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Tom German, *Acting Executive Secretary*

AGENDA

November 3, 2015

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 – October 20, 2015 (Attachment)
- 3) Approve Loans (Attachment)

Old Business:

- 4) Discuss Office of the State Treasurer's Expenses and Relation of those Expenses to the Promotion of Unclaimed Property Program
- 5) Possible Vote to Appoint New Executive Secretary

New Business:

- 6) Discuss Quarterly Investment Report (Attachment)
- 7) Discuss Constitutionality of 2005 Wisconsin Act 352
- 8) Discuss Constitutionality of Wis. Stat. § 36.49

Routine Business:

- 9) Future Agenda Items
- 10) Acting Executive Secretary's Report
- 11) Adjourn

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**BOARD MEETING
NOVEMBER 3, 2015**

**AGENDA ITEM 2
APPROVE MINUTES**

Attached for approval are the minutes from the October 20, 2015, board meeting.

Board Meeting Minutes
October 20, 2015

Present were:

Doug La Follette, Commissioner	Secretary of State
Matt Adamczyk, Commissioner	State Treasurer
Brad Schimel, Board Chair	Attorney General
Tom German, Acting Executive Secretary	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 2:05 p.m.

ITEM 2. APPROVE MINUTES – OCTOBER 6, 2015

MOTION: Commissioner La Follette moved to approve the minutes; Commissioner Adamczyk seconded the motion.

DISCUSSION: None.

VOTE: The motion passed 3-0.

ITEM 3. APPROVE LOANS

Board Chair Schimel asked if the loans had been reviewed for public purpose. Acting Executive Secretary German confirmed they had.

Municipality	Municipal Type	Loan Type	Loan Amount
1. Cross Plains Dane County Application #: 02016084 Purpose: Finance TID #1 projects	Village Rate: 3.25% Term: 10 years	General Obligation	\$692,500.00
2. Durand Pepin County Application #: 02016085 Purpose: Refinance promissory note	City Rate: 3.75% Term: 13 years	General Obligation	\$700,000.00
3. Durand Pepin County Application #: 02016086 Purpose: Refinance BCPL loan #2015008	City Rate: 3.75% Term: 18 years	General Obligation	\$383,500.00
4. Freedom Outagamie County Application #: 02016083 Purpose: Finance highway and drainage projects	Town Rate: 3.00% Term: 5 years	General Obligation	\$240,000.00

5.	Madison Metropolitan Dane County Application #: 02016087 Purpose: Finance tennis court renovation	School Rate: 3.00% Term: 5 years	General Obligation	\$425,000.00
6.	Preston Trempealeau County Application #: 02016088 Purpose: Purchase fire truck	Town Rate: 3.25% Term: 8 years	General Obligation	\$182,500.00
TOTAL				\$2,623,500.00

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

DISCUSSION: None.

VOTE: The motion passed 3-0.

ITEM 4. DISCUSS OFFICE OF STATE TREASURER’S EXPENSES AND RELATION OF THOSE EXPENSES TO THE PROMOTION OF UNCLAIMED PROPERTY PROGRAM

Board Chair Schimel asked Acting Executive Secretary German if he received an explanation of the expenses. Mr. German replied that he had not.

Commissioner Adamczyk said that he would provide whatever information he had to the Board at the next meeting. He added that he supports the elimination of the State Treasurer’s Office and that his office does no promotion of the Unclaimed Property Program.

ITEM 5. FUTURE AGENDA ITEMS

None.

ITEM 6. ACTING EXECUTIVE SECRETARY’S REPORT

Mr. German reported that:

- Trust Fund monies have been invested in Treasury, Farm Credit, and taxable municipal bonds;
- Common School Fund earnings are projected to be in excess of \$37 million;
- \$40 million in Trust Fund monies were moved to ADM (American Deposit Management) in accordance with recent Board approval;
- Financing plans for the Bucks arena are in the process of being developed and staff will keep the Board informed as information becomes available;
- An appraisal has been ordered for the Pigeon Lake Trust Lands property in Bayfield county; and
- Staff will be attending the WI Towns Association and League of Wisconsin Municipalities annual conferences.

ITEM 7. CONVENE IN CLOSED SESSION UNDER s.19.85 (1)(c) TO DISCUSS CANDIDATES FOR EXECUTIVE SECRETARY POSITION

MOTION: Board Chair Schimel moved to convene into closed session; Commissioner Adamczyk seconded the motion. The motion passed 3-0.

[The Board convened into closed session at 2:10 PM and reconvened into open session at 3:20 PM.]

ITEM 8. RECOVENE IN OPEN SESSION – POSSIBLE NOMINATION(S) AND VOTE TO APPOINT NEW EXECUTIVE SECRETARY

Board Chair Schimel reported that the Commissioners had met in closed session to discuss the five candidates' qualifications as well as the direction they would like the new Executive Secretary to take. The Board did not reach unanimity on a candidate and some Commissioners expressed a desire to interview one or more of the potential candidates. Commissioner La Follette asked about the legality of the Commissioners conducting interviews individually rather than the Board conducting interviews as a whole. Board Chair Schimel replied he would have his staff research the issue and the decision would be relayed to the other Commissioners. If permissible, those Commissioners wishing to conduct interviews could proceed.

ITEM 9. ADJOURN

MOTION: Commissioner La Follette moved to adjourn the meeting; Commissioner Adamczyk seconded the motion.

The meeting adjourned at approximately 3:25 p.m.



Thomas P. German, Acting 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/2015-10-20_BCPL-BoardMtgRecording.mp3

**BOARD MEETING
NOVEMBER 3, 2015**

**AGENDA ITEM 3
APPROVE LOANS**

Municipality	Municipal Type	Loan Type	Loan Amount
1. Beloit Rock County Application #: 02016099 Purpose: Finance property acquisition and demolition	City Rate: 3.25% Term: 10 years	General Obligation	\$200,000.00
2. Campbellsport Fond Du Lac County Application #: 02016089 Purpose: Refinance Note Anticipation Notes dated 10/24/2011	Village Rate: 3.75% Term: 20 years	General Obligation	\$1,080,813.00
3. Center Outagamie County Application #: 02016095 Purpose: Purchase fire truck	Town Rate: 3.00% Term: 5 years	General Obligation	\$125,000.00
4. Center Outagamie County Application #: 02016096 Purpose: Refinance BCPL loan #2010099	Town Rate: 3.00% Term: 4 years	General Obligation	\$133,483.31
5. Clark Clark County Application #: 02016091 Purpose: Finance road construction	County Rate: 2.50% Term: 2 years	General Obligation	\$848,000.00
6. Concord Jefferson County Application #: 02016092 Purpose: Purchase snow plow truck	Town Rate: 3.25% Term: 10 years	General Obligation	\$220,000.00
7. Elkhart Lake Sheboygan County Application #: 02016094 Purpose: Finance TID #2 and TID #4 related projects	Village Rate: 3.75% Term: 19 years	General Obligation	\$1,420,000.00
8. Hustler Juneau County Application #: 02016090 Purpose: Finance village hall lighting project	Village Rate: 3.25% Term: 10 years	General Obligation	\$8,870.00

Municipality	Municipal Type	Loan Type	Loan Amount
9. Millhome Dam Lake District Manitowoc County Application #: 02016098 Purpose: Finance dam repair	Lake District Rate: 3.25% Term: 10 years	General Obligation	\$300,000.00
10. Wascott Douglas County Application #: 02016097 Purpose: Purchase ambulance	Town Rate: 3.25% Term: 10 years	General Obligation	\$78,072.00
11. Webster Burnett County Application #: 02016093 Purpose: Finance sanitary sewer system improvements	Village Rate: 3.75% Term: 20 years	General Obligation	\$436,970.00
TOTAL			\$4,851,208.31

**BOARD MEETING
NOVEMBER 3, 2015****AGENDA ITEM 6
DISCUSS QUARTERLY INVESTMENT REPORT****BCPL Trust Fund Investment Management
Investment Report - Third Quarter 2015**

Executive Summary - Staff is pleased to announce that the annual distribution of Common School Fund earnings to Wisconsin school districts is projected to be at least \$37 million in 2016. This will mark the ninth consecutive year that our distribution will exceed \$30 million, and will surpass the previous record of \$35.5 million set last year.

While uncertainty continues to roil financial markets and the historic low interest rate environment lingers on, staff is confident that BCPL fund management strategies will allow record library aid to be distributed to the 424 Wisconsin public school districts in 2016.

BCPL investment performance continues to surpass benchmark returns. For the third quarter of 2015, interest earnings exceeded the benchmark by \$2.21 million, with an additional \$1 million in trading profits earned during this period.

Q3 Investment Highlights and Outlook

Interest rates trended significantly lower throughout the third quarter of 2015, with increasing concerns regarding a slowdown of global economic activity and the risks associated with the possible escalation of war in the Middle East. This anxiety overshadowed generally good economic news in the United States and the likelihood of an increase in short term rates by the Federal Reserve Bank by year end.

BCPL staff took advantage of these lower rates by selling bonds for a total profit of slightly more than \$1 million (bond prices increase when interest rates decrease). This strategy was driven by four distinct motivations: sell lower-yielding bonds to improve expected long-term portfolio returns, reduce the overall portfolio exposure to specific types of bonds, capture the capital gains on bonds that have risen in value since the time of purchase, and improve portfolio liquidity in anticipation of future investment opportunities.

Demand within the BCPL State Trust Fund Loan Program remains moderately strong, and BCPL staff expects an opportunity to invest in loans/bonds to finance the new Milwaukee Bucks arena. More importantly, the BCPL investment authority is now subject to the Prudent Investor Standard, providing new investment opportunities that will result in higher long-term returns for our beneficiaries at lower overall risk.

Summary and Benchmark Comparison

The expected yield of funds managed by BCPL was 3.36% on September 30, 2015. This snapshot calculation is reduced significantly by the large amount of cash currently held within the portfolios, as this cash is now invested in the State Investment Fund (SIF) with yields near zero. As approved by the board at the meeting of September 15, staff has completed the transfer of \$40 million in cash reserves to federally insured accounts managed by American Deposit Management. This allocation is expected to nearly double our return on transferred reserves and generate additional annual revenues of nearly \$50,000 for Trust Fund beneficiaries.

The sale of lower yielding bonds during the third quarter had the effect of increasing the average yield on bond investments to 4.09%. However, the average interest rate on loans declined to 3.92% due to the continuation of historically low yields across the interest rate markets. Downward pressure on loan yields will continue as higher rate loans are paid down and replaced with new loans at the current lower rates. Regardless of current conditions within the interest rate markets, the BCPL Trust Fund Loan program remains the best available combination of risk and return for fixed-income investment of BCPL-managed funds.

Trust Fund investments continue to generate much better yields than the benchmark portfolio. During the third quarter of 2015, BCPL outperformed our benchmark by 0.87% after adjusting returns to account for differences in both credit quality and portfolio maturity. Excess returns total \$2.21 million greater than would have been earned by investing in the benchmark portfolio during the third quarter. In addition, trading profits of slightly more than \$1 million were realized during the third quarter.

Attachment – BCPL Investment Summary 3rd Quarter 2015

BCPL Investment Summary

3rd Quarter 2015

as of September 30, 2015

Portfolio Summary	Total Assets	Expected Yield ¹	SEC Yield ²	Average Credit Quality ³	Weighted Avg Maturity
Total BCPL Managed Financial Assets	\$1,014,475,046	3.36%	3.26%	Aa1	9.38
Benchmark Performance ⁴		3.36%	2.93%	A1	9.03
BCPL Components					
	% of Total BCPL Managed Assets				
State/Municipal and Farm Credit Bonds					
Common School Fund Bonds	\$438,302,968	4.09%	3.88%	Aa2	15.81
Normal School Fund Bonds	\$12,544,329	4.08%	3.90%	Aa3	15.55
Agricultural College Fund Bonds	\$152,457	3.67%	4.19%	Aa3	13.97
University Fund Bonds	\$16,396	4.25%	4.66%	Aa2	14.97
Total BCPL Bond Portfolio	\$451,016,150	4.09%	3.88%	Aa2	15.80
Other Financial Assets					
BCPL State Trust Fund Loans	\$391,890,501	3.92%	3.92%	Aa1	6.10
Cash - State Investment Fund ⁵	\$171,568,395	0.14%	0.14%	Aaa	0.00
Total BCPL Loans and SIF	\$563,458,896	2.77%	2.77%	Aa1	4.24
Benchmark Components					
	Weighting				
S&P Long Intermediate Term Taxable Municipal Bond Index ⁶	60.00%	3.42%	3.80%	Aa2	10.07
S&P U.S. Treasury Bill Index ⁷	10.00%	0.02%	0.01%	Aaa	0.27
Wisconsin Tax-Exempt Bond Mutual Funds (combined) ⁸	30.00%	N/A	2.17%	Baa2	9.86
Important Notes on Following Page					

Prepared by Richard Snieder

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 bond 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. **State Investment Fund** - When looking at investments made within the State Investment Fund, there will be a weighted average maturity and duration greater than that indicated on the previous page. However, because our deposits within the State Investment Fund are available for immediately withdrawal, the use of 0.00 for both average maturity and duration in portfolio calculations is appropriate.
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.