

# SUFFOLK COUNTY LEGISLATURE



Gail Vizzini  
Director

## BUDGET REVIEW OFFICE

March 2, 2006

To: William J. Lindsay, Presiding Officer  
and All Suffolk County Legislators

From: Gail Vizzini, Director  
Budget Review Office

**Subject: Vanderbilt Museum Endowment Trust Fund Annual Report for the period January 1, 2005 through December 31, 2005**

Attached is the Budget Review Office annual review and report on the performance of the Vanderbilt Museum Endowment Trust Fund. The Fund provides distributions to assist the Museum with meeting a significant portion of its operating costs. The report includes a historical perspective of the Museum and a discussion of the performance of the Fund's investments.

The Executive Summary highlights our major concerns and findings which are underscored below:

- The Legislature has the sole power and control over the Museum's property and the Fund which provides distributions for the care and operation of the Museum.
- The Fund's investments are in accordance with guidelines established by the Legislature. As of December 31, 2005, the market value of the Fund was \$12.5 million.
- The Fund provides the Museum with its largest source of income, \$1.2 million annually.
- In 2004, Fleet Investment Services was selected through an RFP process to manage the fund. Fleet merged with Bank of America in September 2004. There is no current contract. This should be remedied by directing

the County Attorney to formalize an agreement or through the Request for Proposal process.

- Current policy allows the Fund to continue disbursing \$100,000 per month to the Museum as long as the corpus of the Fund does not go below the value of the original bequest of \$8.2 million. Historically, the Fund has a \$12.2 million threshold as the estimated minimum market value to support the Museums' monthly distributions without adversely impacting the principal or the investment objectives.
  - We are concerned that the continued depletion of the Fund's realized capital gains may cause the Fund to fall below the threshold during 2006. This situation would not adhere to the investment objective of providing for future growth of income through long term capital growth.
  - We recommend annually establishing the minimum threshold of the Fund and requiring a comprehensive review if the market value falls below the established annual threshold.
- The Museum has cash flow problems and has downsized in an effort to address them.
- The Budget Review Office recommends the Legislature consider modifying the current investment policy to allow up to 65% rather than only 50% of the portfolio to be invested in equities.
- The overall return for the fund in 2005 was 7.15 percent.
- The authorization for the \$1.2 million annual distribution from the fund expires December 31, 2006. A resolution will be necessary to continue the authorization beyond this date.

My staff and I are available should you have any questions regarding this report.

\* \* \*

GV:slw  
Attachments

cc: Angie Carpenter, Suffolk County Treasurer  
Joseph Sawicki, Suffolk County Comptroller  
Frederick Pollert, Deputy County Executive, Financial Affairs  
Christine Malafi, Suffolk County Attorney  
Ron Foley, Commissioner of Parks and Recreation  
J. Lance Mallamo, Director, Vanderbilt Museum  
Steven Gittleman, President, Vanderbilt Board of Trustees  
Stephen Malo, Senior Vice President, Fleet Investment Services

**VANDERBILT MUSEUM ENDOWMENT TRUST FUND  
ANNUAL REPORT  
JANUARY 1, 2005 THROUGH DECEMBER 31, 2005**

**March 2, 2006**

**Gail Vizzini, Director  
Budget Review Office  
Suffolk County Legislature  
Hauppauge, New York**

## Executive Summary

The Fund's performance over the past year has enabled it to provide the Museum with its annual \$1.2 million distribution, however, the distribution is adversely affecting the Fund's ability to grow the principal in accordance with the Legislature's investment objectives. The Museum would not be able to meet its operating expenditures without this distribution. Resolution No. 1306-2005 extended:

- The authorization to provide the Museum with a \$1.2 million annual distribution until December 31, 2006. A new resolution will be necessary to extend the authorization.
- Bank of America is currently managing the Fund as a result of its merger with Fleet Bank in September of 2004. An updated contract agreement has not been instituted since the merger. The Budget Review Office recommends legislation directing the Purchasing Division of the Department of Public Works (DPW) to prepare a request for proposal (RFP) for circulation to obtain a current contract agreement in accordance with the investment objectives set forth by the Legislature for investment management services. However Article III of Chapter 708 of the Suffolk County Code does not mandate the Legislature to circulate an RFP for professional consulting services.
  - ✓ Regardless of the decision to commence the RFP process, the Budget Review Office strongly recommends directing the County Attorney to enter into a contractual agreement with Bank of America, since due to the transition between Fleet and Bank of America, there is no contract.
- The portfolio's 2005 allocation of assets was within the guidelines as originally set forth in Resolution 933-1994, which allows up to 50 percent of the Fund's assets to be invested in equities. The Budget Review Office recommends modifying the Fund's current investment management policy to allow up to 65% of the Fund's assets to be invested in equities. Current financial market conditions make it difficult for the Fund's investment advisor to increase the Fund's future income through long-term capital growth. Anticipated rising interest rates restrict capital appreciation from bonds.
- During 2005 the market value of the Fund declined by \$358,246 from \$12,878,029 to its year-end amount of \$12,519,783. The Fund's reduced market value is partially due to its annual distribution of \$1.2 million in \$100,000 monthly payments to the Museum and its \$24,762 payment of investment fees.

- The Fund's total annual return, income from investments, dividends and interest, as well as capital appreciation from stocks and bonds, for 2005 was a gain of 7.15%.
- For the past several years the Budget Review Office has expressed concern over the Museum's dependence on the use of realized capital gains to augment its income. This dependence is likely to increase as the Museum has recently experienced significant cash flow problems.
- **There may not be sufficient realized capital gains to provide the Museum with its \$1.2 million annual distribution during 2006 without the Fund falling below \$12.2 million and jeopardizing its ability to grow the principal of the account in accordance with the Legislature's investment objective.** The Budget Review Office will notify the Legislature if the Fund's market value falls below \$12.2 million with the recommendation to review the account within the context of existing market conditions.

## Historical Information

William Kissam Vanderbilt II (1878-1944) referred to his 43-acre summer estate in Centerport, which overlooks the Northport Harbor and the Long Island Sound, as the "Eagle's Nest". Mr. Vanderbilt traveled extensively throughout the world collecting artifacts to develop his own personal museum at Eagles Nest. In Mr. Vanderbilt's last will and testament, he recognized the potential for his vast estate to become a museum "for the use, education and enjoyment of the general public". Mr. Vanderbilt died in 1944 of a heart attack and his wife whom he married in Paris in September of 1927, Rosamund, died three years later in 1947 at "Eagle's Nest". She was the last Vanderbilt to live there.

In his last will and testament, Mr. Vanderbilt bequeathed his estate in Centerport, together with its real property, furnishings, exhibits, works of art, artifacts, memorabilia and certain moneys either to the State of New York, County of Suffolk or Town of Huntington. Suffolk County accepted the generous bequest in accordance with the terms of the agreement dated August 3, 1949.

The estate was opened as a public museum in 1950. The Museum includes a Spanish revival style mansion with a Memorial Wing constructed in 1936 to commemorate Mr. Vanderbilt's only son who died in 1933 from an automobile accident in South Carolina, a planetarium, outbuildings as well as landscaped grounds.

The Vanderbilt planetarium was erected in 1971 for less than one million dollars on the site of the former Vanderbilt family tennis courts and was paid for from the Endowment Trust Fund. The planetarium is a 238-seat 60-foot diameter domed sky theatre with a central GOTO projector supplemented by dozens of perimeter slide projectors and a video projector. Local Law No. 35-1986, designated and renamed the museum "Suffolk County Vanderbilt Museum" in November of 1986.

The Suffolk County Vanderbilt Museum Commission evolved from the former Suffolk County Park Commission, which was established by resolution of the Board of Supervisors on June 27, 1949, and enlarged by resolution of the Board of Supervisors on December 28, 1959. The Commission is responsible for the management and control of the Suffolk County Vanderbilt Museum, pursuant to Local Law No. 1-1966. The Board of Trustees of the Suffolk County Vanderbilt Museum Commission has the sole power and control over the development, maintenance and operation of the Suffolk County Vanderbilt Museum and Planetarium and to conduct its programs and activities, subject only to the contractual conditions under which the county accepted the Vanderbilt bequest. The Board of Trustees is the appointing body with respect to all personnel engaged in the maintenance and operation of the programs and activities of the museum and planetarium, including the Director. The employees of the Museum are not employees of Suffolk County, but are employees of a privately endowed institution. The Suffolk County Legislature appoints fifteen members to the Commission for four-year terms of office to govern the Vanderbilt Museum. As of this writing, all fifteen appointments are filled.

The Legislature has the sole power and control over Museum property and the distribution of Trust Funds for its operation, care and perpetuation, subject only to the contractual conditions under which the county accepted the Vanderbilt bequest. Mr. Vanderbilt's bequest included \$2 million to establish an endowment fund for the maintenance and care of the estate. In 1973, the Fund had an additional bequest of \$6.2 million from the estate of Muriel Vanderbilt Adams, William K. Vanderbilt's daughter, raising the corpus of the Fund to \$8.2 million. Today, distributions from the Fund partially defray the Museum's operating expenses.

The Museum's operating budget receives no funds from County real property taxes; however the County general fund assumes all debt service for the Museum's capital projects. Resolution No. 557-1998 authorized an annual distribution of \$1.2 million in \$100,000 monthly installments from the Fund to help defray operating expenses. Resolution No. 1306-2005 extends the current distribution policy through December 31, 2006. If the Legislature desires to continue the \$1.2 million annual distribution to the Museum past 2006, the adoption of a resolution will be required by the end of this year.

Analysis of the Fund has shown that the volatility of the stock market and changing economic times has caused the Fund to fluctuate in value over the years. However, the Fund has been able to meet the financial demands of maintaining the Museum. As of December 31, 2005, the value of the Fund was \$12,519,783.

As indicated in correspondence from Stephen V. Malo, Senior Vice President of Fleet Investment Services, dated November 14, 2002, "the necessary cash flow to the Museum (\$1.2 million annually) is sustainable as long as assets of approximately \$12.2 million remain available." Recent conversations with Mr. Malo support his initial reluctance, as stated in his correspondence, to give a figure that could be interpreted as a minimum market value for the account to continue. Although Mr. Malo was reluctant to provide this figure, the Budget Review Office recommends using \$12.2 million as a base figure to notify the Legislature to review the account within the context of existing market conditions.

### **Term of Investment Management Services Contract**

- Fleet Investment Services (Fleet) entered into a contractual agreement in 1996 with the Suffolk County Legislature to provide investment management services for the Vanderbilt Museum Endowment Trust Fund. The two year agreement included two options to renew for a period of two years for each renewal. In 2004, Fleet Investment Services was selected through an RFP. In September of 2004, Fleet merged with Bank of America, which is now the investment manager for the Endowment Trust Fund. Bank of America is currently managing the Fund as a result of its merger with Fleet. An updated contract agreement has not been instituted since the merger. The Budget Review Office recommends directing the Purchasing Division of the Department of Public Works (DPW) to prepare a request for proposal (RFP)

for circulation to obtain a current contract agreement in accordance with the investment objectives set forth by the Legislature for investment management services, however Article III of Chapter 708 of the Suffolk County Code does not mandate the Legislature to circulate an RFP for professional consulting services.

- ✓ The Budget Review Office strongly recommends directing the County Attorney to enter into a contractual agreement with Bank of America regardless of the decision to commence the RFP process.

## **Investment Strategies**

The current investment objectives are to preserve the principal corpus of the fund, maintain a high level of income that is steady and predictable and provide for future growth of income through long-term capital growth.

Resolution 215-1987 restricts bond investments to investment grade, Baa or above, per Moody's Investors Service.

Resolution No. 1306-2005 authorizes the Vanderbilt Museum Trust Fund's Investment Advisor to:

- Utilize a total return concept, by providing a fixed annual income of \$1.2 million, as requested by the Suffolk County Vanderbilt Museum, to be paid to the Suffolk County Vanderbilt Museum at \$100,000 per month.
- Use realized capital gains for cash flow purposes only, as long as the corpus of the Trust does not go below the value of the original bequest (\$8.2 million), with any unused funds from said realized gains to be returned to the Trust Fund for reinvestment subject to the condition that distribution from realized capital gains be limited to a maximum of the realized capital gains, less the trust management fees authorized to be paid from capital gains under Resolution No. 682-1993.
- Invest a 50/50 split between fixed securities and equities (stocks).

For the second year in a row the Budget Review Office recommends modifying the investment policy to allow up to 60% to 65% of the portfolio to be invested in equities to meet the investment objective of growing the principal of the account and to allow the Fund's investment advisor the flexibility to reallocate assets as favorable market conditions dictate.

## **Performance**

During 2005 the market value of the Fund declined by \$358,246 from \$12,878,029 at the beginning of January to its year-end amount of \$12,519,783. The Fund's year-ending asset allocation is detailed in the following chart.

## Year-Ending Asset Allocation

	2005	2004	Variance
<b>Equities (Stocks)</b>	\$6,310,880	\$6,492,236	(\$181,356)
<b>Fixed Income (Bonds)</b>	\$6,113,089	\$6,203,731	(\$90,642)
<b>Cash &amp; Cash Equivalents (Cash &amp; Money Market Fund)</b>	\$95,813	\$182,062	(\$86,249)
<b>Total</b>	<b>\$12,519,783</b>	<b>\$12,878,029</b>	<b>(\$358,246)</b>

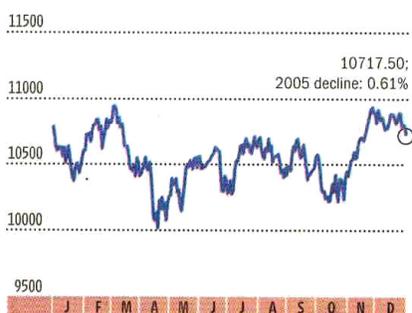
The Fund's total annual return is the income from investments, dividends and interest, as well as capital appreciation from stocks and bonds. The Fund's total annual return for 2005 was a gain of 7.15% compared to a gain of 7.02% in 2004, a gain of 12.8% in 2003, and a loss of 6.32% in 2002. The Fund's reduced market value is due to its annual distribution of \$1.2 million to the Museum and its \$24,762 payment of investment fees.

The Fund's stock portfolio, including stock mutual funds, posted a total return of 8.49% after posting a gain of 12.29% in 2004 and a gain of 25.03% in 2003 and a loss of 29.96% in 2002. The Fund's total return from equities this past year compares favorably to the three main equity indexes, Standard & Poor's 500 stock index (3.0% gain), NASDAQ composite index (1.4% gain) and the Dow Jones industrial average (0.61% decline), as indicated in the charts from the Wall Street Journal that follow.

### A Year of Minor Moves

Daily closes

**Dow Jones Industrial Average**



**Nasdaq Composite Index**



**S&P 500-stock index**



Source: WSJ Market Data Group

The Wall Street Journal January 3, 2006 PP. R1

From 2000 through most of 2002 the "bear market" had noticeable negative effects on the Fund. In 2003 and 2004, "The stock market posted back-to-back yearly gains for the first time since 1999."<sup>1</sup> The stock market had below average returns in 2005, which is the expectation for 2006. "There are plenty of unknowns going into the new year, and that is one reason some analysts warn investors to prepare for sharper ups and downs than they have seen lately. Among the uncertainties: How strong profits will be, whether the economy will continue to boom, whether inflation will return, what oil prices will do, how the midterm Congressional elections will affect stocks and how much longer

<sup>1</sup> Browning, E. S. "Bull Pedals Hard in Uphill Climb." The Wall Street Journal 3 January 2005: PP. R1.

the Federal Reserve will continue raising interest rates.”<sup>2</sup> Adding to the uncertainty is the replacement of Alan Greenspan after his 18½-year tenure as the Chairman of the Federal Reserve Board with Ben Bernanke on February 1, 2006. The Federal Reserve Board is the independent body responsible for setting monetary policy, for overseeing the integrity of the banking system, for containing the risk that can arise in financial markets, and for ensuring a functioning payment system.

The Fund’s fixed income assets (individual bonds and bond mutual funds) posted a total return of 5.87% after gaining 2.05% in 2004, 4.81% in 2003 and 10.4% in 2002. This component of the Fund’s portfolio compares favorably to the 2005 Lehman Brothers Bond Indexes, Lehman Brothers Long Term Treasury Index (6.50%), Lehman Brothers AA-Credit Index (2.38%), Lehman Brothers Municipal Bond Index (3.51%), Lehman Brothers Intermediate-Term Treasury Index (1.56%) and the Lehman Brothers Mortgage-Backed Securities Index (2.61%).

The Fund’s cash equivalents (money market account, treasury bills, and cash) represented .77% of the Fund’s year-ending asset allocation. Treasury Bills are short-term government issued debt instruments that have maturities of one year or less. The 2005 total return for the cash equivalents component of the Fund’s portfolio was 2.73%. This total return does not compare favorably with the 91-Day Treasury total return of 3.35% or the 90-day Treasury Bill total return of 3.07%.

Our financial impact statement for Resolution No. 1306-2005 states that there are **insufficient assets to provide the annual distribution of \$1.2 million to the Museum during 2006 without the market value of the Fund falling below the recommended market value of \$12.2 million. Considering that the market performance for 2006 is projected to be similar to that of 2005 and that the Fund continues its \$100,000 monthly distributions to the Museum, it’s highly probable that the market value of the Fund will fall below \$12.2 million in 2006.** The Budget Review Office will notify the Legislature if the market value falls below \$12.2 million with the recommendation to review the account within the context of existing market conditions.

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<sup>2</sup> Browning, E. S. “A Fight to the Finish for Stocks.” The Wall Street Journal 3 January 2006: PP.R1

## 2005 Income & Remittances to the Museum

During 2005 a total of \$1.2 million was remitted to the Museum, which included the distribution of the Fund's December 2004 income in January 2005, as detailed in the chart that follows.

**Distribution to Museum**

<b>2005</b>	<b>Income Account (Interest &amp; Dividends)</b>	<b>Principal Account</b>	<b>Combined</b>
<b>January</b>	\$88,026	\$11,974	\$100,000
<b>February</b>	\$4,103	\$95,897	\$100,000
<b>March</b>	\$20,699	\$79,301	\$100,000
<b>April</b>	\$62,145	\$37,855	\$100,000
<b>May</b>	\$42,467	\$57,533	\$100,000
<b>June</b>	\$26,360	\$73,640	\$100,000
<b>July</b>	\$62,175	\$37,825	\$100,000
<b>August</b>	\$19,943	\$173,356	\$193,299
<b>September</b>	\$25,851	(\$19,150)	\$6,701
<b>October</b>	\$27,909	\$72,091	\$100,000
<b>November</b>	\$39,712	\$60,288	\$100,000
<b>December</b>	\$24,825	\$75,175	\$100,000
<b>Grand Total</b>	<b>\$444,213</b>	<b>\$755,787</b>	<b>\$1,200,000</b>

The 2005 distributions to the Museum were in accordance with Resolution 1372-2004 and provided the Museum with its guaranteed fixed income of \$1.2 million in \$100,000 monthly payments from income and capital gains. Resolution 1306-2005 continues the policy of using realized capital gains to augment the Museum's income as long as the corpus of the Fund does not go below the value of the original bequest (\$8.2 million) and any unused funds are returned to the Fund for reinvestment. This authorization expires December 31, 2006.

The estimated income for the Fund in 2006 is \$416,462, which is a yield of 3.33% of the market value. Using this 2006 estimated income level as an indication of the Fund's financial status in the coming year, it is estimated that the Fund will require a distribution of \$783,538 from capital gains to augment income from interest and dividends to provide the guaranteed \$1.2 million annual income to the Museum.

The Museum requested to have the Fund's investment manager dispense its distribution on the 1<sup>st</sup> of the month for February 2006 to meet its payroll requirements. Based upon revenues in February, this temporary solution to the Museum's cash flow concerns may be necessary for the Fund's March distribution as well.

## **Advisory Fees**

Investment management fees during 2005 totaled \$24,762. The annual fee is 40 basis points (.40%), calculated on both principal value and accrued income, and taken quarterly. Resolution 682-1993 authorizes the use of capital gains to pay 50 percent of the investment management fees. A total of \$12,381 in investment fees was paid during 2005 from the principal account (realized capital gains from previous years) and a total of \$12,381 was paid from the Fund's income account. Bank of America does not receive any remuneration for the Fund's equity trades. However, a nominal commission is paid to an independent financial institution for equity market transactions.

## **Realized Capital Gains**

Realized capital gains are the profitable difference between an investments' market value and its initial purchase price. The Fund's 2005 year-ending market value includes \$1,033,413 in unrealized capital gains, the difference between the market value of the Fund, \$12,519,783, and its book value, \$11,486,370.

In 1993, the Legislature first authorized the use of capital gains to pay for one half of the investment management fees (Resolution No. 682-1993). Since the inception of this policy through 2005, a total of \$337,164 in realized capital gains has been used to pay investment fees.

In 1994, the Legislature first authorized using realized capital gains to augment distributions to the Museum and to provide a guaranteed annual income with the adoption of Resolution No. 933-1994. From 1995 through 2005 a total of \$6,120,305 in realized capital gains has been remitted to the Museum.

In 2002, Resolution No. 929-2002 changed the long-standing policy of restricting capital gains distributions to a maximum of the realized capital gains accrued during the current calendar year (total return policy) to allow for distributions of capital gains realized during prior years to be distributed. Without this change the Fund would not have been able to provide the Museum with the \$1.2 million income during each of the ensuing years.

For the past several years the Budget Review Office has expressed concern over the Museum's dependence on the use of realized capital gains to augment its income. Specifically, a prolonged market decline coupled with \$100,000 monthly distributions could cause the Fund to fall below \$12.2 million.

While the Museum continues to concentrate on its fund-raising efforts, its attempts to increase revenue from operations have not been sufficient to decrease its reliance on the use of realized capital gains from the Fund to supplement its income. The Museum has taken measures to decrease its expenditures. Recently, the Museum laid off four full-time employees; the special events coordinator, one carpenter and two groundskeepers leaving the Museum with 16 full-time and 69 part-time staffers.

## Allocation of Portfolio Assets

The portfolio's allocation of assets is within the guidelines as originally set forth in Resolution 933-1994, which allows up to 50 percent of the Fund's assets to be invested in equities (i.e. corporate stock, mutual funds, real estate equity fund). During the year the market value of stock equities averaged 33.8% and the bond portfolio represented 14.4% of the Fund's total market value. Investments in bond, stock and real estate equity mutual funds represented the other major investment category, averaging 51.0% of the Fund's market value. As of December 31, 2005, stock mutual funds totaled \$1.97 million and bond mutual funds totaled \$4.42 million. The year-ending equity portfolio, (individual stocks, mutual equity funds, and mutual real estate equity funds) represent 50.41% of the Fund's market value.

The Fund's asset allocation reflects the adopted investment objective to achieve greater growth through capital appreciation as well as provide a steady income from interest and dividends. The Fund's asset allocation as of December 31, 2005 is presented in the following table.

### 2005 Year-Ending Allocation of Fund Assets

Description	Market Value	% Of Portfolio	% Of Portfolio
Individual Stocks (Domestic & Foreign)	\$4,339,377	34.66%	
Mutual Funds (Equity)	\$1,971,503	15.75%	
<b>Total Equities (Stocks)</b>	<b>\$6,310,880</b>		<b>50.41%</b>
Individual Bonds (Treasury Notes; Asset Backed Securities; Corporate Bonds)	\$1,693,701	13.53%	
Mutual Funds-Fixed (Bond)	\$4,419,388	35.30%	
<b>Total Fixed Income Investments (Bonds)</b>	<b>\$6,113,089</b>		<b>48.83%</b>
Short Term Investments (Money Market)	\$95,813	0.77%	
Cash	\$0	0.00%	
<b>Total Other Investments (Money Market &amp; Cash)</b>	<b>\$95,813</b>		<b>0.77%</b>
<b>Total Portfolio</b>	<b>\$12,519,783</b>	<b>100.00%</b>	<b>100.00%</b>

## Equities (Stocks)

The following table details the allocation of equities by category as a percent of the Fund's equities total market value.

### Allocation of Equity (Common Stock) Portfolio by Industry

Category	Market Value 12/31/2005	% of Total Common Stocks
<b>Basic Industry</b>	\$154,729	4%
<b>Capital Goods</b>	\$437,219	10%
<b>Communications</b>	\$218,918	5%
<b>Consumer Cyclical</b>	\$181,566	4%
<b>Consumer Staples</b>	\$367,385	8%
<b>Energy</b>	\$376,118	9%
<b>Finance</b>	\$893,018	21%
<b>Health Care</b>	\$527,751	12%
<b>Retailing</b>	\$313,050	7%
<b>Technology</b>	\$640,488	15%
<b>Transportation</b>	\$71,864	2%
<b>Utilities</b>	\$157,273	4%
<b>Total of Common Stocks</b>	<b>\$4,339,377</b>	<b>100%</b>

The majority of the common stock investments are "blue chip", large cap and Fortune 500 companies, which pay dividends. As of December 31, 2005, ninety-nine (99) of the Fund's one hundred and seventeen (117) equity holdings generate dividends with a market yield of 1.84%, which is an increase from last year's ending dividend yield of 1.65%. In addition to individual stocks, the Fund's year-end portfolio includes five stock mutual funds with a market value of \$1,971,503 million. The market value for all of the Fund's equity investments is \$6,310,880, which is 50.41% of the Fund's year-end market value.

Bank of America's investment policy restricts equity investments in any one company to a maximum of 3 to 5 percent of the total equity portfolio. This conservative investment policy protects the Fund by restricting exposure in any one company. As of the end of 2005, the largest stock holding in the Fund is General Electric Company with a market value of \$155,096.25, which represented 3.6% of the equity portfolio, excluding stock mutual funds.

## Fixed Income Investments (Bonds)

Fixed income investments, individual bonds and bond mutual funds, allow for diversification of the Fund's assets in a type of asset that provides a dependable income. However, the market value for bonds fluctuates with interest rates. The market value may be higher or lower than its book value dependent upon interest rates and bond ratings. Generally, the market value of bonds decreases during times of rising

interest rates, assuming investment grade bonds. Therefore, it is possible to experience a loss of principal when selling a bond prior to its maturity.

The December 31, 2005 market value of all bond investments is \$6,113,089, 48.83% of the Fund's total market value. During the past year, individual bond holdings averaged 14.4% of the portfolio's market value. In addition to individual bonds, the year-ending portfolio includes \$4.4 million in two mutual bond funds yielding 4.83% of book value (\$213,569 annually), as detailed in the following chart.

**Mutual Funds-Fixed (Bond) 2005**

	<b>Yield at Market</b>	<b>Estimated Annual Income</b>	<b>Market Value</b>	<b>Original Cost</b>	<b>Variance</b>
<b>CMG Ultra Short Term Bond Fund</b>	4.09%	\$123,185	\$3,013,972	\$3,049,515	(\$35,544)
<b>Columbia Conservative High Yield</b>	6.43%	\$90,384	\$1,405,416	\$1,427,309	(\$21,893)
<b>Total</b>		<b>\$213,569</b>	<b>\$4,419,388</b>	<b>\$4,476,825</b>	<b>(\$57,437)</b>

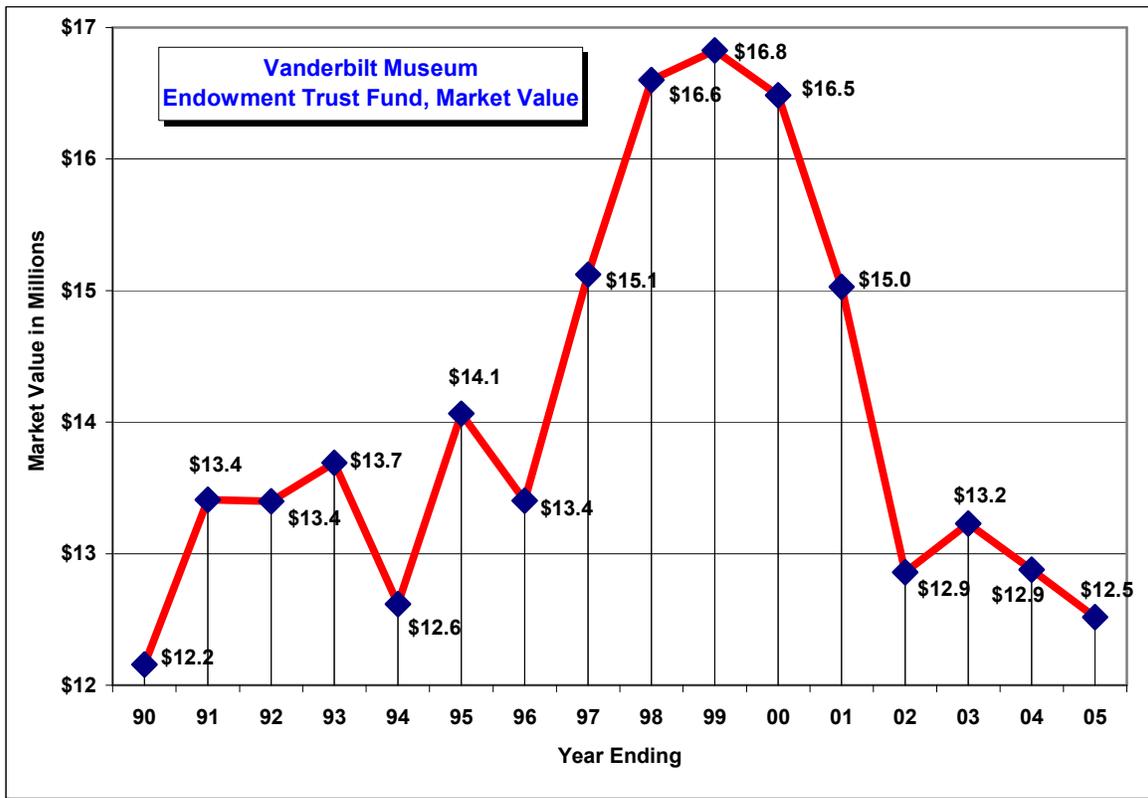
Resolution 215-1987 restricts bond investments to investment grade, Baa or above, per Moody's Investors Service. This legislation structures the Fund's bond portfolio to provide income that is consistent with a reasonable level of risk. The weighted average maturity takes into account the proportional relevance of each bond. The weighted average maturity of the Fund's individual bond portfolio is 12.88 years with a yield of 2.40 percent of book value for a 2006-projected income of \$107,445.

## Summary and Recommendations

The following table summarizes the Fund's 2005 \$358,246 net change (decrease) in market value and the chart that follows plots the Fund's year-end market values during the period 1990-2005.

<b>2005 Endowment Trust Fund Summary</b>			
<b>Beginning Market Value</b>			
Market Value December 31, 2004		\$12,878,029	
<b>Income</b>			
Dividends	\$167,343		
Interest	\$261,377		
Other Income (Money Market interest & dividends)	\$66,860	\$495,579	
<b>Distributions</b>			
Income Remitted to the Museum	(\$444,213)		
Realized Capital Gains Remitted to the Museum	(\$755,787)		
Fees	(\$24,762)		
Foreign Taxes	(\$63)	(\$1,224,825)	
<b>Capital</b>			
Capital Appreciation		\$371,000	
<b>Ending Market Value</b>			
Market Value December 31, 2005		\$12,519,783	
2005 Net Change in Market Value			(\$358,246)

The following graph plots the Fund's market values for the past 16 years ending in December 31, 2005.



The Budget Review Office continues to be concerned with the possibility of a market decline coupled with the \$100,000 monthly distributions to the Museum will cause the Fund to decline below \$12.2 million during 2006. We recommend modifying the Fund's current investment management policy to ensure that the Fund's investment advisor is able to adhere to the Legislature's investment objectives of preserving the principal corpus of the fund, maintaining a high level of steady and predictable income, and increasing the Fund's future income through long-term capital growth. The following investment management policy modifications are recommended as preventative measures to address the concern of using County funds to augment the Museum's operating budget as a result of the continued depletion of the Fund's realized capital gains.

- Formally establish the estimated minimum market value of the Fund that is necessary to support the Museums' monthly distributions without adversely impacting the principal or the investment objectives. The minimum market value of the Fund can be adjusted based on information provided by the Fund's investment advisor, market projections and an accepted and objective economic indicator, such as the consumer price index (CPI) for the New York region, as reported by the U.S. Department of Labor, *Bureau of Labor*

*Statistics.* Without a policy to protect and grow the principal, inflation could erode the Fund's ability to provide sufficient future revenues to the Museum.

- Current policy allows the Fund to continue disbursing \$100,000 per month to the Museum as long as the corpus of the Fund does not go below the value of the original bequest, \$8.2 million. Allowing the market value of the Fund to drop below \$12.2 million does not adhere to the investment objective to provide for future growth of income through long term capital growth. Last year the Budget Review Office recommended establishing a policy by which distributions would be suspended from the principal account (realized capital gains from previous years) in the event that the Fund's market value goes below the established minimum account balance. Based upon the Museum's current significant cash flow shortfall an automatic suspension of distributions would adversely impact the Museum's ability to meet its operating budget demands. Therefore, if the Fund falls below the recommended \$12.2 minimum we recommend a comprehensive review of the Fund to include:
  - ✓ A report to the Legislature from Fund's investment advisor on the Fund's status and ability to continue to supplement the Museum's income from the principal account.
  - ✓ A report from the Museum on its financial status and continued need to supplement its income through the use of realized capital gains distributions from the Fund.
- Modify the current investment policy to allow up to 60% to 65% of the portfolio to be invested in equities from the current ceiling of 50% of the Fund's market value. The recommended change in the equity allocation allows the Fund's investment advisor the flexibility to reallocate assets as favorable market conditions dictate to provide capital appreciation.
- Bank of America is currently managing the Fund as a result of its merger with Fleet Bank in September of 2004. An updated contract agreement has not been instituted since the merger. The Budget Review Office recommends directing the Purchasing Division of the Department of Public Works (DPW) to prepare a request for proposal (RFP) for circulation to obtain a current contract agreement in accordance with the investment objectives set forth by the Legislature for investment management services, however Article III of Chapter 708 of the Suffolk County Code does not mandate the Legislature to circulate an RFP for professional consulting services.
  - ✓ The Budget Review Office strongly recommends directing the County Attorney to enter into a contractual agreement with Bank of America regardless of the decision to commence the RFP process.

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