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Thomas P. German, *Executive Secretary*

AGENDA

August 16, 2022
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 – August 2, 2022 (Attachment)
3. Approve Loans

Old Business:

4. None

New Business:

5. None

Routine Business:

6. Chief Investment Officer's Report
7. Executive Secretary's Report
8. Board Chair's Report
9. Future Agenda Items
10. Adjourn

AUDIO ACCESS INFORMATION

Conference Line Number: **(608) 571-2209**
Conference ID Code: **790 694 843#**

Board Meeting
Minutes
August 2, 2022

Present were:

Sarah Godlewski, Board Chair	State Treasurer
Doug LaFollette, Commissioner	Secretary of State
Josh Kaul, Commissioner	Attorney General
Tom German, Executive Secretary	Board of Commissioners of Public Lands
Richard Sneider, Chief Investment Officer	Board of Commissioners of Public Lands
Denise Nechvatal, Senior Accountant	Board of Commissioners of Public Lands
Mike Krueger, IT Manager	Board of Commissioners of Public Lands
Thuy Nguyen, Office Manager	Board of Commissioners of Public Lands
Emma Stutzman, Chief of Staff	State Treasurer

ITEM 1. CALL TO ORDER

Board Chair Godlewski called the meeting to order at 2:02 p.m.

ITEM 2. APPROVE MINUTES – July 19, 2022

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

DISCUSSION: None

VOTE: The motion passed 3-0.

ITEM 3. APPROVE LOANS

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

DISCUSSION: Mr. Sneider shared loan #1 is a loan to a school district, which are becoming rare for the Trust Fund Loan Program because school districts are generally able to borrow money less expensively in the open market because a lot of their debt is not taxable. Loan #4 is to the town of Sevastopol. They are doing some park work which is actually the reconstruction of their tennis and pickleball courts. And then loan #5 is a little bit unusual for us. The village lost an appeal of a tax assessment that went all the way to the Wisconsin Supreme Court and they are required to pay back the excess taxes they received and that is what the loan proceeds will be used for.

VOTE: The motion passed 3-0

The Board of Commissioners of Public Lands (BCPL) unanimously approved **\$1,752,000.00** in State Trust Fund Loans to support **5** community projects in Wisconsin.

1. Waterford Graded J1 School District / Racine County / Finance asphalt rehabilitation / \$425,000.00
2. Village of Whiting / Portage County / Finance roadwork and equipment purchase / \$307,000.00
3. Town of Rutland / Dane County / Finance roadwork / \$225,000.00
4. Town of Sevastopol / Door County / Finance park reconstruction / \$175,000.00

5. Village of Slinger / Washington County / Finance operations / \$620,000.00

ITEM 4. OLD BUSINESS

None

ITEMS 5. NEW BUSINESS – Quarterly Investment Report

Mr. Sneider presented two quarterly reports for the Common School Fund, plus a new report and a graph that highlight the diversity and growth of income produced by our investments. The first six months of this year were difficult for all investors. Inflation worries caused the Fed to increase short term interest rates, which in turn fueled talks of a coming recession. During the first six months of 2022, U.S. markets had their worst performance since 1970.

In 2022, stocks fell by over 20% by the end of June. The broad investment grade index dropped more than 10% including any interest earned.

The Common School Fund had developed a cushion of unrealized capital gains that reached \$123 million on December 31st of last year. By the end of June, this cushion decreased by nearly \$100 million. This loss totaled less than 7% in the value of the Common School Fund principal but our resilient portfolio did not suffer a decrease in projected income distributions. Our allocations to real estate and private equity offset losses to investments in the public stock and bond markets. We were still sitting on over \$25 million in unrealized gains at the end of June. The ability of our portfolio to develop stable income streams through a range of difficult market conditions is the most important element of our progress. Our investment policy calls for BCPL is to manage the assets of the school trust funds in a manner that maintains significant, stable, and sustainable distributions to beneficiaries.

Portfolio Report: This report shows the current market value, cost, yield, and projected income of the Common School Fund portfolio by asset class. Investments in corporate bonds and preferred stocks took a big hit over the last six months. However, we did not need to sell at the current prices and these assets provide some of the strongest income streams within our portfolio. The overall portfolio yield at cost of 4.3% is more than a half a percent higher than it was a year ago and growth in that number remains the best indication that we are heading in the right direction.

The next page shows income projected for each asset class at the end of the prior 3 fiscal years. Projected annual income is now calculated to be almost \$55 million, up \$17 million from the projection two years ago. The average yield on Common School Fund assets has increased about 1% over the past two years. This increase is primarily the result of our ability to shift allocations from lower yielding assets, including cash, to higher yielding assets and includes a major shift from public to private markets as we believe private markets offer a higher risk adjusted rate of return. Adding a single private fund takes months of work just to get to the starting point when funds can begin the process to get your money to work, which can take years in some cases.

The next page shows the percentage of total income contributed by each asset class over the past three fiscal years. This chart clearly shows the progress we have made in de-risking the annual distribution to our beneficiaries. The largest source of income is now 16% of the total, down from 38% at the end of FY22. The top two sources of income now contribute 30% of the total, down 9% from last year and a full 28% from 2 years ago. A disruption in one or two of our major asset classes would now have a much lower impact on our beneficiaries than in past years and the risks of a major disruption in any single asset class have been reduced even further by diversification within that asset class. The common element throughout our portfolio is the focus on developing stable income for our beneficiaries. Also important is the need to grow the principle of the fund at greater than the long-term rate of inflation. We believe that the portfolio we've put together can and will succeed in meeting both of those goals.

Diversification into other asset classes has reduced the risk to our distribution to beneficiaries significantly. Jason Stephens, CEO, and president of Thompson Investment Management here in Madison, a consulting member of our Investment committee, said that for a portfolio designed to distribute income to beneficiaries, we had already lived out the

worst case scenario of record low interest rates for much of the past decade and we had come through that period with very good results. The Common School Fund portfolio benefits from the fact that the returns from different asset classes are not perfectly correlated. When uncorrelated asset classes are added to the portfolio, the risk to the portfolio as a whole can go down.

Asset Allocation Report: This report shows our current allocations and percentages, commitments made to the individual asset class that have yet to be funded, and potential allocations once those commitments have been called in by fund managers. A column is included at the bottom that filters the commitments to those that are expected to be called. There are situations, especially in venture capital, where distributions from the fund are expected to begin prior to the end of the investment period, when calls are made, meaning the net amount invested never reaches the full amount committed to the fund. Those expectations are an important element in our planning process. These allocations and commitment levels are added together and compared to the target allocations on the right hand side of the chart. Our current investment in state, state agency and municipal bonds is just under \$100 million or 7.6% of the Common School Fund. This remains above the current target of 5%, but well within the range of 0 to 30%. Taxable municipal and state bonds contain hand selected bonds issued by the State of Wisconsin and Wisconsin Municipalities and school districts. These bonds generally have excellent liquidity and virtually no default risk. These taxable bonds also demonstrate BCPL's continued interest in investing within the State of Wisconsin. These bonds are prime candidates for sale should we need to raise cash.

The next asset class includes U.S. Treasury and agency bonds. The \$94 million allocation was acquired over the past few months. Many of these bonds have call dates within the next three to six months and with market rates now easing off their highs, much of this allocation might get redeemed over the next year. We're hoping to maintain that total however, as we're happy to earn 4.5 to 5.5% on a short-term investment.

The Common School Fund currently invests in three separate corporate bond funds. At the end of Q2, we had about \$150 million invested in corporate bond funds, which are generating an average yield of over 5%. We sold approximately \$35 million in corporate bonds at the beginning of 2022 to reduce our risk to the expected increase in interest rates. The remaining funds in our portfolio are primarily high yield funds, which have been some of the hardest hit bond sectors in 2022. Bonds issued by corporations with a lower credit rating are more likely to default on interest payments, should a recession hit. However, these funds are well diversified by holding thousands of different bond issues. This diversification, the risk to the portfolio is held to an acceptable level. We believe the yield at 5.1% compensates us for the extra risk. Meanwhile, investment grade bonds in the market are currently averaging only about 3.25%. 12% allocation to corporate bonds remains higher than the target allocation of 10%, but well within the target range of 0 to 30%.

Currently we have four investments in private debt funds and they can be characterized by great diversity and excellent yields. In the past year, we have committed an additional \$120 million to private debt funds, including a recent \$50 million commitment expected to close within the next few weeks.

One sector of the private debt market is our state trust fund loan program. Our loan portfolio has dropped over the past few years as total demand from local municipalities and school districts has fallen. However, the State Trust Fund loan program remains the bread and butter of our investment policy. Simplicity and flexibility of the program provide a good incentive for many borrowers to use the program, and the program remains active with the number of new loans averaging about 10 per month.

Both the domestic and global public equities are above their target allocations and within their target range. The current allocation of publicly traded stocks is slightly less than 10% when excluding both preferred and shares held in the company BXSL. We've talked about moving the preferred stocks to their own allocation and a recommendation is expected to be presented to the board at an upcoming board meeting. The Common School Fund is a major holder of BXSL not having sold any shares since the company went public last October. BXSL share prices dropped a bit after the public offering, as some prior holders sold some of their stock early. Our current plan is to wait for those shares to recover prior to selling and then possibly reinvesting the proceeds into the Blackstone sister fund BCRED. BCRED is the private alternative to BXSL and is managed by the same team with the same strategy. The fund has performed extremely well to date and the investment committee believes that moving to that private market alternative will reduce volatility within the portfolio. Our allocation to preferred stocks now totals about \$83 million and generates an annual yield of five point 3%. Preferred stocks now account for 6.4% of the portfolio.

As discussed at the last board meeting, the Investment Committee is currently researching the potential benefits of moving our common stock investments to a separately managed account and we will keep the board informed regarding progress in that area.

The Common School Fund was able to finalize commitments to several real estate funds over the past year. We have reached the target allocation of 20% with investments in BlackRock, Blackstone, Brookfield, Invesco, and Nuveen.

Our target 5% allocation to infrastructure has remained unfilled and the investment committee is currently researching several funds that look promising. We expect to make commitments to this asset class over the next year with an idea of creating another source of income that is uncorrelated with current investments.

Private equity and venture capital has grown to over 3% of the Common School Fund. Several of our fund managers will be opening up new funds for investment over the next year or two. The bear market hit small growth companies especially hard this year, which may extend the timelines for closing out our current venture capital funds. It's better to be a buyer than a seller in venture capital today.

To summarize, we will be seeking opportunities to increase our investment in infrastructure over the next several quarters. After years of hard work, we are finally getting close to our allocation targets. We have weathered the storm over the past six months and will continue to distribute record amounts to our beneficiaries into the foreseeable future. The fund continues to perform quite well.

ITEM 6. NEW BUSINESS – Frontier Easement

Executive Secretary German shared that Frontier is requesting an easement for a fiber optic line that would cross BCPL property. There is a statute that provides that the company would not have to pay anything for easements that cross state land. BCPL will not receive any cash in exchange for the granting of the easement. Our Lake Tomahawk office may be the beneficiary of some of these fiber optic lines that are crossing state property. For years our northern office has been plagued with very slow Internet speeds. We hope that having a fiber optic line crossing our property will allow us, within the next six months, to actually have very fast Internet on our property. The fact that there is a state statute that says the company does not have to pay and because the fiber optic line is a benefit to some of the parcels up north that have not had fast Internet, staff is recommending that the board grant the easement in this situation, even though BCPL will not receive any cash for it.

MOTION: Commissioner LaFollette moved to approve the resolution for the Frontier Easement; Board Chair Godlewski seconded the motion.

VOTE: The motion passed 3-0

CHIEF INVESTMENT OFFICER'S REPORT

None

ITEM 7. EXECUTIVE SECRETARY'S REPORT

Executive Secretary German commented that he would like to congratulate the staff on the phenomenal performance of the Common School Fund. Years ago in 2010, we had about \$800 million in the Common School Fund and \$700 million of it was in trust fund loans. Interest rates dropped drastically and we had a half a billion dollars of those loans prepaid. Having a diversified portfolio makes our investment portfolio stronger and more resilient. Like I said, it wasn't that long ago that we were facing some of these shock waves.

He shared that he is heading north tomorrow and to meet with representatives from the Lac du Flambeau tribe regarding a

potential sale of trust fund trust lands that lie adjacent to or within the boundaries of their reservation. Title on several of the parcels is undisputed. However, there are a couple of parcels where title is disputed and has been disputed for a very long time. We have had very good conversations and he is hopeful that a comprehensive agreement can be reached on these lands.

He shared that he will also be meeting with the staff in BCPL's Lake Tomahawk office on Friday morning. He congratulated the northern staff for the record breaking year, last year, on timber revenue. Currently, northern staff is working on preparing this year's timber sales. Preliminary request for proposals for carbon credits have been sent out, and they have received some interest and questions. We look forward to receiving firm proposals in about a month from now.

ITEM 8. BOARD CHAIR'S REPORT

None

ITEM 9. FUTURE AGENDA ITEMS

None

ITEM 10. ADJOURN

Board Chair Godlewski moved to adjourn the meeting; Commissioner Kaul seconded the motion. The motion passed 3-0; the meeting adjourned at 2:36 p.m.

A handwritten signature in black ink, appearing to read "Thomas P. German", written over a horizontal line.

Thomas P. German, Executive Secretary

Link to audio recording:

<https://bcpl.wisconsin.gov/Shared Documents/Board Meeting Docs/2022/2022-08-02 BoardMtgRecording.mp3>

**BOARD MEETING
AUGUST 16, 2022**

**AGENDA ITEM 3
APPROVE LOANS**

Municipality	Municipal Type	Loan Type	Loan Amount
1. Mishicot Manitowoc County Application #: 02023011 Purpose: Finance bridge replacement	Town Rate: 4.50% Term: 10 years	General Obligation	\$150,000.00
2. Eau Galle Dunn County Application #: 02023012 Purpose: Finance new Town Hall, Shop and Salt Shed	Town Rate: 4.25% Term: 20 years	General Obligation	\$650,000.00
3. Garfield Jackson County Application #: 02023013 Purpose: Finance roadwork	Town Rate: 4.50% Term: 2 years	General Obligation	\$200,000.00
	TOTAL		<hr/> \$1,000,000.00