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Jonathan Barry, *Executive Secretary*

AGENDA

October 16, 2018

3:30 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 - October 2, 2018 (Attachment)
- 3) Approve Loans (Attachment)

Old Business: None

New Business: None

- 4) Ratify Adjustments to Loan Program Interest Rates (Attachment)

Routine Business:

- 5) Executive Secretary's Report (Attachment)
 - 2018 Q3 Investment Summary
 - Investment Transaction Report
 - Monthly Portfolio Report - Fixed Income Report
 - Monthly Portfolio Report - Public Equity Report
- 6) Future Agenda Items
- 7) Adjourn

AUDIO ACCESS INFORMATION

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**BOARD MEETING
OCTOBER 16, 2018**

**AGENDA ITEM 2
APPROVE MINUTES**

Attached for approval are the minutes from the October 2, 2018, board meeting.

Board Meeting Minutes
October 2, 2018

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, 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 2:02 p.m.

ITEM 2. APPROVE MINUTES – SEPTEMBER 18, 2018

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. Clover Bayfield County Application #: 02019038 Purpose: Finance storm damage repairs	Town Rate: 4.00% Term: 3 years	General Obligation	\$250,000.00
2. Delafield Waukesha County Application #: 02019036 Purpose: Finance 2018 capital projects	City Rate: 4.00% Term: 2 years	General Obligation	\$311,000.00
3. Kellnersville Manitowoc County Application #: 02019031 Purpose: Finance water main replacement	Village Rate: 4.25% Term: 10 years	General Obligation	\$80,000.00
4. Niagara Marinette County Application #: 02019035 Purpose: Upgrade water meter reading system	City Rate: 4.25% Term: 10 years	General Obligation	\$100,000.00

5.	Pigeon Trempealeau County Application #: 02019033 Purpose: Finance roadwork	Town Rate: 4.25% Term: 6 years	General Obligation	\$440,000.00
6.	Plover Portage County Application #: 02019030 Purpose: Purchase fire truck and refinance GO bonds	Village Rate: 4.25% Term: 10 years	General Obligation	\$1,900,000.00
7.	Port Washington Ozaukee County Application #: 02019037 Purpose: Finance business development loan	City Rate: 4.50% Term: 19 years	General Obligation	\$330,000.00
8.	Sheboygan Falls Sheboygan County Application #: 02019034 Purpose: Finance subdivision infrastructure	City Rate: 4.25% Term: 10 years	General Obligation	\$760,000.00
9.	Tomah Monroe County Application #: 02019032 Purpose: Purchase vehicles	City Rate: 4.00% Term: 3 years	General Obligation	\$200,000.00
		TOTAL		\$4,371,000.00

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. PROPOSED LAND BANK SALE - THREE LAKES SCHOOL DISTRICT, ONEIDA COUNTY (S1812)

Executive Secretary Barry reported that the electorate in the Three Lakes School District voted on and passed a resolution at their annual meeting to purchase the property for school use from BCPL.

MOTION: Board Chair Schimel moved to approve the sale of the School Trust Lands to the Three Lakes School District; Commissioner La Follette seconded the motion.

DISCUSSION: None.

VOTE: The motion passed 3-0.

NOW, THEREFORE BE IT RESOLVED, that the Board of Commissioners of Public Lands approves the sale of the Property to the Three Lakes School District at the price of Sixty-three Thousand Dollars (\$63,000), retaining right of first refusal, in accordance with Chapter 24 of the Wisconsin Statutes on such terms and conditions as the Executive Secretary determines to be reasonable and necessary. The Executive Secretary is authorized and directed to execute any documents reasonably necessary to complete such transaction.

ITEM 5. EXECUTIVE SECRETARY'S REPORT

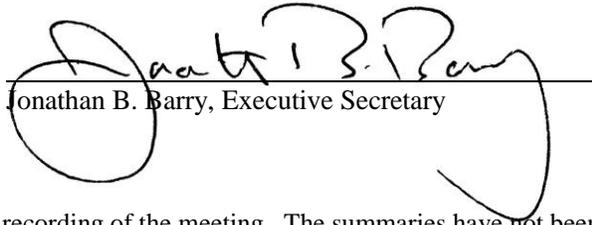
Executive Secretary Barry reported that the Department of Administration notified him that Veterans Loan Bonds would be redeemed in November. Interest earnings on the bonds is expected to total approximately \$390,000.

ITEM 6. FUTURE AGENDA ITEMS

None.

ITEM 7. ADJOURN

The meeting adjourned at 2:06 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/2018-10-02_BCPL-BoardMtgRecording.mp3.

**BOARD MEETING
OCTOBER 16, 2018**

**AGENDA ITEM 3
APPROVE LOANS**

<u>Municipality</u>	<u>Municipal Type</u>	<u>Loan Type</u>	<u>Loan Amount</u>
1. Amnicon Douglas County Application #: 02019039 Purpose: Purchase dump truck	Town Rate: 4.25% Term: 10 years	General Obligation	\$179,950.00
2. Green Bay Brown County Application #: 02019040 Purpose: Finance economic development projects	City Rate: 4.25% Term: 10 years	General Obligation	\$2,000,000.00
3. West Allis Milwaukee County Application #: 02019041 Purpose: Finance economic development projects	City Rate: 4.50% Term: 20 years	General Obligation	\$7,087,105.00
	TOTAL		<hr/> \$9,267,055.00

**BOARD MEETING
OCTOBER 16, 2018**

**AGENDA ITEM 4
RATIFY ADJUSTMENTS TO LOAN PROGRAM INTEREST RATES**

Background

The Federal Reserve has continued to raise short-term rates at a consistent pace, which is reflected in an increase in market yields.

Staff Recommendations

BCPL loan rates should reflect the current market environment and BCPL staff is recommending that we increase our rates by another 0.25% across all loan terms:

Loan Term	Previous Rate	Adjusted Rate	Change
2 Years	4.00%	4.25%	+0.25%
3-5 Years	4.00%	4.25%	+0.25%
6-10 Years	4.25%	4.50%	+0.25%
11-20 Years	4.50%	4.75%	+0.25%

Authorization for Interest Rate Adjustment

The Board had previously authorized the Executive Secretary in consultation with the Board Chairman to adjust loan interest rates up to 1% in between board meetings. In accordance with that authority, the Executive Secretary and Board Chairman approved these changes effective October 9, 2018.

Proposed Resolution

NOW, THEREFORE BE IT RESOLVED, that the Board of Commissioners of Public Lands ratifies the changes in BCPL State Trust Fund Loan Program, with annual interest rates to be set at 4.25% for 2-year loans; 4.25% for 3-5 year loans; 4.50% for 6-10 year loans; and 4.75% for 11-20 year loans.

**BOARD MEETING
OCTOBER 16, 2018**

**AGENDA ITEM 5
EXECUTIVE SECRETARY'S REPORT**

Attachments

- 2018 Q3 Investment Summary
- Investment Transaction Report
- Monthly Portfolio Report - Fixed Income
- Monthly Portfolio Report - Public Equity

BCPL Trust Fund Investment Report – Third Quarter 2018

Executive Summary

BCPL fixed-income investment performance continues to exceed benchmark returns. The yield of BCPL-managed fixed-income investments was 0.65% greater than benchmark yields in the third quarter. When adjusted for differences in credit quality and maturity, the BCPL-managed portfolio provided a yield 0.84% better than the benchmark. Over the course of a year, this means that the BCPL-managed fixed income portfolio would provide over \$9,350,000 more to beneficiaries than a benchmark portfolio of similar quality.

Fixed Income

The 10-year Treasury rate remained volatile, ending the third quarter somewhat higher at 3.06% before climbing sharply to near 3.25% in early October.

As noted in bimonthly transaction reports, Staff acquired a few higher yielding bonds earlier in the quarter while Treasury Inflation Protected Securities (TIPS) were acquired more recently. You will recall that BCPL staff recognized a trading pattern last year and were successful in buying and selling TIPS to deliver significant capital gains. TIPS prices have recently reached relative lows, providing a new opportunity to acquire these securities at attractive levels.

TIPS are Aaa-rated Treasury Bonds that provide advantages for endowments and other funds concerned with the effects of inflation on the purchasing power of future beneficiaries. TIPS pay interest on a semi-annual basis, with the face value of the bond increasing over time by the inflation rate. TIPS are liquid securities, and BCPL will have the option to sell the bonds and capture the increase in value at any time prior to maturity. If held to maturity, total return is guaranteed at over 1% plus CPI, and CPI has increased 2.6% annually over the past 30 years and 4.1% over the past 50 years.

Public Equities

As mentioned in the prior quarterly report, equity risk levels rose in the weeks leading up to the third quarter from escalating rhetoric and executive actions on trade, tariffs and foreign investment. In response, staff took a 'wait and see' approach to the equity market. Stock indices continued to climb to record levels throughout the quarter, while risk seemed to subside upon the renegotiation of trade terms with our two largest export markets - Canada and Mexico. There is still significant tension with China, and rising interest rates have provided an additional risk element to equity markets. However, the recent drop-off in equity prices has improved relative values, and prompted the Investment Committee to resume acquisitions at a prudent pace.

Venture Capital

Capital calls were made for both VC funds – 4490 Ventures II (\$780,000) and Venture Investors Health Fund 6 (\$1,072,500). Total investment in this asset class is now \$5,122,500 or about 0.50% of CSF financial assets.

BCPL Fixed Income Summary

3rd Quarter 2018

as of September 30, 2018

BCPL Fixed Income Summary						
3rd Quarter 2018						
as of September 30, 2018						
Comparison to Benchmark	Total Assets	Expected Yield ¹	SEC Yield ²	Average Credit Quality ³	Weighted Avg Maturity	
Total BCPL-Managed Fixed Income Assets	\$ 1,113,964,307	3.70%	3.79%	Aa1	9.76	
Benchmark Performance ⁴		3.20%	3.47%	A1	8.68	
BCPL Absolute Yield Relative to Benchmark		0.49%	0.32%	+++	+1.29 Yrs	
Adjustment for Better Credit Quality		0.38%	0.36%	'AA' S&P Index yield less 'A' S&P Index yield		
Adjustment for Longer Maturity		-0.03%	-0.03%	Yield adjustment needed to match maturity		
BCPL RISK-ADJUSTED YIELD RELATIVE TO BENCHMARK		0.84%	0.65%			
BCPL Fixed Income Investment Detail						
	% of Total BCPL Managed Assets	Total Assets	Expected Yield ¹	SEC Yield ²	Average Credit Quality ³	Weighted Avg Maturity
Bonds	52.25%	\$ 582,028,945	3.87%	4.05%	Aa1	14.55
BCPL State Trust Fund Loans	43.51%	\$ 484,630,996	3.64%	3.64%	Aa1	4.95
Cash and Cash Equivalents ⁵	4.25%	\$ 47,304,366	2.05%	2.05%	Aaa	0.00
Total BCPL Managed Fixed-Income Investments	100.00%	\$ 1,113,964,307	3.70%	3.79%	Aa1	9.76
Benchmark Components						
	Weighting	Total Assets	Expected Yield ¹	SEC Yield ²	Average Credit Quality ³	Weighted Avg Maturity
S&P Long Intermediate Term Taxable Municipal Bond Index ⁶	60.00%		3.82%	4.29%	Aa3	9.54
S&P U.S. Treasury Bill Index ⁷	10.00%		2.11%	1.96%	Aaa	0.08
Wisconsin Tax-Exempt Bond Mutual Funds (combined) ⁸	30.00%	\$ 261,900,001	2.32%	2.33%	Baa2	9.82
Total Benchmark	100.00%		3.20%	3.47%	A1	8.68
Important Notes on Following Page						
Prepared by Richard Sneider, CFA, CIPM						

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 Moodys 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 Moodys 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.



Douglas La Follette, *Secretary of State*
Matt Adamczyk, *State Treasurer*
Brad D. Schimel, *Attorney General*

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Investment Transaction Report October 12, 2018

Bond Purchases

Issuer	Credit Rating	Trade Date	Par Value	Price Paid	Coupon	Call Date	Yield to Call	Maturity Date	Yield to Maturity
TIPs	Aaa	10/09/18	\$5,110,500	\$4,860,565	1.00%	n/a	n/a	2/15/48	Inflation + 1.20%

Bond Sales

Staff has not sold bonds since the last Investment Transaction Report.

Public Equity Purchases

Staff purchased an additional \$3 million in ETF shares since the last Investment Transaction Report, and the CSF now holds approximately \$25 million in public equities.



BCPL Fixed Income Portfolio

As of 09/30/2018

<u>Description</u>	<u>Moody's Rating</u>	<u>S&P Rating</u>	<u>Weight</u>	<u>Expected Yield</u>	<u>Yield to Maturity at Cost</u>	<u>Modified Duration (years)</u>	<u>Cost Basis</u>	<u>Estimated Current Value</u>	<u>Estimated Unrealized Gain (Loss)</u>	<u>Annual Income</u>
Treasury and Agency Securities	Aaa	AA+	52.8%	3.59%	3.48%	11.96	305,571,198	292,326,763	(13,244,435)	10,555,016
Wisconsin and State Agency	Aa2	AA-	25.5%	4.18%	4.20%	10.04	139,590,744	140,228,262	637,518	5,969,318
Municipal/School District	Aa3	AA-	21.7%	3.90%	3.92%	8.70	120,386,754	119,568,809	(817,944)	4,818,460
	Aa1	AA	100.0%	3.80%	3.75%	10.76	565,548,696	552,123,835	(13,424,861)	21,342,794



BCPL Public Equity Portfolio

As of 09/30/2018

Symbol	Description	Quantity	Avg Cost	Cost Basis	Current Price	Current Value	Weight	Unrealized Gain (Loss)	Percent Gain (Loss)	Current Yield	Projected Annual Dividends
Domestic Equities											
VTI	Vanguard Total Stock Market ETF	39,895	137.77	5,496,514	149.650	5,970,287	26.7%	473,773	8.6%	1.9%	113,972
VYM	Vanguard High Dividend Yield ETF	39,453	83.60	3,298,274	87.090	3,435,962	15.4%	137,688	4.2%	3.1%	106,018
VIG	Vanguard Dividend Appreciation ETF	10,820	101.59	1,099,213	110.700	1,197,774	5.4%	98,561	9.0%	1.8%	21,558
VNQ	Vanguard REIT ETF	14,504	75.82	1,099,737	80.680	1,170,183	5.2%	70,446	6.4%	5.7%	66,353
		<u>104,672</u>		<u>10,993,737</u>		<u>11,774,205</u>	<u>52.7%</u>	<u>780,468</u>	<u>7.1%</u>	<u>2.6%</u>	<u>307,901</u>
Global Equities											
VEU	Vanguard FTSE All World ex-US ETF	101,605	54.11	5,498,001	52.050	5,288,540	23.7%	(209,461)	-3.8%	2.1%	111,278
VYMI	Vanguard International High Dividend ETF	50,009	65.95	3,297,967	62.820	3,141,565	14.1%	(156,402)	-4.7%	3.7%	115,561
VIGI	Vanguard International Div Appreciation ET	16,936	64.91	1,099,283	64.430	1,091,186	4.9%	(8,097)	-0.7%	1.0%	11,022
VNOI	Vanguard Global ex-US Real Estate ETF	18,266	60.19	1,099,509	56.170	1,026,001	4.6%	(73,508)	-6.7%	5.6%	57,806
		<u>186,816</u>		<u>10,994,761</u>		<u>10,547,293</u>	<u>47.3%</u>	<u>(447,468)</u>	<u>-4.1%</u>	<u>2.8%</u>	<u>295,667</u>
		<u>291,488</u>		<u>21,988,498</u>		<u>22,321,499</u>	<u>100.0%</u>	<u>333,000</u>	<u>1.5%</u>	<u>2.7%</u>	<u>603,568</u>