

JEB SPAULDING
STATE TREASURER



ABANDONED PROPERTY DIVISION
TEL: (802) 828-2407

RETIREMENT DIVISION
TEL: (802) 828-2305
FAX: (802) 828-5182

ACCOUNTING DIVISION
TEL: (802) 828-2301
FAX: (802) 828-2884

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 15, 2009

I am pleased to present the State Treasurer's tenth 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).

During Fiscal Year 2009, the Higher Education Trust Fund dollar weighted investment return was 2.40% gross of fees. This return compares to the Barclays (formerly Lehman) Aggregate Bond Index return of 6.06% and to the S&P 500 Stock Index return of -26.21% for the same period, and exceeds the Fund's target allocation index rate (that is, the rate of return that would have been realized if 30% of the Fund was invested in the S&P 500 Index, and 70% in the Barclays Aggregate) of -1.19%. A detailed discussion of the Fund's performance is included in this report.

5% Distribution from Fiscal Year 2009

The statute provides that in August of each fiscal 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. The amount appropriated, however, cannot exceed an amount that would bring the Fund balance below total contributions to principal (total principal contributions through June 30, 2009 have been \$15,879,896; see Chart #1 for a detail of appropriation amounts by fiscal year).

The 5% distribution available this year is \$872,676.09 in total, or \$290,892.03 each for UVM, VSC, and VSAC. This amount represents a 12.2% increase over the distribution made following Fiscal Year 2008 of \$259,215.90 for each institution (see Appendix A for quarterly market values and distributions for Fiscal Year 2009).

2% Distribution from Fiscal Year 2008

16 V.S.A. § 2885 further provides that during the first quarter of each fiscal 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. Similar to the 5% distribution, the amount appropriated cannot exceed an amount that would bring the Fund balance below total contributions to principal. Further, each institution is required to match the appropriation by raising private donations of at least twice the appropriated amount, 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.

At its meeting last year, the Commission authorized this 2% appropriation in the amount of \$311,059.08, or \$155,529.54 each for distribution to UVM and the Vermont State Colleges, dependent upon a finding by the Commission that the terms of this appropriation have been met. Each of these institutions is in the process of establishing the required certification. However, owing to the Fund’s relatively small positive return in FY 2009, the Fund can only distribute \$298,227.18, or \$149,113.59 (approximately 96% of the authorized amount) each to UVM and the Vermont State Colleges, and still maintain the statutorily-required \$15,879,896 balance equal to contributed principal.

After payments of \$872,676.09 and \$298,227.18, the balance in the Fund at the end of FY 2009 totals \$15,879,896. An accounting of the Fund balances is provided below:

Ending balance FY 2008	\$17,917,152.20
Contributions received FY 2009	<u>0.00</u>
Opening balance FY 2009	17,917,152.20
Distribution September 2008	(968,671.55)
Income earned FY 2009	762,760.48
Appreciation (Depreciation) FY 2009	(594,047.48)
Fees and Other Charges FY 2009	<u>(66,394.70)</u>
Balance June 30, 2009	17,050,798.96
5% of 12-Quarter Moving Average as of June 30, 2009	(872,676.09)
Distributions: University of Vermont	(290,892.03)
Vermont State Colleges	(290,892.03)
Vermont Student Assistance Corp.	(290,892.03)
2% Income Available for Endowments from FY 2008	<u>(298,227.18)</u>
Balance after distributions	15,879,895.69

Total contributions as of June 30, 2009 15,879,895.69

2% Income Available for Endowments from FY 2009 \$349,070.43
(requires institutional match in FY 2010)

2% Distribution for Fiscal Year 2009

All principal contributions to the Fund through June 30, 2009 total \$15,879,895.69, which also represents the minimum balance that must be maintained in the Fund (this amount does not include a total of \$1,573,457 of contributions received on June 30, 2009, which will be applied to the starting principal balance for FY 2010). The 2% distribution proposed for this year of \$349,070.43 would leave a balance of \$15,530,825.26 excluding contributions to be received, and the 5% distribution following FY 2010, and any gains from investment activity in FY 2010. If the Commission authorizes this distribution, each institution's share will be \$174,535.22 with a required match to be raised by each entity in FY 2010 of \$349,070.43. The attached Chart #2 provides a graphical depiction of authorized distributions, including this 2% distribution subject to Commission approval.

Fund Balances, Performance, and Additional Information

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 \$17,050,798.96 (prior to cash distributions to be made in FY 2010) comprises approximately 29%. The Tobacco Trust Fund comprises 57% of the account, or \$33,863,923, and the remaining 14% is made up of eight small trusts that total \$462,038.46, the ANR Stewardship Fund at \$703,195.88, two Veterans' Home trusts totaling \$1,031,509, the Fish and Wildlife Trust Fund at \$1,283,566 and a State Employees' retirement benefits trust of \$4,801,431. Chart #3 displays the relative share of the Higher Education Trust Fund compared to the entire Fund, and chart #4 identifies the major asset classes in the portfolio and their performance over the past nine 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. Finally, in FY 2009, assets decreased more significantly owing to larger distributions coupled with virtually flat overall portfolio returns.

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 FY 2006 and FY 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 both FY 2008 and FY 2009, the Fund achieved a modest positive investment return in spite of the worst financial market conditions since the Great Depression. This was due to the

conservative asset allocation in favor of fixed income securities, significant outperformance of the Barclay's Aggregate fixed income benchmark by both fixed income investment managers, and significant outperformance of the S&P 500 Index benchmark by one of the equity managers, Prentiss Smith & Co. The other equity manager, Hanson Investment Management, slightly underperformed the benchmark in 2009, but has otherwise substantially and consistently outperformed the benchmark historically.

In FY 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. For FY 2009, Access Capital returned 8.72% gross of fees, or 266 basis points (2.66%) in excess of its benchmark, and also returned very similar overall performance to NL Capital Management, the other fixed-income manager. Thus, the assets invested with Access Capital are meeting goals of preservation of capital and investment return along with providing benefits to Vermonters.

The asset allocation of the Fund at June 30, 2009, comprised 30.6 % equities and 69.4% fixed income securities, versus 26.8% equities and 73.2% fixed income securities, respectively, on June 30, 2008. Currently, allocations of contributions and sources of distributions in the Trust Investment Account are used to target a 30%-to-70% ratio in favor of fixed income securities. Given that the current allocation is very close to the target, subsequent contributions and minor annual rebalancing will be sufficient to "tune" this ratio to a more precise balance. This asset allocation addresses joint investment objectives of investment return and capital preservation, and has provided an overall positive return despite almost unprecedentedly poor market conditions.

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, and especially in the coming Fiscal Year, distributions will depend on the ongoing performance of the Fund, will require continued monitoring of the Fund's investment performance, and may warrant ongoing consideration of the optimal asset allocation given the recent and substantial changes to the investment marketplace.

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, 2009

	Balance 9/30	Balance 12/31	Balance 3/31	Balance 6/30	
Education Trust					
FY2007	\$16,853,847.32	\$17,407,882.23	\$17,896,475.61	\$18,269,599.72	
FY 2008	\$17,827,605.83	\$18,164,200.03	\$18,010,390.14	\$17,974,360.85	
FY2009	\$16,966,384.87	\$16,320,715.01	\$16,700,000.00	\$17,050,798.96	
Twelve Quarter Average	\$17,453,521.71				
5% Distribution 2009	\$872,676.09				
VSAC		\$290,892.03		<u>Contributions</u>	
UVM		\$290,892.03			
VSC		\$290,892.03		2001	\$6,000,000.00
				2002	\$1,000,000.00
2% FY2008 (Projected)	\$311,059.08			2003	\$635,881.49
UVM		\$155,529.54		2004	\$0.00
VSC		\$155,529.54		2005	\$0.00
				2006	\$2,363,355.61
2% FY2008 (Actual)	\$298,227.18			2007	\$5,823,449.94
UVM		\$149,113.59		2008	\$57,208.65
VSC		\$149,113.59		2009	\$0.00
				Total*	\$15,879,895.69
Balance after Distributions	\$15,879,895.69				
2% FY2009	\$349,070.43				
UVM		\$174,535.22			
VSC		\$174,535.22			
* Does not include \$1,573,457 of contributions received on June 30, 2009.					

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

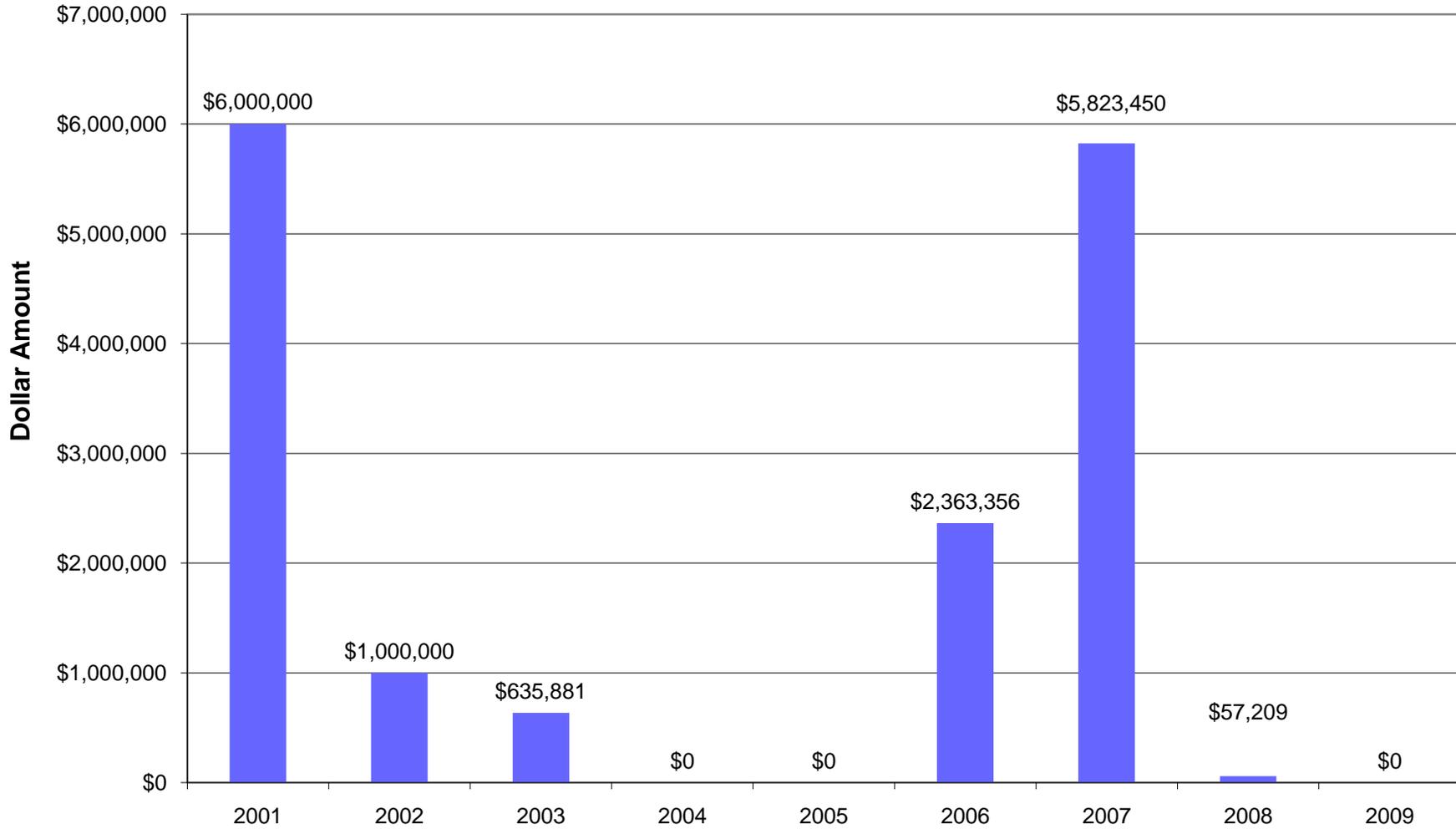
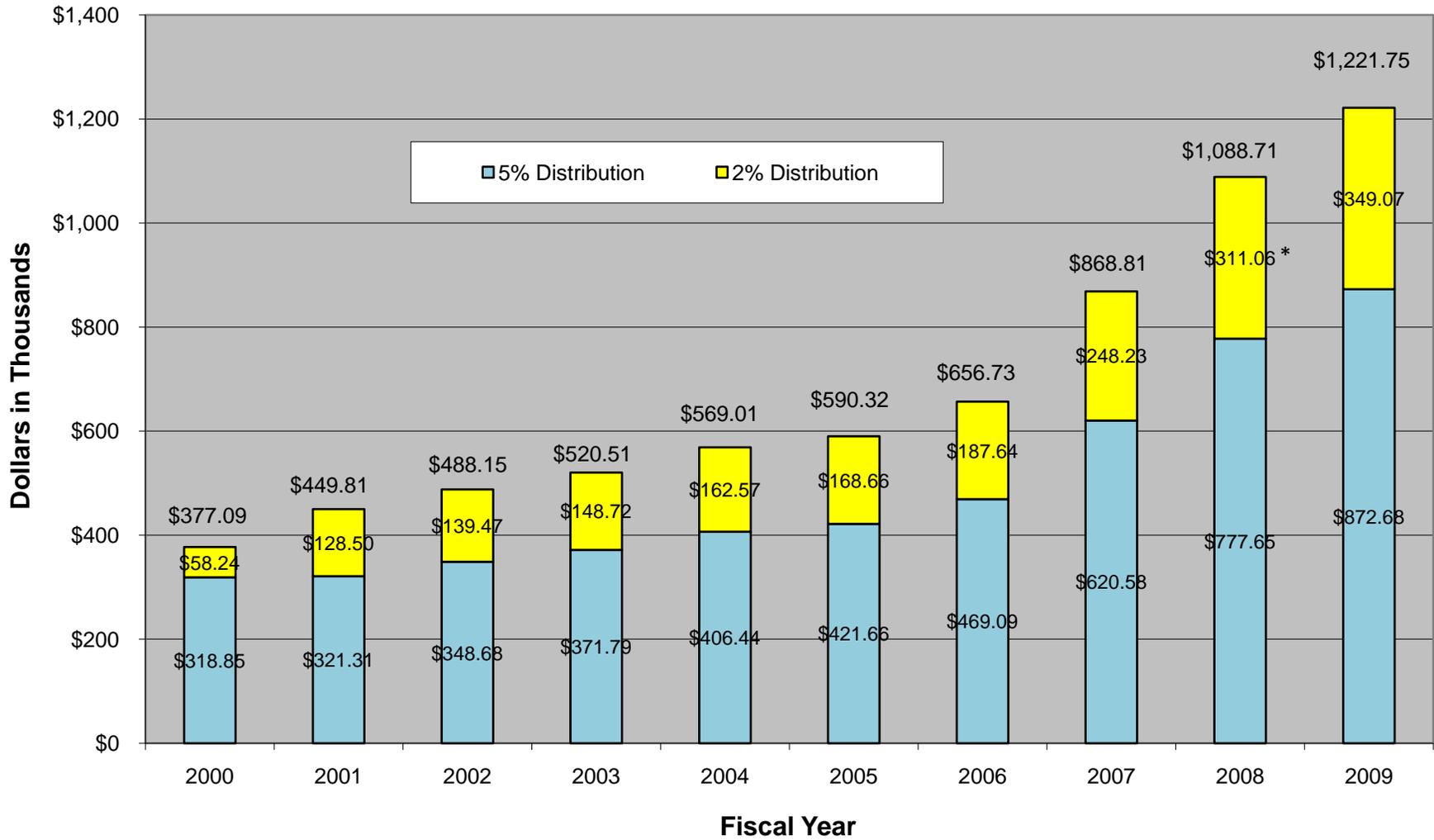


Chart #2
Higher Education Trust Fund
Authorized Distributions by Year and Type



* Actual 2% distribution for 2008 was \$298,227.18.

Chart #3
Common Trust Fund Breakdown as of June 30, 2009

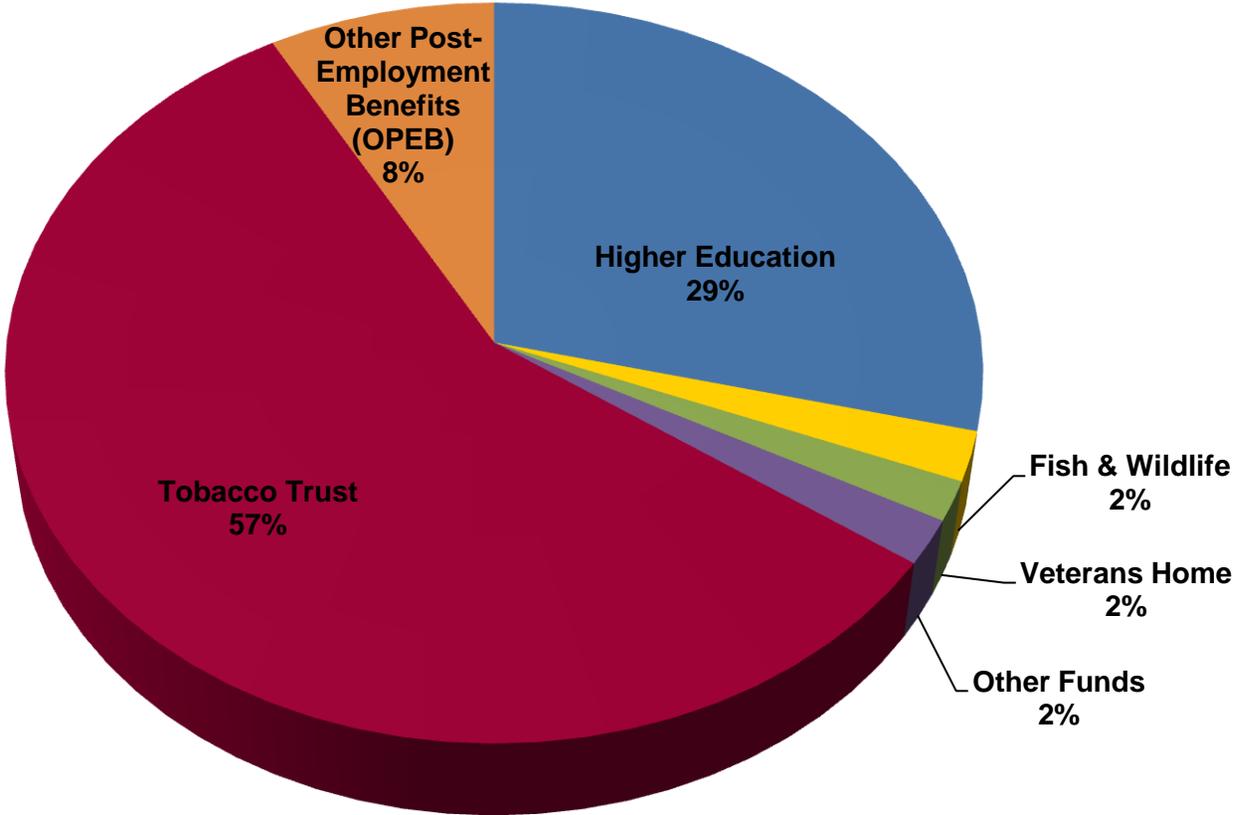


Chart #5
Higher Education Trust Fund
Asset Growth, 6/30/2000 to 6/30/2009
(Includes Distributions)

