

NEBRASKA INVESTMENT COUNCIL

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It is the mission of the Nebraska Investment Council to prudently manage the funds entrusted to us by the people of the State of Nebraska. We deliver investment management services to provide direct financial benefit exclusively to the owners of these funds. We are committed to thorough, sound, and informed analysis in order to achieve superior returns while maintaining prudent levels of risk.

TO: Patrick J. O'Donnell, Clerk of the Legislature
FROM: Michael W. Walden-Newman, State Investment Officer
DATE: September 15, 2016

SUBJ: NEB. REV. STAT. §71-7611 SUSTAINABILITY OF HEALTH CARE TRANSFER

Neb. Rev. Stat. §71-7611 creates the Nebraska Health Care Cash Fund. The law requires annual transfers into the fund of \$60,350,000 on or before July 15 of 2014-2018, and \$60.1 million every year thereafter from the Nebraska Medicaid Intergovernmental Trust Fund and the Nebraska Tobacco Settlement Trust Fund. The law also requires the state investment officer to advise the State Treasurer, in consultation with the Nebraska Investment Council, on the amounts to be transferred to sustain such transfers in perpetuity; and to report to the Legislature on or before October 1 in even-numbered years on the sustainability of the transfers.

The Nebraska Investment Council, through the state investment officer, has for years expressed its concern that these transfers are not sustainable into perpetuity. Specifically, our analysis this year shows that the distribution should not exceed \$54 million, or about \$6 million less than current statutory requirement. This conclusion is based on projected deposits into the trusts and projected investment returns.

This is my first report since my appointment as state investment officer in December 2014. I do echo prior Council concerns:

- Tobacco Settlement payments to Nebraska are presumed to decline over time.
- Earnings are not reinvested.
- Investment returns are likely to be in the 6 percent range for the endowment funds, just under 4 percent after inflation. So, spending should be under 4 percent of the fund's value to preserve the purchasing power of the corpus.
- Investments are already aggressively allocated 75 percent equity and 25 percent fixed income. The portfolio should not take on additional equity risk to seek increased returns.
- Statutory spending must be reduced.

But please accept this year these two concrete recommendations in addition to our continued warnings:

- As indicated above, the Legislature should reduce the statutory distributions of the transfer outlined in Neb. Rev. Stat. §71-7611 to no more than \$54 million, and to consider a reduction to \$50 million annually to be on the safe side.
- Furthermore, the Legislature should conduct its own study of sustainable Health Care Fund transfers before the 2017 session so that it can incorporate potential changes into the State's fiscal profile and FY 2017-2019 budget. We are happy to provide data as needed.

cc: Senator Campbell, Chair, Health and Human Services Committee
Senator Heath Mello, Chair, Appropriations Committee
Liz Hruska and Kathy Tenipor, Legislative Fiscal Office

Governor Ricketts
Gerry Oligmueller, Director, Budget Division