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**STATE OF VERMONT**  
**OFFICE OF THE STATE TREASURER**

**TO:** Commission on Higher Education Funding

**FROM:** Jeb Spaulding, State Treasurer

**RE:** Annual Report on the Higher Education Trust Fund

**DATE:** 29 August 2007

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I am pleased to present the State Treasurer's eighth annual report on the Higher Education Trust Fund. This fund was established in the Office of the State Treasurer by the 1999 General Assembly (16 V.S.A. § 2885). Appropriations totaled \$7,635,881.49 through Fiscal Year 2002, \$2,363,355.61 in FY 2005, and \$5,823,449.94 in FY 2006. The statute 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 2007, the Higher Education Trust Fund dollar weighted return was 12.02%. This return compares to the Lehman Aggregate Bond Index return of 6.12% and to the S&P 500 Stock Index return of 20.60% for the same period, and exceeds the Fund's target rate (based on actual asset allocation and index returns) of 10.62%. The 5% distribution available this year is \$620,582.02 in total, or \$206,860.67 each for UVM, VSC, and VSAC; the distribution made following Fiscal Year 2006 was \$156,365.08 for each institution. (See Appendix A for quarterly market values and distributions for fiscal year 2007.)

16 V.S.A. § 2885 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 total contributions to principal.

At its meeting last year, the Commission authorized this 2% appropriation in the amount of \$187,638.09, or \$93,819.05 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 is required to match the appropriation by raising twice that

amount, or \$187,638.09, 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 \$620,582.02 and \$187,638.09, the balance in the fund at the beginning of fiscal year 2008 totals \$17,461,379.61.

All principal contributions to June 30, 2007, total \$15,822,687.04 (see Chart #1). This represents the current minimum balance that must be maintained in the fund. The 2% distribution proposed for this year of \$248,232.81 would leave a balance of \$17,213,146.80 excluding contributions to be received, 5% distribution, and any gains from investment activity in Fiscal Year 2008. If the committee authorizes this distribution, each institution's share will be \$124,116.40 with a required match to be raised by each entity in Fiscal Year 2008 of \$248,232.81. 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 2006	\$11,188,699.76
Contributions received FY 2007	<u>5,823,449.94</u>
Opening balance FY 2007	17,012,149.70
Distribution August 2006	(637,758.37)
Income earned FY 2007	813,667.62
Appreciation (Depreciation) FY 2007	1,149,774.90
Fees and Other Charges FY 2007	<u>(68,234.56)</u>
Balance June 30, 2007	18,269,599.72
5% of 12-Quarter Moving Average June 30, 2007	(620,582.02)
Distributions: University of Vermont	(206,860.67)
Vermont State Colleges	(206,860.67)
Vermont Student Assistance Corp.	(206,860.67)
2% Income Available for Endowments from FY 2006	<u>(187,638.09)</u>
Balance after distributions	17,461,379.61
Total contributions as of 6/30/2006	15,822,687.04
2% Income Available for Endowments from FY 2007 (requires institutional match in FY 2008)	\$248,232.81

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 \$18,269,599.72 (prior to cash distributions to be made in fiscal year 2008) comprises approximately 32.9%. The Tobacco Trust Fund comprises 60.6% of the account, or \$33,621,059.32, and the remaining 6.5% is made

up of eight small unexpendable trusts that total \$545,197.25, the ANR Stewardship Fund at \$680,300.10, two Veterans' Home trusts totaling \$1,091,681.36, and the Fish and Wildlife Trust Fund at \$1,241,773.90. 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 seven years.

As noted in Chart #5, assets increased significantly due to receipt of funds raised by the Estate Tax in the amount of \$5,223,449.94 and a \$600,000 contribution from the State's unclaimed property fund as a result of legislation proposed by the Treasurer in FY 2006. Both of these amounts were derived from FY 2006 and were received into the fund in FY 2007. Assets also increased significantly as a result of favorable investments returns in FY 2007. Thus, the Fund's investment base significantly increased in fiscal year 2007, and depending upon investment market conditions can be expected to generate ongoing additional returns to the Fund.

In the past, fixed income investments have been the principal source of total return over the life of the Fund due to a combination of Fund asset allocation and market forces. However, in both fiscal years 2006 and 2007 equity investments have provided the majority of the contribution to the Fund's investment performance based on favorable market conditions and a combined above-benchmark performance by the equity managers. The asset allocation of the Fund at June 30, 2007, comprised 33.8 % equities and 66.2% fixed income securities versus 32.5% equities and 67.5% fixed income securities, respectively, at June 30, 2006.

Currently, allocations of contributions and sources of distributions in the Trust Investment Account are used to target a 30% - 70% ratio in favor of fixed income securities. This balance addresses joint investment objectives of investment return and capital preservation. During the FY 2007 legislative session, bill H.40 was introduced, calling for the removal of the restriction contained in 16 V.S.A. § 2885(c) that the 5% distribution withdrawals from the Higher Education Endowment Trust Fund not exceed the Fund's initial funding balance plus subsequent contributions. While H.40 did not progress beyond introduction during the 2007 session, it is likely to be taken up during the second half of the biennium. If the bill is passed, a more aggressive asset allocation increasing the equity allocation for the Higher Education Trust Fund would become appropriate, inasmuch as the risk of not being able to fully fund 5% distributions would be eliminated.

In summary, the investment performance of the Trust Investment Account once again exceeded its target return, and favorable market conditions combined with overall above-benchmark performance by the investment managers created a return well above a level fully supporting this year's distributions. Going forward, distributions will depend on the ongoing performance of the Fund, and will require continued monitoring of the Fund's investment performance, as well as ongoing consideration of optimal asset allocation in evolving investment marketplaces.

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

cc: James Reardon, Commissioner of Finance & Management  
Donna Russo-Savage, Legislative Council

Appendix A  
Quarterly Market Values  
June 30, 2007

	Balance 9/30	Balance 12/31	Balance 3/31	Balance 6/30	
<b>Education Trust</b>					
<b>FY2005</b>	\$8,241,108.63	\$8,566,614.41	\$8,617,473.66	\$8,855,599.91	
<b>FY2006</b>	\$10,849,205.23	\$10,921,067.11	\$11,272,112.39	\$11,188,699.76	
<b>FY 2007</b>	\$16,853,847.32	\$17,407,882.23	\$17,896,475.61	\$18,269,599.72	
<b>Twelve Quarter Average</b>	<b>\$12,411,640.50</b>				
<b>5% Distribution 2007</b>	<b>\$620,582.02</b>				
VSAC		\$206,860.67		<u>Contributions</u>	
UVM		\$206,860.67			
VSC		\$206,860.67		Initial	\$6,000,000.00
				2001	\$1,000,000.00
<b>2% FY2006</b>	<b>\$187,638.09</b>			2002	\$635,881.49
UVM		\$93,819.05		2003	\$0.00
VSC		\$93,819.05		2004	\$0.00
				2005	\$2,363,355.61
				2006	\$5,823,449.94
<b>Balance after Distributions</b>	<b>\$17,461,379.61</b>			Total	<b>\$15,822,687.04</b>
<b>2% FY2007</b>	<b>\$248,232.81</b>				
UVM		\$124,116.40			
VSC		\$124,116.40			

Appendix B

VERMONT COMMON TRUST FUND

TOTAL RETURN ANALYSIS

June 30, 2007

<b>MANAGER</b>	Quarter Ended	Quarter Ended	Calendar Year	Quarter Ended	Quarter Ended	Fiscal Year	Portfolio Market	Portfolio Percent
	9/30/2006	12/31/2006	2006	3/31/2007	6/30/2007	2007	6/30/2007	6/30/2007
<b>DOMESTIC EQUITY</b>								
Hanson Investment Management	2.70%	7.20%	20.28%	6.58%	10.05%	29.13%	\$10,585,985	19.1%
Prentiss Smith & Co.	1.32%	8.28%	16.61%	1.60%	7.74%	20.09%	\$8,139,800	14.7%
<i>S&amp;P 500</i>	5.67%	6.70%	15.80%	0.64%	6.28%	20.60%	\$18,725,785	33.8%
<b>DOMESTIC FIXED INCOME</b>								
NL Capital Management	3.43%	1.48%	5.31%	2.20%	-1.07%	6.12%	\$36,723,827	66.2%
<i>Lehman Aggregate</i>	3.81%	1.24%	4.33%	1.50%	-0.52%	6.12%		
<b>TOTAL FUND DOLLAR WEIGHTED RETURN</b>	3.00%	3.39%	9.48%	2.88%	2.24%	12.02%		
<i>Total Fund Target</i>	4.39%	2.92%	7.96%	1.23%	1.71%	10.62%		
<b>TOTAL FUND MARKET VALUE</b>	\$53.8	\$52.8	\$52.8	\$54.3	\$55.5	\$55.5	\$55,449,612	100.0%

Appendix B

VERMONT COMMON TRUST FUND

TOTAL RETURN ANALYSIS

Performance Prior to FY 2007

MANAGER	Fiscal Year	Calendar Year	Fiscal Year						
	2001	2001	2002	2002	2003	2003	2004	2004	2005
<b>DOMESTIC EQUITY</b>									
Hanson Investment Management	29.41%	17.41	(7.78)	(18.01)	-1.89%	42.55%	29.10%	15.92%	22.25%
Prentiss Smith & Co.	7.59%	13.69	3.60	(7.35)	7.70%	18.17%	11.47%	13.25%	11.00%
<i>S&amp;P 500</i>	-13.56%	-11.89%	-17.99%	-22.11%	0.25%	28.69%	19.14%	10.90%	6.32%
<b>DOMESTIC FIXED INCOME</b>									
NL Capital Management	10.34%	10.07%	9.41%	9.48%	8.92%	5.43%	3.48%	5.56%	7.42%
<i>Lehman Aggregate</i>	10.23%	8.44%	8.63%	10.25%	10.40%	4.10%	0.32%	4.34%	6.80%
<b>TOTAL FUND DOLLAR WEIGHTED RETURN</b>	11.27%	11.62	7.94	5.15	8.59%	11.24%	7.59%	8.14%	10.17%
<i>Total Fund Target</i>	7.52%	6.57	3.94	3.29	9.23%	9.94%	4.96%	6.23%	6.76%
<b>TOTAL FUND MARKET VALUE (\$mil)</b>	\$26.5	\$32.6	\$33.3	\$34.9	\$37.3	\$38.8	\$39.3	\$41.1	\$43.5

**Appendix B**

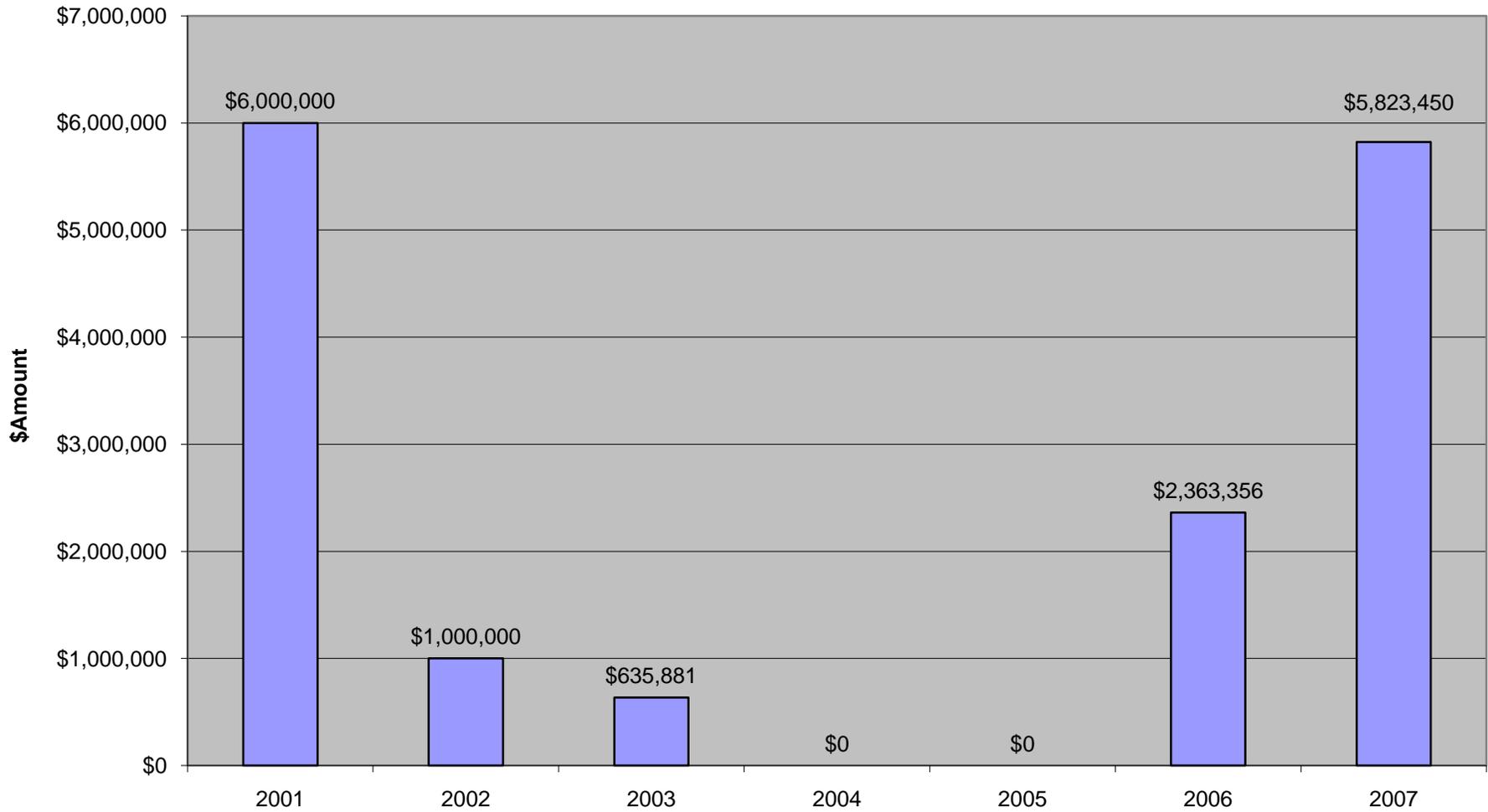
**VERMONT COMMON TRUST FUND**

**TOTAL RETURN ANALYSIS**

**Performance Prior to FY 2007**

<b>MANAGER</b>	<b>Quarter Ended</b>	<b>Quarter Ended</b>	<b>Calendar Year</b>	<b>Quarter Ended</b>	<b>Quarter Ended</b>	<b>Fiscal Year</b>	<b>Portfolio Market</b>	<b>Portfolio Percent</b>
	9/30/2005	12/31/2005	2005	3/31/2006	6/30/2006	2006	6/30/2006	6/30/2006
<b>DOMESTIC EQUITY</b>								
Hanson Investment Management	8.40%	2.26%	<b>19.18%</b>	13.33%	-3.60%	<b>21.10%</b>	\$8,781,896	17.7%
Prentiss Smith & Co.	7.92%	0.86%	<b>10.68%</b>	6.40%	-0.10%	<b>15.77%</b>	\$7,369,828	14.8%
<i>S&amp;P 500</i>	<i>3.60%</i>	<i>2.09%</i>	<i>4.91%</i>	<i>4.21%</i>	<i>-1.44%</i>	<i>8.63%</i>		<i>32.5%</i>
<b>DOMESTIC FIXED INCOME</b>								
NL Capital Management	-0.50%	0.44%	<b>3.07%</b>	0.16%	0.17%	<b>0.26%</b>	\$33,529,229	67.5%
<i>Lehman Aggregate</i>	<i>-0.67%</i>	<i>0.59%</i>	<i>2.43%</i>	<i>-0.65%</i>	<i>0.08%</i>	<i>-0.81%</i>		
<b>TOTAL FUND DOLLAR WEIGHTED RETURN</b>	2.15%	0.80%	<b>6.64%</b>	3.37%	-0.55%	<b>5.86%</b>		
<i>Total Fund Target</i>	<i>0.64%</i>	<i>1.05%</i>	<i>3.27%</i>	<i>0.91%</i>	<i>-0.42%</i>	<i>2.19%</i>		
<b>TOTAL FUND MARKET VALUE (\$mil)</b>	<b>\$48.3</b>	<b>\$48.6</b>	<b>\$48.6</b>	<b>\$50.1</b>	<b>\$49.7</b>	<b>\$49.7</b>	\$49,680,953	<b>100.0%</b>

Chart #1  
Higher Education Trust Fund  
Fund Contributions (Fiscal Years)



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

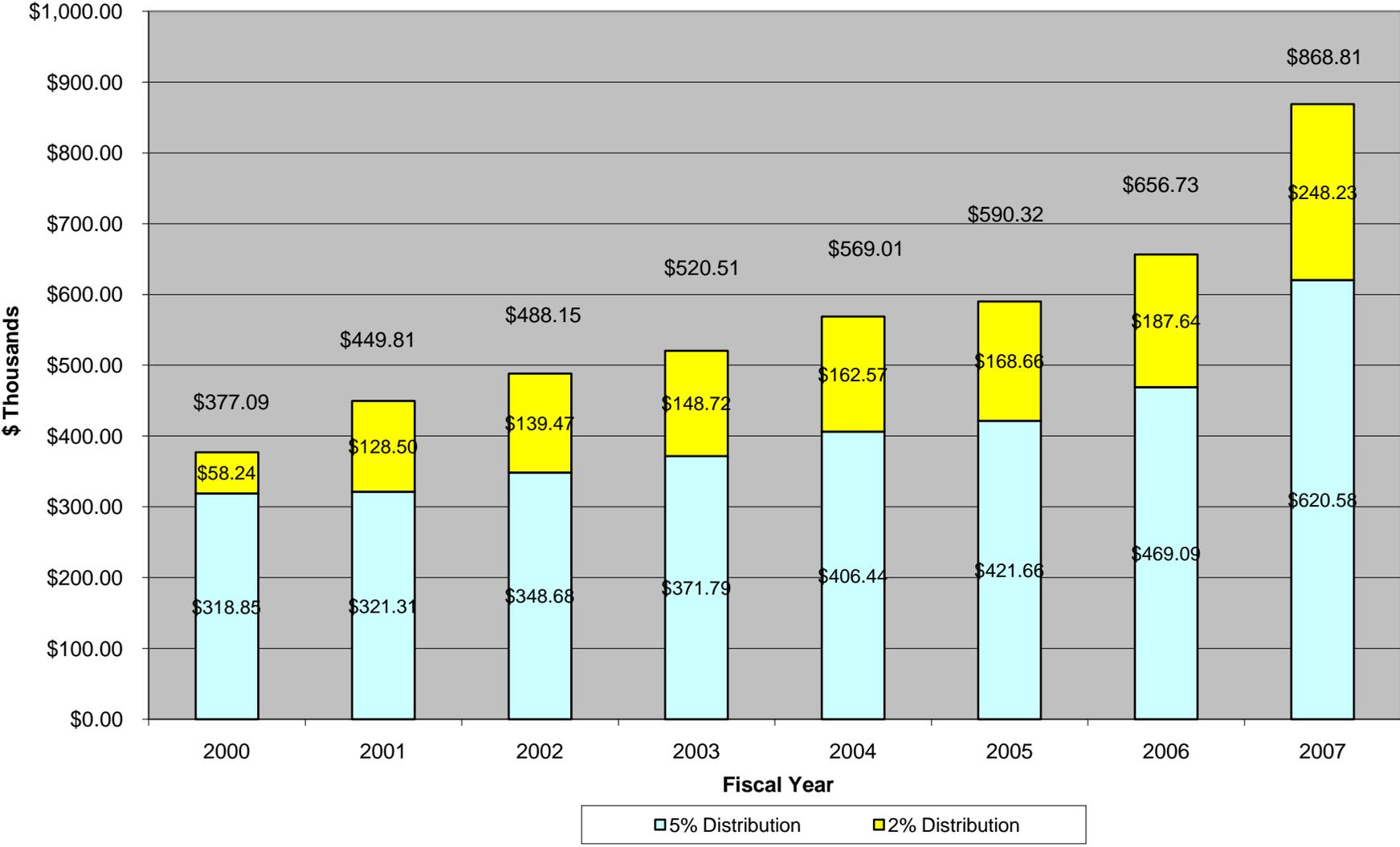
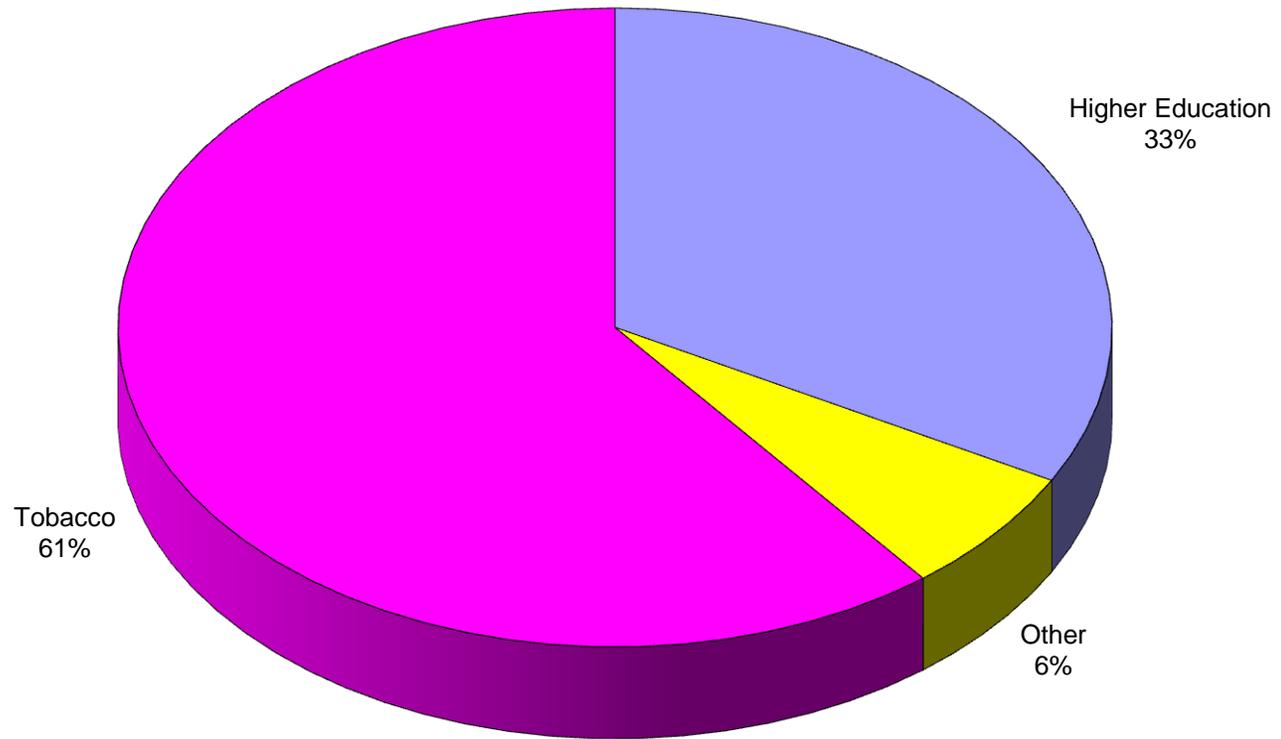
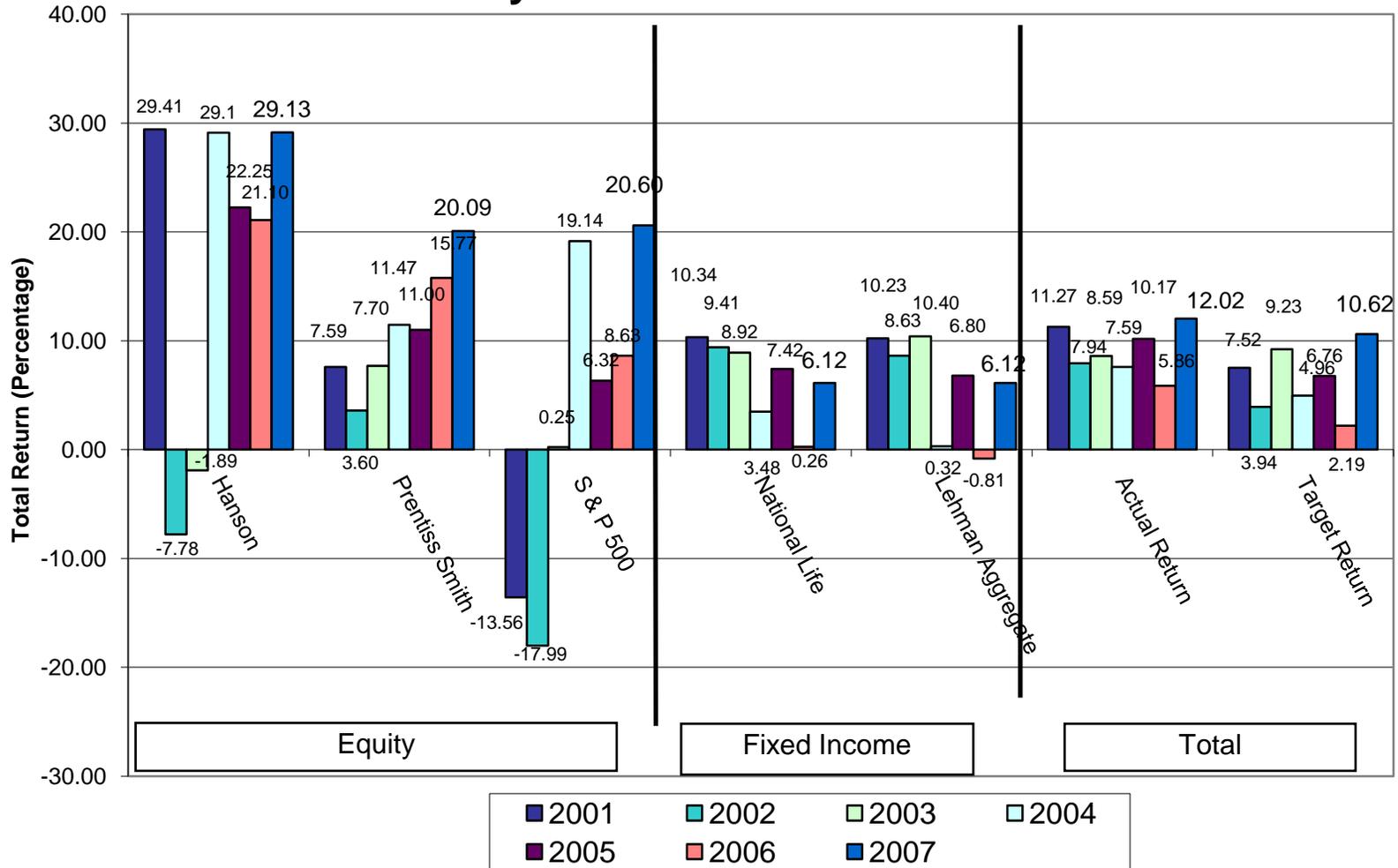


Chart #3  
Common Trust Fund Breakdown as of June 30, 2007



**Chart #4**  
**Higher Education Trust Fund**  
**Total Return by Asset Class Fiscal Years 2001- 2007**



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

**Chart #5**  
**Higher Education Trust Fund**  
**Asset Growth, 6/30/2000 to 6/30/2007**  
**(Includes Distributions)**

