1978

Proposed Amendment: Investment of School Lands Funds

Cooperative Extension South Dakota State University

Historic, archived document

Do not assume content reflects current scientific knowledge, policies, or practices.

SDSU Extension

For current policies and practices, contact SDSU Extension
Website: extension.sdstate.edu
Phone: 605-688-4792
Email: sdsu.extension@sdstate.edu

FS 707

Proposed Amendment: Investment of School Lands Funds

Cooperative Extension Service
South Dakota State University
U.S. Department of Agriculture

Proposed Amendment:

Investment of School Lands Funds

Galen Kelsey
Extension economist--public affairs

The proposed amendment deals with investment of education and school lands funds. It would repeal Article XXVIII and amend Section 11 of Article VIII of the South Dakota Constitution.

Repeal of Article XXVIII

Article XXVIII is one of the shortest articles in the state Constitution and reads as follows:

> The several counties of the state shall invest the moneys of the Permanent School and Endowment Funds in bonds of school corporations, state, county and municipal bonds or in first mortgages upon good improved farm lands within their limits respectively, under such regulations as the legislature may provide, but no farm loan shall exceed one thousand dollars to any one person, firm or corporation.

Analysis

The repeal of Article XXVIII is purely a housekeeping measure. This article was made obsolete by the voters in 1952 when they passed an earlier version of Section 11, Article VIII. This amendment took the counties out of the loan business and released them from the responsibility of administering the permanent school funds. Prior to 1952 all monies from the permanent school funds invested in the counties, townships, or incorporated cities were divided among the organized counties in proportion to their population. The amendment passed in 1952 placed the administration of the permanent school funds in the hands of the Commissioner of School and Public Lands.

The second part of this proposed constitutional amendment deals with further changes in the administration of the permanent school funds.

Amendment to Article VIII, Section 11

The present Article VIII, Section 11 passed in 1952 and amended in 1968 reads as follows:

> The money of the Permanent School and other Educational Funds shall be invested by the Commissioner of School and Public Lands only in bonds of the United States,securities guaranteed by the United States, bonds of the State of South Dakota, or in bonds of any school corporation, organized county, or incorporated city within the state of South Dakota, and at such rates of interest as the Legislature shall, from time to time determine.
>
> The Legislature shall provide by law, such rules, regulations and safeguards as it may deem necessary to secure safe and continuous investment of such funds so far as possible, and notwithstanding, other provisions of this Article, may authorize the sale of bonds of the United States below cost in order to secure the highest income compatible with safe investment."

The proposed amendment seeks to substitute the following:

> The money of the Permanent School Fund, other educational funds and institutional trust funds shall beinvested in a prudent manner as provided by law.

Analysis

The intent of the proposed amendment is to allow wider latitude in the investment of school funds and increase the earnings of these funds to be distributed to the school districts and educational institutions in the state.

The present Constitution charges the Commissioner of School and Public Lands with the responsibility of investing the money received from various school funds. The proposed amendment is silent on who would be responsible for the investment of such funds.

Administering the funds

Although the proposed amendment does not so state, it may be assumed the Legislature would assign the responsibility for the funds to the South Dakota Investment Council (SDIC) which will administer the investment of the school funds in the same manner as it now supervises the investment of other state funds (cash surplus, S.D. employees retirement fund,etc.).

The SDIC is composed of six people qualified by education and experience in the field of finance management. They are appointed by the executive board of the Legislative Research Council. The SDIC employs a full time professional investment officer who is responsible for the investment of all state funds under the direction of the SDIC.

The SDIC was established by action of the Legislature in 1971. The act of the Legislature charges the investment council with the responsibility of investing state funds in "a prudent manner." The act defines prudent as "the exercise of that degree of judgment and care, under circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation but for investment, considering the probable safety for their capital as well as the probable income to be derived" (SDCL 4-5-27).

Kinds of investments

The act specifies a list of eligible investments the Legislature deems to be prudent (SDCL 4-5-26). This list limits investments to (1) direct and indirect obligation of the U.S. government, (2) agencies and instrumentalities of U.S. government, (3) direct obligations of the state of South Dakota and any of its political sub-divisions, (4) obligations ... of a solvent corporation, ... provided that such investment shall be rated in the four highest classifications established by at least two standard rating services, (5) savings and share accounts and certificates of deposit of banks, and savings and loan and building and loan associations and bankers' acceptances.

Of the above list, the first three are essentially the same investments allowed under the present Constitution. The changes this amendment would make are contained in the last two, investments allowed in corporate bonds and lending institutions. These limitations are by law only, and they may be changed by the Legislature.

The investment policy established by the Legislature allows wider latitude and a higher degree of risk taking in the investment of state funds than does the present Constitution for the investment of school funds, although the policy of the Legislature might be considered to be conservative as it allows investment in only the highest rated bonds and does not allow investments in the stock market.

Presently the monies in the permanent trust funds may be invested only in bonds of the United States, securities guaranteed by the United States, bonds of the state of South Dakota, or bonds of any school corporations, organized county or incorporated city. These investments, while safe, are usually relatively low yield and long term investments. State, county, city and school bonds are low return because the interest earned is tax exempt and will sell on the money market at low yield to investors who might otherwise have to pay tax on their earnings. The interest earned from permanent trust funds are not subject to tax, so this is not an advantage.

These securities are usually considered to be long term investments. At this time of rising interest rates it might not be prudent to make long term investments at fixed interest rates.

The people of South Dakota recognized this point in 1968 when they added the section to this constitutional article which allowed the sale of holdings below cost so the money might be reinvested in higher yield securities.

Yields and risks

Investment in shorter term securities requires a high degree of expertise by the manager of the investment funds. The manager must be constantly buying and selling to obtain the highest yield. Such active trading also increases the risk of making a poor investment, although any losses are likely to be minimal under the safeguards outlined by the Legislature. It should be recognized, however, that the success of such an active trading policy depends upon the expertise of the SDIC and its professional investment officer.

In the event there are losses from investments of the trust funds, the fund is protected from decreases by Section 7, Article III, which states "The principal of every such fund may be increased, but shall never be diminished and the interest and income only shall be used." (The various funds suffered losses in the 1930's from investments in "good improved farm lands," hence funds had to be replaced by the counties. The counties were responsible for administering a portion of the funds at that time.)

Rates of return

There is presently about $70 million invested from the combined school trust funds. In fiscal 1977 the rate of return on investment of the fund was 7.67% or $5,386,000. According to information supplied by the SDIC investment office, if the permanent school funds were invested to yield the same return as had been realized from the South Dakota employees consolidated retirement system funds, the return in fiscal 1977 would have been 14.7%. In the 4-year period fiscal 1974-1977, the average annual earnings of the retirement funds ranged from a low of 3.1% in 1974 to a high of 14.7% in 1975. The rate of return in 1976 was 14.2%.

This is not to imply that rates in excess of 14% can be expected every year. In some years the return on the funds, if invested by the investment officer under his policies, would be expected to be the same as if invested under policies stipulated in the present Constitution, because there are times when government issue bonds are better investments than highly rated corporate bonds and certificates in lending institutions.

The question before the people of South Dakota in this constitutional amendment is: shall they allow the investment policy of the permanent school funds to be broadened with a potentially higher degree of risk to seek more income for distribution to South Dakota schools?

Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the USDA. Hollis D. Hall, Director of Cooperative Extension Service, South Dakota State University, Brookings. Educational programs and materials offered without regard to age, race, color, religion, sex, handicap or national origin. An Equal Opportunity Employer

File: 5.3--20,000 printed at estimated 2.5 cents each--8-78mb--2446A

FS 707

Proposed Amendment: Investment of School Lands Funds

Cooperative Extension Service
South Dakota State University
U.S. Department of Agriculture