



**COUNTY ADMINISTRATION
OFFICE
COUNTY OF TULARE
AGENDA ITEM**

BOARD OF SUPERVISORS

KUYLER CROCKER
District One

PETE VANDER POEL
District Two

AMY SHUKLIAN
District Three

EDDIE VALERO
District Four

DENNIS TOWNSEND
District Five

AGENDA DATE: August 20, 2019

Public Hearing Required	Yes	<input type="checkbox"/>	N/A	<input checked="" type="checkbox"/>
Scheduled Public Hearing w/Clerk	Yes	<input type="checkbox"/>	N/A	<input checked="" type="checkbox"/>
Published Notice Required	Yes	<input type="checkbox"/>	N/A	<input checked="" type="checkbox"/>
Advertised Published Notice	Yes	<input type="checkbox"/>	N/A	<input checked="" type="checkbox"/>
Meet & Confer Required	Yes	<input type="checkbox"/>	N/A	<input checked="" type="checkbox"/>
Electronic file(s) has been sent	Yes	<input checked="" type="checkbox"/>	N/A	<input type="checkbox"/>
Budget Transfer (Aud 308) attached	Yes	<input type="checkbox"/>	N/A	<input checked="" type="checkbox"/>
Personnel Resolution attached	Yes	<input type="checkbox"/>	N/A	<input checked="" type="checkbox"/>
Agreements are attached and signature line for Chairman is marked with tab(s)/flag(s)	Yes	<input type="checkbox"/>	N/A	<input checked="" type="checkbox"/>

CONTACT PERSON: Jason T. Britt 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; and
2. Accept the Annual Report for the Millennium Fund Investment Program.

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

SUBJECT: Tulare County's Millennium Fund Investment Program Report
DATE: August 20, 2019

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

FISCAL IMPACT/FINANCING:

There will be no Net County Cost associated with this agenda item.

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.

ADMINISTRATIVE SIGN-OFF:



Jason T. Britt
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 TULARE COUNTY'S MILLENNIUM FUND INVESTMENT PROGRAM REPORT)))))	Resolution No. _____ Agreement No. _____
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UPON MOTION OF SUPERVISOR _____, SECONDED BY
SUPERVISOR _____, THE FOLLOWING WAS ADOPTED BY THE
BOARD OF SUPERVISORS, AT AN OFFICIAL MEETING HELD _____
_____, BY THE FOLLOWING VOTE:

AYES:
NOES:
ABSTAIN:
ABSENT:

ATTEST: Jason T. Britt
 COUNTY ADMINISTRATIVE OFFICER/
 CLERK, BOARD OF SUPERVISORS

BY: _____
 Deputy Clerk

* * * * *

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

- 2. Accepted the Annual Report for the Millennium Fund Investment Program.

Administrative Report-Millennium Fund Investment Program



May 22, 2019

Mr. Jason Britt
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. Britt:

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 \$53.2 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, 2019, the market value of cash and investments exceeded \$55.7 million.

Market Valuation

Tulare County Millennium Fund Program Market Valuation as of April 1, 2019	
Fund Name	Market Value
Bond Fund	\$681,476
Millennium Fund	\$55,064,006
Tobacco Settlement Fund (TSR)	\$0
Total	\$55,745,482



Unwind Position

The table below shows that the market value of the Millennium Fund Program exceeds the outstanding par value of the bonds by \$23.4 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).

Unwind Position as of April 1, 2019	
Market Value of Millennium Fund Program	\$55,745,482
Principal of Bonds Outstanding	<u>\$32,315,000</u>
Unwind Position – Favorable	\$23,430,482

Appropriations

As of April 1, 2019, the County has appropriated a total of \$53,223,359 from the Program for capital expenditures. For FY 2018-19, the County received a disbursement of \$3,500,000 on September 21, 2018.

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 \$23.4 million). In the current fiscal year, the available amount for withdrawal is \$3,500,000 and will be available on July 1, 2019.

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



Year	Allowable Appropriations	Actual Appropriations
2016	\$3,500,000	\$3,500,000
2017	\$3,500,000	\$3,500,000
2018	\$3,500,000	\$3,500,000
Total		\$53,223,359

Tobacco Settlement Receipts

The County received an annual tobacco settlement payment totaling \$4,536,164 on May 2, 2019. 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 2007¹ 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 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 ²	State Projections ³	Variance
2001	\$3,614,123	\$3,638,531	(\$24,408)
2002	\$4,447,073	\$4,417,085	\$29,988

¹ Updated State projections are shown for periods following April 2007, and are available at: <http://aq.ca.gov/tobacco/settlements/PAPLGTS.pdf>

² 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/aqweb/pdfs/tobacco/settlements/TMSAPC_REV.pdf

³ Updated State projections are shown for periods following April 2007, and are available at: <http://aq.ca.gov/tobacco/settlements/PAPLGTS.pdf>



Year	Actual Payments ²	State Projections ³	Variance
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)
2019	\$4,536,164	\$5,395,741	(\$859,577)
Total	\$78,733,975	\$86,249,651	(\$7,515,676)

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 annual payments Settlement participants, including the County, would receive. Since the Millennium Fund Program is above parity—by \$23.4 million as of April 1, 2019—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 settlement payments could also 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 2.46% between April 2018 and April 2019, increasing by 0.60% over the year as short-term yields moved higher throughout 2018 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. Over the past several years we have been adding 150 basis points to the reset rate due to expectations that interest rates would increase over the subsequent year. However, for the upcoming year, rates are expected to remain fairly stable and so the 100 basis point cushion is appropriate.

The reset rate for the Bonds on April 1, 2019, was 2.74%; therefore, debt service for the following fiscal year is estimated using a rate of 3.74%. The projected debt service amount includes the \$1,210,000 principal payment due on August 1, 2019. 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 2019-2020 Estimated Debt Service and Fees		
Type of Fee	Payee	Estimated Cost
Debt Service	Bondholders	\$2,400,145
Trustee Fees	The Bank of New York Mellon Global Corporate Trust	\$2,300
Management & Administration	PFM Asset Management LLC	\$66,653
Total Gross Lease Payment for FY 19-20		\$2,469,098



On June 1, funds from the TSR (Tobacco Settlement Receipts) Fund will be 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 June 1, 2019, transfers are shown in the following table.

Net Transfers to Millennium Fund	
FISCAL YEAR 2019-20 LEASE REQUIREMENT	
Gross Lease Payment Requirement	\$2,469,098
Minus: June 1 Bond Fund balance after Debt Service Payment and Fees	<u>- \$356,056</u>
Net Requirement/Deposit to Bond Fund on June 1, 2019	\$2,113,042
FISCAL YEAR 2018-19 TOBACCO RECEIPTS	
May 2, 2019 Payment	\$4,536,164
NET TRANSFER TO MILLENNIUM FUND	
FY 2018-19 Tobacco Receipts	\$4,536,164
Less: Net Requirement/Deposit to Bond Fund	<u>- \$2,113,042</u>
Transfer to Millennium Fund on June 1, 2019	\$2,423,122

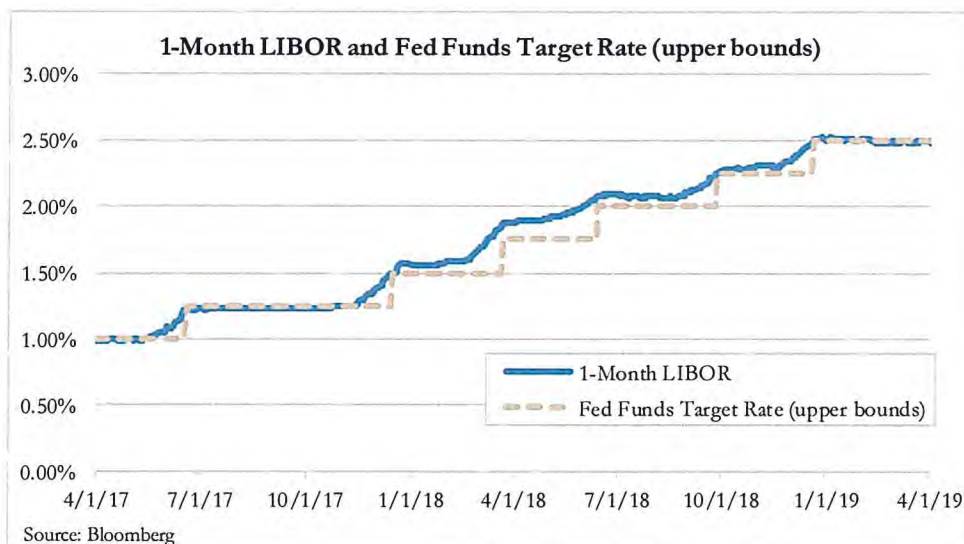
Economic and Interest Rate Update

Economic conditions throughout the year ended April 1, 2019, have been strong. U.S. gross domestic product had three quarters of strong growth, with readings of 4.2%, 3.4% and 3.2% for quarters ended June 30, 2018, September 30, 2018, and March 31, 2019, respectively. The U.S. labor market has remained strong. The unemployment rate fell to an all-time low of 3.6% in April 2019 and the U.S. economy added an average of 212,000 jobs per month for year ended April 1, 2019. In addition, over the past year, inflation has been running near the Federal Reserve's (Fed) 2% target.

Interest rates moved higher for the first nine months of 2018, however fell sharply during the fourth calendar quarter as equity markets sold off almost 20% on concerns of a global growth slowdown. Investors fleeing equity markets during the final months of the calendar year sought the safety of U.S. Treasuries, thereby pushing yields on longer-term Treasuries sharply lower. Although equity markets have recovered and have been moving higher in 2019, yields on Treasuries and other high quality fixed-income sectors have continued to trend lower in the first four months of 2019. The chart on the following page shows the movement in the 2-year U.S. Treasury yield over the past year.

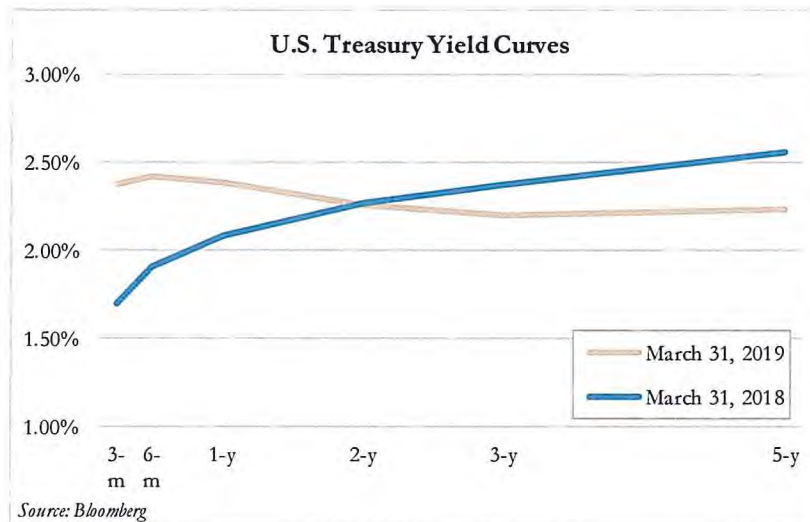


The Fed raised the Fed Funds rate four times in 2018, before pausing in early 2019, increasing the target rate to 2.25%-2.50% in December 2018. After the volatile end to 2018, however, the Fed shifted their stance to one of “patience” and is now projecting no additional rate hikes in 2019, while market expectations are that it is more likely the next move will be a rate cut rather than a rate hike. As is typical, LIBOR rates closely followed the trend of the Fed Funds target rate and after moving up steadily during most of 2018, 1-month LIBOR, has recently leveled off.





At the end of March 2019, the U.S. Treasury yield curve inverted in the 6-month to 5-year area of the curve, as short-term yields remained elevated, tied to the Fed Funds target rate, and intermediate- and longer-term yields fell on low inflation readings and concerns of a possible economic slowdown.



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 in May 2019 in the TSR account were invested in a U.S. Treasury note with a maturity date of May 31, 2019, just prior to the June 1 transfer. 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 Program expenses for the upcoming year, including monthly debt service, quarterly management and administration fees, and the trustee fee which is paid annually. Funds are invested in high-quality short-term securities, with maturities targeted to monthly debt service payment 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. During the past year, funds in the Bond Fund were invested in high quality commercial paper, federal agency discount notes, and short-term Treasuries.



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

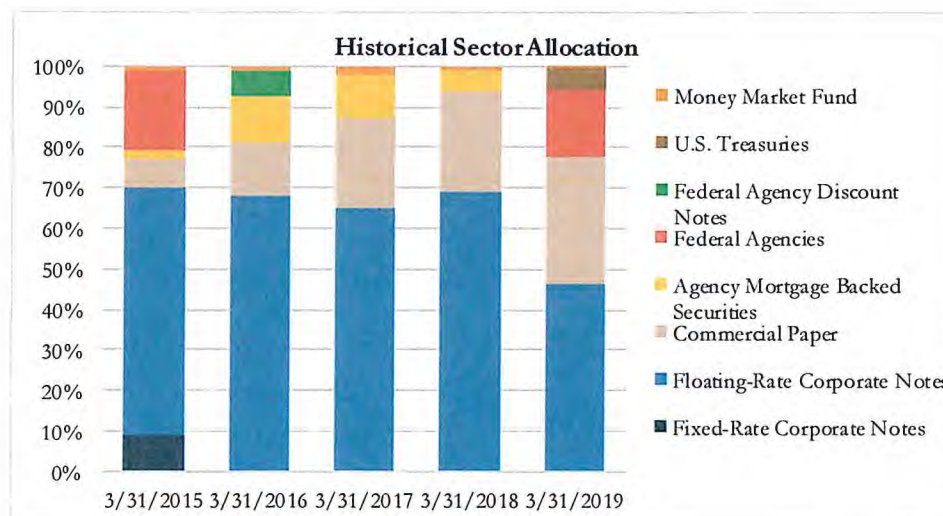
- (1) Achieve and maintain parity, so that the County would have the necessary resources to unwind the transaction if tobacco settlement proceeds were interrupted;
- (2) Maximize the earnings spread on the Millennium Fund, consistent with the liability requirement of the Fund, in order to grow the Fund 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 while carefully managing interest rate and credit risk. During most of the year, the security types that best help meet this goal were commercial paper and floating-rate corporate notes. We also occasionally invested in agency discount notes and U.S. Treasuries when other options were not available. Longer-term floating-rate corporate notes are tied to a similar index as the Program Bonds, and typically offer higher yields. During 2018 and 2019, the yield curve was very flat, and short-term commercial paper also offered yields above the borrowing rate. After it became clear the Federal Reserve was done with its current cycle of rate hikes, we also began to purchase some fixed-rate securities, including corporate notes, U.S. Treasuries and callable federal agencies, since there is now a greater likelihood that interest rates may fall during the upcoming years.

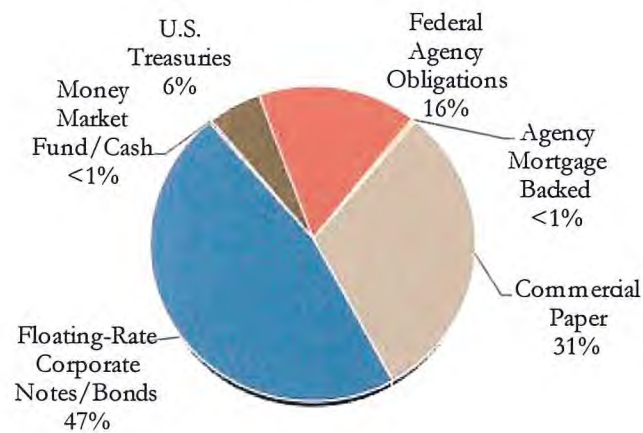
The chart below, illustrating the Millennium Fund portfolio's sector allocation over the past five years, demonstrates where PFM has found value during each year. During the past year, PFM added callable federal agencies and U.S. Treasuries to the portfolio. In the current interest rate environment, characterized by a flat yield curve and relatively stable interest rates, callable agencies offer incremental yields and favorable performance characteristics. As shown, our allocation to floating rate corporate notes has declined.



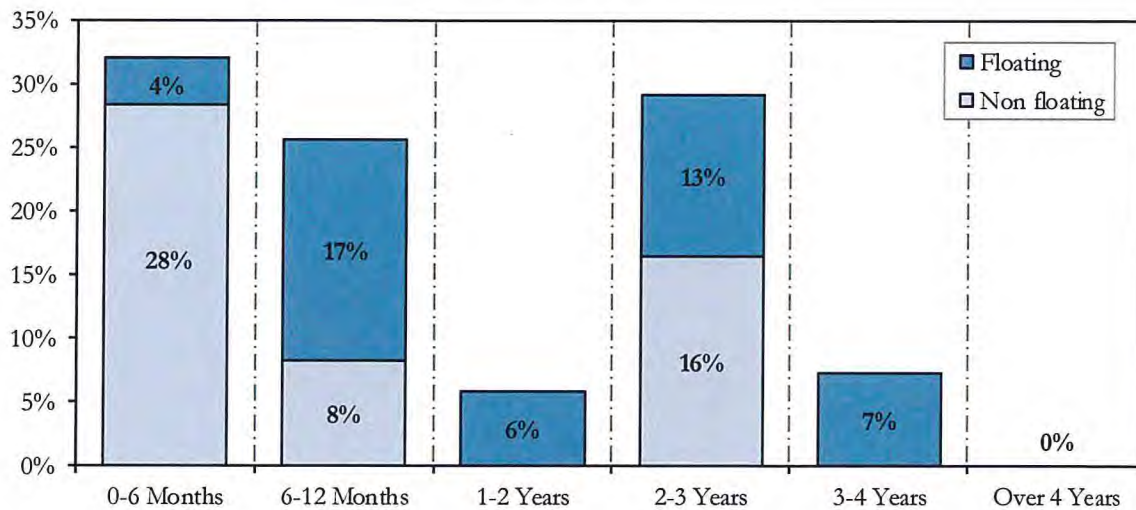


A sector breakdown and maturity distribution of the Millennium Fund portfolio as of April 1, 2019, is as follows:

Millennium Fund Sector Allocation
April 1, 2019



Millennium Fund Maturity Distribution
April 1, 2019





Investment Results

During the year ended April 1, 2019, the borrowing rate on the underlying bonds continued to increase for most of the year as the Fed raised the Fed Funds target rate throughout 2018. Rising interest rates also meant the yields on securities purchased for the portfolio moved higher, allowing us to continue to increase the yield on the portfolio. However, rising interest rates can have a negative impact on the portfolio's market values, detracting from the overall investment return. As of April 1, 2019, the cumulative earnings rate on the investments since inception is approximately 34 basis points (0.34%) higher than the aggregate borrowing rate, demonstrating the continued financial strength of the Program.

Investment Results December 17, 1999 – April 1, 2019	
Average Investment Return	2.46%
Average Borrowing Rate	2.13%
Earnings Spread	+0.34%

Expectations for U.S. economic growth and interest rates over the next year have changed significantly from what they were one year ago. U.S. economic growth is expected to decelerate, however remain positive. And current risk factors include some weakness in manufacturing, possible trade wars, and challenging global and national politics. Interest rates are expected to remain range bound, with the Fed taking a "patient" approach to further interest rate increases as they have projected no rate hikes in 2019. In addition, the intermediate (1-5 year) yield curve is inverted, signaling rates may fall over the coming years.

We 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. We recommend that the County begin conversations with its municipal advisor, legal counsel, and FMS Wertmanagement Service Company (the financial services company that purchased Depfa Bank in 2014 and with whom you hold the loan agreement) to contemplate options for a new benchmark rate.

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: Paul Guerrero, Senior Administrative Analyst, Tulare County
Phong Truong, Relationship Manager, The Bank of New York Mellon