One of the State Investment Board's most important tasks is to pick the right managers and watch their performance, said Wrigley, who has chaired the board since he was elected lieutenant governor in 2010.

The best board members must have a "good BS meter," he said. "You've got people coming in who have financial investment expertise that will dazzle most folks. ... You've got to have a good sense of what questions to ask, what information to glean, what assurances to build in if you do end up going into an agreement."

Wrigley, who grew up in Fargo, said he gained some of those skills as U.S. attorney for North Dakota and, earlier, as an assistant district attorney in Philadelphia.

While performance is an important factor, it's not the only factor, said Dave Hunter, RIO's executive director since December. When bringing potential management firms to the board, his staff looks for things such as customer service, plans for replacing key employees who may retire or quit and whether the firm's portfolio complements the portfolio of other firms working for RIO.

Hunter, who worked with investment managers at his last job in HSBC bank's pension unit, compared it to a football team. A great running back might turn up but, if the team needs a tight end, a tight end is who it's going to hire, he said.

Each investment manager plays such a key role that, in addition to diversifying the assets it owns, the state also diversifies the managers it works with, said Jeff Engleson, Trust Lands' investments director.

"You don't want to put all your eggs in one basket and have the main investment guy leave or that firm go bankrupt," he said.

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Tussling over members

Playing key roles, too, are the governance boards that pick the investment managers.

Currently, the State Investment Board has six representatives of the two largest pension funds, three elected officials from the executive branch and two appointed officials from the executive branch.

In the last legislative session, Kempenich and others made a push to get some lawmakers on the board. They met resistance from the governor's office and didn't get their proposal passed.

As Kempenich sees it, the Legacy Fund is the Legislature's business – a lock box can only be opened by a vote of two-thirds of lawmakers – and, as the fund grows to become the State Investment Board's second-biggest fund, lawmakers should have a seat at the table. He said he plans to bring the proposal back in the next legislative session.

Lawmakers already have a seat at a different table, though. There are four, Kempenich among them, on the Legacy and Budget Stabilization Fund Advisory Board.

Wrigley was careful to call the advisory panel a "policy board," arguing that lawmakers set investment policies, but the executive branch should execute those policies, which is what the State Investment Board does. Having lawmakers on the board would be an inappropriate "blurring of lines," he said.

Kempenich said lawmakers have also discussed putting more financial professionals on the board.

U.S. public funds, unlike many Canadian ones, tend not to have any financial professional on their boards, relying instead on the expertise of hired staff.

"It doesn't mean every person that joins the board is the next Milton Friedman and everyone that's on there has got to be able to talk to the president of Goldman Sachs and give him or her advice," Wrigley said. "It's not that kind of expertise."

Board members should simply be good judges of people, he said.

Growing wealth

By most measures, North Dakota's investments have grown along with its wealth.

"I have to say the performance level has just been exceptional," Wrigley said. "We're really pleased with the position of the funds."

One exceptional fund was the teachers' pension fund, which reported a return of 16.9 percent for fiscal year 2014, putting it at the top 37 percent among peers, according to unaudited financial data from RIO.

The fund could use the good news because it has seen liabilities grow in the last few years, with a combination of increasing life expectancy of retirees and the impact of the recent recession on investments, said Fay Kopp, RIO's chief retirement officer. Less than 60 percent of its liabilities are funded, as of the end of fiscal year 2013, the latest data available.

Another high flyer was the school and university trust funds, which reported a return of 13.85 percent for fiscal year 2014, according to unaudited financial data from Trust Lands. The funds' stocks alone soared 22.8 percent.

Lance Gaebe, a New Salem native who became head of Trust Lands in 2010, said there's so much money in the funds that people wonder why more of it isn't being used to alleviate the state's growing pains. A lot of those people, he said, have schools or other projects they want to build to accommodate the state's growing population.

The school and university trusts, though, are endowments and, by law, they can only give out so much, he said. "It's a prudent approach. We try to do both: support current generations and future generations and not lose value over time."

In fiscal year 2014, Trust Lands reported giving \$65.2 million to K-12 education and \$4.2 million to universities and other beneficiaries. That's an estimated 2 percent of the total assets of the trusts.

A bigger fish

North Dakota is enjoying other benefits of its wealth as well.

With more money to invest, it's becoming a bigger client to its investment managers and can negotiate lower fees. Hunter said RIO is also reducing the number of managers, increasing further the amount of money that each firm manages.

In the last fiscal year, RIO has seen fees drop from 0.65 percent of the value of assets under management to 0.5 percent. With the \$9.4 billion RIO controls, that's a savings of \$13 million, Hunter said.

The state has more money to give to the Bank of North Dakota to lend to farmers and for major economic development projects. The State Investment Board has made available about \$200 million for the latter, some of which went to the new diesel refinery in Dickinson, the first such refinery to be built since the 1970s. The board gets a certificate of deposit in return.

Bank President Eric Hardmeyer said most of the funds the bank gets from the state are not suitable for longer-term loans like the one for the refinery.

The bank is now seeking to expand the program to \$300 million, Hunter said.

Room to grow

For all its oil wealth, though, North Dakota is still a pretty small fish compared to the other oil powers in the world.

According to a ranking by the Sovereign Wealth Fund Institute, North Dakota's Legacy Fund is way at the bottom.

Sovereign wealth funds are investment funds of state and national governments. Among U.S. states, the biggest is Alaska's with \$51.7 billion followed by one of Texas' two listed funds with \$30.3 billion. Among nations, the biggest is Norway's with \$893 billion, followed by one of Abu Dhabi's four listed funds with \$773 billion.

"You take a look at a lot of these sovereign funds around the world, we're just getting started in North Dakota," Kempenich said.

Where's North Dakota's money?

Most of the money that the state of North Dakota invests goes through the Retirement and Investment Office and the Department of Trust Lands, which together have assets of \$14 billion.

Here are a few things the state owns as a result of those investments.

- \$1.7 billion of the U.S. national debt (that's Treasury bills).
- \$33.5 million in Microsoft stock.
- \$34.5 million Apple stock.
- \$18.7 million in CVS Caremark stock.
- \$12.6 million in Anheuser-Busch stock.

- \$8.5 million of Italy's national debt.
- \$8 million in Pfizer stock.
- \$5.4 million Wells Fargo stock.
- Shares in Williams Tower, a 64-story skyscraper in Houston and in other office buildings in Boston, Chicago, Los Angeles, New York City and San Francisco.
- Shares in wind farms in the U.S. and United Kingdom.
- Shares in airports in Australia.
- Shares in a utility providing heating to European cities.
- Shares in a "premier hospital" in the United Kingdom.
- Shares in "major regional shopping centers" in California, New Jersey and Texas.

In some cases, details are lacking because the private investment funds the state works with does not allow those details to be disclosed.

Source: RIO, Department of Trust Lands

State Investment Board

The 11-member State Investment Board oversees the Retirement and Investment Office. The board's main role is to carry out investment goals set by the boards of individual funds managed by RIO, such as the board overseeing the Legacy Fund and public-employee pensions.

State Investment Board members:

- Chairman Drew Wrigley, lieutenant governor
- Vice Chairman and PERS rep Mike Sandal, state Department of Transportation employee
- TFFR rep Clarence Corneil, retired elementary school principal in Dickinson
- TFFR rep Mike Gessner, high school teacher in Minot
- TFFR rep Rob Lech, school superintendent in Jamestown
- PERS rep Yvonne Smith, retired state disability-services director
- PERS rep Tom Trenbeath, chief deputy attorney general
- Kelly Schmidt, state treasurer
- Adam Hamm, state insurance commissioner
- Lance Gaebe, state land commissioner
- Cindy Ternes, Workforce Safety and Insurance finance director

Note: PERS is the state-employee pension fund. TFFR is the K-12-educators pension fund.

Land Board

The five-member Land Board oversees the Department of Land Trusts. The board's other name, the Board of University and School Lands, indicates where most of money goes.

Land board members:

- Jack Dalrymple, governor
- Alvin A. Jaeger, secretary of state
- Kirsten Baesler, superintendent of public instruction
- Kelly Schmidt, state treasurer
- Wayne Stenehjem, state attorney general