

**VANDERBILT MUSEUM ENDOWMENT TRUST FUND
ANNUAL REPORT
JANUARY 1, 2008 THROUGH DECEMBER 31, 2008**



July 8, 2009

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

Table of Contents

| | |
|--|----|
| Executive Summary | 3 |
| 2008 Fund Performance and Asset Allocation | 4 |
| Equities (Stocks)..... | 5 |
| Bonds (Fixed Income)..... | 6 |
| Cash & Cash Equivalents | 7 |
| Capital Gains | 7 |
| Income & Remittances to the Museum..... | 8 |
| Investment Management Services Contract..... | 9 |
| Investment Objectives | 9 |
| Terms of the Contractual Agreement..... | 9 |
| Advisory Fees | 10 |
| Summary Table and Graph | 10 |
| Appendix A..... | 12 |
| Historical Information | 12 |

Executive Summary

Historically, the Suffolk County Vanderbilt Museum Endowment Trust Fund (Fund) has used \$12.2 million as an estimated minimum market value necessary to sustain the \$100,000 monthly distribution to the Museum. Unfortunately, due to the significant economic downturn and the Fund's resultant performance, the market value of the Fund decreased below \$12.2 million in January 2008 to a month-ending market value of \$11,747,785 and remained below this benchmark for the 2008 year. In fact, the Fund's (Fund) total annual return; dividends and interest, as well as capital appreciation from stocks and bonds, for 2008 was a loss of 24.88% compared to a gain of 7.12% in 2007 and a gain of 11.39% in 2006. During 2008, the market value of the Fund decreased by \$4,075,309 from \$12,336,418 at the beginning of January to its year-end market value of \$8,261,109, which is net distributions to the Museum and payment of investment management fees. Although the Fund's performance was negatively impacted by the economic downturn during 2008, it provided the Museum with a \$1.2 million annual distribution without falling below the value of the Fund's original bequest (\$8.2 million). However, without the distributions from the Fund, the Museum would not have been able to meet its operating expenditures.

Resolution No. 1266-2007 extended the authorization to provide the Museum with \$1.2 million annually, \$100,000 each month, through December 31, 2008 as long as the corpus of the Fund did not go below the value of the original bequest, (\$8.2 million). To date, the Legislature has not extended this authorization for 2009, as the market value of the Fund cannot support a \$1.2 million distribution. To support the Museum in meeting its 2009 operating budget expenses and to enable the Museum to continue to operate as an educational resource for the residents of Suffolk County as well as a tourist attraction for visitors, Resolution No. 870-2008 authorized the transfer of \$800,000 from the General Fund during 2009.

2008 Fund Performance and Asset Allocation

The Suffolk County Vanderbilt Museum Endowment Trust Fund's (Fund) 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 2008 was a loss of 24.88% compared to a gain of 7.12% in 2007 and a gain of 11.39% in 2006. During 2008, the market value of the Fund decreased by \$4,075,309 from \$12,336,418 at the beginning of January to its year-end market value of \$8,261,109, which is net distributions to the Museum and payment of investment management fees. The table that follows details the 2008 month-ending market values for the Fund.

**Month-ending Market Values
for the Fund in 2008**

| Month | Total Account Market Value |
|--------------|---------------------------------------|
| January | \$11,747,785 |
| February | \$11,505,332 |
| March | \$11,381,074 |
| April | \$11,628,847 |
| May | \$11,628,972 |
| June | \$10,995,249 |
| July | \$10,816,861 |
| August | \$10,733,639 |
| September | \$9,991,150 |
| October | \$8,390,901 |
| November | \$8,372,583 |
| December | \$8,261,109 |

During 2008, the market value of stock equities averaged 28.4%, individual bond portfolio averaged 6.7%, mutual funds (stocks and bonds) averaged 50.6%, and money market averaged 15.0% of the Fund's total market value. These percentages are distorted by changes to the portfolio's asset allocation that began in October. On October 10, 2008, given the market value of the Fund (\$8.7 million) and the financial market conditions, the Legislature exercised its fiduciary responsibility by directing the investment manager to convert (sell) volatile securities (equities) to cash, cash equivalents or other secure investments that were less volatile in order to preserve the Fund's \$8.2 million corpus. Excluding the last three months of the year, the market value of stock equities averaged 37.9%, individual bond portfolio averaged 6.3%, mutual funds (stocks and bonds) averaged 55.1%, and money market averaged 1.4% of the Fund's total market value.

The Fund's year-ending asset allocation is presented in the table that follows.

2008 Year-Ending Allocation of Fund Assets

| Description | Market Value | % Of Portfolio | % Of Portfolio |
|--|--------------------|----------------|----------------|
| Individual Stocks (Domestic & Foreign) | \$0 | 0.00% | |
| Mutual Funds (Equity) | \$0 | 0.00% | |
| Total Equities* | \$0 | | 0.00% |
| Individual Bonds (Treasury Notes; Asset Backed Securities; Corporate Bonds) | \$677,296 | 8.20% | |
| Mutual Funds-Fixed (Bond) | \$2,787,356 | 33.74% | |
| Total Bonds | \$3,464,652 | | 41.94% |
| Short Term Investments (Money Market) | \$4,796,456 | 58.06% | |
| Cash | \$0 | 0.00% | |
| Total Other Investments | \$4,796,456 | | 58.06% |
| Total Portfolio | \$8,261,109 | 100.00% | 100.00% |
| Note: On October 10, 2008, the Legislature directed the Fund's investment manager to convert (sell) volatile securities (equities) to cash, cash equivalents or other secure investments that were less volatile in order to preserve the Fund's \$8.2 million corpus. | | | |

The following table details the Fund's 2008 year-ending asset allocation in comparison to 2007.

2008 Year-Ending Asset Allocation in Comparison to 2007

| | 2008 | 2007 | Variance |
|--|--------------------|---------------------|----------------------|
| Equities (Stocks) | \$0 | \$6,693,654 | (\$6,693,654) |
| Bonds (Fixed Income) | \$3,464,652 | \$5,329,088 | (\$1,864,436) |
| Cash & Cash Equivalents (Money Market Fund) | \$4,796,456 | \$313,676 | \$4,482,780 |
| Total | \$8,261,109 | \$12,336,418 | (\$4,075,309) |

Equities (Stocks)

The Fund's year-end portfolio did not include equities. On October 10, 2008, in response to the financial market conditions, the Legislature exercised its fiduciary responsibility by directing the investment manager to convert (sell) volatile securities to cash, cash equivalents or other secure investments that were less volatile in order to preserve the Fund's \$8.2 million corpus. This was a prudent investment decision considering that "Four of the 20 biggest daily percentage declines in Dow history happened in the last four months of 2008¹". The Wall Street Journal reported that 2008 was the Dow's worst year since 1931 and the NASDAQ Composite Index's worst percentage decline in its 38-year history; it fell 40.5%².

¹ Browning, E.S. "After the Collapse, Guarded Hope for '09" *The Wall Street Journal*. 2 January 2009: PP. R1

² Ibid

Bonds (Fixed Income)

Resolution No. 215-1987 restricts bond investments to investment grade³, Baa⁴ or above, per Moody's Investors Service.⁵ This legislation structures the Fund's bond portfolio to provide income that is consistent with a reasonable level of risk. 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 prevailing market 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. Bond prices rise when investors seek the safety of government-backed debt and during times of declining interest rates.

The December 31, 2008 market value of all bond investments was \$3,464,652, which was 41.94% of the Fund's total market value. This portion of the portfolio included one individual Procter and Gamble corporate bond (\$567,664) and one Federal National Mortgage Association (FNMA) mortgage backed security (\$109,632), which when combined (\$677,296) represented 8.20% of the Fund's total market value, and one mutual bond fund, Columbia Short Term Bond Fund, (\$2,787,356) that represented 33.74% of the Fund's total market value and yielded 4.81% of book value (\$134,019 annually).

The Procter and Gamble corporate bond was rated AA3 by Moody's Investor Service and matures in 12.3 years with a projected income of \$42,833. The FNMA mortgage backed security is implicitly rated AAA as it is a government backed agency. This FNMA mortgage backed security consists of a "pool" of 30 year mortgages that will be paid off on August 25, 2022. The principal and interest is distributed every month as people pay down their mortgage during the life of the security. Its projected annual income is \$6,319.

The Fund's fixed income assets (individual bonds and bond mutual funds) posted a total return of -5.37% in 2008 after gaining 3.48% in 2007. This component of the Fund's portfolio does not compare favorably to the Merrill Lynch 1-3 Year Treasury Index (6.61%) or the Barclays Capital Aggregate Bond Index⁶ (5.24%). The total annual return for the portfolio's individual bond funds was 4.32% and the portfolio's mutual bond fund had a total annual return of -4.35%.

³ An investment grade bond is generally considered suitable for purchase by prudent investors. Moody's Investors Service designate bonds in their top four categories (AAA/Aaa, A/Aa, A and BBB/Baa) as investment grade.

⁴ Obligations rated Baa are subject to moderate credit risk.

⁵ Moody's Investors Service provides investment grade opinions of the relative credit risk of fixed-income obligations with an original maturity of one year or more that address the possibility that a financial obligation will not be honored as promised.

⁶ Effective November 3, 2008, the Lehman Brothers indices were renamed Barclays Capital indices.

Cash & Cash Equivalents

Cash and cash equivalents (money market⁷, treasury bills⁸, and cash) represented the largest portion of the Fund's portfolio at the end of 2008. The December 31, 2008 market value for the cash and cash equivalents portion of the Fund was \$4,796,456, which represented 58.06% of the Fund's year-ending asset allocation.

The 2008 total return for the cash and cash equivalents component of the Fund's portfolio was 2.30%. This total return compares favorably with the Merrill Lynch 91 Day T-Bill⁹ (2.06%).

Capital Gains

Capital gains are the profitable difference between an investment's market value and its initial purchase price. The Fund's 2008 year-ending market value includes \$73,208 in unrealized capital gains, the difference between the market value of the Fund, \$8,261,109, and its book value, \$8,187,901.

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 2008, a total of \$369,122 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 2008 a total of \$8,497,433 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.

⁷ Money market funds are designed to provide safety of principal and current income by investing in securities that mature in one year or less, such as bank certificates of deposit, commercial paper and U.S. Treasury bills. Money market funds have the lowest risk of any type of mutual fund.

⁸ Treasury Bills are short-term government issued debt instruments that have maturities of one year or less.

⁹ The benchmark Merrill Lynch 91-Day U.S. Treasury Bill Index is an unmanaged index that seeks to measure the performance of U.S. Treasury bills currently available in the marketplace.

The Budget Review Office has historically expressed concern over the Museum's dependence on the use of realized capital gains to augment its income. We recognize that the Museum would not have been able to meet its operating expenditures without the Fund's \$100,000 monthly distribution. Market conditions during 2008 required the suspension of distributions during 2009, as there are insufficient realized capital gains.

Income & Remittances to the Museum

During 2008, a total of \$1.2 million was remitted to the Museum, which included the distribution of the Fund's December 2007 income in January 2008, as detailed in the chart that follows.

2008 Monthly Distributions to Museum

| 2008 | Income Account (Interest & Dividends) | Principal Account | Combined |
|--------------------|--|--------------------------|--------------------|
| January | \$100,000 | \$0 | \$100,000 |
| February | \$59,492 | \$40,508 | \$100,000 |
| March | \$25,957 | \$74,043 | \$100,000 |
| April | \$26,236 | \$73,764 | \$100,000 |
| May | \$24,597 | \$75,403 | \$100,000 |
| June | \$25,530 | \$74,470 | \$100,000 |
| July | \$50,080 | \$49,920 | \$100,000 |
| August | \$22,250 | \$77,750 | \$100,000 |
| September | \$22,381 | \$77,619 | \$100,000 |
| October | \$24,231 | \$75,769 | \$100,000 |
| November | \$0 | \$0 | \$0 |
| December | \$43,062 | \$156,938 | \$200,000 |
| Grand Total | \$423,817 | \$776,183 | \$1,200,000 |

Resolution No. 1266-2007 continued the policy of using realized capital gains to augment the Museum's income as long as the corpus of the Fund did not go below the value of the original bequest (\$8.2 million) and any unused funds were returned to the Fund for reinvestment. This authorization expired December 31, 2008. To date, the Legislature has not extended this authorization for 2009. To support the Museum in meeting its 2009 operating budget expenses and to enable the Museum to continue to operate as an educational resource for the residents of Suffolk County as well as a tourist attraction for visitors, Resolution No. 870-2008 authorized a maximum transfer of \$800,000 from the General Fund during 2009 not to exceed \$100,000 per month based upon monthly cash flow needs analysis. This Resolution also directed the Executive Director of the Museum or successor and the President of the Museum's Board of Trustees to appear before the Suffolk County Legislature's Parks and Recreation Committee

or successor committee, no later than June 30, 2009 to submit a formal written business plan demonstrating how the Museum is to replace the one-year \$800,000 subsidy from the County.

As of December 31, 2008, the Funds estimated 2009 annual income is \$223,461, which is a yield of 2.7% of the market value.

Investment Management Services Contract

Investment Objectives

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 No. 215-1987 restricts bond investments to investment grade, Baa or above, per Moody's Investors Service.
- Resolution No. 1477-2006 modified the investment guidelines to allow a 50/50 split between fixed securities (bonds) and equities (stocks) to range between 5-10% of the 50/50 split, as determined by market conditions.
- Resolution No. 1266-2007 set the Fund's 2008 investment policy. It authorized the Vanderbilt Museum Trust Fund's Investment Advisor, Bank of America, to:
 - ✓ Utilize a total return concept, meaning investing for a comprehensive return, including interest and dividends earned on stocks and bonds, plus realized and unrealized gains and losses.
 - ✓ Provide 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 to augment the monthly income distribution to the Museum, as long as the corpus of the Fund does not go below the value of the original bequest (\$8.2 million).
- The Legislature is currently reviewing the Fund's investment objectives related to the current financial markets and is in the process of developing a Request for Proposal (RFP) for investment management services.

Terms of the Contractual Agreement

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. The contract agreement with Bank of America expired at the end of 2008. A Request For Expressions of Interest (RFEI) for Investment Management Services for the Suffolk County Vanderbilt Museum Endowment Trust Fund was advertised on April 2, 2009 with proposals to be received by April 23, 2009. The proposals were reviewed and in the upcoming months the County will be issuing a Request for Proposal (RFP) to the seven companies that were chosen to participate in the next phase of the selection process.

Advisory Fees

Investment management fees during 2008 totaled \$19,348. The annual fee is 40 basis points (.40%), calculated on both principal value and accrued income, and taken quarterly. Resolution No. 682-1993 authorizes the use of capital gains to pay 50 percent of the investment management fees. A total of \$9,674 in investment fees was paid during 2008 from the principal account (realized capital gains from previous years) and a total of \$9,674 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.

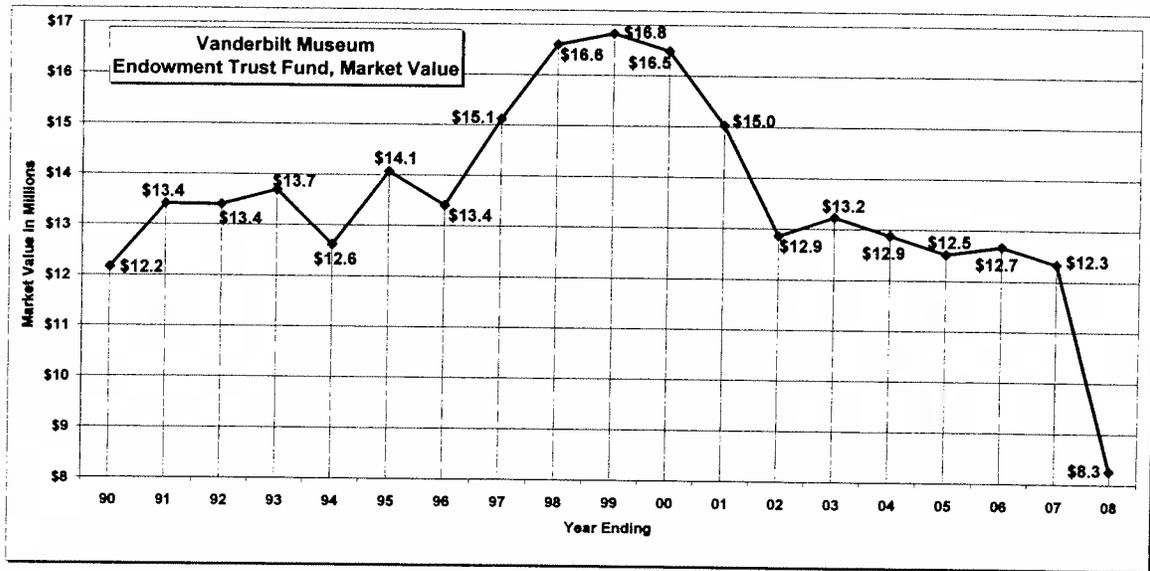
Summary Table and Graph

The following table summarizes the Fund's 2008 \$4,075,309 net change (decrease) in market value and the chart that follows plots the Fund's year-end market values during the period 1990-2008.

2008 Endowment Trust Fund Summary

| | | |
|--|---------------|---------------|
| Beginning Market Value | | |
| Market Value December 31, 2007 | | \$12,336,418 |
| Income | | |
| Dividends | \$295,886 | |
| Interest | \$51,103 | \$346,989 |
| Distributions | | |
| Remitted to the Museum | (\$1,200,000) | |
| Fees | (\$19,348) | |
| Application Fee for Form 8802 US Residency Certification | (\$35) | (\$1,219,383) |
| Capital | | |
| Capital Appreciation | | (\$3,202,915) |
| Ending Market Value | | |
| Market Value December 31, 2008 | | \$8,261,109 |
| 2008 Net Change in Market Value | | (\$4,075,309) |

The following graph plots the Fund's market values for the past 19 years ending in December 31, 2008.



Appendix A

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, and 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.

In November of 1986, Local Law No. 35-1986, designated and renamed the museum "Suffolk County Vanderbilt Museum". 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.

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. Distributions from the Fund partially defray the Museum's operating expenses.

Historically, the Museum's operating budget did not receive funds from County real property taxes; however the County general fund assumed all debt service for the Museum's capital projects. In 2008, Resolution No. 870-2008 made a one-year commitment to provide the Museum \$800,000 in General Fund distributions in 2009 not to exceed \$100,000 per month based upon monthly cash flow needs analysis prepared by the Vanderbilt Museum no later than the 15th of the previous month. The one-year commitment to provide the Museum revenue from the General Fund will sunset on December 31, 2009.