County Administration Office
COUNTY OF TULARE
AGENDA ITEM

AGENDA DATE: August 28, 2018

Public Hearing Required	Yes	☐	N/A	☒
Scheduled Public Hearing w/Clerk	Yes	☐	N/A	☒
Published Notice Required	Yes	☐	N/A	☒
Advertised Published Notice	Yes	☐	N/A	☒
County Counsel Sign-Off	Yes	☒	N/A	☐
Meet & Confer Required	Yes	☐	N/A	☒
Electronic file(s) has been sent	Yes	☒	N/A	☐
Budget Transfer (Aud 308) attached	Yes	☐	N/A	☒
Personnel Resolution attached	Yes	☐	N/A	☒
Agreements are attached and signature line for Chairman is marked with tab(s)/flag(s)	Yes	☐	N/A	☐

CONTACT PERSON: Michael C. Spata PHONE: 636-5005

SUBJECT: Tulare County's Millennium Fund Investment Program Report

REQUEST(S):

That the Board of Supervisors:

1. Receive a presentation by the Public Financial Management, Asset Management LLC ("PFM") regarding the Annual Report for the Millennium Fund Investment Program;

2. Accept the Annual Report for the Millennium Fund Investment Program; and

3. Provide direction to the County Administrative Office regarding the appropriation from the Millennium Fund for Fiscal Year 2018/19.

SUMMARY:

The PFM Asset Management LLC ("PFM"), in its role as Administrator, is providing a presentation on the annual report to update the County of Tulare on the status of the Millennium Fund Program (the "Program") and the associated Refunding Bonds, Series 2006 (the "Bonds").

Since inception in 1999, the Program has generated earnings sufficient to cover its costs. The earnings rate on the investment portfolio continues to exceed the borrowing rate. In December 2006, the bonds that support the Program were refinanced as a private placement, which helped to reduce the County's costs and served to isolate the Program from the credit crisis and liquidity crunch that existed in the markets in 2007 and 2008.

The Program's ongoing investment goals are to achieve and maintain parity while generating an investment rate higher than the borrowing rate of the bonds to grow Program over time, and carefully control risk to ensure ongoing success.

This presentation will provide specifics on the Millennium Fund Program and the associated Refunding Bonds, Series 2006 which will include:

- Value of the Millennium Fund Endowment
- Program's Annual Appropriations
- Program's Performance
- Investment Strategy and Interest Rates

Accordingly, it is respectfully requested that the Board of Supervisors (1) Receive a presentation by the PFM Asset Management LLC ("PFM") regarding the Annual Report for the Millennium Fund Investment Program; (2) Accept the Annual Report for the Millennium Fund Investment Program; and (3) Provide direction to the County Administrative Office regarding the appropriation from the Millennium Fund for Fiscal Year 2018/19.

FISCAL IMPACT/FINANCING:

There will be no Net County Cost associated with this agenda item. As part of the discussion, the Board will be asked to provide direction regarding the amount of the appropriation for Fiscal Year 2019/19. The request is for a $3.5 million appropriation. Alternatively, the Board could approve a lower amount such as $2.5 million. The discussion at the Board by PFM and the CAO will help inform the direction.

LINKAGE TO THE COUNTY OF TULARE STRATEGIC BUSINESS PLAN:

Tulare County's Strategic Plan includes the initiative of Organizational Performance to promote continuous improvement of organization effectiveness and fiscal stability. The Board's approval of the presentation on the Millennium Fund report helps fulfill this Initiative by ensuring the stability of county operations through efficient financial processes.

SUBJECT: Tulare County's Millennium Fund Investment Program Report
DATE: August 28, 2018

ADMINISTRATIVE SIGN-OFF:

Sophia Almanza, MBA
Deputy CAO – Budget and Finance

Michael C. Spata
County Administrative Officer

cc: Auditor-Controller
County Administrative Office
County Counsel

Attachment(s) Administrative Report - Millennium Fund Investment Program

BEFORE THE BOARD OF SUPERVISORS
COUNTY OF TULARE, STATE OF CALIFORNIA

IN THE MATTER OF APPROVAL OF THE MILLENNIUM FUND PRESENTATION	)) **Resolution No. ___________**) **Agreement No. ___________**)

UPON MOTION OF SUPERVISOR ______________, SECONDED BY SUPERVISOR ____________________, THE FOLLOWING WAS ADOPTED BY THE BOARD OF SUPERVISORS, AT AN OFFICIAL MEETING HELD AUGUST 28, 2018 ________, BY THE FOLLOWING VOTE:

AYES:
NOES:
ABSTAIN:
ABSENT:

ATTEST: MICHAEL C. SPATA
COUNTY ADMINISTRATIVE OFFICER/
CLERK, BOARD OF SUPERVISORS

BY: ________________________________
Deputy Clerk

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1. Received a presentation by the Public Financial Management, Asset Management LLC ("PFM") regarding the Annual Report for the Millennium Fund Investment Program;

2. Accepted the Annual Report for the Millennium Fund Investment Program; and

3. Provided direction to the County Administrative Office regarding the appropriation from the Millennium Fund for Fiscal Year 2018/19.

August 16, 2018

Mr. Michael Spata
County Administrative Officer, Tulare County
Tulare County Administration Building
2800 West Burrel Avenue
Visalia, CA 93291-4582

pfm

50 California Street
Suite 2300
San Francisco, CA 94111
415.982.5544

pfm.com

Dear Mr. Spata:

As required annually by the Program Administration Agreement, PFM Asset Management LLC ("PFM"), in its role as Administrator, is providing this report to update the County of Tulare (the "County") on the status of the Millennium Fund Program (the "Program") and the associated Refunding Bonds, Series 2006 (the "Bonds").

Executive Summary

The Program continues to be successful. Since inception in 1999, the Program has generated earnings sufficient to cover its costs and has provided over $49.7 million in appropriations to the County—funds the County has used to provide services to the community. The earnings rate on the investment portfolio continues to exceed the borrowing rate.

In December 2006, the bonds that support the Program were refinanced as a private placement, which allowed the County to reduce costs and served to isolate the Program from the credit crisis and liquidity crunch that gripped the markets in 2007 and 2008. As of April 1, 2018, the market value of cash and investments exceeded $55.1 million.

Market Valuation

Tulare County Millennium Fund Program Market Valuation as of April 1, 2018	
Fund Name	**Market Value**
Bond Fund	$608,055
Millennium Fund	$54,498,523
Tobacco Settlement Fund (TSR)	$350
Total	**$55,106,928**

Unwind Position

The table below shows that the market value of the Millennium Fund Program exceeds the outstanding par value of the bonds by $21.6 million, which is the amount of proceeds that would remain if the Program were collapsed and the Bonds completely paid off (excluding any costs associated with collapsing the Program). The difference between the current unwind position and the original 2006 projections is due to lower than expected tobacco settlement receipts since inception of the Program. Although the unwind position is currently less than originally projected, it remains a significant positive amount.

Unwind Position as of April 1, 2018	
Market Value of Millennium Fund Program	$55,106,928
Principal of Bonds Outstanding	$33,425,000
Unwind Position – Favorable	$21,681,928

Projections for April 1, 2018[1]	
Projection—Market Value of Millennium Fund Program	$56,276,875
Projection—Principal of Bonds Outstanding	$33,425,000
Projection—Unwind Position	$22,851,875
Difference Between Current and Projections	
Difference between Current Unwind Exposure and Original Projection of Unwind Exposure	**($1,169,947)** unfavorable

Appropriations

As of April 1, 2018, the County has appropriated a total of $49,723,359 from the Program for capital expenditures. For FY 2017-18, the County received a disbursement of $3,500,000 on September 6, 2017.

In accordance with Section 5.03(c) of the Trust Indenture, the County has the option to withdraw an amount equal to the lesser of (i) $3,500,000 or (ii) the amount by which the aggregate market value of assets exceeds the outstanding principal amount of Bonds (currently $21.6 million). In the current fiscal year, the available amount for withdrawal is $3,500,000 and became available on July 1, 2018.

[1] *As of December 2006*

Millennium Fund Program Appropriations

Year	Allowable Appropriations	Actual Appropriations
2000	$2,500,000	$2,500,000
2001	$2,500,000	$2,500,000
2002	$2,500,000	$2,500,000
2003	$2,500,000	$1,223,359
2004	$2,500,000	$2,500,000
2005	$2,500,000	$2,500,000
2006	$2,500,000	$2,500,000
2007	$4,500,000	$4,500,000
2008	$3,500,000	$3,500,000
2009	$3,500,000	$2,500,000
2010	$3,500,000	$3,000,000
2011	$3,500,000	$2,500,000
2012	$3,500,000	$3,000,000
2013	$3,500,000	$2,500,000
2014	$3,500,000	$2,500,000
2015	$3,500,000	$2,500,000
2016	$3,500,000	$3,500,000
2017	$3,500,000	$3,500,000
Total		**$49,723,359**

Tobacco Settlement Receipts

The County received an annual tobacco settlement payment totaling $4,679,764 on April 26, 2018. Since it was received after April 1st, this amount was not included in the market value summary above.

The payments received by the County to date are less than projected by the California Attorney General in 2007[1] primarily due to some tobacco companies, specifically Philip Morris USA Inc., R.J. Reynolds Tobacco Co., and Lorillard Inc., withholding a portion of their respective Master Settlement Agreement payments as

[1] *Updated State projections are shown for periods following April 2007, and are available at:* http://ag.ca.gov/tobacco/settlements/PAPLGTS.pdf

they dispute the obligations. In December 2012, these tobacco companies reached an agreement in principle with 17 states, including California, to settle the claims from 2003 through 2012 related to the company's Master Settlement Agreement (MSA) payments to the states. The agreement included a release to the joining states of their portion of more than $4 billion from disputed payment accounts. The settlement for payments through 2012, and the agreement to a new system for 2013 and subsequent years was viewed favorably by all parties involved.

Year	Actual Payments[1]	State Projections [2]	Variance
2001	$3,614,123	$3,638,531	($24,408)
2002	$4,447,073	$4,417,085	$29,988
2003	$4,674,919	$4,434,157	$240,762
2004	$3,922,923	$3,949,862	($26,939)
2005	$3,979,083	$4,024,713	($45,630)
2006	$3,639,835	$4,088,870	($449,035)
2007	$3,788,038	$4,096,450	($308,412)
2008	$4,068,387	$4,438,589	($370,202)
2009	$4,470,521	$4,497,186	($26,665)
2010	$3,727,742	$4,548,679	($820,937)
2011	$3,853,660	$4,605,533	($751,873)
2012	$3,929,789	$4,662,355	($732,566)
2013	$5,935,172	$4,715,894	$1,219,278
2014	$3,880,612	$4,767,758	($887,146)
2015	$3,855,103	$4,818,206	($963,103)
2016	$3,811,221	$4,878,084	($1,066,863)
2017	$3,919,846	$4,938,123	($1,018,277)
2018	$4,679,764	$5,333,835	($654,071)
Total	$74,197,811	$80,853,910	($6,656,099)

Potential Impact of Declining Tobacco Sales

The Master Settlement Agreement recognizes that payments to states could be reduced if tobacco sales go down or if tobacco companies go out of business. In either case, declining tobacco sales could impact the

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[1] *Revisions have been made to some of the historical actual payments to account for payments received after the report date. Data available at: http://oag.ca.gov/sites/all/files/agweb/pdfs/tobacco/settlements/TMSAPC_REV.pdf*

[2] *Updated State projections are shown for periods following April 2007, and are available at: http://ag.ca.gov/tobacco/settlements/PAPLGTS.pdf*

annual payments Settlement participants, including the County, would receive. Since the Millennium Fund Program is above parity—by $21.6 million as of April 1, 2018—a reduction in future tobacco settlement payments would not jeopardize the viability or success of the Program. The existing Program balances are sufficient to allow the County to pay all remaining principal and interest from internal funds until the bonds are paid off. A reduction in payments would, however, affect the future growth of the Fund. For example, if future receipts are less than $3.5 million, the County would have to dip into the Fund principal to withdrawal the full $3.5 million apportionment, although this has not yet happened. Reduced annual payments may cause the ultimate growth of the Fund balance to slow, but the program is self-sustaining.

Annual Lease Payment

Section 403 of the Lease Agreement requires a deposit into the Bond Fund on June 1 to cover estimated Gross Lease Payments (estimated debt service and Program fees) for the following fiscal year.

The gross borrowing rate averaged 1.53% between April 2017 and April 2018, increasing by 0.68% over the year as short-term yields continued to move higher in response to Federal Reserve rate hikes. Because the Bonds are variable-rate, where the interest rate is reset monthly at 1-month LIBOR plus 25 basis points (0.25%), the exact amount of debt service cannot be determined in advance. As has been the procedure in recent years, the next year's debt service is estimated by calculating the interest payments using an interest rate equal to the most recent reset rate plus 100 basis points (1.00%). The addition of 100 basis points provides a cushion should 1-month LIBOR rise during the upcoming fiscal year. Because of the low level of current rates and the potential for rates to rise, perhaps significantly in the future, PFM recommends a more conservative 150 basis point cushion for FY 2018-19.

The reset rate for the Bonds on April 1, 2018, was 1.91%; therefore, debt service for the following fiscal year is estimated using a rate of 3.41%. The projected debt service amount includes the $1,110,000 principal payment due on August 1, 2018. As a reminder, because of the 2006 private placement refunding, the County no longer has to pay fees for remarketing, ratings, or a letter of credit.

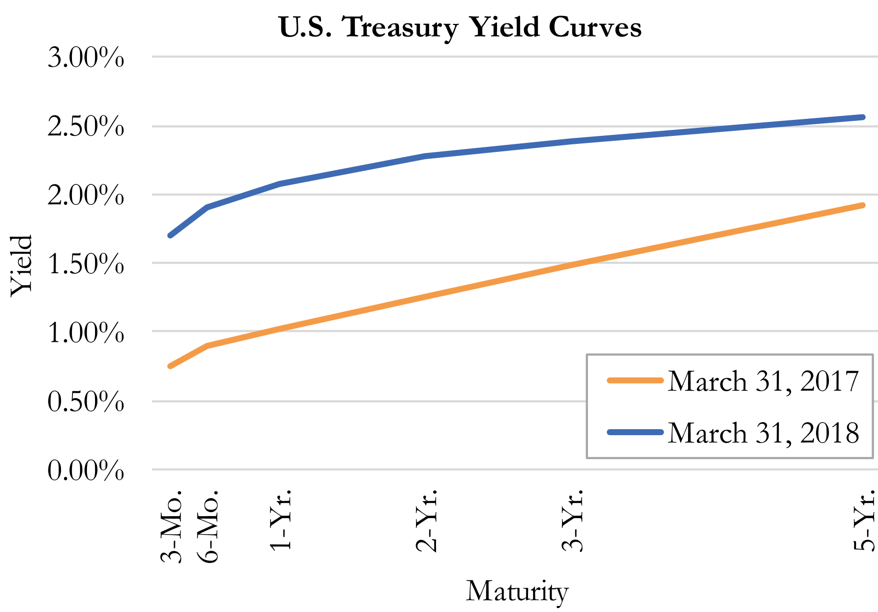
Tulare County Millennium Fund Program Fiscal Year 2018-2019 Estimated Debt Service and Fees		
Type of Fee	**Payee**	**Estimated Cost**
Debt Service	Bondholders	$2,235,024
Trustee Fees	The Bank of New York Mellon Global Corporate Trust	$2,300
Management & Administration	PFM Asset Management LLC	$65,462
Total Gross Lease Payment for FY 17-18		**$2,302,786**

On June 1, funds from the TSR (Tobacco Settlement Receipts) Fund were transferred to the Bond Fund to cover estimated Gross Lease Payments for the upcoming fiscal year. Excess funds in the TSR Fund are transferred to the Millennium Fund for longer-term investment. Details of the transfers are shown in the following table.

Net Transfers to Millennium Fund	
FISCAL YEAR 2018-19 LEASE REQUIREMENT	
Gross Lease Payment Requirement	$2,302,786
Minus: June 1 Bond Fund balance after Debt Service Payment and Fees	- $299,590
Net Requirement/Deposit to Bond Fund on June 1, 2018	$2,003,196
FISCAL YEAR 2017-18 TOBACCO RECEIPTS	
April 26, 2018 Payment	$4,679,764
NET TRANSFER TO MILLENNIUM FUND	
FY 2017-18 Tobacco Receipts	$4,679,764
Less: Net Requirement/Deposit to Bond Fund	- $2,003,196
Transfer to Millennium Fund on June 1, 2018	$2,676,568

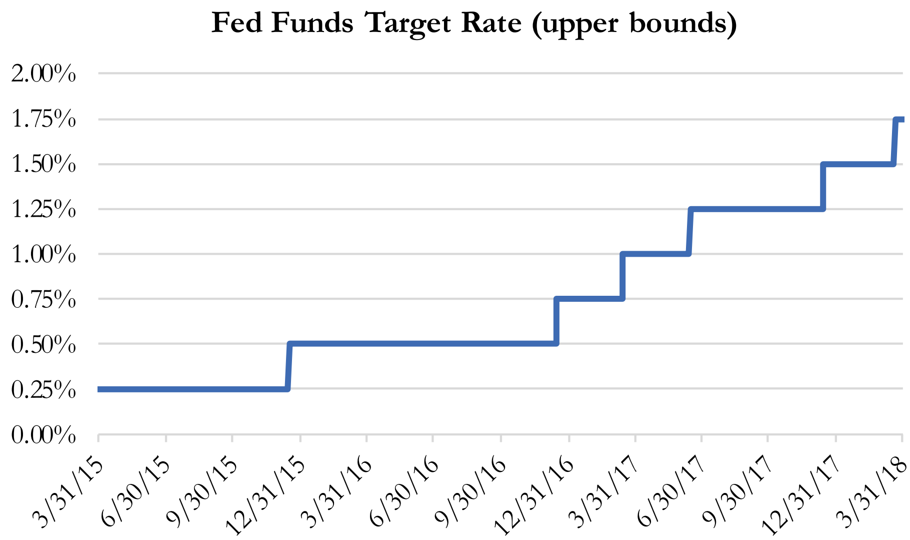
Economic and Interest Rate Update

Since late 2016, interest rates on securities with maturities under five years have been steadily rising, with significant increases coming at the end of 2017 through the first calendar quarter of 2018. For the year ended March 31, 2018, the yield on the 3-month Treasury bill increased by 95 basis points (0.95%), the 2-year Treasury increased by 101 basis points (1.01%), and the 5-year yield increased 64 basis points (0.64%).



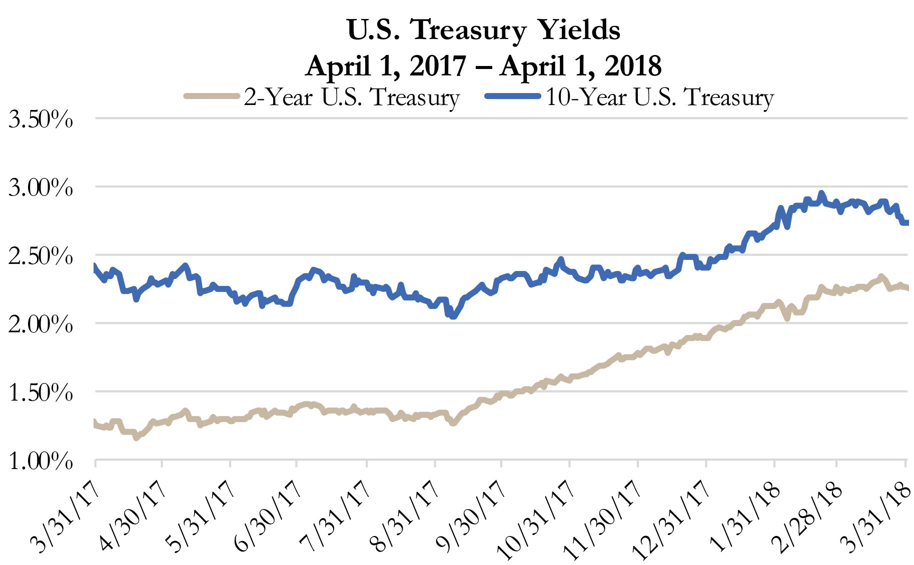
Source: Bloomberg

The increase in short-term interest rates has been driven in large part by a series of Federal Reserve (the Fed) rate hikes. As shown in the following chart, the Fed began raising the rate in December 2015 and, since December 2016, the increases have occurred regularly. During the year ended March 31, 2018, the Fed raised the target rate three times, from a range of 0.75%% to 1.00% to a range of 1.50% to 1.75%.



Source: Federal Open Market Committee (FOMC), Bloomberg

While short-term rates have been moving sharply higher, yields on maturities beyond five-years have only moved up less. The effect of shorter-term yields moving up more than longer-term yields was a significant flattening of the yield curve. The yield difference, or spread, between 10-year and 2-year maturity Treasuries was just 47 basis points (0.47%) on April 1, 2018, its narrowest level since 2007. Longer-term yields have been held down by low inflation expectations and strong demand.



Source: Bloomberg

Economic conditions have been generally positive in the U.S. during the past year. U.S. GDP grew at an average rate of 2.8% for the four quarters ended March 31, 2018. Personal consumption and fixed investment have been strong contributors to GDP, reflecting the recent strong readings of business and consumer confidence. Inflation, as measured by the core personal consumption expenditures (PCE) price index, was nearing the Fed's 2% target as of March 31, 2018, with a reading of 1.8%. Strength in the labor market continued over the past year. The U.S. economy added an average of 192,000 net new jobs a month in the year ended March 31, 2018, as the unemployment rate declined to 4.1%. As a further sign of a strong jobs market, in March the number of job openings was nearly equal to the number of unemployed Americans. But, given the strength of the labor market, wage growth has been disappointing.

Investment Strategy

The investment strategy for each of the Program's funds is described below.

Tobacco Settlement Fund (TSR). This account is funded once a year, on or shortly after April 15. Funds in the TSR account are transferred to the Bond Fund on June 1 in an amount sufficient to cover the next year's estimated Gross Lease Payments, as described above. All remaining funds in the TSR are transferred to the Millennium Fund. Funds received this April in the TSR account remained invested in the money market fund, given its attractive yield relative to other short-term investment options. Once transferred, funds are invested in accordance with the strategy for the respective fund.

Bond Fund. Funds in the Bond Fund are used to pay debt service and administrative costs for the program. Each year, a portion of the annual settlement is transferred into the Bond Fund so that sufficient funds are available to cover monthly debt service, quarterly management and administration fees, and the trustee fee which is paid annually. A short-term investment strategy is employed to meet the regular liquidity needs of the Bond Fund. Funds are invested in high-quality securities targeted to the Bond's future monthly payments and reset dates—the first business day of each calendar month. This strategy is designed to ensure that funds are available to pay debt service and other fees, to maximize the return on the investment, and to minimize "basis risk"—the difference between the investment rate and the borrowing rate on the Bonds. Similar to last year, high-quality commercial paper, federal agency discount notes, and short-term Treasuries were the primary security types purchased for the Bond Fund, with maturities targeted to monthly interest payment dates and to cover the annual principal payment.

Millennium Fund. The management of the Millennium Fund is guided by several long-term objectives that were established at the Program's inception date:

(1) Achieve and maintain parity, so that the County would have the necessary resources to unwind the transaction if tobacco settlement proceeds were interrupted;

(2) Maximize the earnings spread on the Millennium Fund, consistent with the liability requirement of the Fund, in order to grow the Fund over time and to provide annual appropriations;

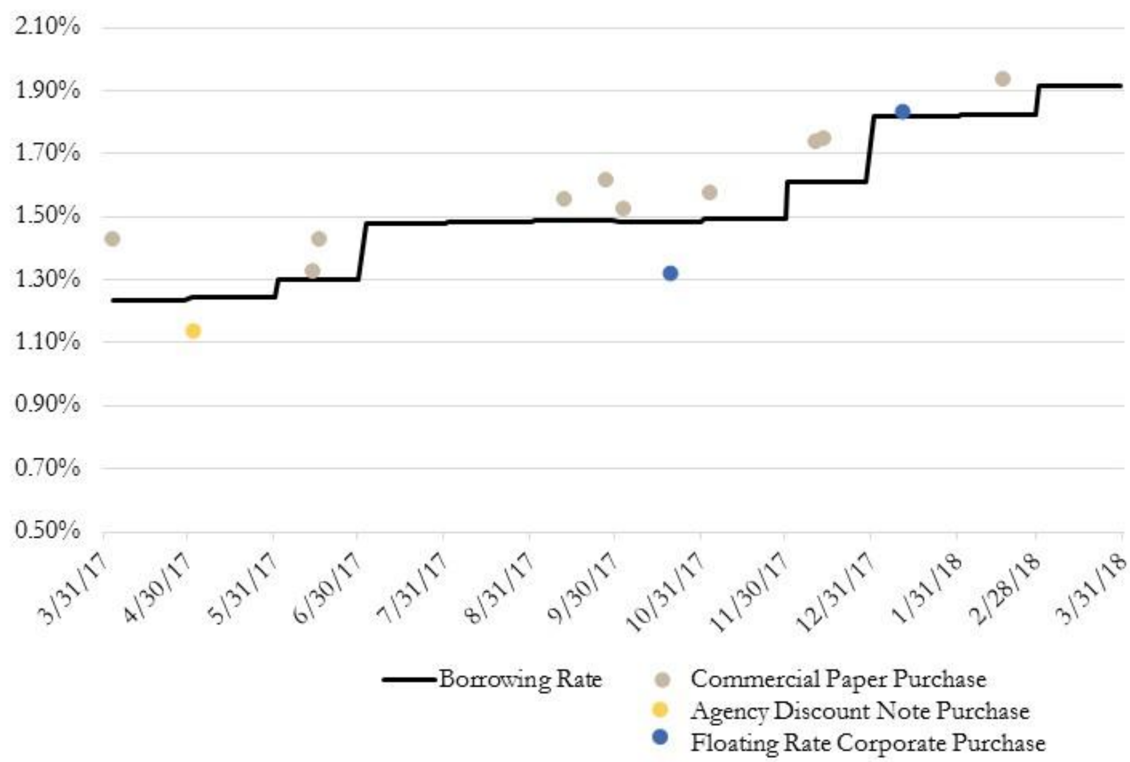
(3) Carefully control Program risk to ensure its ongoing success; and

(4) Invest in accordance with the trust indenture.

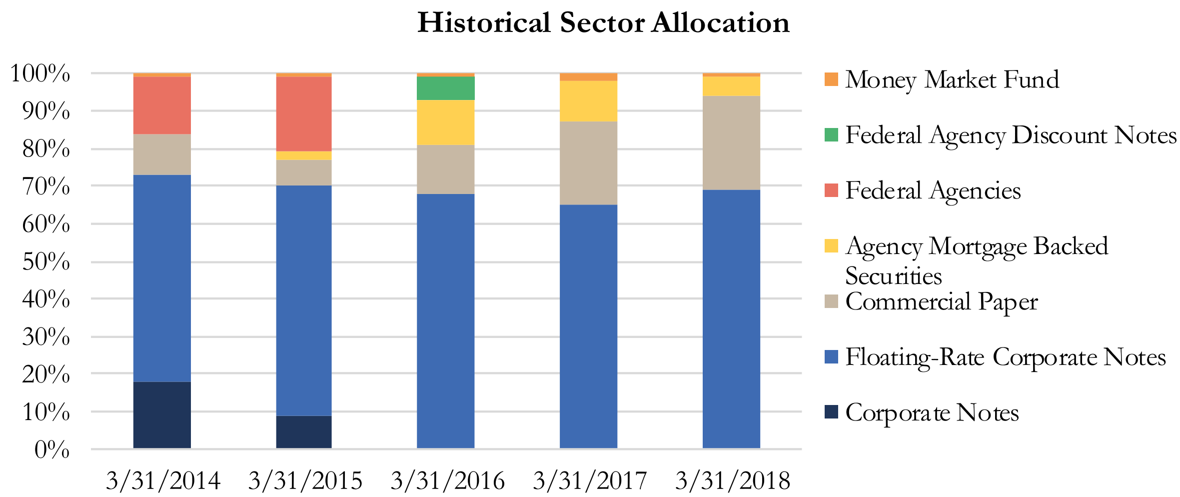
Each of these four objectives has been met.

In January 2003, the Program achieved parity. This means that even if there were to be a significant shortfall of tobacco revenues, the Millennium Fund itself could be used to pay off the Bonds at no cost to the County (other than typical transaction-oriented expenses).

In an effort to safely achieve favorable earnings, PFM looks to purchase high quality investments with yields at or above the borrowing rate and with minimal interest rate risk. The security types that best help meet this goal are commercial paper, federal agency discount notes, and floating rate corporate notes. As of April 1, 2018, over 90% of the portfolio was invested in floating rate corporate notes and commercial paper, with a small allocation to agency mortgage backed securities. The chart below provides information on the securities purchased during the year ended March 31, 2018, relative to the borrowing rate of the bonds.



During the past year, as was true for the prior year, there was significant value in the commercial paper sector. Commercial paper purchases made during the year ended March 31, 2018, comprised 67% of all purchases. We also purchased an agency discount note and floating rate corporate notes. The following chart shows the portfolio's sector allocation over the past five years.

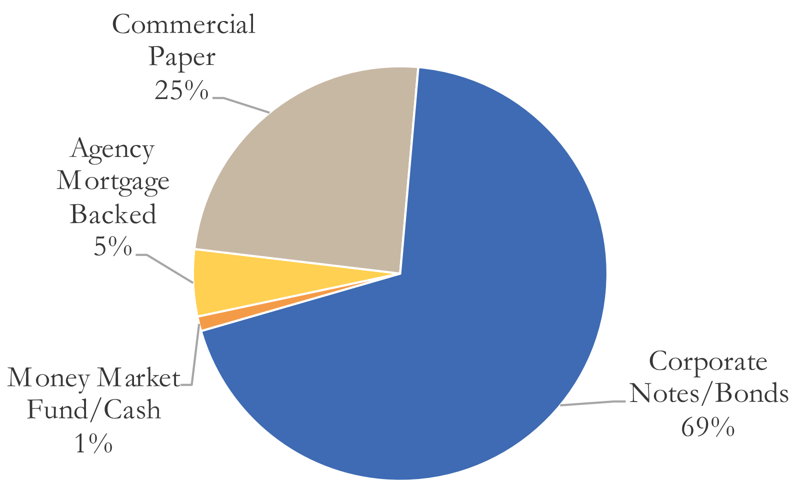


Since March of 2014, we have been reducing the portfolio's allocation to fixed-rate corporate notes and federal agencies and instead have been focusing on floating rate corporates, and short-term securities like commercial paper. These investment types have shorter durations than fixed-rate investments and benefit a portfolio in a rising rate environment.

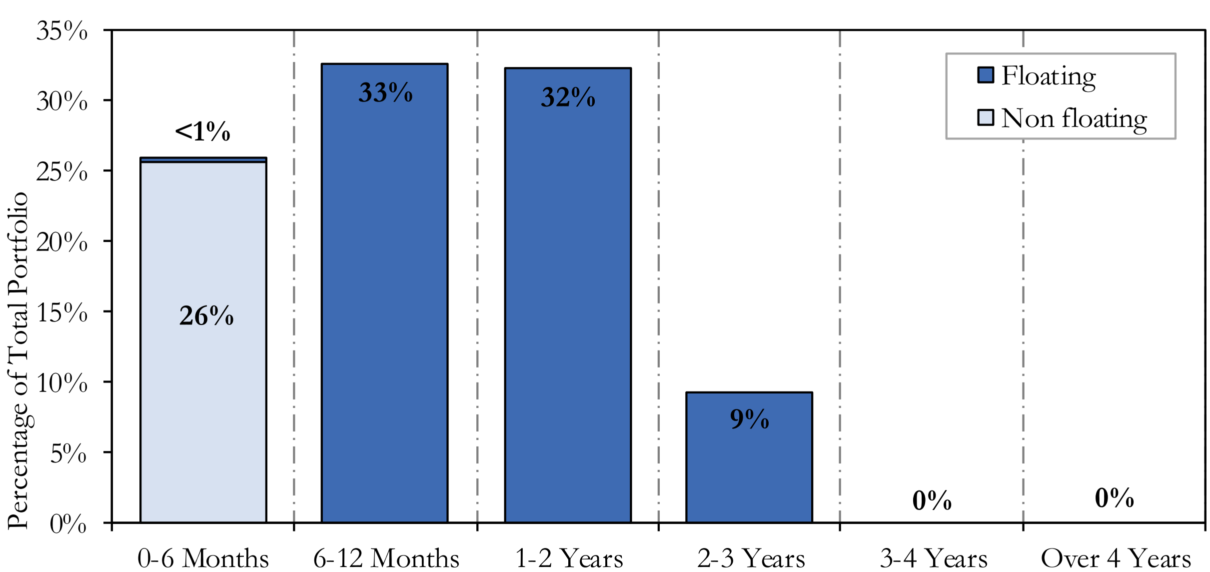
Utilizing short duration securities helps to protect the market value of the portfolio in the current rising rate environment. It also allows the portfolio to turnover at a quicker pace, allowing the purchase of new investments at the higher yields. Over the past five years, we have reduced the portfolio's duration from 0.77 years to 0.22 years. In addition, because the borrowing rate is a floating rate tied to one-month LIBOR, having a portfolio comprised of mostly floating rate securities helps it maintain its positive earnings spread over the borrowing rate.

A sector breakdown and maturity distribution of the Millennium Fund portfolio as of April 1, 2018, is as follows:

Millennium Fund Sector Allocation
April 1, 2018



Millennium Fund Maturity Distribution
April 1, 2018



Investment Results

Short-term interest rates moved significantly higher over the past year, once again boosted by the Fed's multiple rate hikes. As a result, the borrowing rate on the underlying bonds increased. But, we were also able to purchase new investments at higher yields. As of April 1, 2018, the cumulative earnings rate on the investments since inception is approximately 36 basis points (0.36%) higher than the aggregate borrowing rate.

Investment Results December 17, 1999 – April 1, 2018	
Average Investment Return	2.46%
Average Borrowing Rate	2.11%
Earnings Spread	**+0.36%**

The Program's earnings goal since inception was to earn a rate of return in excess of the borrowing rate, with a target to achieve a positive spread over an interest rate cycle of 50 basis points (0.50%) between the earnings rate on the funds and the borrowing rate on the bonds. While the spread as of April 1, 2018, is less than the target, the earnings rate remains higher than the borrowing rate and the spread remains significantly positive and beneficial to the financial strength of the program, despite a year where we saw the borrowing rate nearly double.

While there is natural uncertainty regarding the future path of the U.S. economy, we expect the U.S. to continue growing over the next year. Interest rates are expected to continue trending higher. Since April 1, the FOMC has raised the target rate one addition time, to a new range of 1.75%-2.00%, and has signaled two more hikes in 2018. Under these assumptions, both the borrowing rate on the bonds and yields on investment opportunities will continue to move higher. PFM will continue to thoughtfully manage the Program funds to ensure cash is available to meet program needs and to safely increase the investment return potential.

We also continue to monitor developments regarding the phase out of LIBOR, which is scheduled for year-end 2021. Currently alternative options are being developed and researched. Action is not yet required; however, we will keep the County updated on the changes, and PFM's financial advisory team for the County, along with the County's legal counsel and related parties, will work with the County to prepare for an orderly transition.

If you have any questions, please call Lauren Brant at 415-982-5544 or me at 717-232-2723.

Sincerely,
PFM Asset Management LLC

Kenneth Schiebel, CFA
Managing Director

cc: Sophia Almanza, Deputy County Administrative Officer, Tulare County
Phong Truong, Relationship Manager, The Bank of New York Mellon