

TO: Commission on Higher Education Funding
FROM: Jeb Spaulding, State Treasurer
RE: Annual Report on the Higher Education Trust Fund
DATE: August 23, 2005

I am pleased to present the State Treasurer's sixth annual report on the Higher Education Trust Fund. This fund was established in the Office of the State Treasurer by Act No. 27 of the General Assembly in 1999 and was initially funded with an appropriation of \$6 million. Additional appropriations include \$1 million in 2001 and \$635,881.49 in 2002 and, as discussed further below, \$2,363,355.61 in 2005. The Act was amended in 2001 to provide that in August of each year, the State Treasurer shall withdraw 5% of up to a 12-quarter moving average of the fund's assets and divide the amount equally among the University of Vermont, the Vermont State Colleges, and the Vermont Student Assistance Corporation.

During fiscal year 2005, the Higher Education Trust Fund dollar weighted return was 10.17%. This return compares to the Lehman Aggregate Bond Index return of 6.80% and to the S&P 500 Stock Index of 6.32% for the same period, and exceeds the Fund's target rate of 6.76%. The 5% distribution available this year is \$421,657.83 in total, or \$140,552.61 each for UVM, VSC, and VSAC; the distribution made following Fiscal Year 2004 was \$135,482.92 for each institution. (See Appendix A for quarterly market values and distributions for fiscal year 2005.)

Act No. 27 further provides that in August of each year, the Commission on Higher Education Funding may authorize the State Treasurer to make an additional amount equal to up to 2% of the fund's average assets available to UVM and the Vermont State Colleges for the purpose of creating or increasing a permanent endowment fund. The amount appropriated, however, cannot exceed an amount that would bring the fund balance below the \$6 million initial appropriation plus any additional contributions to principal.

At its meeting last year, the Commission authorized this 2% appropriation in the amount of \$162,579.50, or \$81,289.75 each, for distribution to the University of Vermont and the Vermont State Colleges dependent upon a finding by the Commission that the terms of

this appropriation have been met. Each institution was given until the end of fiscal year 2005 to match the appropriation by raising twice that amount, or \$162,579.50, and to certify to the Commissioner of Finance and Management that it received private donations in the requisite amount and that the funds will be used to create or increase a permanent endowment at the respective institution. Each of these institutions is in the process of establishing the required certification.

After payments of \$421,657.83 and \$162,579.50, the balance in the fund at the beginning of fiscal year 2006 totals \$8,271,362.58.

All principal contributions to date total \$7,635,881.49 (see Chart #1). This represents the current minimum balance that must be maintained in the fund. The 2% distribution proposed for this year of \$168,663.14 would leave a balance of \$8,102,699.44 excluding any gains from investment activity in Fiscal Year 2006. If the committee authorizes this distribution, each institution's share will be \$84,331.57, with a required match to be raised by each entity in Fiscal Year 2006 of \$168,663.14. Chart #2 is a graphical depiction of distributions, including this 2% distribution subject to committee approval.

An accounting of the fund balances is provided below:

Ending balance FY 2004	\$8,625,716.81
Contributions received FY 2005	<u>-0-</u>
Opening balance FY 2005	8,625,716.81
Distribution August 2005	(555,166.37)
Income earned fiscal year 2005	378,889.16
Appreciation (Depreciation) FY 2005	438,983.33
Fees and Other Charges FY 2005	<u>(32,823.02)</u>
Balance June 30, 2005	8,855,599.91
5% of 12-Quarter Moving Average June 30, 2005	(421,657.83)
Distributions: University of Vermont	(140,552.61)
Vermont State Colleges	(140,552.61)
Vermont Student Assistance Corp.	(140,552.61)
2% Income Available for Endowments from FY 2004	<u>(162,579.50)</u>
Balance after distributions	8,271,362.58
Addition to Principal	<u>- 0 -</u>
Post-distribution balance FY 2006	<u>\$8,271,362.58</u>
2% Income Available for Endowments from FY 2005 (requires institutional match in FY 2006)	\$168,663.14

I have attached a spreadsheet as Appendix B that shows the total return of the entire Trust Investment Account, of which the Higher Education Trust Fund at \$8,855,599.91 (prior to cash distributions made in fiscal year 2006) comprises approximately 20%. The Tobacco Trust Fund comprises 73% of the account, or \$31,515,641.45, and the remaining 7% is made up of eight small unexpendable trusts that total \$507,153.80, the ANR Stewardship Fund at \$579,503.29, two Veterans' Home trusts totaling \$1,023,116.92, and the most recent addition to the Trust Investment Account (June 2005), the Fish and Wildlife Trust Fund at \$1,057,786.21. Chart #3 displays the relative share of the Higher Education Trust Fund compared to the entire fund. Chart #4 identifies the major asset classes in the portfolio and their performance over the past four years.

As noted in Chart #5, assets increased slightly despite a second year in a row of zero contributions. Fixed income continues to be the principal source of total return over the life of the Fund due to a combination of asset allocation and market forces. However, the Fund's equity investments have again provided a significant contribution to the Fund's performance for the most recent fiscal year. The asset allocation of the Fund at June 30, 2005, comprised 30.4% equities and 69.6% fixed income securities versus 26.7% equities and 73.3% fixed income securities, respectively, at June 30, 2004; thus the Fund's equity allocation continued to increase to a targeted approximately 70%-30% ratio in favor of fixed income securities. We continue to believe this overall asset risk allocation plan takes into consideration both the beneficiaries' long-term investment objectives and the distribution needs afforded by current income.

The Higher Education Endowment Trust Fund Act further provides that contributions shall include "... in any fiscal year in which a general fund surplus exists and the general fund stabilization reserve is funded to its required statutory level, funds raised by the estate tax under chapter 190 of Title 32 which are more than 125 percent of the amount projected by the emergency board in the July annual forecast made pursuant to section 305a of Title 32." This year a substantial contribution in the amount of \$2,363,355.61 derives from fiscal year 2005, and this contribution became part of the Higher Education Trust Fund in July 2005. Thus the Fund's investment base is significantly increased for fiscal year 2006, and depending upon investment market conditions can be expected to generate additional returns to the Fund.

In summary, the investment performance of the Trust Investment Account again supported the distribution requirements of the Higher Education Trust Fund. Going forward, distributions will depend on the ongoing performance of the Fund, and will require continued monitoring of the Fund's investment performance.

Please feel free to contact me if you have any questions or concerns regarding this report.

cc: James Reardon, Commissioner of Finance & Management
Anne Winchester, Legislative Council

Appendix A

Quarterly Market Values

June 30, 2005

	Balance 9/30	Balance 12/31	Balance 3/31	Balance 6/30	
Education Trust					
FY2003	\$7,885,377.45	\$8,175,418.30	\$8,212,332.41	\$8,572,981.01	
FY2004	\$8,242,399.79	\$8,505,386.89	\$8,697,470.84	\$8,625,716.81	
FY2005	\$8,241,108.63	\$8,566,614.41	\$8,617,473.66	\$8,855,599.91	
Twelve Quarter Average	\$8,433,156.68				
5% Distribution 2005	\$421,657.83				
VSAC		\$140,552.61		<u>Contributions</u>	
UVM		\$140,552.61			
VSC		\$140,552.61		Initial	\$6,000,000.00
				2001	\$1,000,000.00
2% FY2004	\$162,579.50			2002	\$635,881.49
UVM		\$81,289.75		2003	\$0.00
VSC		\$81,289.75		2004	\$0.00
Balance after Distributions	\$8,271,362.58			Total	\$7,635,881.49
2% FY2005	\$168,663.13				
UVM		\$84,331.57			
VSC		\$84,331.57			

Appendix B

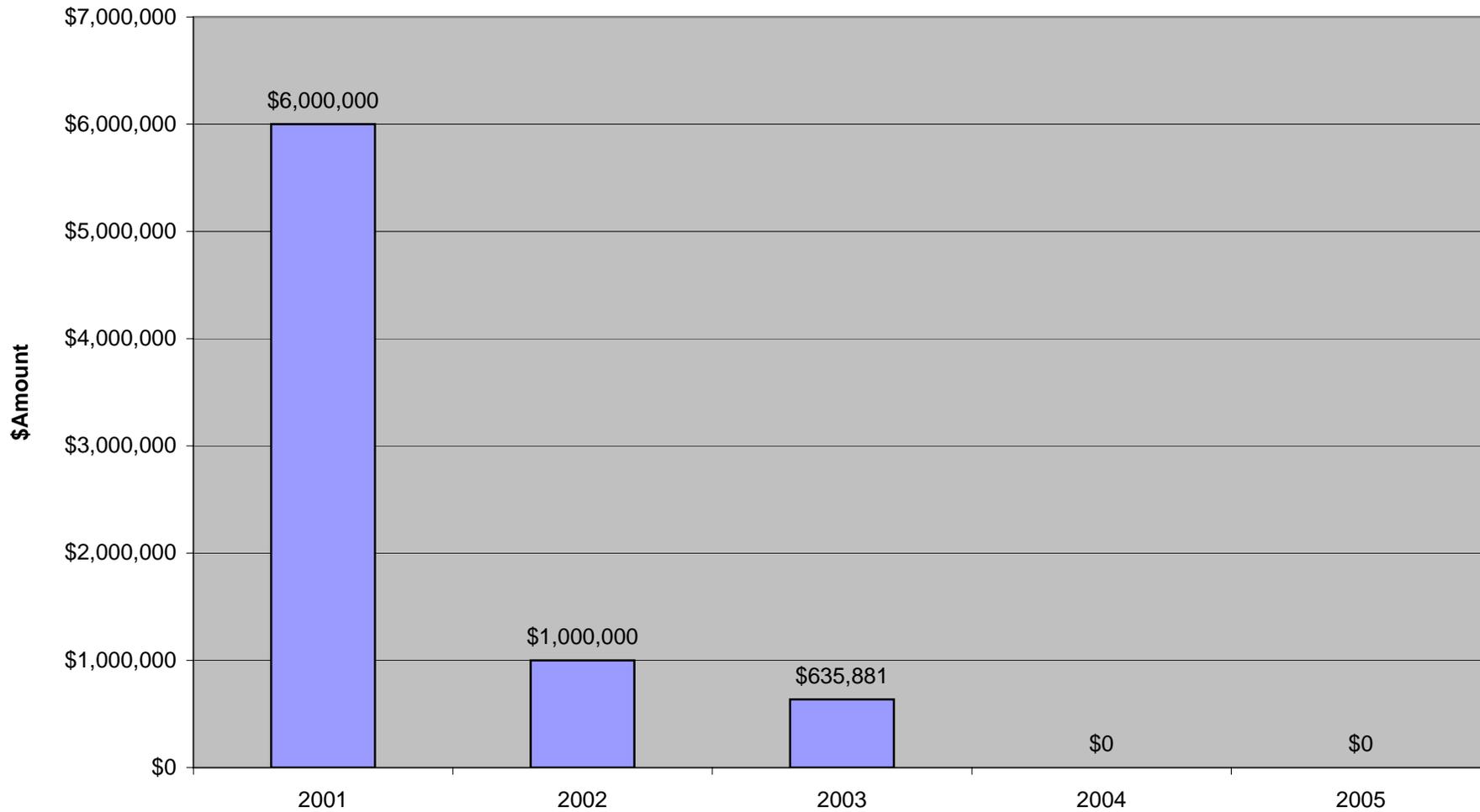
VERMONT COMMON TRUST FUND

TOTAL RETURN ANALYSIS

June 30, 2005

MANAGER	Fiscal Year	Calendar Year	Fiscal Year	Calendar Year	Fiscal Year	Calendar Year	Fiscal Year	Quarter Ended	Quarter Ended	Calendar Year	Quarter Ended	Quarter Ended	Fiscal Year	Portfolio Market	Portfolio Percent
	2001	2001	2002	2002	2003	2003	2004	9/30/2004	12/31/2004	2004	3/31/2005	6/30/2005	2005	6/30/2005	6/30/2005
DOMESTIC EQUITY															
Hanson Investment Management	29.41%	17.41	(7.78)	(18.01)	-1.89%	42.55%	29.10%	-0.05%	13.77%	15.92%	3.00%	4.38%	22.25%	\$7,073,222	16.2%
Prentiss Smith & Co.	7.59%	13.69	3.60	(7.35)	7.70%	18.17%	11.47%	-1.52%	11.61%	13.25%	0.07%	1.35%	11.00%	\$6,162,361	14.2%
S&P 500	-13.56%	-11.89%	-17.99%	-22.11%	0.25%	28.69%	19.14%	-1.87%	9.23%	10.90%	-2.15%	1.37%	6.32%		30.4%
DOMESTIC FIXED INCOME															
NL Capital Management	10.34%	10.07%	9.41%	9.48%	8.92%	5.43%	3.48%	2.97%	1.14%	5.56%	0.22%	2.91%	7.42%	30,303,219	69.6%
Lehman Aggregate	10.23%	8.44%	8.63%	10.25%	10.40%	4.10%	0.32%	3.20%	0.95%	4.34%	-0.48%	3.01%	6.80%		
TOTAL FUND DOLLAR WEIGHTED RETURN	11.27%	11.62	7.94	5.15	8.59%	11.24%	7.59%	1.98%	4.31%	8.14%	0.62%	2.93%	10.17%		
Total Fund Target	7.52%	6.57	3.94	3.29	9.23%	9.94%	4.96%	1.86%	3.22%	6.23%	-0.96%	2.52%	6.76%		
TOTAL FUND MARKET VALUE (\$mil.)	\$25.6	\$32.6	\$33.3	\$34.9	\$37.3	\$38.8	\$39.3	\$39.6	\$41.1	\$41.1	\$41.3	\$43.5	\$43.5	\$43,538,802	100.0%

Chart #1
Higher Education Trust Fund
Fund Contributions



**Chart #2
Higher Education Trust Fund
Distributions by Year and Type**

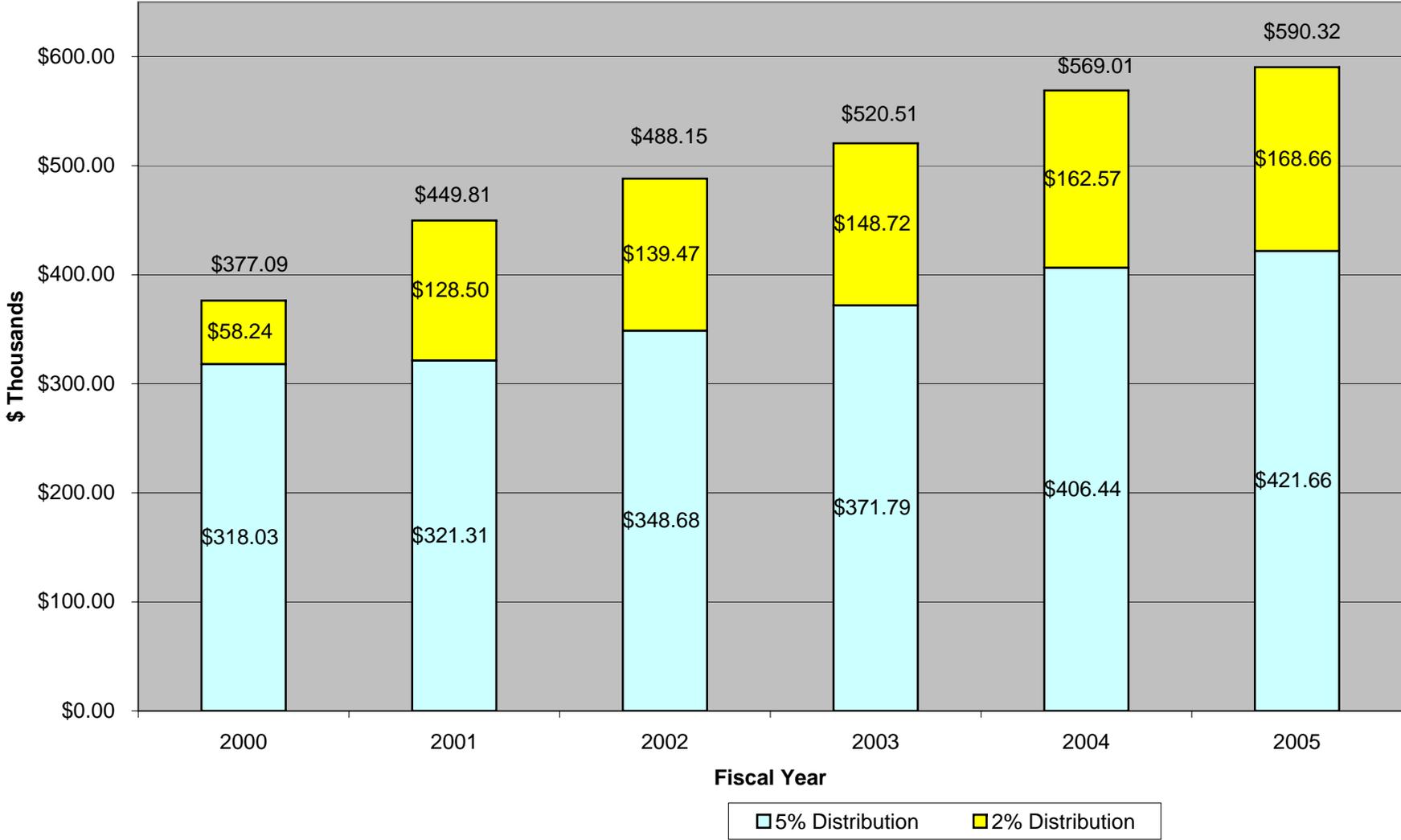


Chart #3
Common Trust Fund Breakdown as of June 30, 2005

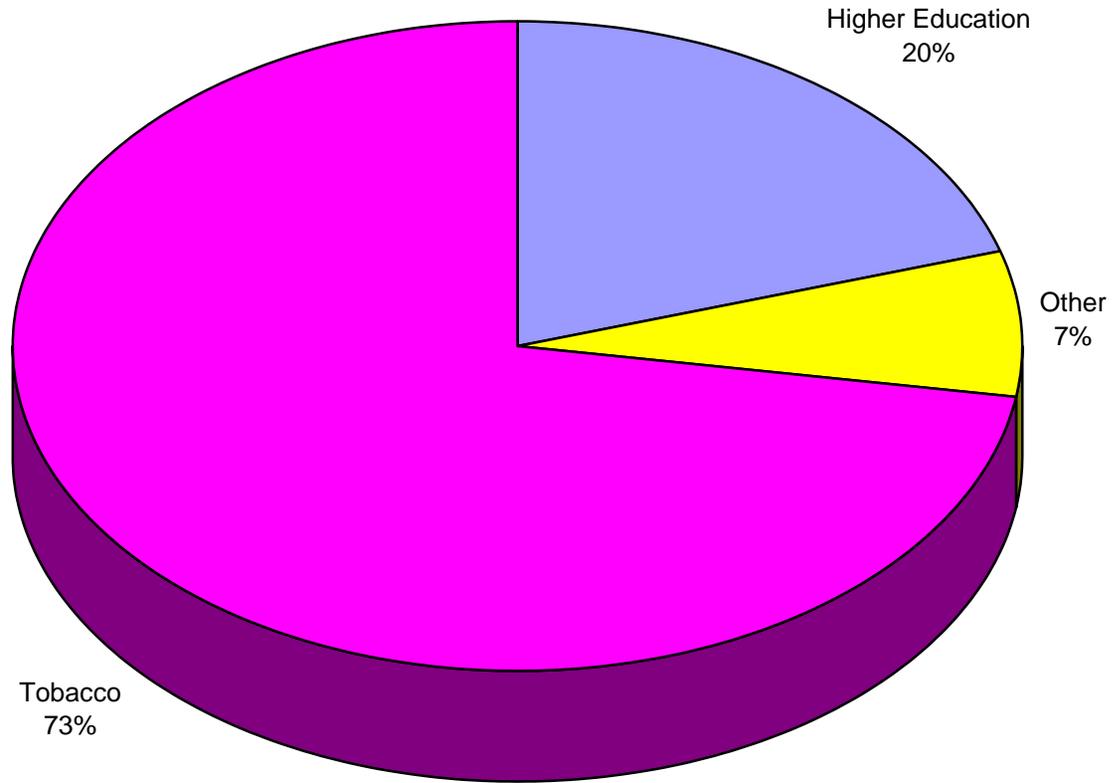
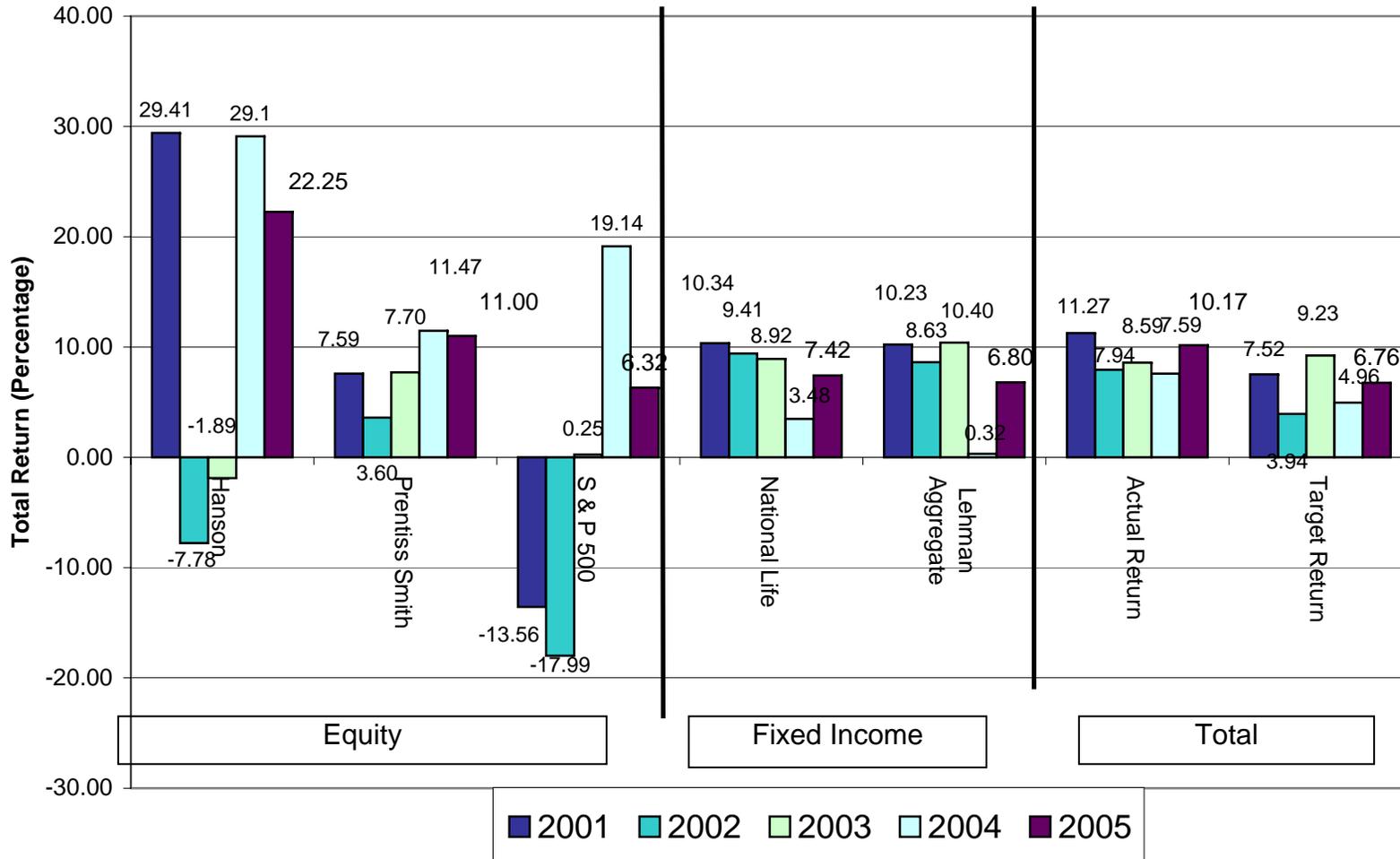


Chart #4
Higher Education Trust Fund
Total Return by Asset Class Fiscal Years 2001- 2005



Note: Some performance figures are restated to reflect a uniform reporting methodology.

Chart #5
Higher Education Trust Fund
Asset Growth, 6/30/2000 to 6/30/2005
(Includes Distributions)

