



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

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Jonathan Barry, *Executive Secretary*

AGENDA

January 17, 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 – December 19, 2016 (Attachment)
- 3) Approve Loans (Attachment)

Old Business:

None

New Business:

- 4) Discuss and Vote on Staff Attending Fixed Income Conference in Chicago

Routine Business:

- 5) Future Agenda Items
- 6) Executive Secretary's Report (Attachments)
 - BCPL Trust Fund Investment Report – 4th Quarter 2016
 - Investment Transaction Report
- 7) Adjourn

AUDIO ACCESS INFORMATION

Toll Free Number: **(888) 291-0079**
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**BOARD MEETING
JANUARY 17, 2017**

**AGENDA ITEM 2
APPROVE MINUTES**

Attached for approval are the minutes from the December 19, 2016, board meeting.

Present via teleconference were:

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 3:06 pm. He noted that Commissioner La Follette was not present for the roll call.

ITEM 2. APPROVE MINUTES – DECEMBER 6, 2016

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

DISCUSSION: None.

VOTE: The motion passed 2-0.

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. Blair Trempealeau County Application #: 02017125 Purpose: Finance TID #7 infrastructure	City Rate: 4.00% Term: 20 years	General Obligation	\$135,000.00
2. Bloom Richland County Application #: 02017123 Purpose: Repair storm damaged roads	Town Rate: 2.50% Term: 3 years	General Obligation	\$68,000.00
3. Columbus Columbia and Dodge Counties Application #: 02017124 Purpose: Purchase land for fire station and library	City Rate: 3.50% Term: 20 years	General Obligation	\$800,000.00
4. River Falls Pierce and St. Croix Counties Application #: 02017121 Purpose: Finance corporate park costs	City Rate: 3.50% Term: 15 years	General Obligation	\$1,100,000.00

5.	River Falls Pierce and St. Croix Counties Application #: 02017122 Purpose: Purchase snow blower	City Rate: 2.50% Term: 5 years	General Obligation	\$112,500.00
TOTAL				\$2,215,500.00

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

DISCUSSION: None.

Commissioner La Follette joined the teleconference.

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

ITEM 4. INVESTMENT COMMITTEE TRANSACTION REPORT

Staff reported that approximately \$50 million in long-term and short-term bonds had been purchased over the past two weeks in order to take advantage of increased interest rates. Commissioner Adamczyk asked if any bonds had been purchased using the Board’s approved, expanded investment authority; staff replied no. Commissioner La Follette inquired about the progress of staff’s research for ETF (exchange traded funds) investments. Staff said meetings were being held with investment firms to discuss fee structures, etc. A report could possibly be ready for presentation at the next Board meeting.

ITEM 5. FUTURE AGENDA ITEMS

None.

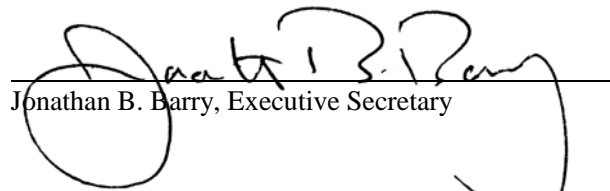
ITEM 6. EXECUTIVE SECRETARY’S REPORT

Executive Secretary Barry reported that staff could “attend” the Western States Land Commissioners Association winter conference via an on-line, Internet webcast. This option will save the agency the cost of travel expenses including airfare and lodging. In addition, the registration cost of \$400 allows an unlimited number of staff to participate.

ITEM 7. ADJOURN

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

The meeting adjourned at approximately 2:20 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://doaftp1380.wi.gov/doadocs/BCPL/2016-12-19_BCPL-BoardMtgRecording.mp3

**BOARD MEETING
JANUARY 17, 2017**

**AGENDA ITEM 3
APPROVE LOANS**

<u>Municipality</u>	<u>Municipal Type</u>	<u>Loan Type</u>	<u>Loan Amount</u>
1. Lac La Belle Waukesha County Application #: 02017132 Purpose: Finance sewer improvements	Village Rate: 3.50% Term: 20 years	General Obligation	\$56,000.00
2. Milltown Polk County Application #: 02017129 Purpose: Purchase skidsteer	Village Rate: 3.00% Term: 5 years	General Obligation	\$24,500.00
3. Poplar Douglas County Application #: 02017130 Purpose: Purchase dump truck	Village Rate: 3.50% Term: 15 years	General Obligation	\$60,000.00
4. Twin Lakes Kenosha County Application #: 02017131 Purpose: Refinance NAN	Village Rate: 4.00% Term: 20 years	General Obligation	\$775,000.00
5. Union Rock County Application #: 02017133 Purpose: Refinance fire department building construction loan	Town Rate: 2.50% Term: 5 years	General Obligation	\$52,135.99
TOTAL			\$967,635.99

**BOARD MEETING
JANUARY 17, 2017**

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

Attached for review are the following reports:

- BCPL Trust Fund Investment Report – 4th Quarter 2016
- Investment Transaction Report – January 12, 2017

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BCPL Trust Fund Investment Management

Investment Report - Fourth Quarter 2016

Executive Summary

BCPL investment performance continues to exceed benchmark returns. After adjusting returns for differences in both credit quality and average maturity, the BCPL-managed portfolios had a yield that was **0.83% greater** than our benchmark. This difference in yield means that beneficiaries earned **\$2.2 million more** in the fourth quarter than would have been generated by an investment in the benchmark portfolio.

The BCPL Investment Committee has scheduled weekly meetings and is formulating plans for the methodical purchase of equity ETFs beginning in the near-term.

Q4 Investment Highlights and Outlook

The interest rate on the benchmark 10 year Treasury doubled from a record low of 1.32% in early July to 2.64% in mid-December with about half of that movement immediately following the Presidential election. Staff believed that markets overreacted to the potential economic impacts of a new administration. With interest rates rising to higher levels than expected, Staff purchased bonds heavily at year-end, which helped provide a net reduction in cash of \$76.2 million during the quarter. The benchmark rate has since settled back down to approximately 2.40%.

At the end of the fourth quarter, the bond portfolio contained unrealized gains estimated at \$8.9 million, which means that our bonds were valued at 1.8% above the initial cost of these investments. The amount of unrealized gains reported within the portfolio needs to be taken with a grain of salt: Bond valuations are a difficult issue throughout the asset management industry. Unlike publicly-traded common stocks, many bonds are held by the initial purchaser and do not trade from the date of issuance to the date of maturity. However, financial and accounting regulations require assets (including bonds) to be valued on a regular basis to promote market transparency. Because trade data is unavailable for many bonds, asset managers generally utilize mathematical algorithms developed by S&P and other firms to estimate the value of managed portfolios. Staff has mixed experience with the accuracy of these bond pricing services, with bonds selling at prices both higher and (mostly) lower than the estimated values.

The estimated amount of unrealized gains is lower than reported in the prior quarter due to the increase in market interest rates since early November. While the amount of unrealized gains has no impact on the distribution to beneficiaries, the decline in bond prices in the fourth quarter underlines the fact that bond prices go down when interest rates go up.

Loan demand remains very strong and relative yields on the loan portfolio continue to outperform investment alternatives. BCPL received \$125 million in loan applications during the first six months of FY17, which is an increase of nearly 35% over last year and 87% over the average six month total from 2012-2016.

Summary and Benchmark Comparison

The overall expected yield of funds managed by BCPL was 3.26% at the end of third quarter, an increase from the prior quarter that was anticipated with higher market interest rates.

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 market indexes that comprise our benchmark. Adjustments to account for our better average credit rating and shorter maturity increase the BCPL yield to 0.83% greater than benchmark returns.

BCPL Investment Summary

4th Quarter 2016

as of December 31, 2016

Portfolio Summary		Total Assets	Expected Yield ¹	SEC Yield ²	Average Credit Quality ³	Weighted Avg Maturity
Total BCPL Managed Financial Assets		\$ 1,063,050,216	3.26%	3.16%	Aa1	7.74
Benchmark Performance ⁴				3.07%	A1	8.77
BCPL Investments						
	% of Total BCPL Managed Assets					
Bonds	41.48%	\$ 440,947,234	3.91%	3.68%	Aa2	13.35
BCPL State Trust Fund Loans	41.97%	\$ 446,153,828	3.69%	3.69%	Aa1	5.19
Cash and Cash Equivalents ⁵	16.55%	\$ 175,949,154	0.52%	0.52%	Aaa	0.17
Total BCPL Managed Investments	100.00%	\$ 1,063,050,216	3.26%	3.16%	Aa1	7.74
Benchmark Components						
	Weighting					
S&P Long Intermediate Term Taxable Municipal Bond Index ⁶	60.00%		3.51%	3.96%	Aa3	9.82
S&P U.S. Treasury Bill Index ⁷	10.00%		0.38%	0.38%	Aaa	0.11
Wisconsin Tax-Exempt Bond Mutual Funds (combined) ⁸	30.00%	\$ 374,000,001	N/A	3.07%	Baa2	9.56
Total Benchmark	100.00%			3.07%	A1	8.77
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 January 12, 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	12/19	\$10,000,000	\$10,000,000	3.87%	12/29/17	3.87%	12/29/31	3.87%
FFCB	Aaa	12/29	\$10,000,000	\$10,000,000	3.79%	04/04/17	3.79%	01/04/30	3.79%

Bond Sales

Staff has not sold any bonds since the prior bond activity report.

Current Holdings

Combined Trust Fund Bond Portfolios Current Holdings as of January 12, 2017

Investment Type	
State of Wisconsin Bonds	\$164,543,717
Wisconsin Municipal Bonds	\$227,453,027
Agency Bonds	<u>\$126,484,150</u>
Total Bond Investments (at cost)	\$518,480,894
(at market value)	<u>\$529,440,619</u>
Unrealized Gains	\$10,959,725