

**TRUST AND LEGACY FUND (FUND 09022)**  
**INVESTMENT POLICY STATEMENT**

## **INTRODUCTION**

The purpose of an investment policy statement is to give the investment manager guidance in developing an investment program to achieve the objectives agreed upon and enable the sponsor, Department of Natural Resources & Conservation, to monitor the progress of the plan.

## **OBJECTIVES**

Return Requirement: To maximize the total rate of return through a broadly diversified portfolio of fixed income investments while exceeding the return posted on Lehman Aggregate Index over a five-year moving average.

Current income is important since 95 percent of investment earnings are appropriated and distributed to school districts quarterly.

Risk Tolerance: This is a permanent trust fund; therefore, it has an above average ability to assume risk. The ability to tolerate volatility in value of the portfolio is larger than the ability to tolerate volatility in total spendable return. The Montana Constitution requires safe and conservative investments of public school funds.

## **CONSTRAINTS**

Liquidity Needs: As a long-term, permanent fund, liquidity needs are low. Except for distribution requirements and investment purposes, there is no need to maintain any sizable short-term holdings in the fund.

Time Horizon: The Montana Constitution requires this fund to forever remain inviolate; therefore, this fund has a long-term investment horizon and can tolerate market fluctuations.

Tax Considerations: This fund is tax-exempt; therefore tax-advantaged investments will not be used.

Legal Considerations: This fund is governed by state regulations, specifically, the "prudent expert principle" which requires the Board of Investments to: (a) discharge its duties with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity with the same resources and familiar with like manners exercises in the conduct of an enterprise of a like character with like aims; (b) diversify the holdings of each fund within the unified investment program to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is clearly prudent not to do so; and (c) discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program.

Cash Investments: Cash investments held at the pool level, any managed account within it, or any separate account entail an element of credit risk. Thus, only approved cash investment vehicles are permitted. These include the custodian's STIF vehicle, STIP, or any SEC-registered money market fund, all of which specifically address credit risk in their respective investment guidelines."

The Montana Constitution does not allow equity type investments.

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Client Preferences: None

Constitution of Montana (Art. X)

**Section 2. Public School Fund.** The public school fund of the state shall consist of:

- (1) Proceeds from the school lands, which have been or may hereafter be granted by the United States;
- (2) Lands granted in lieu thereof;
- (3) Lands given or granted by any person or corporation under any law or grant of the United States;
- (4) All other grants of land or money made from the United States for general educational purposes or without special purpose;
- (5) All interests in estates that escheat to the state;
- (6) All unclaimed shares and dividends of any corporation incorporated in the state; and
- (7) All other grants, gifts, devises or bequests made to the state for general educational purposes.

**Section 3. Public School Fund Inviolable.** The public school fund shall forever remain inviolate, guaranteed by the state against loss or diversion.

**Section 5. Public School Fund Revenue.**

- (1) Ninety-five percent of all the interest received on the public school fund and ninety-five percent of all rent received from the leasing of school lands and all other income from the public school fund shall be equitably apportioned annually to public elementary and secondary school districts as provided by law.
- (2) The remaining five percent of all interest received on the public school fund, and the remaining five percent of all rent received from the leasing of school lands and all other income from the public school fund shall annually be added to the public school fund and become and forever remain an inseparable and inviolable part thereof.

Constitution of Montana (Art. VIII)

**Section 13. Investment of Public Funds.**

- (2) The Public School Fund and the permanent funds of the Montana University System and all other state institutions of learning shall be safely and conservatively invested in:
  - (a) Public securities of the state, its subdivisions, local government units, and districts within the state, or;
  - (b) Bonds of the United States or other securities fully guaranteed as to principle and interest by the United States, or;
  - (c) Such other safe investments bearing a fixed rate of interest as may be provided by law.

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**ADDITIONAL INFORMATION**

SB 495 (2001):

It allows the Trust & Legacy Fund to borrow up to \$75 million from the Permanent Trust Fund. The loan would be backed with expected cash flow from mineral royalties. The maximum loan term is 30 years with no payment required until fiscal year 2004.

On July 1, 2001, \$46,366,904 was borrowed from the Permanent Trust Fund by transferring 483,604 Trust Fund Bond Pool (TFBP) units with a cost of \$95.877833 to this account. The loan will be paid back in TFBP units over 30 years but is was interest only until June 30, 2004.

As of June 30, 2007, the loan balance has been paid down to 187,421 TFBP units or \$17,969,519 at cost.

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**CASH FLOW SUMMARY**  
(in millions)

<u>Fiscal Year</u>	<u>Addition to Fund</u>	<u>Addition as % Ending Book</u>	<u>Book</u>	<u>Market</u>	<u>Total Inv. Income</u>	<u>Income Return</u>
1998	\$11.1	3.3%	\$336.3	\$358.7	\$25.9	7.84%
1999	8.4	2.4	344.7	347.6	26.3	7.70
2000	9.8	2.8	354.5	343.0	25.5	7.29
2001	11.7	3.2	366.2	370.4	26.2	7.28
2002	48.7*	11.7	414.9	425.6	29.8	7.62
2003	(4.3)	(1.1)	410.6	450.9	29.2	7.07
2004	0.1	0.0	410.7	427.4	30.1	7.34
2005	0.0	0.0	410.7	433.0	28.4	6.91
2006	19.9	4.6	430.6	435.8	24.8	5.90
2007	(2.4)	(0.6)	428.2	429.6		

\*483,604 TFBP units loans from Permanent Trust Fund on 7/1/01. Interest only payments made for the 1st two years. Balance outstanding on 6/30/07 is 187,421 units.

Source: BOI Annual Report

**ASSET ALLOCATION**  
(at market)

<u>FIXED INCOME</u>	<u>6-05</u>	<u>6-06</u>	<u>6-07</u>	<u>Ranges</u>	<u>Proposed Ranges</u>
Trust Funds Bond Pool (TFBP)	89.8%	91.8%	95.8%	87-92%	95-100%
Loan from Permanent Trust	10.2	8.2	4.2	7-12	0-5
Short-Term Investment Pool (STIP)	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0-5</u>	<u>0-5</u>
Total Fixed Income	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>