

HOUSE BILL REPORT

HB 2396

As Reported by House Committee On:
Capital Budget

Title: An act relating to investment of moneys in the permanent common school fund.

Brief Description: Regarding investment of moneys in the permanent common school fund.

Sponsors: Representatives Fromhold and McDonald.

Brief History:

Committee Activity:

Capital Budget: 3/29/07, 3/30/07 [DP].

Brief Summary of Bill

- Clarifies the law to authorize investment of the Permanent Common School Fund in equities when the investment is in the best interest of the state and the Permanent Common School Fund.

HOUSE COMMITTEE ON CAPITAL BUDGET

Majority Report: Do pass. Signed by 18 members: Representatives Fromhold, Chair; Ormsby, Vice Chair; Schual-Berke, Vice Chair; McDonald, Ranking Minority Member; Newhouse, Assistant Ranking Minority Member; Blake, Dunshee, Flannigan, Goodman, Hankins, Kelley, McCune, Orcutt, Pearson, Pedersen, Sells, Skinner and Upthegrove.

Minority Report: Do not pass. Signed by 1 member: Representative Hasegawa.

Staff: Nona Snell (786-7153).

Background:

At statehood, the Enabling Act granted certain lands to the state to be held in trust for various public purposes. Article 9 of the State Constitution reflects the Enabling Act by establishing the Permanent Common School Fund (CSF) and the Common School Construction Fund.

There are five other permanent funds. According to the Washington State Investment Board's (WSIB) 25th Annual Report (June, 30 2006), the total market value of all the permanent funds

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is \$712,819,394. Fund proceeds are invested in fixed income and short-term holdings, with the exception of the CSF, which is also invested in the U.S. Equity Market Index Fund. The following is a list of the six funds and their value as reported in the annual report:

- Common School Fund - \$164,731,466
- Normal School Fund - \$205,542,307
- Scientific Fund - \$166,740,242
- Agricultural College Fund - \$150,563,410
- State University Fund - \$25,236,818
- Millersylvania Park Fund - \$5,151

The Department of Natural Resources transfers proceeds from the sale of stone, minerals, or property other than timber and crops for school and state land to the WSIB for investment in the CSF. Earnings of the CSF are deposited in the Common School Construction Fund, which is appropriated for K-12 school construction.

In 1966, Article 9, Section 3 of the State Constitution was amended to declare that the principal of the CSF, as such existed on June 30, 1965, shall remain "permanent and irreducible." In addition, Article 9, Section 5 of the State Constitution declares that losses to the Permanent Fund from "defalcation, mismanagement, or fraud" constitute debts of the state.

Although Article 12, Section 9 establishes a general prohibition on investment of state funds in corporate stock, Article 16, Section 5 expressly provides that the Permanent Fund may be invested as authorized by the Legislature.

In 1999, an opinion of the Washington State Attorney General concluded that the state constitution does not prohibit the investment of moneys in the CSF, as long as the investment is authorized by law and is consistent with applicable trust principles. This opinion further reasoned that the constitutional phrase "permanent and irreducible" bars the Legislature from abolishing the CSF or expending its principal for purposes other than those for which the CSF was established, but does not prohibit the Legislature from specifying permissible investments.

Summary of Bill:

The Legislature declares its intent to clarify the law authorizing investment of the Permanent Common School Fund in equities when the investment is in the best interest of the state and the CSF. The legislative findings and declarations of intent also describe the reasoning of the Attorney General's Opinion and the need for more growth in the CSF, given the gap between the CSF's income and actual expenditures on school construction.

The WSIB has the authority to invest the CSF to achieve a balance of long-term growth and current income. The State Treasurer calculates the irreducible principal. The irreducible principal does not include investment gains, and the WSIB may retain or distribute income and

investment earnings to achieve a balance between growth and income. Statutes governing the Permanent Fund and the WSIB's investment authority are amended to reflect this change.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony:

(In support) The Office of the Superintendent of Public Instruction and the Washington State Investment Board believe the bill provides policy clarification in statute. Inflation will be offset by capital gains that are added to the Permanent Common School Fund.

(Opposed) None.

Persons Testifying: Brenda Hood, Office of the Superintendent of Public Instruction; and Joe Dear, Washington State Investment Board.

Persons Signed In To Testify But Not Testifying: None.