
Board Meeting Minutes
August 15, 2023

Present were:

Sarah Godlewski, Board Chair	Secretary of State
Josh Kaul, Commissioner	Attorney General
John Leiber, Commissioner	State Treasurer
Tom German, Executive Secretary	Board of Commissioners of Public Lands
Rich Sneider, Chief Investment Officer	Board of Commissioners of Public Lands
Denise Nechvatal, Controller	Board of Commissioners of Public Lands
Chuck Failing, IT Manager	Board of Commissioners of Public Lands
Thuy Nguyen, Office Manager	Board of Commissioners of Public Lands
Hannah Menchhoff, Communications Director	Secretary of State

ITEM 1. CALL TO ORDER

Board Chair Godlewski called the meeting to order at 2:00 p.m.

ITEM 2a. APPROVE MINUTES – AUGUST 1, 2023

MOTION: Board Chair Godlewski moved to approve the minutes; Commissioner Leiber seconded the motion.

DISCUSSION: None.

VOTE: The motion passed 3-0.

ITEM 2B. APPROVE MINUTES – AUGUST 7, 2023

MOTION: Board Chair Godlewski moved to approve the minutes; Commissioner Leiber seconded the motion.

DISCUSSION: None.

VOTE: The motion passed 3-0.

ITEM 3a. APPROVE LOANS

MOTION: Board Chair Godlewski moved to approve the loans; Commissioner Leiber seconded the motion.

DISCUSSION: Mr. Sneider shared that these are all part of our bread-and-butter loans this meeting. We have three loans for roads, three loans for trucks and a town building.

VOTE: The motion passed 3-0.

The Board of Commissioners of Public Lands (BCPL) unanimously approved **\$2,582,584.00** in State Trust Fund Loans to support **7** community projects in Wisconsin.

1. Village of Pewaukee / Waukesha County / Finance road and well projects / \$670,688.00
2. Town of Conover / Vilas County / Finance roadwork / \$485,000.00
3. Village of Whiting / Portage County / Finance Street and Sidewalk Projects / \$155,000.00
4. Town of Antigo / Langlade County / Finance purchase of fire truck / \$250,000.00
5. Town of Pelican / Oneida County / Finance purchase of plow truck / \$200,000.00
6. Town of Knowlton / Marathon County / Finance purchase of grader / \$250,000.00
7. Town of Fremont / Clark County / Finance construction of Fire Hall and Community Center / \$571,896.00

ITEM 3b. BLACK HAWK SCHOOL DISTRICT LOAN EXTENSION

Board Chair Godlewski asked that meeting rules be suspended so that a preliminary discussion can be had about the loan extension. All agreed.

DISCUSSION: Mr. Sneider explained that BCPL approved a 10-year loan for the Black Hawk School District a few months ago and now the school district would like to like to extend that loan out to 20 years. State statutes allow BCPL to extend the loan to the school district out for that time.

Executive Secretary German added that most of the state statutes for municipal borrowing are found in Chapter 67 which includes a statute that provides any municipality, school district, town, county, etc. may refinance an existing debt without getting additional approval from their electors. BCPL statutes do not have specific statutes for refinancing, so there is a slight difference. However, Chapter 24 does contain a statute that expressly authorizes the board to extend a loan. Extensions are a straightforward process, and it does not change the risk profile of the loan. It would still be a good loan for the longer period of time. Market interest rates are relatively the same throughout the timelines involved here. BCPL staff is fully supportive of this request.

Commissioner Leiber asked the reason for the extension.

Mr. Sneider responded that they wanted to have lower payments going forward and extended over 20 years.

Board Chair Godlewski inquired about the original loan amount and why the resolution references a date of March 15th.

Mr. Sneider replied, the loan amount was \$850,000 and March 15th is the date that annual payments are due.

MOTION: Board Chair Godlewski moved to approve the Black Hawk School District Loan Extension in accordance with the proposed resolution; Commissioner Leiber seconded the motion.

VOTE: The motion passed 3-0.

ITEM 4. OLD BUSINESS

None

ITEM 5. NEW BUSINESS

None

ITEM 6. CHIEF INVESTMENT OFFICER'S REPORT – QUARTERLY INVESTMENT REPORT

Mr. Sneider began his report by noting that 12 months ago his report focused on two themes; 1) the public bond and stock markets had just been through the worst six-month period since 1970. Inflation worries had caused the Feds to rapidly increase short term interest rates, which in turn fueled talks of a coming recession; and 2) the resilience that we had built into our portfolio allowed the Common School Fund to weather the storm better than most. Our principal losses during the first half of 2022 compared very favorably to the 20% loss of the overall stock markets and 10% average loss in the bond markets. We did not need to tap into the smoothing fund to support earnings distributions during the worst market since 1970.

Mr. Sneider spoke about the portfolio report. Market interest rates have continued to climb and are now at the highest level since January of 2001. As a result, bond valuations continue to weaken. Projected annual income for the Common School Fund has grown by more than \$20 million over the past two years. Unless there is a default, bonds will pay back 100% of the par value upon maturity. For equities and other assets, higher rates increase the cost of capital and reduce future net earnings, but short-term price volatility has little impact on the income to be distributed to either current or future beneficiaries. There is a decline in the value of our preferred stock portfolio, assets that behave somewhat like bonds in the current rising interest rate market. Bond and preferred stock portfolios continue to generate good distributable income for our beneficiaries and contribute to the diversification of the portfolio.

The total of trust fund loans and the income generated from these loans is slightly higher than it was at the end of the first quarter of this calendar year. The strong activity of recent months will begin to show up in the next few quarters as new loans start to generate interest income. Private debt has been a game changer for generating distributable income and the shift to these higher yielding assets has had a huge impact. The fixed income portfolio of the Common School Fund is now generating nearly \$38 million in projected annual income, \$11 million higher than only 18 months ago.

Private debt (not including the State Trust Fund Loan Program) currently comprises about 10% of Common School Fund assets. However, these investments produce more than 20% of our projected income. These loan funds invest in senior secured debt issued by privately held companies with diversification across sectors and industries.

BCPL has made commitments to a stable of managers that have long track records of excellent performance throughout a variety of economic conditions. We have diversified our investments across the type of assets financed, the size and industry of the underlying companies, and the source of the investment. We currently own funds that provide debt for infrastructure projects, commercial real estate and privately held companies. Borrowers include a spectrum from smaller family held enterprises to well-known firms with hundreds of millions in annual earnings. The losses on the chart have primarily involved the write down of a few commercial mortgage loans secured by office buildings that were hit hard by the pandemic impact on occupancy. We have strong confidence in this particular management team in our portfolio. The team has taken aggressive measures to reduce fund exposure to pre COVID office loans and returns are expected to stabilize at, or above target returns in the near future. While that example shows that we are not immune to the increased default risk with these private debt funds, we believe that the risk adjusted rates of return provide more than adequate compensation for those risks. And because private debt has and will continue to provide the Common School Fund with excellent levels of distributable income and high risk adjusted rates of return, staff is currently working to add one or two additional private debt funds to our portfolio over the next several months.

Our portfolio of preferred stocks has had a difficult year due to the interest rate market but continues to provide a good source of distributable income. For public equities, the investment committee is currently looking at changing the way that we invest in domestic and global common stocks. We currently invest in about 10 individual exchange traded funds (ETFs) with allocations to provide a tilt towards higher dividends. The portfolio is generally rebalanced each month and requires staff to track and create journal entries for all dividend and other

transactions. You might recall that about a year ago staff started looking into private indexing as an alternative to publicly traded ETFs. The investment committee has made significant progress on this front.

Besides State Trust Fund Loans, commercial real estate continues to be our largest current allocation of Common School Fund assets. Capitalization rates have moved up in the past year, and that effect has reduced the values of all sectors in commercial real estate. But few real estate markets in modern history have experienced the dramatic decline seen in office values over the past two years. Demand for offices nationwide has dropped significantly as remote work has taken hold. High-cost cities have been especially hard hit. The office market has become bifurcated with the one bright spot being Class A trophy buildings, where leasing continues to be strong to the detriment of lower quality space. Another example of problem real estate has been regional malls which have lost value for many years due to the increasing competition from online retailers. Fortunately, the BCPL portfolio of real estate funds was chosen to selectively overweight the multifamily and industrial sectors. These two sectors have clearly been outperforming other property types. The Common School Fund portfolio was 75% multifamily and industrial an overweight of nearly 20% compared to the nationwide index. While the Common School Fund portfolio does contain a little retail, we have no interest in regional mall type properties. If one of our funds does hold retail, it'll be a higher end grocery anchored strip mall which continue to perform reasonably well. Our office portfolio was similarly focused on the best performing sectors. These include life science buildings favored by growing high tech companies and properties protected by long term leases with AAA tenants. The retail and office sectors of the Common School Fund portfolio are currently 20% underweight the retail and office values nationwide.

We made our first investments to infrastructure in the second quarter of the year. Over the next few years, we expect that infrastructure to develop into another source of stable distributable income.

There has been some minor repricing of assets within our venture capital portfolio, primarily due to fallout from a difficult market after the failure of Silicon Valley Bank and Republic Bank. We remain excited about many of the companies owned through our venture capital funds, but we also expect some delays in the return of capital from these funds.

The state investment fund, where we hold our cash, is one area where the increase in market interest rates has actually helped the Common School Funded beneficiaries. Please note that the higher rate paid by the state investment fund is finally producing another solid income stream, providing more interest income.

We are patient investors and fluctuations in asset values are less important to our long-term strategy. The Common School Fund is producing a lot of income. We should expect another large disbursement in 2024, perhaps well above \$60 million and we also hold over \$35 million in the smoothing fund. The average yield on the Common School Fund portfolio has grown from 3.2% in FY20 to 5% in FY23. The reallocation of Common School Fund assets is nearly complete. We should not expect the current level of income growth to continue, and we may need to temper expectations for our stakeholders. The era of 10 million plus increases in our annual distribution is not going to continue forever. We expect a big increase for this fiscal year. We hope to continue increasing distributions even after 2024, but the increases will likely be at a slower rate. We still have some room to shift additional assets into higher yielding securities, but we can't put all of our money into private debt and real estate. We need to maintain the diversification necessary to provide long term stability for our beneficiaries.

Mr. Sneider expressed his view that additional increases in the annual distribution in future years are more likely to result from increasing the total amount of principal invested rather than changes within the asset allocation. There are only two ways to increase trust fund principal. The first - Article 10 of the State Constitution requires that all monies and the clear proceeds of all property that may accrue to the state by forfeiture or escheat shall be placed into the Common School Fund. These additions have been critical to growing the Common School Fund to where it is today. However, fines and forfeitures have been declining for years and the Department of Revenue (DOR) has cautioned BCPL that unclaimed property will also likely decline in the coming years. The second way to increase trust fund principal is to generate long term capital gains through our investment portfolio.

Over the coming year, the investment committee will be discussing the need to continue adding growth assets to the portfolio.

The fund continues to perform extremely well and continues to deliver record amounts of distributable income. After producing another large jump in 2024, we should expect that growth and distributions will likely slow down a little.

The allocation report shows that we're closing in on meeting the revised strategic asset allocation approved for the Common School Fund by the Board last October. We are very close to the 50/50 allocation between fixed income and equities alternatives. The biggest changes from the last quarter have been the initial funding in the BlackRock Global Infrastructure Fund IV and the closing on commitments to the KKR Diversified Core Infrastructure Fund, Baird Venture Partner VI, and Venture Investors Health Fund VII. We had expected the infrastructure funds to take a few years for full funding of our commitments, but both funds have indicated that they are already finding good opportunities in the market. So, these investments may happen a little quicker than originally anticipated. Baird and Venture Investors are the second commitments that we've made to these Venture Capital firms, and we are excited about the management teams and opportunities provided by each. Chicago-based Baird Venture Partners focuses on Business to Business (B2B) technology and services, while Madison based Venture Investors is a national leader in healthcare innovation. Both firms have excellent track records and focus on Midwest opportunities. Our commitment will likely take several years to be fully funded, just as our earlier commitments in the venture asset class begin to pay off.

The final page of the board report is an analysis highlighting the growth of the fund versus inflation. Our mandate is to serve both Wisconsin school children of today as well as future generations. The only way that we can make that happen in a fair way is if fund principal grows at or above the long-term rate of inflation. It is important to maintain that focus because the compounding of inflation has an incredible impact over long periods of time.

Mr. Sneider shared examples of the concept of compound interest. Over the next 100 years, if our investments could beat inflation by only 1% each year, our portfolio would grow by 70% and we would have the purchasing power of a \$2.3 billion portfolio today. If we could beat inflation by 2%, our portfolio would grow to the equivalent of \$8.3 billion and our impact would be over six times as great as today. Growth needs to remain an important factor in our long-term strategy.

The Common School Fund growth rate is declining over time. There are at least four reasons for this. Contributions from fines and forfeitures and unclaimed property are declining in absolute terms. Second, as the fund grows, the increase from these contributions falls even greater when looking in percentage terms. Third, we have only had the authority to invest in growth assets for a few years. Prior to the prudent investor standard, we had no growth from investments. We could only invest in various fixed income assets that were held in maturity. Finally, financial markets had a difficult year, and our one-year growth rate was impacted by the unrealized losses in our fixed income portfolio. We expect our growth rate from capital gains to increase over time.

We have done pretty well against inflation. We are having a much greater impact on the lives of Wisconsin school children than 40 years ago and even 10 years ago. He's very optimistic that we will continue to have greater impacts on Wisconsin public schools for generations to come.

Board Chair Godlewski expressed appreciation for the thorough explanation of the current performance of the Common School Fund. She noted the progress that has been made since she joined the investment committee and pointed out that almost \$800 million in new investments had been made over the last 4 1/2 years. She stated that all the different new private investment funds require a lot of time and due diligence but are clearly paying off as Mr. Sneider noted, fund income grew by \$20 million in two years despite a pandemic. That is really, really well done. She asked Mr. Sneider if he believed that deposits in the Common School Fund from fines, forfeitures and unclaimed property were likely to continue to decline for the foreseeable future.

Mr. Sneider responded that he thought fines and forfeitures have had a long-term trend downward as people and other institutions throughout the state try to get a piece of that pie. Unclaimed property seems to have some volatility to it. Over the last few years we've had good increases in the amount that we've received for unclaimed property. Recently DOR cautioned us that that the proceeds from unclaimed property were likely to go down and potentially significantly over the next few years. We may have to make some of that up with growth in the investment portfolio.

Executive Secretary German explained that part of the reason that unclaimed property deposits in the Common School Fund increased is that DOR recently had an amnesty period for holders of unclaimed property. After a certain period of time, holders are required by law to report unclaimed property and turn it over to DOR, but some businesses don't. DOR offered an amnesty program for those entities that were not in compliance and a lot more unclaimed property poured into the program. DOR's experience has been that after unclaimed property comes in, claims follow but there's a lag time on those claims. DOR is essentially projecting decreases in future unclaimed property but increases in claims in the next 18 months following that surge of money coming in. Secretary German agreed that Mr. Sneider is right to be concerned about future deposits of unclaimed property. Secretary German expressed his opinion that the annual level would revert to approximately \$20 million.

Executive Secretary German noted that one of the factors that has influenced the decline of fines and forfeitures that are deposited in the Common School Fund was explosive growth in the number of municipal courts where fines accrue to the municipality not the state and Common School Fund. As Mr. Sneider pointed out, what goes into the Common School Fund are the clear proceeds of fines and forfeitures that accrue to the state. If you get a speeding ticket in the City of Madison, that fine goes to the City of Madison. There have been some smaller communities that decided it was not quite worth it to have their own municipal court. The number of municipal courts has faded a bit, but the total amount of revenue coming in from fines and forfeitures has shrunk. Many years ago the Common School Fund was receiving almost \$20 million a year and now we're down to half that amount. It is a significant drop.

Board Chair Godlewski commented that Commissioner Leiber has a formal role with respect to unclaimed property and she asked if he was working with DOR on these matters.

Commissioner Leiber clarified that it was not an amnesty program for unclaimed property of DOR, but rather a voluntary disclosure program. He went on to note that his dual roles as State Treasurer and Commissioner created a bit of a conflict. He noted that he was supposed to help promote the program and help people claim their money or property but that then results in less money going into the Common School Fund. He expressed willingness to talk with the Board Chair about possible initiatives with DOR.

Board Chair Godlewski expressed her willingness to talk with the Commissioner Leiber about possible initiatives as well. She then asked if there was anything that we should be thinking about with fines and forfeitures knowing that it has been such a significant or noteworthy decrease while we consider modifying our investment strategy.

Executive Secretary German noted that he had recently taken a step on addressing that issue. He stated that he gave a speech last week to the Wisconsin Narcotics Officers Association. He shared the stage with the Dane County Assistant District Attorney who gave a presentation on civil and criminal forfeitures and received lots of questions about how to get around that pesky School Fund. Secretary German pointed out to the audience that all of us had taken an oath of office to uphold the Wisconsin Constitution. He said as a lawyer, he should have read it more closely, but he admitted that he hadn't until he got to BCPL. And that's when he discovered Article 10 and how it specifically provides that the clear proceeds of fines and forfeitures go to the School Fund. He noted that you could see that there was an "Aha" moment in the crowd. "Oh, that's where the School Fund comes in."

Executive Secretary German pointed out to his audience that they were not only keeping communities safe,

but they were also helping to grow the Common School Fund, which loans money to municipalities for law enforcement vehicles and equipment, and which generates earnings which pay for practically all the library materials, which makes schools a better learning environment, which hopefully keeps more kids from encountering the officers in their everyday line of duty. Executive Secretary German thanked the officers for what they're doing for schools, which they probably hadn't heard before. After his presentation quite a few people come up and thanked him as they had never heard the connection before. Executive Secretary German noted that this was a first step. As more people understand the connection, there might be less resistance to having fines and forfeitures go into the School Fund.

Board Chair Godlewski asked if there were other outreach and education and advocacy opportunities like this.

Executive Secretary German expressed his belief that there are. He shared that there may also be publications that may help too. He noted that he believes DOJ sends out publications to law enforcement officials on how to correctly handle forfeitures. DOA legal receives reports on expenses incurred in civil asset forfeiture actions, but DOA takes no other official action. He explained that was why he took the initiative to reach out to the Narcotics Officers Association in order to create some communication channels, but noted again that this was a small first step.

Board Chair Godlewski asked Commissioner Kaul if there was somebody in his office that we could connect with on these matters.

Commissioner Kaul suggested that Executive Secretary German get in touch with DOJ's Government Affairs Director, Chris McKinney. Executive Secretary German thanked Commissioner Kaul for the suggestion and said he would contact Mr. McKinney.

ITEM 7. EXECUTIVE SECRETARY'S REPORT

Executive Secretary German followed up on a couple points that Mr. Sneider had made earlier. Two months ago, Executive Secretary German pointed out that BCPL staff had had the best performance in the history of the agency and Mr. Sneider provided more numbers that back up that statement. Not only are we growing the distributable income of the fund, but the Common School Fund itself grew to \$1.338 billion. We are able to tell DPI and hopefully the schools much earlier than before what their share of the annual distribution will be. We look forward to working with DPI on a press event, hopefully earlier in the fall. That will allow the schools to use that information to set their budgets and set their levies accordingly. It's hard enough to be a librarian these days to figure out what you can buy and what you can't. Compressing the time to make that decision from the spring until June 30th, makes it even harder. Giving them a little bit more time is very helpful.

Executive Secretary German noted that distributable income for the Normal School Fund is up as well. Our tentative income projections for FY2023 are in the neighborhood of \$1.6 million. While this pales in comparison to the gross earnings of the Common School Fund, it's important to remember you're talking about a Normal School Fund that generated zero distributable earnings not that long ago. It is great that we are now up to \$1.6 million. He noted that we're able to translate that earnings number into numbers of scholarships and numbers of programs we are funding. We still need to work more closely with the UW to pry that information out of them so that we can talk about that.

Mr. Sneider pointed out the smoothing funds for both the Common School Fund and the Normal School Fund are full, which allows us flexibility for distributions going into the future. That is awesome. We are very thankful to have the staff we do here. They do a great job, and he can't thank them enough.

Executive Secretary German provided a short follow up report on the Town of Sanborn as the board had expressed concerns at the last meeting as to the timeline to complete all the work they needed to get done. Shortly

after the board approved the loan, the town requested the funds. The town officials signed the Certificate of Indebtedness and handed it off to our Chief Investment Officer. We wired the funds to the town's bank account. The town clerk wrote out all the refund checks for years 2015, 16, 17 and 18. The town clerk submitted the chargebacks for all the parcels associated with those refunds to DOR. There were more than 170 chargebacks. Chargebacks are done by year and by parcel and DOR has acknowledged receipt of those submissions, but they haven't reviewed and approved them all yet. Everything moved forward pretty much as we described at the last meeting. Thank you, again, to our staff for making that happen.

ITEM 8. BOARD CHAIR'S REPORT

Board Chair Godlewski reported that she talked to the Town of Sanborn Chairman, and he was incredibly appreciative, especially he commented that the Chief Investment Officer got in his car and drove all the way up north to Ashland County to make sure that they had the papers in hand so we could they could meet their deadlines, which they did to qualify for those chargebacks. Thank you, Mr. Sneider and staff, for turning that around so quickly. The town met their deadline, which August 15th. The community was very appreciative. We did not realize that it was going to take driving up north to make it all happen. Thank you.

Piggy backing off of what Executive Secretary German said, we are looking at two sets of dates to announce the Normal School Fund distribution and the Common School Fund distribution. We are looking at a date at the end of September for the Normal School Fund distribution. We thought it would be best to wait until school starts and students who have benefited from this and our partnership with the university to be back. We hope to come back with more information about that date at one of our next board meetings.

With respect to the Common School Fund, as Executive Secretary German mentioned, we started last year announcing it in November and it was really appreciated by DPI but also the librarians as they could understand the income that was coming in and then they could plan accordingly. We are planning on continuing that timeline and looking at the fall for that announcement. More information to come.

ITEM 9. FUTURE AGENDA ITEMS

None

ITEM 10. ADJOURN

Commissioner Kaul moved to adjourn the meeting; Commissioner Leiber seconded the motion. The motion passed 3-0; the meeting adjourned at 3:49 p.m.



Thomas P. German, Executive Secretary

Link to audio recording:

<https://bcpl.wisconsin.gov/bcpl.wisconsin.gov/Shared Documents/Board Meeting Docs/2023/2023-08-15 BoardMtgRecording.mp3>