

Investment of State Cultural Trust Funds

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All state cultural trust funds are structured differently, however, the one core mechanism all of them share is the intention to identify and collect a substantial amount of cash in an investment corpus for the purpose of investing the corpus to benefit the arts. In the design of state cultural trust funds, two key questions inevitably arise: Who should invest the funds? and What rate of return on investment should be expected? Because the trusts commonly rely on public funding as the foundation for the establishment of their corpuses, the advantages and disadvantages of a state's management of trust investments are common issues. State management of these funds is a concern for many because state investment strategies have traditionally been quite conservative and, as a result, their return on investment has been modest. Because of the relatively low return on investment results of state government investment mechanisms, many involved in the development of cultural trusts have sought to identify ways to increase the return on investment for cultural trust funds by moving the funds partially or wholly outside the state system. Illustrated below are two issues intended to assist those who are engaged in discussions regarding the investment of cultural trust funds. The first issue presents some of the reasons that state investment policies have traditionally reflected a conservative return on investment. The second details the investment structures and returns of a selection of existing state cultural trust funds.

Reasons for the Modest Rate of Return Investment Policies of State Treasurers

Traditionally, funds invested by state treasurers do not commonly earn high rates, and in some cases even competitive rates of return on investment. Some of the key reasons for this are:

- Because state treasurers invest monies as agents for the public, the treasurers commonly choose to conserve funds by not placing them in higher-than standard risk-level accounts. Such prudence, they believe, is congruent with their roles as conservators of funds and guardians of the public trust.
- There are few political incentives for a state treasurer to invest funds in investment instruments that have a high-than-average rate of return. Such high return rates are generally associated with higher risk and the possibility that the principle of an investment might actually shrink. Although the public may choose to exert some political discipline on state treasurers who invest funds at very low rates of return, they have not demonstrated an understanding of, or appreciation, for public officials who invest funds at high rates that might result in the shrinkage of public funds.
- In the past ten years, the perception of what constitutes an appropriate level of risk has changed. While the public may continue to find high rates of return unacceptable due to associated risk factors, the expectation today is that an investment that has a low rate level of risk may yield 6% to

7% when not too many years ago rate of return of 4% to 5% were considered to be the highest reasonable conservative rates of return. This of course is due to economic factors such as current interest rates and increased competition for investable funds, for example the booming mutual fund business and increased confidence in the stock market.

Existing Cultural Trust Investment Frameworks

Existing state cultural trust funds use and are projected to use a variety of investment mechanisms. Following is a detailing of the management and investment structures for these funds:

Arizona

The Arizona Arts Endowment Fund, projected to total \$40 million in ten years, will have both public and a private components. An anticipated \$20 million in public monies will flow into the fund and be managed by the State Treasurer's office. In fiscal year 1996, the rate of return of all state funds invested by the State Treasurer totaled 5.51%. In order to match the public monies, \$20 million in private funds will be raised. These private monies will be managed by the Arizona Community Foundation. The Foundation is expected to invest the funds in a manner that will yield approximately 5% on the principal annually. Investment income that exceeds 5% will be reinvested.

Delaware

The Delaware Arts Stabilization Fund was established to benefit eight Delaware cultural organizations. The fund, which is a blend of government, private and corporate contributions totaled \$21.5 million upon its establishment in 1996. The Fund is managed by the Delaware Community Foundation, which holds the monies in separate accounts for each of the beneficiaries. Each of the eight participating arts organization are entitled to withdraw the annual earnings from the fund or they may elect to leave all or part of the earnings in the fund to encourage growth of the principle. In addition to the funds set aside for the eight designated cultural organizations, income from 5% of the fund is set aside to fund applications for brick and mortar projects. The eight designated major organizations with established funds are prohibited from applying; however Arts organizations from across the state are eligible to apply for these monies.

Missouri

The Missouri Cultural Trust currently has approximately \$15 million in the public segment of its corpus and arrangements are currently being made to secure private matching funds. The goal of the trust is to secure a corpus of \$200 million over a ten year period with half of the monies flowing from the public sector and half secured through a designated fund matching program. The Missouri Cultural Trust legislation does not require that public funds be matched. At the present time, the public funds are managed by the state treasurer and yield a rate of return of approximately 5.5%. Arrangements have been made for the community foundations of Kansas City, Saint Louis and Springfield to act as depositories for the private funds that will be secured. The return on investment rate for the funds invested by the community foundations is expected to be measurably higher than the return on investment rate for funds invested by the state.

Montana

Currently, Montana's Cultural Trust Fund holds \$3.8 million. The Fund is managed by the Board of Investments which is appointed by the governor and administered by the Department of Commerce. In fiscal year 1997, the Fund generated approximately \$500,000 in income. That income represents a 6.7% return on investment. However, as of May 1, 1997, the Fund was reduced from \$7 million to its current level when \$3.2 million was transferred to purchase the historic town of Virginia City, Montana. In addition, the Fund received \$250,000 in new coal tax revenues. Rather than adding these monies to the trust principle, they were transferred directly to the Montana Arts Council and designated to be used as grant funds.

Texas

The Texas Arts Commission is in the process of funding its already established cultural trust. Although legislation authorizing the fund has been on the books for several years, the Commission has not succeeded in securing either a dedicated revenue stream to underwrite the fund or the direct appropriations necessary to build the trust to the projected \$200 million level. In the past several legislative sessions, the Texas legislature has allocated some monies to the Trust and contributions from the state license plate program as well as and non-designated contributions from the private sector have provided additional monies. As of January 1998, the fund had a corpus of approximately \$7 million. The fund is managed as a part of "Texpool", the state investment pool that is operated by the state. The Texas Arts Commission is empowered to invest Trust funds outside of the Texpool system and is also allowed to invest them out-of-state. Commission staff has been advised that until the fund reaches approximately \$10 million, monies are best kept with Texpool. Although the Commission is authorized to contract with an independent financial firm to invest

the Trust funds, the State of Texas has established guidelines that limit the level of risk an investment advisor is allowed to take.

Utah

The Utah Arts Endowment Fund totals approximately \$3 million. The fund was established in 1990 to encourage the stabilization of the financial structure of Utah's arts organizations. The fund serves a total of 95 arts organizations all of which raised matching funds from the private sector to secure a share of the State and the National Endowment for the Arts-originated public-sector funds. The State Treasurer manages the funds of 86 of the participants while the remaining nine organizations manage their own endowment accounts. At the time the endowment was established, these nine organizations had operating budgets of \$500,000 or more, and therefore were authorized to oversee their own endowment accounts. Organizations working with the State Treasurer have two accounts, one for principal and one for interest. The organizations receive monthly statements regarding account activity and an annual check representing the income from the investment of endowment funds. Participants are allowed to forego all or part of their annual checks from the State Treasurer provided the funds they forego are permanently reinvested to their designated principle account. Funds managed by the State Treasurer are invested as part of the Public Treasurer's Investment Fund. This Fund earned 5.69% in calendar year 1997. The return on investment for the funds managed by the nine organizations managing their own monies is not reported. However, the return on investment for funds not managed by the state is anticipated to be significantly higher.

Wyoming

The Wyoming Trust Fund was established from a \$500,000 legislative appropriation that was matched by a \$500,000 challenge grant from the National Endowment for the Arts (NEA). The terms of the NEA challenge grant required that the funds be matched further by private contributions. All but a small portion of these funds is managed by the Wyoming Community Foundation. The current \$2 million plus corpus of the fund is held in the name of a number of arts organizations and earns a 5% guaranteed annual rate of return. If the Community Foundation should earn a higher rate of return on the Funds' investment, those participating in the cultural endowment fund receive no more than the 5% annual payout but have the benefit of reinvesting the additional earnings to the principle.