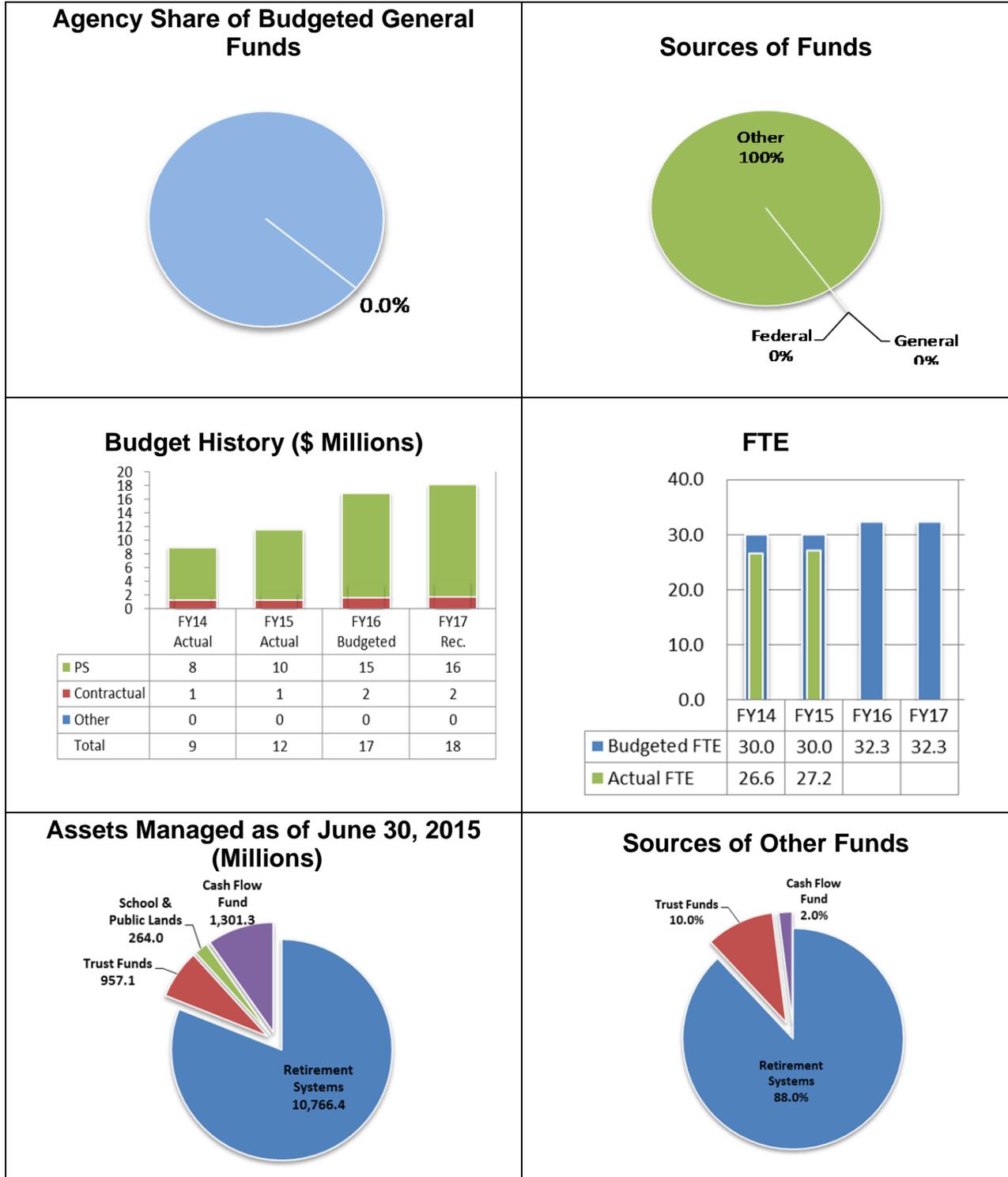


FY17 Budget Briefing

State Investment Council

Information contained in this document is based on the Governor's original FY17 recommended budget.
This document may not correspond with the final FY17 budget adopted by the Legislature.



Key Personnel

- Matthew L. Clark, State Investment Officer
- Christopher L. Nelson, Assistant Investment Officer
- Laurie A. Riss, Business Manager
- Brett D. Fligge, Assistant Investment Officer
- Tammy V. Otten, Assistant Investment Officer

Investment of State Funds

To manage the South Dakota Retirement System assets in order to obtain long-term maximum total returns consistent with prudent risk; to manage the state's cash flow fund in order to obtain long-term maximum total returns consistent with the liquidity needs of the fund, the legal list and prudent risk; to manage the investment portfolios of the School and Public Lands Fund, the Dakota Cement Trust, the Health Care Trust and the Education Enhancement Trust to obtain the highest risk adjusted return over the long term and to provide income payouts; to determine investment options for the 457 deferred compensation savings plan; and to establish and oversee the Higher Education Savings Plan.

	Actual FY2014	Actual FY2015	Budgeted FY2016	Agency Request FY2017	Gov Rec FY2017	Gov Rec Inc/Dec FY2017	% Change From FY2016
Personal Services							
Employee Salaries	3,718,524	4,048,774	5,075,231	5,233,544	5,233,544	158,313	3.1%
Employee Benefits	803,609	814,552	955,550	985,055	985,055	29,505	3.1%
FTE	26.6	27.2	32.3	32.3	32.3	0.0	0.0%
Funding Types							
General	0	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0	0.0%
Other	4,522,133	4,863,327	6,030,781	6,218,599	6,218,599	187,818	3.1%
Total PS	4,522,133	4,863,327	6,030,781	6,218,599	6,218,599	187,818	3.1%
Operating Expenses							
Travel	70,871	61,098	85,000	85,000	85,000	0	0.0%
Contractual Services	1,228,596	1,275,526	1,605,892	1,656,796	1,656,796	50,904	3.2%
Supplies & Materials	8,567	6,311	12,733	12,733	12,733	0	0.0%
Capital Outlay	46,338	47,882	47,192	44,400	44,400	(2,792)	(5.9%)
Funding Types							
General	0	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0	0.0%
Other	1,354,373	1,390,816	1,750,817	1,798,929	1,798,929	48,112	2.7%
Total OE	1,354,373	1,390,816	1,750,817	1,798,929	1,798,929	48,112	2.7%
Totals							
Funding Types							
General	0	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0	0.0%
Other	5,876,506	6,254,143	7,781,598	8,017,528	8,017,528	235,930	3.0%
Total	5,876,506	6,254,143	7,781,598	8,017,528	8,017,528	235,930	3.0%

Performance Based Compensation

To focus on adding value over the long term in all financial market conditions and to motivate and retain successful investment team members by linking a portion of total compensation to investment return performance relative to benchmarks.

	<u>Actual</u> <u>FY2014</u>	<u>Actual</u> <u>FY2015</u>	<u>Budgeted</u> <u>FY2016</u>	<u>Agency</u> <u>Request</u> <u>FY2017</u>	<u>Gov Rec</u> <u>FY2017</u>	<u>Gov Rec</u> <u>Inc/Dec</u> <u>FY2017</u>	<u>% Change</u> <u>From</u> <u>FY2016</u>
Personal Services							
Employee Salaries	2,813,173	4,788,672	8,034,522	8,921,550	8,921,550	887,028	11.0%
Employee Benefits	338,219	590,862	1,117,494	1,231,174	1,231,174	113,680	10.2%
FTE	0.0	0.0	0.0	0.0	0.0	0.0	0.0%
Funding Types							
General	0	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0	0.0%
Other	3,151,392	5,379,533	9,152,016	10,152,724	10,152,724	1,000,708	10.9%
Total PS	3,151,392	5,379,533	9,152,016	10,152,724	10,152,724	1,000,708	10.9%
Totals							
Funding Types							
General	0	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0	0.0%
Other	3,151,392	5,379,533	9,152,016	10,152,724	10,152,724	1,000,708	10.9%
Total	3,151,392	5,379,533	9,152,016	10,152,724	10,152,724	1,000,708	10.9%

Budget Notes:

Performance Based Compensation allows the Investment Council to:

- Link a portion of total compensation to investment return relative performance;
- To motive investment team members and retain those who add value;
- To focus on long-term investing; and
- To encourage adding value in all financial market conditions.

Department Object Detail

Item	Actual FY2014	Actual FY2015	Budgeted FY2016	Governor		% Change FY2016
				Rec FY2017	Inc/Dec FY2016	
PERSONAL SERVICES						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	7,673,525	10,242,860	15,182,797	16,371,323	1,188,526	7.8%
Total Personal Services	7,673,525	10,242,860	15,182,797	16,371,323	1,188,526	7.8%
FTE	26.6	27.2	30.0	30.0	0.0	0.0%
TRAVEL						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	70,871	61,098	85,000	85,000	0	0.0%
Total Travel	70,871	61,098	85,000	85,000	0	0.0%
CONTRACTUAL SERVICES						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	1,228,596	1,275,526	1,605,892	1,656,796	50,904	3.2%
Total Contractual Services	1,228,596	1,275,526	1,605,892	1,656,796	50,904	3.2%
SUPPLIES AND MATERIALS						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	8,567	6,311	12,733	12,733	0	0.0%
Total Supplies and Materials	8,567	6,311	12,733	12,733	0	0.0%
GRANTS AND SUBSIDIES						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	0	0	0	0	0	0.0%
Total Grants and Subsidies	0	0	0	0	0	0.0%
CAPITAL OUTLAY						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	46,338	47,882	47,192	44,400	(2,792)	(5.9%)
Total Capital Outlay	46,338	47,882	47,192	44,400	(2,792)	(5.9%)
OTHER						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	0	0	0	0	0	0.0%
Total Other	0	0	0	0	0	0.0%
TOTAL						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	9,027,897	11,633,677	16,933,614	18,170,252	1,236,638	7.3%
Total All Funds	9,027,897	11,633,677	16,933,614	18,170,252	1,236,638	7.3%

Major Expansions and Reductions

Budget Item	Governor's Recommendation	
	Other Funds	FTE
Base Salary, Promotional Increases	187,818	-
Contractual Services	50,904	-
Capital Outlay	(2,792)	-
Perfomanced Based Compensation	1,000,708	-
Total	1,236,638	-

Budget Notes:

The Governor is recommending an increase of \$187,818 in other fund expenditure authority for personal services promotional development and salary adjustments based on the SDIC's long-term compensation plan and \$48,112 for operating expenses in FY17.

The Governor is also recommending an increase of \$1,000,708 in other fund expenditure authority for Performance Based Compensation within the SDIC.

INVESTMENT COUNCIL

The mission of the Investment council is to:

- To professionally manage the South Dakota Retirement System and South Dakota Cement Plant Retirement Fund portfolios in order to obtain long-term maximum total returns consistent with prudent risk;
- To professionally manage the state's cash flow fund in order to obtain long-term maximum total returns consistent with the liquidity needs of the fund, the legal list and prudent risk;
- To professionally manage the investment portfolios of the School and Public Lands Fund, the Dakota Cement Trust, the Health Care Trust and the Education Enhancement Trust to obtain the highest risk adjusted return over the long term and to provide income payouts;
- To oversee the Higher Education Savings Plan per SDCL 13-63-1 to 13-63-31 by establishing the program and monitoring the selected program manager, Allianz Global Investors Distributors LLC; and
- To comply with SDCL 3-13-51.2 regarding Section 457 deferred compensation plan investment options; and, to comply with the requirements of SDCL 4-5-12 to 4-5-39, "Investment of State Funds Law".

Narrative – Provided by Investment Council

Personal Services:

This FY 2017 budget request was approved by the Investment Council on June 16, 2015 and by the LRC Executive Board on August 24, 2015.

For investment position salaries, total compensation consists of base pay and investment performance incentive pay. The Investment Council targets a 30% discount after cost-of-living adjustments to the private sector for investment positions total compensation. The

compensation study completed in early 2013 indicated total compensation was at 55% rather than the 70% cost of living adjusted industry median. To get back to target level, the Investment Council expanded the incentive compensation plan in FY 2015 as opposed to adjusting base compensations (see Performance Based Compensation). Base pay increases for FY 2017 are in line with the Council's long-term plan.

Base Salaries: The base salaries budget (not including state salary policy) increases 3.11%. This includes a 1.8% increase for the 26 investment positions according to our long-term plan, plus promotional increases of between 1.2% and 16% for newer level and intermediate level investment team members as they transition through the steep learning curve to senior investment team members. The investment accountant positions increase between 1% and 4.6% on top of salary policy to move toward compensation levels for years of experience and CPA designations.

Longevity: It is anticipated that 24 employees will be eligible for longevity pay in FY 2017.

Board & Commission Members: Five of the eight Investment Council members receive the daily rate (\$75) for all Investment Council related activities including Council meetings, subcommittee meetings, meetings with Investment Office staff, and appearances at legislative committee meetings. Budget allows up to 15 such meetings each year.

Benefits: Benefit adjustments were made to current staff according to the calculations provided by the Bureau of Finance and Management.

No new FTEs are being requested.

Operating Expenses:

Central Services: Increase of \$554 to expected levels.

Telecommunications Services: Increase of \$2,000 to expected levels.

Rent: Rent is increasing by \$4,515 for an additional 284 sq. ft. of office space to accommodate the Investment Accounting Department. Total office square footage is 7,866 sq. ft. with a gross rate of \$15.90 per sq. ft., or a net rate of \$9.65 per sq. ft. before operating expenses of utilities, maintenance and cleaning.

Other Contractual Services: Other contractual services for all investment research services netted to an increase of \$43,835. Because of new investment research staff, increases are expected in quote fees, Factset and S&P Capital IQ. Whenever research services are newly acquired or renewed, we negotiate to get the best price possible. At times, an investment service may be replaced by another provider if a better price or quality product is found.

Capital Outlay: Purchases projected for FY 2017 include:

- Two desktop computers at \$1,100 each for new FTEs
- Five desktop computers at \$1,100 each to upgrade existing computers
- Five replacement monitors at \$229 each
- Five mobile computer devices and docking stations at \$1,130 each
- Software for 3 upgrades to OfficePro 2013 @ \$333 each
- Three phone headsets at \$285 each

- Furniture and chair upgrades \$25,000. This includes a portion of the amount budgeted for furniture in FY 2016 which is being deferred to FY 2017.
- In addition to the miscellaneous books purchased during the year (approximately \$300), it is expected that five staff will be involved in the Chartered Financial Analyst program requiring approximately \$550 each for CFA books.

Performance Based Compensation:

The Investment Council targets a 30% discount after cost-of-living adjustments to the private sector for investment positions total compensation. The compensation study completed in early 2013 indicated total compensation was at 55% rather than the 70% cost-of-living adjusted industry median. To get back to target level, in FY 2015 the Investment Council increased the incentive compensation plan from 100% maximum with an average of 50% over time, to 200% maximum with an of average 80% over time. The revised plan includes longer term and stretch incentives.

The incentive plan includes funding for potential maximum incentives of 200% of FY 2016 base salaries of investment positions. The incentive plans are annually reviewed by the Investment Council, and the Investment Officer's plan is approved by the LRC Executive Board each year in setting the Investment Officer's compensation. The incentive compensation is based on a formula that pays only for outperformance versus capital market benchmarks tied to one-year and multi-year returns. These incentives will reward outperformance and range from 0% to a maximum of 200%. Unearned incentive funds remain unexpended. Typically, due to historically superior performance, the average earned incentive compensation across all positions in total has averaged 40% to 60% of the maximum. The goal of the revised plan is to average 80% over time which will accomplish meeting Council's target total compensation of 70% of the cost-of-living adjusted industry median.

Benefits: Benefits applied to the total maximum incentive funding including Social Security/Medicare, Retirement, Unemployment Insurance, and Worker's Compensation.

Other Fund Balances						
Company and Fund Name	Blue Book Page	Ending Cash and Investment Balance		60-Month Average	Lowest Monthly Cash Balance in Past Five Years	
		June 30			Cash Balance	Amount
		FY2014	FY2015			
Company 3017 - Investment Council Expense Fund	311	1,247,180	3,865,242	3,755,062	(115,382)	August 2013
Company 8000 - Agency Fund	312	8,621,677	16,448,082	N/A	N/A	N/A

The Agency Fund (8000) is used for deposit of pooled investment earnings of the Cash Flow Portfolio. These earnings are distributed to the participating agency funds based upon their average daily cash balance in the portfolio in accordance with SDCL 4-5-30.

Governor's Recommended Employee Compensation and Billings Pool – (from page 21 of the Governor's FY17 budget book)

For FY17, the Governor recommended the funding for the state employee compensation plan and bureau billings be placed in a pool in BFM to be distributed to each agency. *Therefore, individual agency personal services and contractual services budgets do not reflect budget increases for the compensation plan, bureau billings, or the decrease for health insurance.*

- Below are the estimated distributions for employee compensation for FY17. BFM will distribute dollars from the Pool after calculating the increase for salary policy and the decrease for employee health insurance. The distributed amount to the agency will be in addition to the agency's appropriated personal services budget.

FY17 Salary Policy Component	Object	General	Federal	Other	Total
Health Insurance	PS	\$0	\$0	(\$8,525)	(\$8,525)
Market Adjustment	PS	\$0	\$0	\$160,736	\$160,736
Movement Towards Market Value	PS	\$0	\$0	\$0	\$0
Health Insurance	OE	\$0	\$0	(\$161)	(\$161)
Market Adjustment	OE	\$0	\$0	\$2,359	\$2,359
Movement Towards Market Value	OE	\$0	\$0	\$1,098	\$1,098
	Total	\$0	\$0	\$155,507	\$155,507

- Recommended FY17 - 2.7% market adjustment for all permanent employees (except Career Bands); 0%-2.7% market adjustments for Career Bands; 2.5% movement toward market value for General Pay Structure and PACE; 0% to 4.5% pay for performance for Career Bands; decrease of \$275 per benefitted employee for the employer-paid portion of the health insurance plan.
 - Recommended FY16 – 2% market adjustment for all permanent employees (except Career Bands); 0%-6.6% market adjustments for Career Bands; 2.5% movement toward market value for General Pay Structure and PACE; 0% to 4.5% pay for performance for Career Bands; 0% health insurance.
 - FY15 – 3% across-the-board/market adjustment for all permanent employees (including Career Bands); 3% adjustment toward job worth for PACE; 0%-4.5% pay for performance for Career Bands; targeted compensation adjustments for a small number of hard-to-fill, below market vocational jobs; 18.6% health insurance.
 - FY14 – 3% across-the-board for all permanent employees (except Career Bands); 3.5% to 4% market adjustment for Career Bands; 3.5% adjustment toward job worth for PACE; 0%-4.5% pay for performance for Career Bands; 14.7% health insurance.
- Below are the estimated increases to the bureau billings for FY17. The amount distributed from the BFM pool to the agency will be in addition to the agency's appropriated contractual services budget.

Estimated FY17	General	Federal	Other	Total
Bureau Billing Adjustments	-	-	2,040	2,040

Cash & Investment Balances in State Reserve & Trust Funds as of November 30, 2015

