COUNTY ADMINISTRATION OFFICE
COUNTY OF TULARE
AGENDA ITEM

AGENDA DATE: August 11, 2020

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	☒
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: Paul Guerrero 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

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: County Administrative Office

Attachment(s) Administrative Report - Millennium Fund Investment Program

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

IN THE MATTER OF TULARE	)	
COUNTY'S MILLENNIUM FUND	)	**Resolution No. ____________**
INVESTMENT PROGRAM REPORT	)	**Agreement No. ____________**
	)	

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

June 18, 2020

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 meet and exceed its original objectives. Since inception in 1999, the Program has generated earnings sufficient to cover its costs and has provided over $56.7 million in appropriations to the County—funds the County has used to provide services to the community. The return 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, 2020, the market value of cash and investments exceeded $55.8 million.

Market Valuation

Tulare County Millennium Fund Program Market Valuation as of April 1, 2020		Program Market Valuation as of May 31, 2020
Fund Name	**Market Value**	**Market Value**
Bond Fund	$753,559	$657,763
Millennium Fund	$55,056,956	$55,828,797
Tobacco Settlement Fund (TSR)	$2	$4,348,995
Total	**$55,810,517**	**$60,835,555**

Unwind Position

The table below shows that the market value of the Millennium Fund Program exceeds the outstanding par value of the bonds by $24.7 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, 2020	
Market Value of Millennium Fund Program	$55,810,517
Principal of Bonds Outstanding	$31,105,000
Unwind Position – Favorable	$24,705,517

Appropriations

As of April 1, 2020, the County has appropriated a total of $56,723,359 from the Program for capital expenditures. For FY 2019-20, the County requested and received a disbursement of $3,500,000 on September 6, 2019.

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, 2020.

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
2019	$3,500,000	$3,500,000
Total		**$56,723,359**

Tobacco Settlement Receipts

The County received an annual tobacco settlement payment totaling $4,348,992 on May 27, 2020. Since it was received after April 1, 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 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 [1]	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. Projection document is currently not available on the Attorney General's website.*

[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/agweb/pdfs/tobacco/settlements/TMSAPC_REV.pdf*

Year	Actual Payments[2]	State Projections[1]	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)
2020	$4,348,992	$5,455,682	($1,106,690)
Total	$83,082,967	$91,705,333	($8,622,366)

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 2.31% between April 2019 and April 2020, decreasing by 0.92% over the year as short-term yields moved lower throughout 2019 and 2020 in response to Federal Reserve rate cuts. 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. 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. For the upcoming year, rates are expected to remain fairly stable at these lower levels, and so the 100 basis point cushion is appropriate.

The reset rate for the Bonds on April 1, 2020, was 1.83%; therefore, debt service for the following fiscal year is estimated using a rate of 2.83%. The projected debt service amount includes the $1,305,000 principal payment due on August 1, 2020. 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 2020-2021 Estimated Debt Service and Fees		
Type of Fee	**Payee**	**Estimated Cost**
Debt Service	Bondholders	$2,166,655
Trustee Fees	The Bank of New York Mellon Global Corporate Trust	$2,300
Management & Administration	PFM Asset Management LLC	$66,668
Total Gross Lease Payment for FY 20-21		**$2,235,623**

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 were transferred to the Millennium Fund for longer-term investment. Details of the June 1, 2020, transfers are shown in the following table.

Net Transfers to Millennium Fund	
FISCAL YEAR 2020-21 LEASE REQUIREMENT	
Gross Lease Payment Requirement	$2,235,623
Minus: June 1 Bond Fund balance after Debt Service Payment and Fees	- $511,702
Net Requirement/Deposit to Bond Fund on June 1, 2020	$1,723,921
FISCAL YEAR 2020-21 TOBACCO RECEIPTS	
May 27, 2020 Payment	$4,348,992
NET TRANSFER TO MILLENNIUM FUND	
TSR Fund balance on June 1, 2020	$4,348,995
Less: Net Requirement/Deposit to Bond Fund	- $1,723,921
Transfer to Millennium Fund on June 1, 2020	$2,625,074

Economic and Interest Rate Update

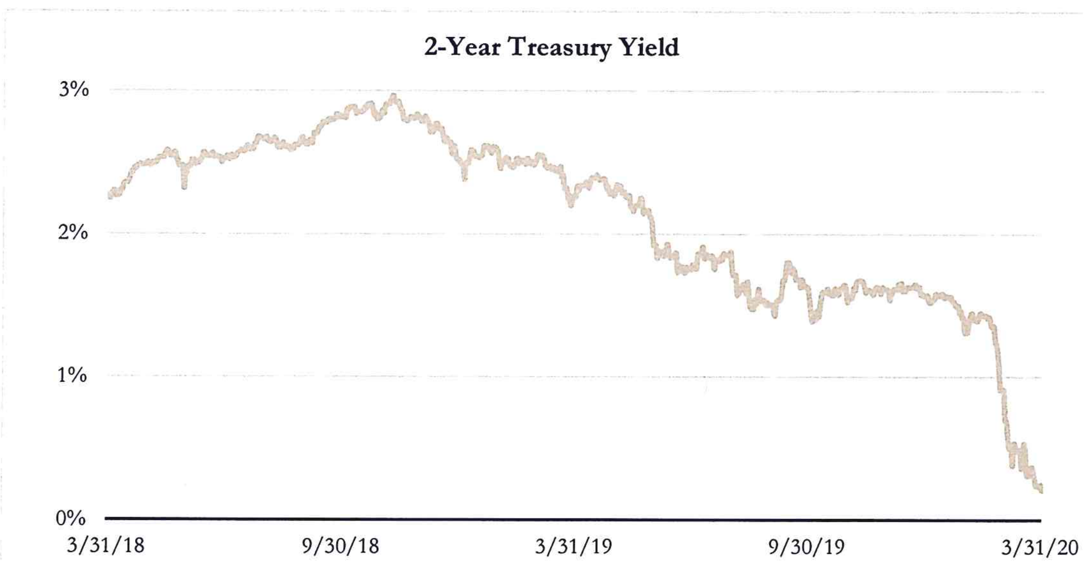
During 2019 and through the first two months of 2020, U.S. economic fundamentals were solid. Gross domestic product was moderate and stable, the labor market was strong, the unemployment rate was historically low, and the housing market was improving. For the first seven months of 2019 the Federal Reserve held the fed funds target rate at 2.25%-2.50%, after hiking the rate seven times throughout 2017 and 2018. However, mid-way through the year, the Fed noted some potential risks to U.S. growth, particularly surrounding trade tensions between the U.S. and China; as such, the Fed preemptively lowered the target rate three times in 2019 to a new range of 1.50%-1.75%. At the end of the calendar year, the Fed signaled the rate would remain steady over the near term absent a "material reassessment of their outlook."

The Fed's perceived path for interest rates and the solid economic fundamentals in the U.S. were made largely irrelevant by the emergence of the COVID-19 pandemic in early 2020. As the COVID-19 pandemic took hold across the globe, it created a threefold crisis: (1) a global health crisis, (2) a virtual economic shutdown in the U.S. and elsewhere, and (3) sudden, extreme volatility in the financial markets. U.S. states attempted to slow the spread of the virus through closures of non-essential businesses and lockdowns, causing severe and abrupt economic distress.

The solid economic fundamentals were quickly replaced with global economic shutdowns enforced to slow the spread of the virus, rapid equity market sell-offs, bond market dislocations amid liquidity concerns and sharply wider yield spreads, record-shattering weekly jobless claims, and contraction in both the manufacturing and services sectors. Policymakers responded with massive monetary and fiscal initiatives designed to support markets, households, and businesses.

The Fed acted quickly and aggressively by cutting the Fed Funds target rate at two emergency meetings in March to the new target range of 0% to 0.25%. It also initiated unlimited bond-buying (quantitative easing) of various security types and rolled out numerous programs to support the markets totaling $2.3 trillion. Some programs were dusted off from the 2008–2009 financial crisis playbook and new, even broader, programs were created to cushion the potential blow on financial markets.

U.S. Treasury yields plunged in the wake of the Fed's rate cuts and a broad flight-to-quality. Short-term yields settled near 0%, and long-term rates fell to record lows, with the 10-year Treasury yield falling below 1% for the first time ever. At the same time, credit spreads widened to the highest levels since the 2008–09 financial crisis and equity markets plunged. U.S. equities ended its 11-year bull market (2009–2020), and the S&P 500 fell 34% from its February all-time high.



U.S. gross domestic product fell at an annualized rate of 4.8% in the first calendar quarter of 2020, the worst level since the Great Recession, even though the economic impact of the pandemic-induced shutdown was concentrated late in the quarter. The quarter ended June 30, 2020 is expected to be much weaker. U.S. jobless claims soared to record levels, with more than 10 million new unemployment claims in the last two weeks of March, and over 40 million in the first 10 weeks of the economic shutdown, erasing all the jobs created since the 2008-2009 recession. Unemployment spiked to 14.7% in April, the highest level since the Great Depression, and will likely go much higher. The Markit manufacturing PMI survey fell to 48.5 in March, the lowest reading since the financial crisis and an indication of an economy in contraction. The services PMI survey fared worse, posting a record decline to 39.8.

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, typically around April 15. Funds in the TSR account are transferred to the Bond Fund on June 1 each year 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. 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 laddered U.S. Treasuries and federal agencies.

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

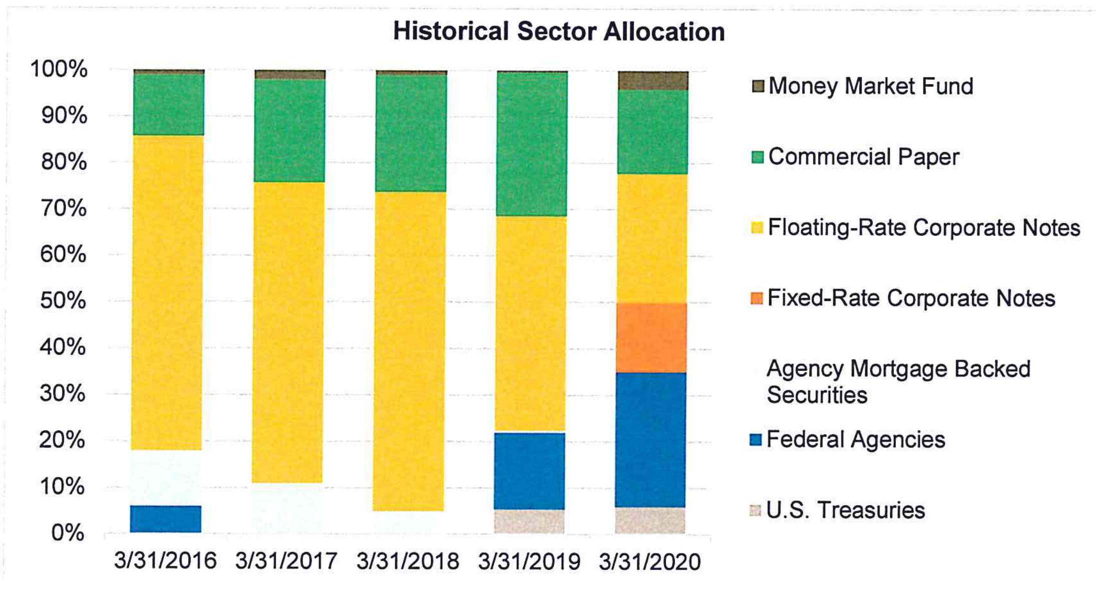
(4) Invest in accordance with the trust indenture, which specifically defines and limits what sectors each of the Program funds can invest in.

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. A strategy that invests in high quality bonds is designed to add value while safely maintaining the positive unwind position. In recent years, because interest rates were moving higher, PFM found the best value in floating-rate securities whose coupons would move up in tandem with market rates. However, because the trend reversed in 2019 and rates began to move lower, we shifted the strategy to focus on fixed-rate securities that would benefit the Program by locking in higher yields. During the year ended April 1, 2020, PFM added more intermediate-term fixed-rate securities to the portfolio, diversified by sector.

The chart below illustrates the sector allocation of the Millennium Fund portfolio over the past five years, demonstrating where PFM found value during each year's market environment. Because yield spreads had narrowed in the corporate sector, we reduced the allocation to credit instruments in favor of more federal agencies in the last program year, a shift that proved beneficial.

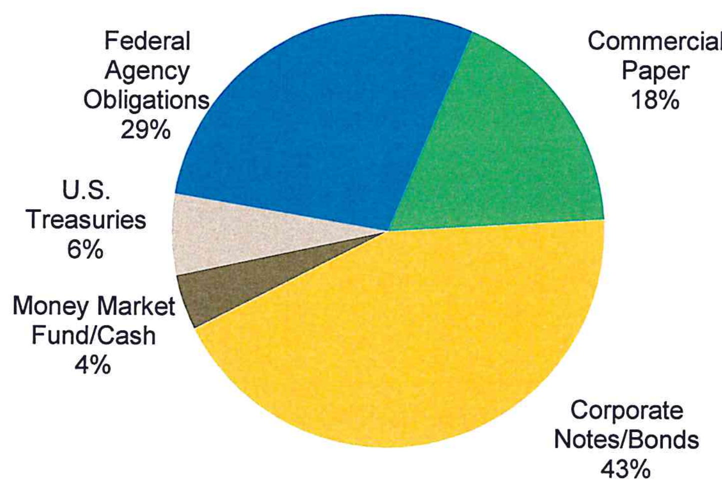


As rates fell throughout 2019 in response to the Federal Reserve lowering the Fed Funds target rate, the portfolio's allocation to fixed rate securities helped the portfolio maintain an earnings rate in line with the borrowing rate. In March of 2020, when the Fed lowered rates to near zero in response to the emerging coronavirus crisis, the portfolio's allocation proved especially beneficial.

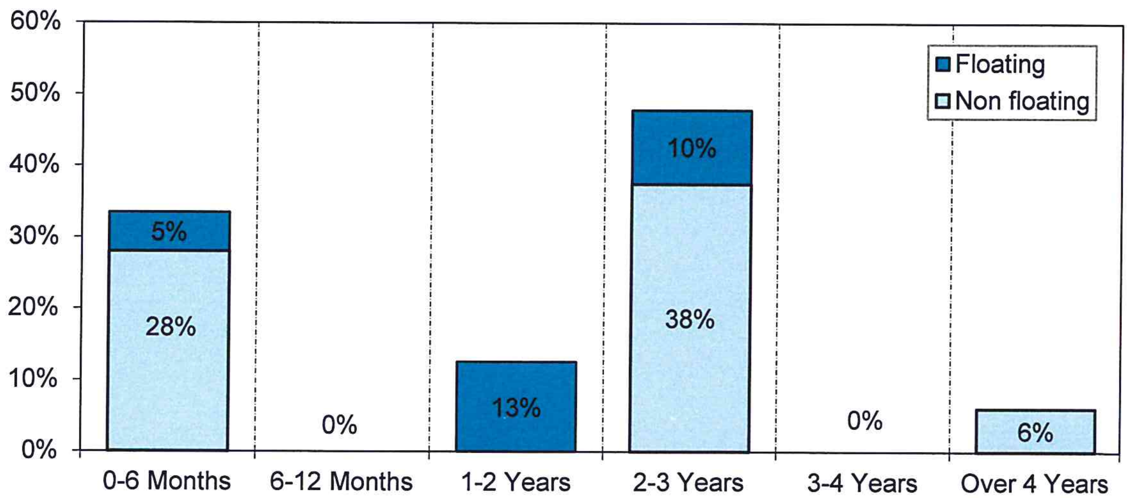
As the U.S. economy deteriorated, credit spreads widened markedly, hurting the market value and performance of corporate securities. PFM took a proactive response to managing credit risk in the portfolios by avoiding any new corporates securities from February through mid-May, while carefully evaluating the impact that the crisis could have on existing holdings. The unprecedented economic conditions will stress many companies' revenue, profits, liquidity, and credit ratings. PFM undertook a wholesale review of all issuers on our approved list and redoubled our ongoing monitoring and due diligence efforts.

A sector breakdown and maturity distribution of the Millennium Fund portfolio as of April 1, 2020, is as follows:

Millennium Fund Sector Allocation
April 1, 2019



Millennium Fund Maturity Distribution
April 1, 2020



Investment Results

The portfolio produced a strong market value return for the year ended April 1, 2020, as a result of falling interest rates and the strong market value growth on the portfolio's Treasury and Agency holdings. However, the economic malaise that began in March, and the resulting wider yield spreads, negatively impacted the market values of corporate securities. Subsequently, however, credit spreads have narrowed, and stability has returned to the corporate bond market, in large part due to liquidity support provided by the Federal Reserve.

As of April 1, 2020, the cumulative earnings rate on the investments since inception is approximately 30 basis points (0.30%) higher than the aggregate borrowing rate, demonstrating the continued financial strength of the Program.

Investment Results December 17, 1999 – April 1, 2020	
Average Investment Return	2.43%
Average Borrowing Rate	2.13%
Earnings Spread	**+0.30%**

The U.S. economy is expected to continue to struggle, even as states gradually reopen. Yields remain near historically low levels and are expected to remain low for some time; Fed Chair Powell recently said they are going "to be very patient, that means we are not going to be in any hurry to move rates up."

PFM will continue to carefully manage the Millennium Fund Program portfolios to achieve and maintain their objectives. As noted in prior years, we continue to also monitor developments regarding the phase out of LIBOR, which is scheduled for year-end 2021. We recommend the County continue to explore alternatives 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, Principal Administrative Analyst, Tulare County
Cass Cook, CFIP, Auditor-Controller/Treasurer-Tax Collector, Tulare County
Phong Truong, Senior Analyst, Client Services, The Bank of New York Mellon