

TO: Patrick J. O'Donnell, Clerk of the Legislature
FROM: Michael W. Walden-Newman, State Investment Officer
DATE: August 26, 2022



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

Neb. Rev. Stat. §71-7611 creates the Nebraska Health Care Cash Fund. The Nebraska Investment Council manages the Fund investments. The law requires specified annual transfers into the fund from the Nebraska Tobacco Settlement Trust Fund. The law also requires the state investment officer to report to the Legislature on or before October 1 in even-numbered years on the sustainability of the transfers.

The Council's investment consultant Aon prepared the attached "Health Care Endowment Sustainability" report.

Key Findings

The Health Care Endowment has a very good chance of meeting its investment goals to:

- Provide funds for current spending needs, and
- Increase the size of the portfolio to support future needs.

This year's forecasts are much healthier than past versions of this biennial analysis. What has changed?

- Forecasted future distributions/spending have declined by \$11.4 per year from \$62.4 million to \$51 million.
- Forecasted Tobacco Master Settlement Agreement payments have increased by approximately \$7 million per annum.
- Forecasted returns have increased by approximately 70 bps per year on an inflation-adjusted basis, which translates to an extra \$3.7 million in earnings per year under the median case, based on current endowment market value.

cc: Senator John Stinner, Chair, Appropriations Committee
Governor Pete Ricketts
Liz Hruska and Bill Biven, Legislative Fiscal Office
Lee Will, State Budget Division Administrator



Health Care Endowment Sustainability

Nebraska Investment Council
August 2022

Investment advice and consulting services provided by Aon Investments USA Inc.



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Health Care Endowment Sustainability Analysis – Key Findings

The forecasts shown on the following slides suggest the Health Care Endowment has a very good chance of meeting its investment goals, which are:

- 1) Provide funds for current spending needs
- 2) Increase the size of the portfolio to support future needs

This year's forecasts are much healthier than the version of this analysis that was presented in 2020

- What has changed?

Forecasted future distributions (spending) have declined by \$11.4 per annum (\$62.4 million → \$51 million)

Forecasted MSA payments have increased by approximately \$7 million per annum

Forecasted returns have increased by approximately 70 bps per annum on a real (after inflation) basis, which translates to an extra \$3.7 million in earnings per year under the median case, based on current endowment market value

Overview of Health Care Endowment

- The Health Care Endowment (Nebraska Tobacco Settlement Trust) had a market value of \$534.1 million as of June 30, 2022
- The investment goals of the Endowment are twofold:
 - 1) Provide funds for current spending needs
 - 2) Increase the size of the portfolio to support future needs
- NIC determines asset allocation policy only (i.e., not distribution policy)
- Spending policy is determined by legislation; historically a fixed dollar amount rather than a % of assets:

2007	\$52.0 million	2015	\$60.3 million
2008	\$55.0 million	2016	\$60.4 million
2009	\$56.4 million	2017	\$60.4 million
2010	\$53.6 million	2018	\$61.2 million
2011	\$56.1 million	2019	\$61.6 million
2012	\$59.1 million	2020	\$62.0 million
2013	\$56.3 million	2021	\$61.5 million
2014	\$56.1 million	2022	\$49.3 million

Overview of Health Care Endowment (Cont'd)

- Tobacco Master Settlement Agreement (MSA) payments received by the State of Nebraska each year are contributed in to the endowment
- Forecasts for Tobacco MSA payments exist through 2035, though it should be noted that there is a great deal of uncertainty in projecting these payments
 - Additional detail on Tobacco MSA payment projections can be found in the Appendix of this document
- NIC determines asset allocation policy; the endowment targets 75% return-seeking assets / 25% risk-reducing assets

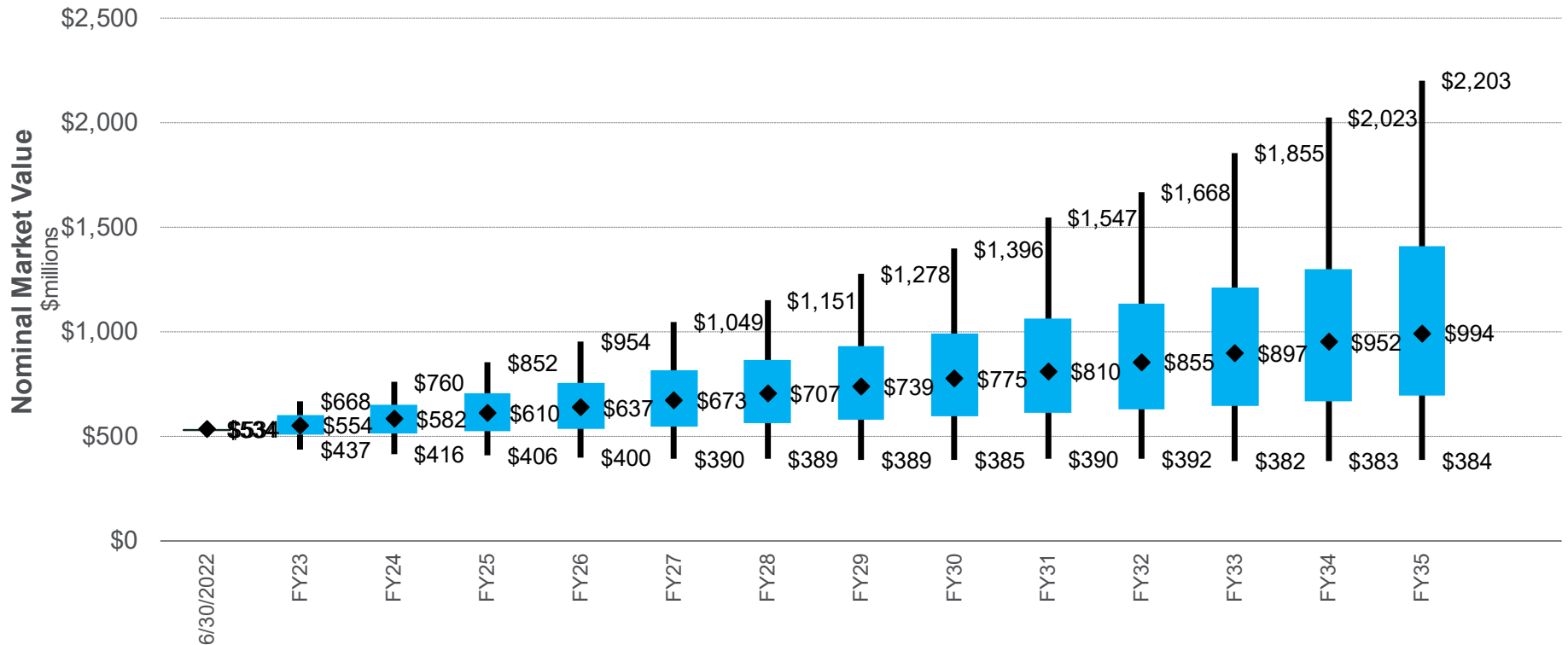
	Policy Allocation
U.S. Equity	30.5%
Non-U.S. Equity	13.0%
Global Equity	21.5%
Real Estate	5.0%
Private Equity	5.0%
Fixed Income	25.0%
Total Health Care Endowment	100.0%
Projected Returns*	7.0%
Projected Volatility*	12.7%

*Based on Aon CMAs

Overview of Health Care Endowment (Cont'd)

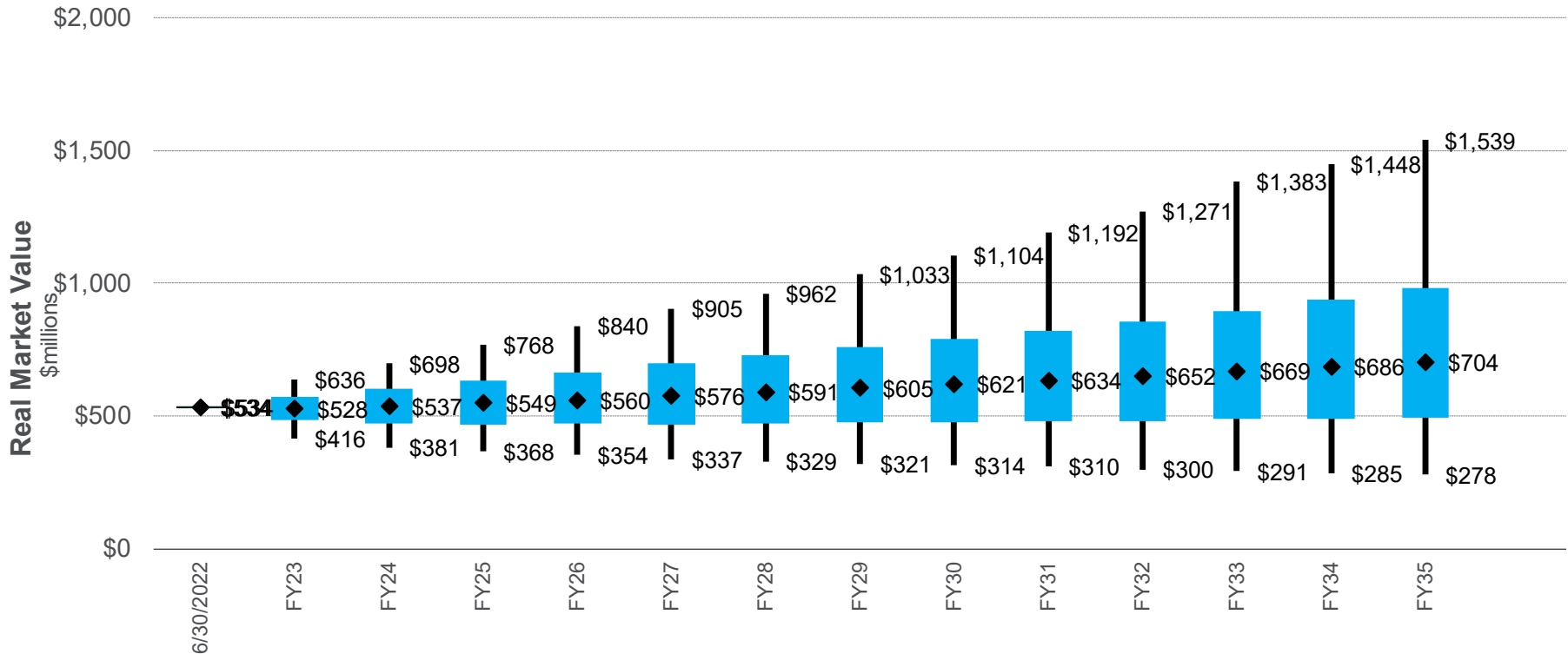
- The following two slides provide our forecasted market values for the Health Care Endowment through 2035
 - I.e., as far out as we have forecasted values for Tobacco MSA payments
- We provide forecasts on both a nominal and real (i.e., net of the impact inflation) basis
- Ideally, real market value would remain stable (or increase) under the median scenario
 - This would imply that the Health Care endowment could continue to provide the same level of funding (at least) to the various programs it supports in the future as it does today

Health Care Endowment – Future Market Value Forecast (Nominal)

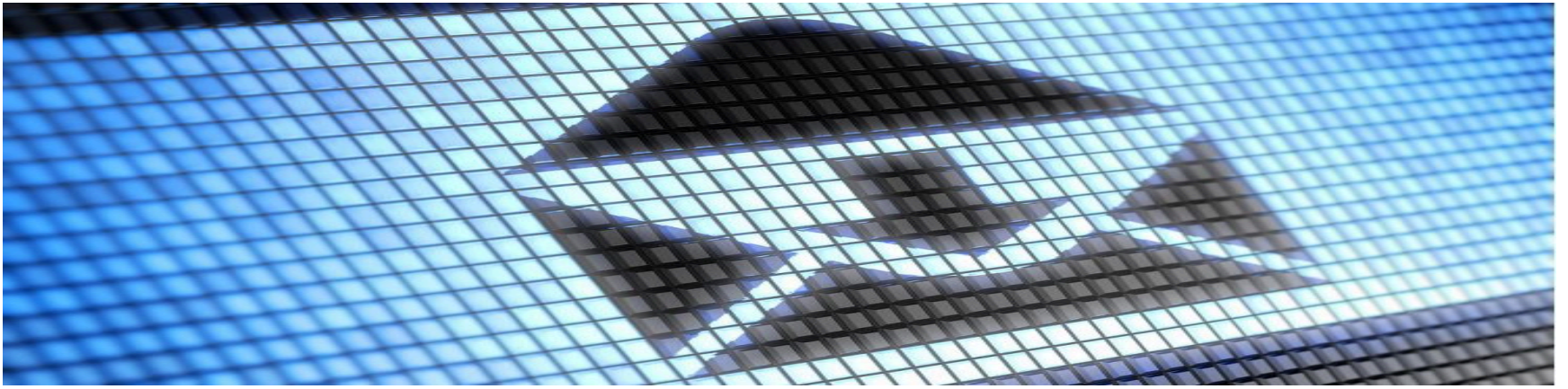


- As shown above, median forecasted market values increase over the next 13 years
 - Increases to median market value accelerate as the forecast progresses

Health Care Endowment – Future Market Value Forecast (Real)



- The exhibit above recreates the analysis on the previous slide on a “real” (i.e., net of inflation) basis
- As shown, forecasted median real market values increase over the next 13 years



Appendices

Appendix I: Health Care Endowment Cash Flow Forecasts

Year	Estimated Contributions	Estimated Distribution	Net Distributions
FY 2023	\$39,839,782	\$60,826,974	-\$20,987,192
FY 2024	\$39,485,231	\$51,000,000	-\$11,514,769
FY 2025	\$39,137,402	\$51,000,000	-\$11,862,598
FY 2026	\$38,796,300	\$51,000,000	-\$12,203,700
FY 2027	\$38,461,935	\$51,000,000	-\$12,538,065
FY 2028	\$38,134,319	\$51,000,000	-\$12,865,681
FY 2029	\$37,813,469	\$51,000,000	-\$13,186,531
FY 2030	\$37,499,399	\$51,000,000	-\$13,500,601
FY 2031	\$37,192,129	\$51,000,000	-\$13,807,871
FY 2032	\$36,891,684	\$51,000,000	-\$14,108,316
FY 2033	\$36,598,085	\$51,000,000	-\$14,401,915
FY 2034	\$36,311,363	\$51,000,000	-\$14,688,637
FY 2035	\$36,031,547	\$51,000,000	-\$14,968,453

Appendix II: Additional Detail on Tobacco MSA Payment Projections*

- The table below represents the most recent estimates of Tobacco Master Settlement Agreement (MSA) payments to be received by the State of Nebraska.

Nebraska MSA Payment Projections

3% Infl. Adj.

4% Vol. Adj.

Fiscal Year	Total Est. Annual MSA Payments (excl. adjustments)
2023	39,839,782
2024	39,485,231
2025	39,137,402
2026	38,796,300
2027	38,461,935
2028	38,134,319
2029	37,813,469
2030	37,499,399
2031	37,192,129
2032	36,891,684
2033	36,598,085
2034	36,311,363
2035	36,031,547

*Source: Nebraska Department of Administrative Services -- State Budget Division

Appendix II: Additional Detail on Tobacco MSA Payment Projections* (Cont'd)

- It should be noted that there is a great deal of uncertainty in projecting Tobacco Master Settlement Agreement payments. The Non-Participating Manufacturer (NPM) adjustment, disputed amounts, and credits allowed to participating manufacturers are very difficult to estimate as little if any certainty is known in advance about the factors that led to these adjustments
- One cautionary note—if at any point Nebraska is found to have not diligently enforced the NPM escrow provisions of the MSA, it could result in a complete loss of the MSA payment for Nebraska (though that is a worst-case scenario).

*Source: Nebraska Department of Administrative Services -- State Budget Division

Appendix II: Additional Detail on Tobacco MSA Payment Projections* (Cont'd)

NOTES:

A. While the Master Settlement Agreement provides that the payments will continue in perpetuity, only the next 13 years through 2035 are shown in this analysis.

B. The payment projections make certain assumptions about cigarette consumption and the rate of inflation. If the rate of increase in the CPI-U is higher than the assumption, the actual payments could be higher. Likewise, if cigarette consumption varies from the assumption, the payments could be higher or lower. And, if more consumption shifts from Participating Manufacturers to Non-Participating Manufacturers, the payments could be lower.

C. The projections ignore the possibility of default by any Participating Manufacturer. If experience is any indication of the future, some of the Participating Manufacturers, especially the smaller ones, are likely to fail to pay, go out of business, and/or file bankruptcy. The projections also ignore back payments and interest, but such amounts tend to be quite marginal relative to the total. Finally, the projections do not include any assumptions regarding future distributions from the dispute account.

D. The annual estimates in both scenarios are based on the following assumptions:

1. Annual Inflation Adjustment of 3.0% (the minimum adjustment pursuant to the MSA)
 - a) For example, actual CPI-U growth for calendar year 2021 was 7.036%. The ten-year average CPI-U increase through 2020 was 1.743%. An increase less than 3% results in application of the 3% minimum.
2. Annual Volume Adjustment of 4.0% (Source: NAAG)
 - a) The actual volume adjustment to be applied for any one year is not typically known until March or April of that year. The volume adjustment over the last fifteen years has averaged 4.459%.