



NEBRASKA INVESTMENT COUNCIL

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September 30, 2014

Patrick J. O'Donnell
Clerk of the Legislature
2018 State Capitol
Lincoln, NE 68509

Re: Sustainability of Health Care Transfer

Dear Mr. O'Donnell,

Revised Neb. Statute Sec. §71-7611 states in part: "The state investment officer shall report to the Legislature on or before October 1 of every even-numbered year on the sustainability of such transfers." To fulfill this requirement, attached to this letter is a projection for the Health Care Endowment Fund (Fund) for the next ten years prepared by the Council's investment consultant. In addition, the Appendix provides a projection of the Net Distribution amounts through 2035 if the legislated annual distribution amount (transfer) is maintained at the current level of \$60.1 million.

At the current pace of spending the projections suggest that there is a high probability that the Fund transfers are not sustainable indefinitely. The Fund earning cannot keep pace because a significant portion of the earnings are being used to cover a growing negative distribution amount and not reinvested. The Appendix shows that legislated distributions (transfers) at the current level exceed contributions by \$18.0 million in 2015 and by 2035 the shortfall rises to \$25.7 million. In FY 2015 the projected amount available for reinvestment is \$5.5 million. In FY 2024 the dollar amount available for reinvest is projected to be only \$3.5 million. 100% of the annual tobacco settlement distribution is being used to fund the annual transfer.

There also is a high probability that the corpus of the Fund will decline in the next ten years and beyond. As the tobacco settlement distributions decline the time will come when it will be necessary to distribute not only the earnings but also the corpus of the Tobacco Settlement Trust Fund to make the transfers. The Medicaid Intergovernmental Trust which no longer receives contributions is already being depleted because the annual transfer exceeds the investment return.

The projections show that at the 50th percentile of forecast investment outcomes, **the Fund balances are expected to decline by \$30 million.** There is at least a 50% probability that the Fund balances will decline even more over the next 10 years. **There is no possibility that the \$60.1 million annual transfer can be increased to offset inflation to maintain its purchasing power.**

The current asset allocation is 75% equity/25% fixed income. This is an aggressive asset allocation intended to grow the corpus of the Fund through reinvesting earning to make it sustainable and provide growth. It would not be prudent to take on more investment risk in hopes of growing the Funds faster.

It is critical to note that the projected contributions are subject to political and economic changes. Accordingly, the projected contributions may change over this time period. **Transfers are sustainable in each of the next ten years by only by utilizing most of the investment income and at the expense of maintaining the longer term viability of the Fund.**

Sincerely,



Jeffrey W. States
State Investment Officer

Attachment: Health Care Endowment Update

Cc: Governor Heineman
Gerry Oligmueller, Director, DAS Budget Division
Senator Campbell, Chair, Health and Human Services

Health Care Endowment Update

Updated September 2014

Information for the Nebraska Investment Council

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Health Care Endowment Summary

- The Health Care Endowment includes two funds grouped together with a similar spending policy and asset allocation:
 - Nebraska Medicaid Intergovernmental Trust
 - Nebraska Tobacco Settlement Trust
- The investment goals of the Endowment are two part:
 - 1) provide funds for current spending needs
 - 2) increase the portfolio to support future needs
- Contributions from the Tobacco Settlement Trust are invested in a high-quality, short-term fixed income portfolio managed internally before distribution
- NIC determines asset allocation only, currently positioned somewhat aggressively at 75% equity/25% fixed income
- Spending policy is determined by legislation; historically a fixed dollar amount:

2014	\$59.5 million	2010	\$56.1 million
2013	\$57.0 million	2009	\$53.6 million
2012	\$56.3 million	2008	\$56.4 million
2011	\$59.1 million	2007	\$55.0 million

Health Care Endowment Modeling

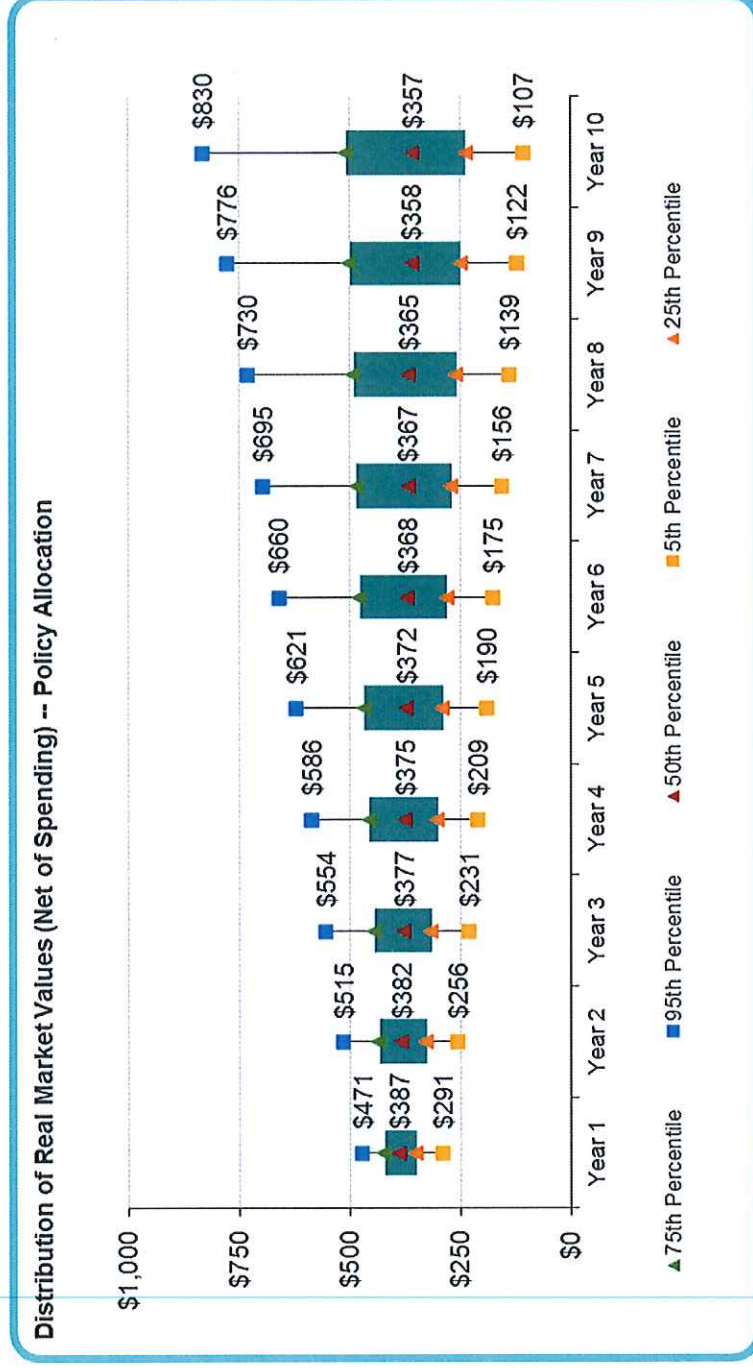
- Projections are updated to include:
 - Expected annual contributions and distributions through 2035 (see appendix)
 - Asset allocation: 75% equity/25% fixed income
 - Market value as of June 30, 2014
 - Hewitt EnnisKnupp 3Q14 Capital Markets Assumptions

Health Care Endowment

	Policy Allocation
Real Estate	5.0%
Private Equity	5.0%
Fixed Income	25.0%
U.S. Equity	40.0%
Non-U.S. Equity	15.0%
Global Equity	10.0
Total Health Care Endowment	100.0%

	Market Value (as of 6/30/2014)
Medicaid Intergovernmental	\$89,586,450
Tobacco Settlements	\$358,659,247
Total Health Care Endowment	\$448,245,697

Health Care Endowment – Distribution of Real Market Values: Expected Net Distributions at Policy Allocation (\$s in Millions)



- Portfolio corpus will likely decline slightly in real terms over the next 10 years (at 50th percentile result)
- Upside potential for portfolio growth

Appendix: Expected Distributions

	Estimated Contribution	Estimated Distribution	Net Distribution
2015	\$42,060,767	\$60,100,000	(\$18,039,233)
2016	\$41,660,983	\$60,100,000	(\$18,439,017)
2017	\$41,267,813	\$60,100,000	(\$18,832,187)
2018	\$39,775,762	\$60,100,000	(\$20,324,238)
2019	\$39,406,072	\$60,100,000	(\$20,693,928)
2020	\$39,042,798	\$60,100,000	(\$21,057,202)
2021	\$38,865,934	\$60,100,000	(\$21,234,066)
2022	\$38,335,479	\$60,100,000	(\$21,764,521)
2023	\$37,991,434	\$60,100,000	(\$22,108,566)
2024	\$37,653,802	\$60,100,000	(\$22,446,198)
2025	\$37,322,587	\$60,100,000	(\$22,777,413)
2026	\$36,997,796	\$60,100,000	(\$23,102,204)
2027	\$36,679,441	\$60,100,000	(\$23,420,559)
2028	\$36,367,531	\$60,100,000	(\$23,732,469)
2029	\$36,062,081	\$60,100,000	(\$24,037,919)
2030	\$35,763,109	\$60,100,000	(\$24,336,891)
2031	\$35,470,633	\$60,100,000	(\$24,629,367)
2032	\$35,184,675	\$60,100,000	(\$24,915,325)
2033	\$34,905,259	\$60,100,000	(\$25,194,741)
2034	\$34,632,413	\$60,100,000	(\$25,467,587)
2035	\$34,366,164	\$60,100,000	(\$25,733,836)