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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:** September 5, 2008

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I am pleased to present the State Treasurer's ninth annual report on the Higher Education Trust Fund. This fund was established in the Office of the State Treasurer by the 1999 General Assembly to provide non-loan financial aid to Vermont students attending the University of Vermont, the Vermont State Colleges, and other Vermont post-secondary institutions (16 V.S.A. § 2885). Total principal contributions through June 30, 2008 have been \$15,879, 896 - \$6,000,000 appropriated in FY 2001, \$1,000,000 in FY 2002, \$635,881 in FY 2003, \$2,363,357 in FY 2006, \$5,823,449 in FY 2007, and \$57,209 in FY 2008.

The statute provides that in August of each year, the State Treasurer is to 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 2008, the Higher Education Trust Fund dollar weighted investment return was 3.10% gross of fees. This return compares to the Lehman Aggregate Bond Index return of 7.12% and to the S&P 500 Stock Index return of -13.13% for the same period, and exceeds the Fund's target rate (based on actual asset allocation and index returns) of 1.14%. The 5% distribution available this year is \$777,647.69 in total, or \$259,215.90 each for UVM, VSC, and VSAC; the distribution made following Fiscal Year 2007 was \$206,860.67 for each institution. (See Appendix A for quarterly market values and distributions for fiscal year 2008.)

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 \$248,232.81, or \$124,116.40 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 \$248,232.80, 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 \$777,647.69 and \$248,232.80, the balance in the fund at the beginning of fiscal year 2008 totals \$16,948,480.36.

All principal contributions through June 30, 2008 total \$15,879,895.69 (see Chart #1). This represents the current minimum balance that must be maintained in the fund. The 2% distribution proposed for this year of \$311,059.08 would leave a balance of \$16,637,421.28 excluding contributions to be received, 5% distribution following FY 2009, and any gains from investment activity in Fiscal Year 2009. If the committee authorizes this distribution, each institution's share will be \$155,529.54 with a required match to be raised by each entity in Fiscal Year 2009 of \$311,059.08. 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 2007	\$18,269,599.72
Contributions received FY 2008	<u>57,208.65</u>
Opening balance FY 2008	18,326,808.37
Distribution September 2007	(815,776.66)
Income earned FY 2008	1,537,099.12
Appreciation (Depreciation) FY 2008	(1,001,292.84)
Fees and Other Charges FY 2007	<u>(72,477.14)</u>
Balance June 30, 2008	17,974,360.85
5% of 12-Quarter Moving Average June 30, 2008	(777,647.69)
Distributions: University of Vermont	(259,215.90)
Vermont State Colleges	(259,215.90)
Vermont Student Assistance Corp.	(259,215.90)
2% Income Available for Endowments from FY 2007	<u>(248,232.80)</u>
Balance after distributions	16,948,480.36
Total contributions as of 6/30/2008	15,879,895.69
2% Income Available for Endowments from FY 2008 (requires institutional match in FY 2009)	\$311,059.08

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 \$17,974,360.85 (prior to cash distributions to be made in fiscal year 2009) comprises approximately 30.29%. The Tobacco Trust Fund comprises 58.14% of the account, or \$34,503,352.62, and the remaining 11.57% is

made up of eight small trusts that total \$477,711.92, the ANR Stewardship Fund at \$698,152.73, two Veterans' Home trusts totaling \$1,065,614.30, the Fish and Wildlife Trust Fund at \$1,274,360.88 and a State Employees' retirement benefits trust of \$3,352,123.37. 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 eight years.

As noted in Chart #5, assets increased significantly in FY 2007 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 decreased slightly in FY 2008 as a result of investments returns in FY 2008 being less than distributions made in FY 2008 as well as the small amount of contributions received in FY 2008.

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 provided the majority of the contribution to the Fund's investment performance based on favorable equity market conditions in those years and a combined above benchmark performance by the equity managers. In FY 2008, the Fund achieved a modest investment return in spite of very poor equity market conditions and turmoil in debt capital markets. This was due to the conservative asset allocation in favor of fixed income securities, strong fixed income benchmark performance and a significant outperformance of the fixed income benchmark by the fixed income investment manager. The asset allocation of the Fund at June 30, 2008, comprised 26.8 % equities and 73.2% fixed income securities versus 33.8% equities and 66.2% fixed income securities, respectively, at June 30, 2007.

In Fiscal Year 2008, the Access Capital Strategies Community Investment Fund was added to the Trust Investment Account as a fixed income manager. This fund invests in very high grade housing and other bonds with an amount approximately equal to the initial investment of \$2,500,000 funding principally housing in Vermont. Thus, these assets are meeting goals of preservation of capital and investment return along with providing benefits to Vermonters.

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 mechanism and annual rebalancing will be used again this year to bring this ratio back in balance. This balance addresses joint investment objectives of investment return and capital preservation.

In summary, while the investment performance of the Trust Investment Account once again exceeded its target return, unfavorable equity market conditions created a return below 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 Period Ending June 30, 2008

	Balance 9/30	Balance 12/31	Balance 3/31	Balance 6/30		
<b>Education Trust</b>						
<b>FY2006</b>	\$10,849,205.23	\$10,921,067.11	\$11,272,112.39	\$11,188,699.76		
<b>FY2007</b>	\$16,853,847.32	\$17,407,882.23	\$17,896,475.61	\$18,269,599.72		
<b>FY 2008</b>	\$17,827,605.83	\$18,164,200.03	\$18,010,390.14	\$17,974,360.85		
<b>Twelve Quarter Average</b>	<b>\$15,552,953.85</b>					
<b>5% Distribution 2008</b>	<b>\$777,647.69</b>					
VSAC		\$259,215.90		<u>Contributions</u>		
UVM		\$259,215.90				
VSC		\$259,215.90		2001	\$6,000,000.00	
				2002	\$1,000,000.00	
<b>2% FY2007</b>	<b>\$248,232.81</b>			2003	\$635,881.49	
UVM		\$124,116.40		2004	\$0.00	
VSC		\$124,116.40		2005	\$0.00	
				2006	\$2,363,355.61	
				2007	\$5,823,449.94	
<b>Balance after Distributions</b>	<b>\$16,948,480.35</b>			2008	\$57,208.65	
				Total	<b>\$15,879,895.69</b>	
2% FY2008	\$311,059.08					
UVM		\$155,529.54				
VSC		\$155,529.54				*



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**

<b>MANAGER</b>	Quarter Ended 9/30/2005	Quarter Ended 12/31/2005	Calendar Year 2005	Quarter Ended 3/31/2006	Quarter Ended 6/30/2006	Fiscal Year 2006	Portfolio Market 6/30/2006	Portfolio Percent 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>	3.60%	2.09%	<b>4.91%</b>	4.21%	-1.44%	<b>8.63%</b>		32.5%
<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>	-0.67%	0.59%	<b>2.43%</b>	-0.65%	0.08%	<b>-0.81%</b>		
<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>	0.64%	1.05%	<b>3.27%</b>	0.91%	-0.42%	<b>2.19%</b>		
<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>

Appendix B

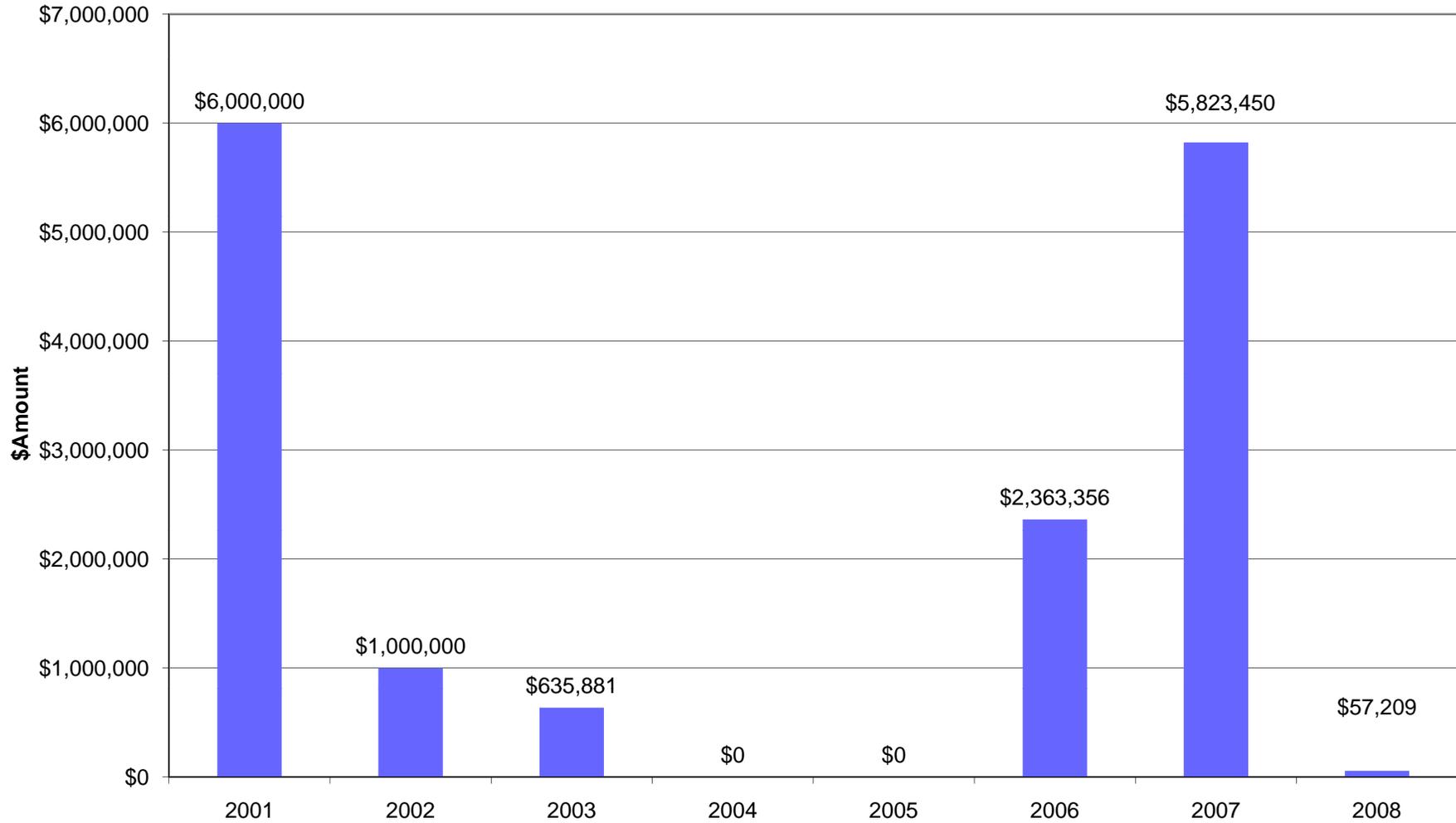
VERMONT COMMON TRUST FUND

TOTAL RETURN ANALYSIS

Performance Prior to FY 2007

MANAGER	Fiscal Year 2001	Calendar Year 2001	Fiscal Year 2002	Calendar Year 2002	Fiscal Year 2003	Calendar Year 2003	Fiscal Year 2004	Calendar Year 2004	Fiscal Year 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	3.12	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

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



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

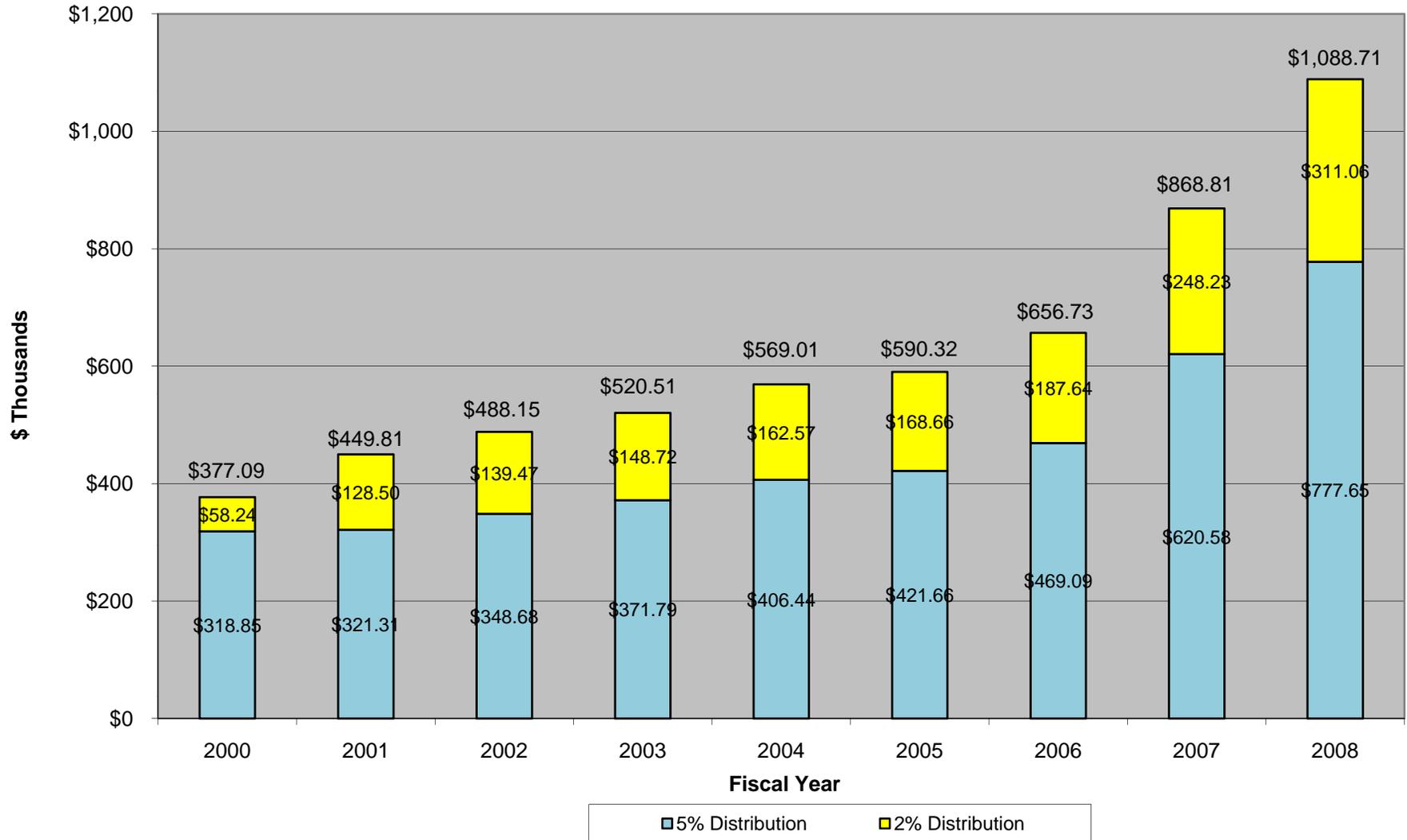
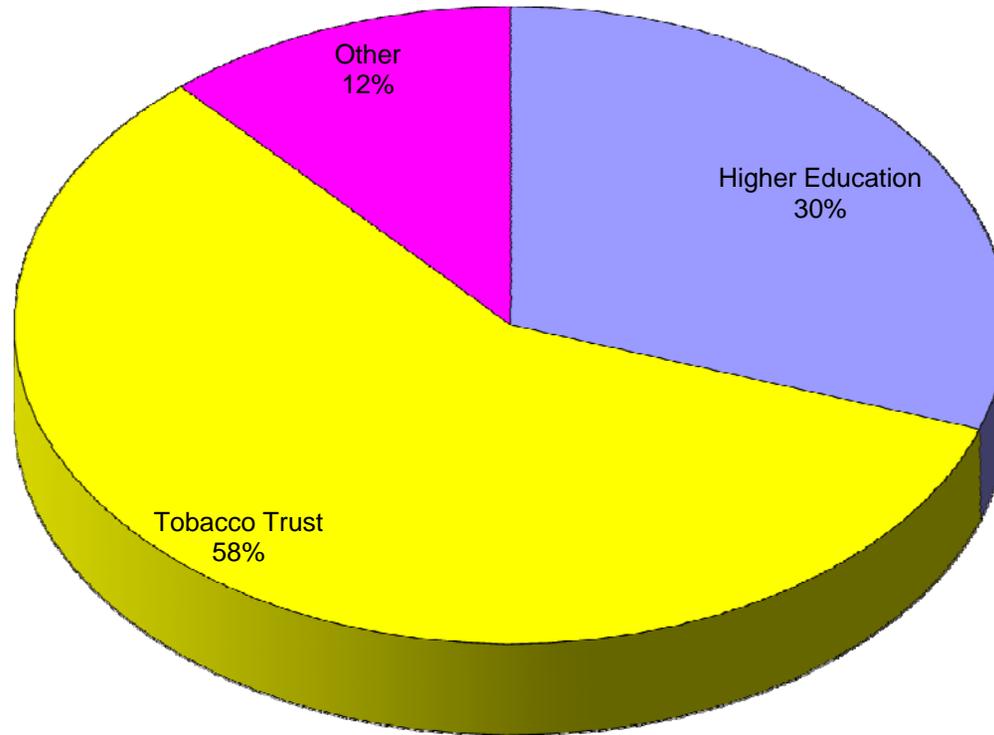


Chart #3  
Common Trust Fund Breakdown as of June 30, 2008





**Chart #5**  
**Higher Education Trust Fund**  
**Asset Growth, 6/30/2000 to 6/30/2008**  
**(Includes Distributions)**

