

# NEBRASKA INVESTMENT COUNCIL

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September 19, 2012

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." In response to this requirement, attached are two cash flow projections for the Health Care Endowment Fund for the next ten years.

These projections focus on two main sets of variables: the investment asset mix and the magnitude of the cash distribution (transfer) level above the contribution level over a ten year period. The two variables of asset mix are the current mix (75% equity/25% fixed income) and a conservative version (50% equity/50% fixed income). The variables in the distribution (transfer) level exceeding the contribution level are categorized as low, high and very high. Low describes the situation where distributions (transfers) exceed contributions by \$10 million per year. High is \$25 million and very high is where distributions (transfers) exceed contributions by \$40 million. It is important to note that Nebraska does not set the contribution level, but the Legislature does set the distribution (transfer) level and the Nebraska Investment Council does determine the asset mix. The asset mix determines the investment outcome and this outcome is uncertain.

The results of the projections are fairly clear. The portfolio will likely grow in value over ten years regardless of the asset mix if distributions (transfers) exceed contributions by only \$10 million per year. Regardless of the asset mix, the portfolio will likely lose value over ten years when the distributions (transfers) exceed contributions by \$25 million and \$40 million per year.

The current asset mix is 75% equity/25% fixed income and the legislated distributions (transfers) exceed contributions by \$13.9 million to \$19.1 million per year. The corpus of the portfolio quite likely will be negatively affected over the next ten year period. The recent change in Health Care distributions (transfers) helps this situation by decreasing the future distributions (transfers) to \$56.145 million in 2013 and \$53.190 million in 2014; and finally, to \$50.235 million per year starting in 2015.

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. However, based on what we know at this time, the transfers are sustainable in each of the next ten years utilizing a portion of the Health Care Endowment Fund when expected contributions and expected investment returns are considered.

Sincerely,



Jeffrey W. States  
State Investment Officer

Attachment

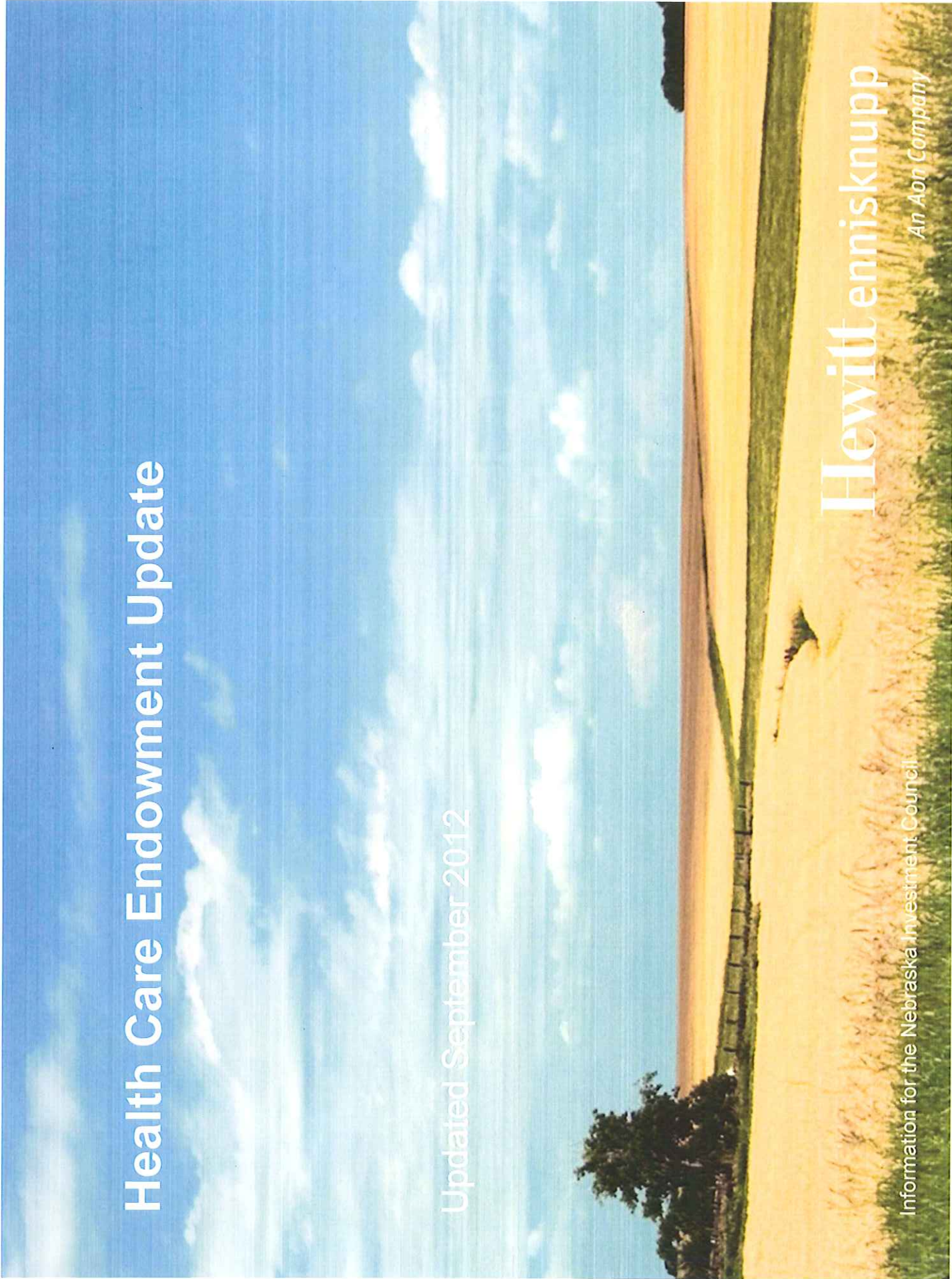
# Health Care Endowment Update

Updated September 2012

**Hewitt** ennisknupp

*An Aon Company*

Information for the Nebraska Investment Council



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## Health Care Endowment Summary

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- 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:

2012	\$56.3 million	2008	\$56.4 million
2011	\$59.1 million	2007	\$55.0 million
2010	\$56.1 million	2006	\$52.0 million
2009	\$53.6 million	2005	\$52.0 million

## Health Care Endowment Modeling

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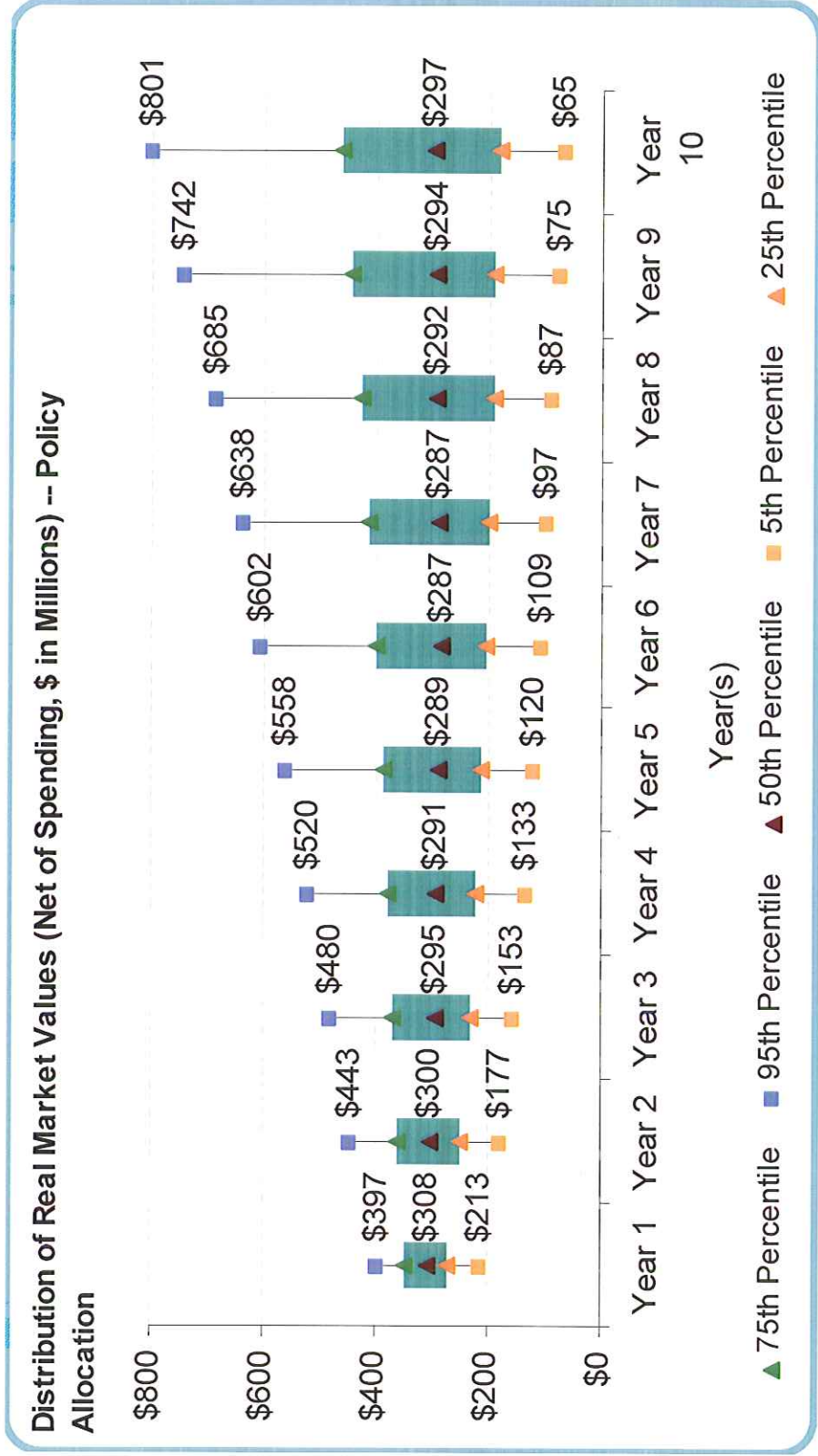
- Projections are updated to include:
  - Expected annual contributions and distributions through 2035 (see appendix)
  - Two asset allocation scenarios:
    - 1) Policy: 75% equity/25% fixed income
    - 2) Conservative: 50% equity/50% fixed income
  - Market value as of July 31, 2012
  - Hewitt Ennisknupp 2Q12 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
<b>Total Health Care Endowment</b>	<b>100.0%</b>

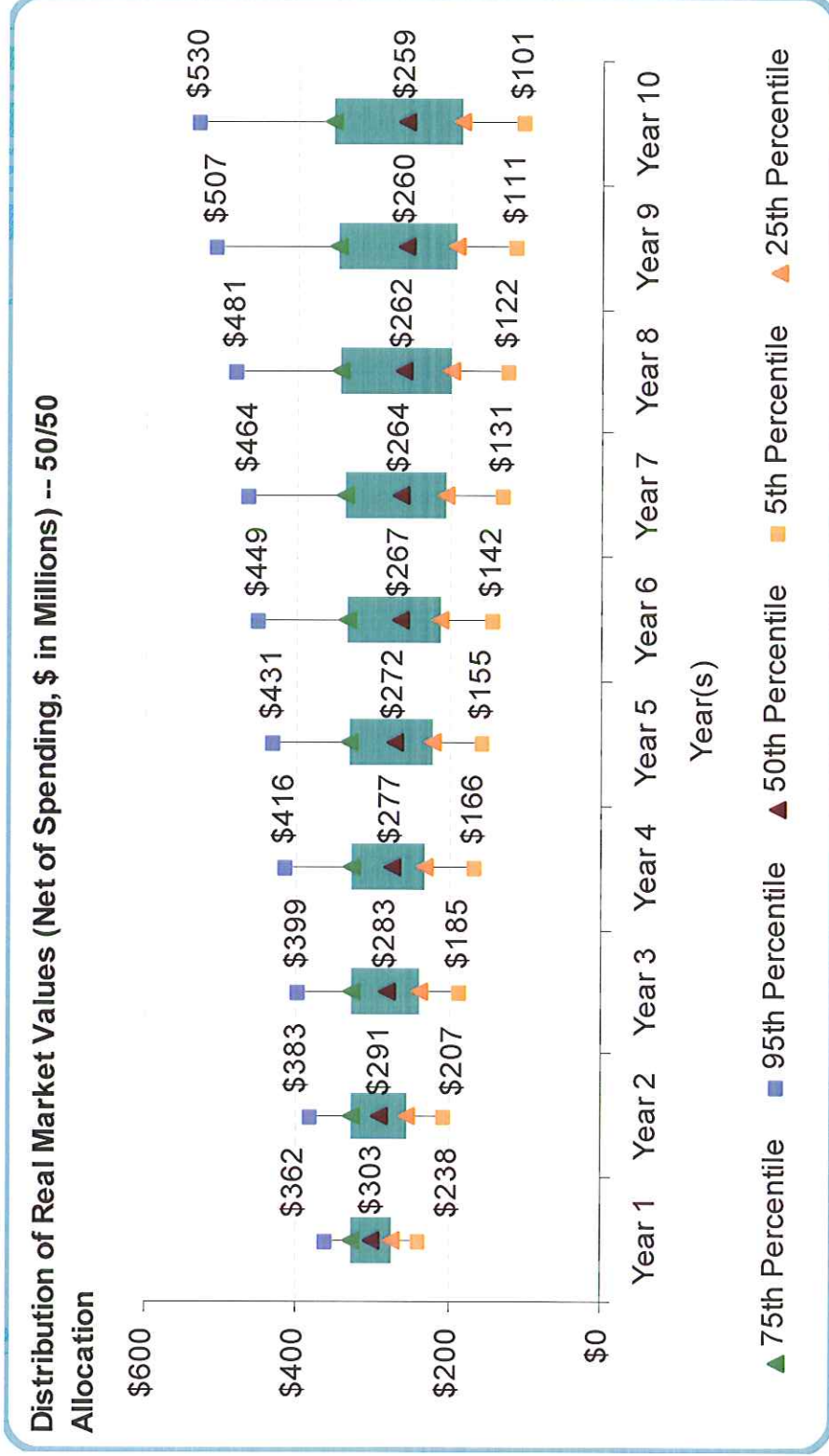
	Market Value (as of 7/31/2012)
Medicaid Intergovernmental	\$76,163,018
Tobacco Settlements	\$237,171,130
<b>Total Health Care Endowment</b>	<b>\$313,334,148</b>

## Health Care Endowment – Distribution of Real Market Values: Expected Net Distributions at Policy Allocation



- Portfolio corpus will likely decline slightly over the next 10 years (at 50<sup>th</sup> percentile result)
- Upside potential for portfolio growth

## Health Care Endowment – Distribution of Real Market Values: Expected Net Distributions at a Conservative Allocation



- Portfolio corpus will likely decline over the next 10 years (at the 50<sup>th</sup> percentile result)
- Upside potential for portfolio growth



## Appendix: Expected Distributions

Year	Estimated Contribution	Estimated Distribution	Net Distribution
2013	\$37,053,290	\$56,145,000	-\$19,091,710
2014	\$36,649,529	\$53,190,000	-\$16,540,471
2015	\$36,252,307	\$50,235,000	-\$13,982,693
2016	\$35,861,612	\$50,235,000	-\$14,373,388
2017	\$35,477,431	\$50,235,000	-\$14,757,569
2018	\$34,013,986	\$50,235,000	-\$16,221,014
2019	\$33,652,863	\$50,235,000	-\$16,582,137
2020	\$33,298,060	\$50,235,000	-\$16,936,940
2021	\$32,949,574	\$50,235,000	-\$17,285,426
2022	\$32,607,403	\$50,235,000	-\$17,627,597
2023	\$32,271,551	\$50,235,000	-\$17,963,449
2024	\$31,942,021	\$50,235,000	-\$18,292,979
2025	\$31,618,819	\$50,235,000	-\$18,616,181
2026	\$31,301,952	\$50,235,000	-\$18,933,048
2027	\$30,991,434	\$50,235,000	-\$19,243,566
2028	\$30,687,275	\$50,235,000	-\$19,547,725
2029	\$30,389,490	\$50,235,000	-\$19,845,510
2030	\$30,098,098	\$50,235,000	-\$20,136,902
2031	\$29,813,119	\$50,235,000	-\$20,421,881
2032	\$29,534,575	\$50,235,000	-\$20,700,425
2033	\$29,262,493	\$50,235,000	-\$20,972,507
2034	\$28,996,898	\$50,235,000	-\$21,238,102
2035	\$28,737,822	\$50,235,000	-\$21,497,178