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Jonathan Barry, *Executive Secretary*

AGENDA

April 18, 2017

2:00 P.M.

Board of Commissioners of Public Lands
101 E. Wilson Street, 2nd Floor
Madison, Wisconsin

Routine Business:

- 1) Call to Order
- 2) Approve Minutes – April 4, 2017 (Attachment)
- 3) Approve Loans (Attachment)

Old Business:

None

New Business:

- 4) Discuss and Vote on Staff Attendance at WSLCA Summer Conference (Attachment)

Routine Business:

- 5) Future Agenda Items
- 6) Executive Secretary's Report (Attachment)
 - BCPL Trust Fund Investment Report – 1st Quarter 2017
 - Investment Transaction Report – April 13, 2017
- 7) Adjourn

AUDIO ACCESS INFORMATION

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**BOARD MEETING
APRIL 18, 2017**

**AGENDA ITEM 2
APPROVE MINUTES**

Attached for approval are the minutes from the April 4, 2017, board meeting.

Board Meeting Minutes
April 4, 2017

Present via teleconference were:

Doug La Follette, Commissioner	Secretary of State
Matt Adamczyk, Commissioner	State Treasurer
Brad Schimel, Board Chair	Attorney General
Jonathan Barry, Executive Secretary	Board of Commissioners of Public Lands
Tom German, Deputy Secretary	Board of Commissioners of Public Lands
Richard Sneider, Loan Analyst and Chief Investment Officer	Board of Commissioners of Public Lands
Vicki Halverson, Office Manager	Board of Commissioners of Public Lands

ITEM 1. CALL TO ORDER

Board Chair Schimel called the meeting to order at 2:00 pm.

ITEM 2. APPROVE MINUTES – MARCH 22, 2017

MOTION: Commissioner La Follette moved to approve the minutes; Board Chair Schimel seconded the motion.

DISCUSSION: None.

VOTE: The motion passed 3-0.

ITEM 3. APPROVE LOANS

Executive Secretary Barry reported that the loans had been reviewed for proper public purpose.

<u>Municipality</u>	<u>Municipal Type</u>	<u>Loan Type</u>	<u>Loan Amount</u>
1. Leon Waushara County Application #: 02017161 Purpose: Finance dam repair	Town Rate: 3.50% Term: 7 years	General Obligation	\$300,000.00
2. Pleasant Springs Dane County Application #: 02017162 Purpose: Finance road repairs	Town Rate: 3.00% Term: 1 year	General Obligation	\$200,000.00
	TOTAL		<hr/> \$500,000.00

MOTION: Board Chair Schimel moved to approve the loans; Commissioner La Follette seconded the motion.

DISCUSSION: None.

VOTE: The motion passed 2-1. Commissioner La Follette and Board Chair Schimel voted aye; Commissioner Adamczyk voted no.

ITEM 4. FUTURE AGENDA ITEMS

Board Chair Schimel asked that a discussion and possible vote on staff attending the Western States Land Commissioners Association’s summer conference be included on the April 18 meeting agenda. He added that it will be held in Alaska and asked that staff provide an estimate of the expenses.

Board Chair Schimel reported that a potential land purchase was in progress and asked that it also be added to the next agenda. Executive Secretary Barry said more time was needed to gather and prepare the necessary information. Board Chair Schimel said the item should be included on a future agenda once the materials are ready.

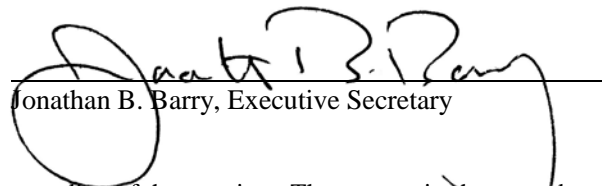
ITEM 5. EXECUTIVE SECRETARY’S REPORT

Executive Secretary Barry reported that the yield on bonds is rising and are consistently above 3.5%. Since the last report, staff sold nearly \$24 million in bonds. The portfolio realized long-term capital gains of \$2.24 million from the sales, which increased the average annual return to 6.55% during their investment holding period. He recognized Tom German and Richard Sneider for their diligence in watching the market and purchasing and selling bonds at the most opportune time.

ITEM 6. ADJOURN

MOTION: Board Chair Schimel moved to adjourn the meeting; Commissioner Adamczyk seconded the motion.

The meeting adjourned at approximately 2:10 p.m.



Jonathan B. Barry, Executive Secretary

These minutes have been prepared from a recording of the meeting. The summaries have not been transcribed verbatim. Link to audio recording: ftp://doafpt1380.wi.gov/doadocs/BCPL/2017-04-04_BCPL-BoardMtgRecording.mp3

**BOARD MEETING
APRIL 18, 2017**

**AGENDA ITEM 3
APPROVE LOANS**

<u>Municipality</u>	<u>Municipal Type</u>	<u>Loan Type</u>	<u>Loan Amount</u>
1. Beaver Dam Dodge County Application #: 02017173 Purpose: Finance TID development incentive	City Rate: 3.50% Term: 10 years	General Obligation	\$1,000,000.00
2. Bloomfield Walworth County Application #: 02017165 Purpose: Refinance BCPL loan #2015068.02	Village Rate: 3.50% Term: 10 years	General Obligation	\$68,493.30
3. Bloomfield Walworth County Application #: 02017166 Purpose: Refinance BCPL loan #2016113.01	Village Rate: 3.50% Term: 10 years	General Obligation	\$38,769.27
4. Bloomfield Walworth County Application #: 02017167 Purpose: Refinance BCPL loan #2017074.01	Village Rate: 3.50% Term: 10 years	General Obligation	\$540,000.00
5. Bloomfield Walworth County Application #: 02017168 Purpose: Refinance BCPL loan #2017102.01	Village Rate: 3.50% Term: 10 years	General Obligation	\$200,000.00
6. Bloomfield Walworth County Application #: 02017169 Purpose: Finance 2017 budget shortfall	Village Rate: 3.50% Term: 10 years	General Obligation	\$635,000.00
7. Bloomfield Walworth County Application #: 02017170 Purpose: Finance 2017 capital budget	Village Rate: 3.00% Term: 10 years	General Obligation	\$260,000.00
8. Dunkirk Dane County Application #: 02017177 Purpose: Purchase patrol truck, road equipment and finance road repairs	Town Rate: 3.00% Term: 2 years	General Obligation	\$200,000.00

<u>Municipality</u>	<u>Municipal Type</u>	<u>Loan Type</u>	<u>Loan Amount</u>
9. Kenosha Unified Kenosha County Application #: 02017174 Purpose: Finance energy efficiency projects	School Rate: 3.50% Term: 10 years	General Obligation	\$16,355,000.00
10. Longwood Clark County Application #: 02017171 Purpose: Purchase road grader	Town Rate: 3.00% Term: 5 years	General Obligation	\$152,000.00
11. Martell Pierce County Application #: 02017163 Purpose: Construct municipal shop building	Town Rate: 4.00% Term: 15 years	General Obligation	\$450,000.00
12. Onalaska La Crosse County Application #: 02017176 Purpose: Purchase refuse and recycle carts	Town Rate: 3.50% Term: 10 years	General Obligation	\$220,000.00
13. Owen Clark County Application #: 02017172 Purpose: Finance TID #4 projects	City Rate: 3.00% Term: 5 years	General Obligation	\$680,000.00
14. Plum Lake Vilas County Application #: 02017175 Purpose: Purchase ambulance	Town Rate: 3.00% Term: 5 years	General Obligation	\$150,000.00
15. Racine Racine County Application #: 02017164 Purpose: Purchase and remodel building	School Rate: 3.50% Term: 10 years	General Obligation	\$6,750,000.00
TOTAL			\$27,699,262.57

**BOARD MEETING
APRIL 18, 2017**

**AGENDA ITEM 4
DISCUSS AND VOTE ON STAFF ATTENDING
WSLCA SUMMER CONFERENCE IN ANCHORAGE, AK**

The cost for staff to attend the conference is estimated to be \$2,350 per person, which includes the conference registration fee, airfare, ground transportation, meals, lodging, and other minor incidentals.

**BOARD MEETING
APRIL 18, 2017**

**AGENDA ITEM 6
EXECUTIVE SECRETARY'S REPORT**

Attached for review are the following reports:

- BCPL Trust Fund Investment Report – 1st Quarter 2017
- Investment Transaction Report – April 13, 2017

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BCPL Trust Fund Investment Management

Investment Report - First Quarter 2017

Executive Summary

BCPL investment performance continues to exceed benchmark returns. Risk-adjusted returns in the BCPL-managed portfolios had a yield **0.57% greater** than our benchmark. This difference in yield means that beneficiaries earned **\$1.5 million more** during the fourth quarter than would have been generated by an investment in the benchmark portfolio.

The above performance measure does not include **\$4.425 million in capital gains** realized through bond sales during the first quarter of 2017. These transactions had the immediate impact of reducing portfolio risk by converting 'paper gains' into cash, increasing the 2018 distribution to beneficiaries, and providing the initial funding of the CSF smoothing account in accordance with the Investment Policy Statement.

The BCPL Investment Committee continues to formulate plans for the methodical purchase of equity ETFs beginning in the near-term.

Q1 Investment Highlights and Outlook

Staff believed that following the November election, longer-term interest rates moved to levels higher than expected given current economic conditions. Staff proceeded to heavily invest in bonds when interest rates reached the upper levels of the new trading range. Conversely, when interest rates dropped back down, staff sold individual bonds to realize significant capital gains. This execution of the age-old strategy of 'buy low and sell high' has worked quite well, with staff able to take advantage of anticipated market volatility. During this period, staff has been much more active buying than selling, and the total bond portfolio has increased by almost \$100 million since Election Day.

Loan demand remains very strong and relative yields on the loan portfolio continue to outperform investment alternatives. BCPL has received \$184 million in loan applications during the first nine months of FY17, an increase of 50% over last year and double the average from 2012-2016.

Cash levels have remained stubbornly high at \$137 million, primarily due to \$101 million in loan principal payments received during the first quarter. This liquidity provides the benefit of strengthening our ability to fund strong loan demand while also taking steps to diversify the portfolio in 2017. However, even though short-term returns at 0.75% have improved significantly over the past few months, investing excess reserves in longer-term investments will improve our ability to increase future distributions to Trust Fund beneficiaries.

Summary and Benchmark Comparison

The overall expected yield of funds managed by BCPL was 3.30% at the end of third quarter, a slight increase from the prior quarter. This expected yield does not include \$4.425 million in capital gains realized through bond sales during the first quarter of 2017.

The best measure for comparing investment performance against our benchmark is the SEC yield, which provides a standard methodology that is available for the mutual funds and bond indices that comprise our custom benchmark. The risk-adjusted yield of BCPL-managed portfolios remains an impressive 0.57% greater than benchmark returns.

BCPL Investment Summary

1st Quarter 2017

as of March 31, 2017

Portfolio Summary		Total Assets	Expected Yield ¹	SEC Yield ²	Average Credit Quality ³	Weighted Avg Maturity
Total BCPL Managed Financial Assets		\$ 1,066,936,122	3.30%	3.21%	Aa1	8.78
Benchmark Performance ⁴				3.16%	A1	8.82
BCPL Investments						
	% of Total BCPL Managed Assets					
Bonds	49.49%	\$ 527,986,882	3.65%	3.49%	Aa2	13.26
BCPL State Trust Fund Loans	37.63%	\$ 401,475,592	3.68%	3.68%	Aa1	5.86
Cash and Cash Equivalents ⁵	12.88%	\$ 137,473,648	0.79%	0.79%	Aaa	0.12
Total BCPL Managed Investments	100.00%	\$ 1,066,936,122	3.30%	3.21%	Aa1	8.78
Benchmark Components						
	Weighting					
S&P Long Intermediate Term Taxable Municipal Bond Index ⁶	60.00%		3.44%	3.93%	Aa3	9.79
S&P U.S. Treasury Bill Index ⁷	10.00%		0.59%	0.59%	Aaa	0.09
Wisconsin Tax-Exempt Bond Mutual Funds (combined) ⁸	30.00%	\$ 363,800,001	N/A	2.49%	Baa2	9.81
Total Benchmark	100.00%			3.16%	A1	8.82
Important Notes on Following Page						
Prepared by Richard Sneider						

Notes to BCPL Benchmark Comparison:

- 1 **Expected Yield** is the weighted average yield to the redemption date for each bond, and assumes that issuers will redeem bonds at the earliest possible date, when it is in their best interest given current market interest rates. Also called 'yield-to-worst', this number is equal to the lower of the 'yield to call' and 'yield to maturity' for each investment in the portfolio.
- 2 **SEC Yield** - The SEC yield should not be confused with the expected yield on invested funds. The SEC yield will vary substantially with market conditions because it is calculated using the current market value of assets, and the value of fixed income assets fluctuates with market interest rates. For example, although interest payments produced by an individual bond remain constant following the issuance of the bond, the SEC yield on this bond will increase with market interest rates solely because the value of the bond decreases (Yield = Income/Value). If all bonds are held to maturity, the actual return to the investor would equal the "yield to maturity at cost". This calculation is not provided for benchmark components and is therefore not included in this comparison. Many investors prefer to use "yield to worst", which calculates the return using the lower of the "yield to call" and "yield to maturity". The most appropriate method to compare bond portfolios is to look at **Total Return**, which combines both income and changes in the market value of the underlying assets (see note 8 below). BCPL does not have the ability to use Total Return as a method of comparison because the Trust Fund Loan Portfolio has never been valued. Rather, the SEC Yield is used for comparison because it is a standardized methodology for calculating yield as required by the Securities and Exchange Commission for all mutual funds and provides a means to compare BCPL managed funds to a simple benchmark. The SEC yield is a close approximation to the net yield to maturity of the fund using the current market value of the fund, and is calculated as the yield to the investor (after fund expenses and fees) during the previous 30 days assuming all bonds are held to maturity. The SEC Yield for the State Investment Fund is for the most recent month available.
- 3 **Average Credit Quality** - Except for the BCPL loan portfolio, all average credit quality ratings shown equal the weighted average credit rating of individual securities held within each portfolio. A rating for the loan portfolio is provided to improve the ability to compare BCPL managed funds to other funds. The Aa1 rating presumed for the loan portfolio is considered reasonable, as there has not been a single default in the State Trust Fund loan program since inception in 1871, and BCPL has the statutory right and requirement to cure any future default by intercepting state aid otherwise due the borrower. Mutual Fund credit quality is provided by Morningstar. The global long-term rating scale of Moody's Investor Services begins at 'Aaa' for obligations judged to be of the highest quality, subject to the lowest level of risk. The ranking in order from highest to lowest quality then includes: Aa, A, Baa, Ba, B, Caa, Ca, and C. Ratings from Aa to Caa are modified with 1,2, or 3 to provide a high, middle and low ranking within each alphabetic category. 'Investment-grade' securities have ratings of Baa3 or higher.
- 4 **Benchmark Components and Weighting** - Due to the unique set of BCPL authorized investments consisting primarily of the BCPL State Trust Fund Loan Program, and bonds issued by the State of Wisconsin and Wisconsin municipalities and school districts, there are no managed funds that perfectly match the characteristics of the BCPL portfolio. However, the chosen benchmark components provide the best opportunity to compare BCPL investments to funds managed by other professionals. The justifications of including individual benchmark components are provided below. Component weighting begins with an estimate of average liquidity levels required throughout the year, with additional factors including an estimate of the proportion between taxable and tax-exempt project funding, and the use of current taxable and tax-exempt bond yields in developing program interest rates.
- 5 **Cash** - Cash and cash equivalents includes all investments in the State Investment Fund and Farm Credit adjustable rate notes, and all funds managed by ADM in FDIC-insured deposit accounts.
- 6 **S&P Long Intermediate Term Taxable Municipal Bond Index** - This taxable municipal bond index is included as a benchmark component because it properly reflects the investment strategies of BCPL managed Trust Funds, including both the direct investment in taxable municipal bonds and the influence of taxable bond yields on the development of loan program interest rates. The S&P Long Intermediate Term Taxable Municipal Bond Index matches the weighted average maturity and duration of total BCPL managed funds fairly well, although BCPL maintains better average credit quality. This index is comprised of all taxable bonds issued by any state (including the Commonwealth of Puerto Rico and U.S. territories such as the U.S. Virgin Islands and Guam) with an investment grade rating (minimum S&P BBB- or Moody's Baa3), a minimum par amount of \$1 million, and remaining maturity between 5 and 15 years. Average credit quality level is not published by S&P, but was calculated at the weighted average rating of amounts held within the separate S&P AAA, AA, A, and BBB Rated Taxable Municipal Bond Indices using a formula developed by Schwab Portfolio Center, the portfolio analysis software used by BCPL. Overall, a weighting of 60% is appropriate given the average levels of cash and tax-exempt investments held by the Trust Funds throughout the year.
- 7 **S&P U.S. Treasury Bill Index** - The U.S. Treasury Bill Index represents the average cash position held by the Trust Funds throughout the year, and is included because BCPL maintains significant levels of liquidity needed to fund expected trust fund loan demand over the next 3-6 months. The amount of portfolio liquidity (cash) varies significantly throughout the year, and is impacted by factors including the interest rate environment, the absence of prepayment penalties within the loan program, and the statutory payment structure requiring annual loan payments on March 15 each year. The S&P U.S. Treasury Bill index is a market weighted index that includes all U.S. Treasury Bills with maturities ranging from 0-12 months. Because an index is not a managed portfolio, but only a collection of securities within a specific set of criteria, management expenses are not included. Overall, a weighting of 10% for this benchmark component is appropriate given the average levels of cash held by the Trust Funds throughout the year.
- 8 **Wisconsin Tax-Exempt Bond Funds** - Tax-exempt bond funds are included as a benchmark component for three reasons: BCPL invests directly in tax-exempt bonds when available at acceptable terms; a significant portion of loans made through the BCPL State Trust Fund Loan Program fund projects that would qualify as tax-exempt; and current tax-exempt bond yields are an important factor in the construction of loan program interest rates. There are three bond mutual funds that invest primarily in Wisconsin State and Municipal Bonds, investments that are similar to the securities approved for BCPL investment. These funds are sponsored by Wells Fargo, Nuveen and Nationwide Ziegler, and there are significant differences between the management of these mutual funds and BCPL trust funds. All three mutual funds are limited to tax-exempt investments, a universe of securities that generally provide lower yields than the taxable instruments favored by BCPL. On the other hand, all three of these funds invest substantial amounts in bonds that have considerable default risk including bonds issued by the Commonwealth of Puerto Rico, community development revenue bonds, hospital revenue bonds, and other bonds types not available within the risk parameters of the BCPL investment authority. Overall, a weighting of 30% for this benchmark component is appropriate given the level of Trust Fund investment in tax-exempt instruments and the influence of tax-exempt bond rates on the interest rates charged within the loan program.
- 9 **Total Return Analysis** - A total return analysis including the periodic change in asset values in addition to earnings would provide a more comprehensive and accurate comparison between the returns generated by BCPL managed funds and our benchmark. However, total return analysis requires accurate asset valuation in order to provide a reasonable basis for measuring management performance. A significant portion of BCPL managed assets are invested in loans to municipalities and school districts through the BCPL State Trust Fund Loan Program. BCPL has never sold a trust fund loan and has always held these investments to maturity. There is currently no formula or model available to determine an accurate market value of the loan portfolio. Should BCPL sell loans in the future and establish a secondary market in BCPL State Trust Fund Loans, total return analysis may provide an improvement over the current method of yield comparison as the model for measuring BCPL investment performance against the appropriate benchmarks.

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Investment Transaction Report April 13, 2017

Bond Purchases

Issuer	Credit Rating	Trade Date	Par Value	Price Paid	Coupon	Call Date	Yield to Call	Maturity Date	Yield to Maturity
FFCB	Aaa	04/11	\$10,000,000	\$10,000,000	3.69%	04/20/18	3.69%	04/20/37	3.69%
FFCB	Aaa	04/12	<u>\$1,350,000</u>	\$1,352,025	3.54%	06/27/17	2.80%	06/27/29	3.53%
			\$11,350,000						

Bond Sales

Since the last report, staff has sold bonds with total par value of \$11.3 million and realized long-term capital gains of about \$950,000 from these sales. The profit earned on these transactions increased the average annual return during the investment holding period to 6.0%.

To date in 2017, BCPL has earned \$5.4 million in long-term capital gains from the sale of \$60.7 million (par value) in bonds. As provided in the IPS, 25% of total gains will be distributed to Trust Fund beneficiaries with 75% retained in the CSF smoothing fund.

Current Holdings

Combined Trust Fund Bond Portfolios

Investment Type	4/13/17	3/30/17
State of Wisconsin Bonds	\$171,036,062	\$177,385,994
Wisconsin Municipal Bonds	\$201,530,122	\$225,805,398
Agency Bonds	<u>\$128,859,910</u>	<u>\$126,172,977</u>
Total Bond Investments (at cost)*	\$501,426,094	\$529,364,369
(at market value)	<u>\$514,894,064</u>	<u>\$540,210,666</u>
Unrealized Gains	\$13,467,970	\$10,813,496