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Title: Authority to Invest and Reinvest Funds, Approval of the Statement of Investment Policy, and Auditor-Controller -Treasurer-Tax Collector Informational Treasury Report

Sponsors: Auditor-Controller-Treasurer-Tax Collector

Indexes:

Attachments: 1. Agenda Summary, 2. Att 1 -- Investment and Reinvestment Resolution, 3. Att 2 -- Statement of Investment Policy

| Date | Ver. | Action By | Action | Result |
|------|------|-----------|--------|--------|
|------|------|-----------|--------|--------|

To: County of Sonoma Board of Supervisors
Department or Agency Name(s): Auditor-Controller-Treasurer-Tax Collector
Staff Name and Phone Number: David Maurice, (707) 565-2858
Vote Requirement: Majority
Supervisory District(s): Countywide

Title:

Authority to Invest and Reinvest Funds, Approval of the Statement of Investment Policy, and Auditor-Controller -Treasurer-Tax Collector Informational Treasury Report

Recommended Action:

- Approval of the Concurrent Resolution of the Board of Supervisors of the County of Sonoma and all Districts governed ex-officio by the Board of Supervisors renewing authorization for the County Treasurer to assume full responsibility for all transactions and expenditures related to the investment and reinvestment of Funds on deposit in the County Treasury.
- Approval of the County of Sonoma Statement of Investment Policy.

Executive Summary:

This item provides for the annual review of the delegated authority of the Board to the County Treasurer to invest and reinvest funds, as provided for in County Ordinance 5037, and approval of the Statement of Investment Policy.

This item also provides an update of the investment function for the Sonoma County Pooled investment Fund ("Pooled Investment Fund") and a discussion of status of funds invested in the Pooled Investment Fund.

Discussion:

The Board of Supervisors adopted County Ordinance 5037 on June 17, 1997. The Ordinance permits the annual delegation of the authority to invest and reinvest funds held on deposit in the Pooled Investment Fund, as well as the authority to sell or exchange securities. The County Treasurer then assumes full responsibilities for all transactions and expenditures related to the investment and reinvestment of funds on deposit until the

annual delegation expires or until the Board revokes its delegation of authority by ordinance.

Authority is also requested in order to comply with the County of Sonoma Statement of Investment Policy ("Policy"), amended by the Board of Supervisors on December 10, 2019. Section 6 of the Policy states the Sonoma County Board of Supervisors, by resolution, has delegated investment responsibility for the Sonoma County Investment Program to the Auditor-Controller-Treasurer-Tax Collector.

Regardless of whether changes are made, the Policy is brought annually to the Board for approval per Government Code Section 53646. On August 26, 2020, the Treasury Oversight Committee reviewed the Policy and it is unchanged since last reviewed and approved by the Board of Supervisors.

Treasury Investment Status Update

Overview

The Sonoma County Treasurer is responsible for safely managing the daily investment of the approximately \$2.7 billion Pooled Investment Fund on behalf of the County, schools, special districts, and other agencies. The below table outlines the approximate percentages of each participant type as of 6/30/20:

| Participants | Percent 2020 | Percent 2019 |
|--------------------------------|-------------------------|-------------------------|
| School Trust Funds | 39.9% | 38.2% |
| Agency Funds | 16.8% | 17.0% |
| County Special Revenue Funds | 8.6% | 10.0% |
| General Fund | 7.7% | 5.3% |
| Other Governmental Entities | 5.5% | 6.0% |
| Investment Trust Funds | 5.3% | 5.5% |
| Sonoma County Water Agency | 5.1% | 5.0% |
| Internal Service Funds | 3.5% | 4.8% |
| County Enterprise Funds | 2.5% | 2.4% |
| Special Districts Enterprise | 1.3% | 1.5% |
| Community Development Comm | 0.8% | 1.2% |
| Independent Special Districts | 0.8% | 0.9% |
| Capital Projects Funds | 0.7% | 0.6% |
| Special Districts Spec. Rev. | 0.7% | 0.5% |
| County Service Areas | 0.4% | 0.4% |
| Special Districts Debt Service | 0.2% | 0.5% |
| Private Purpose Trust Funds | 0.2% | 0.2% |

Funds are invested in accordance with both State Code and the Policy. Government Code Section 53601 guides the investment process and establishes the following three investment objectives in order of importance: 1) Safety of Capital, 2) Liquidity to meet participant cash flow needs, and 3) Maximum Rate of Return.

In December 2019, your Board added social and environment considerations to the investment strategy. Whenever possible and consistent with the three statutory objectives listed above, investment opportunities

will be evaluated for social and environment impacts with the intent to create positive impacts by investing in socially and environmentally responsible agencies and corporations.

The Pooled Investment Fund is restricted to fixed income instruments that mature within 5 years with the exception of Sonoma County Energy Independence Program bonds for which the Board has granted express authority. Investments are limited to very high credit quality and include US Treasury securities; obligations issued by US Government Agencies such as the Fannie Mae and Freddie Mac, states, and California municipalities and local agencies; and supranational bonds, which are issued by multi-national institutions devoted to economic, health, education and social development as well as green projects. Investments in corporations such as commercial paper, bank certificates of deposit or medium term notes are restricted to single-A or better credit ratings.

Following the Policy amendment in December 2019, Treasury staff has significantly increased holdings in investments that make positive social and environmental impacts. Investments in green bonds, which are devoted to financing sustainable energy and efficiency projects total \$58 million or 2% of the Fund, an increase from no previous holdings. Investments in supranational development bonds have increased to \$291 million or 11% of the Fund, from no prior holdings. Investments in California schools and municipalities total \$156 million or 6% of the Fund, and includes \$4 million in Sonoma County schools and \$39 million in other educational entities.

The current economic and market situation has significantly changed since our last update in December 2019. The global COVID-19 pandemic, and the ensuing economic recession has produced market impacts not seen in over a lifetime. The response of fiscal and monetary authorities in both Washington DC and Sacramento have also been sizable, and have made meaningful impacts on California and the country as a whole. However, the course of the pandemic is still fluid and an outcome is unknown, as are the efficacies and implementations of various programs to combat the economic impacts.

The actions most directly effecting the investment performance of the Pooled Investment Fund have been taken by the Federal Reserve ("the Fed"), which lowered target interest rates to a range between 0% and 0.25% in March of this year. This had the effect of dramatically reducing investment yields. We have seen the earnings yield decline from just over 2% at the beginning of the calendar year to just over 1% as of the end of August. We expect that the earnings will continue to fall as higher-yield investments mature and reinvestment opportunities continue to reflect the Fed's zero interest rate policy. We anticipate that this situation is likely to continue for several years, as the Fed has communicated that they will hold rates this low for as long as needed to return the labor market to full employment, which is part of their mandate from Congress.

In the early stages of the Pandemic, the market shock created widespread dis-locations in various market sectors. Treasury staff promptly responded by increasing the average maturity of our portfolio and added holdings of high quality corporate and municipal issuers. In doing so, we were able to lock in significantly higher than normal yields. We also focused on adding investments with higher Environmental/Social/Governance ("ESG") ratings, Green bonds, and bonds issued by Sonoma County agencies and schools, and other educational entities. Many of these issuers are small and issue infrequently,

and we expect to increase these positions over time as new investment opportunities present.

Cash Flow Management

Each year the Treasurer oversees the investment of over \$4 billion primarily comprised of the inflow of property taxes (\$1.2 billion), reinvestment (\$2.0 billion), State school apportionments (\$480 million), sales tax revenues (\$240 million), and school bond proceeds (up to \$300 million). Interest earnings are accrued and apportioned to participants based on their average balance in the Pooled Investment Fund during each reporting period. Participants received \$51.4 million in interest earnings during FY 2019-20.

On a daily basis, the Treasurer's Investment staff assesses participant needs to assure there is sufficient cash on hand to cover expenditures. Quarterly, Government Code Section 53646(b)(3) requires the Treasurer to state that the Pooled Investment Fund has the ability to cover 6 months of participant expenditures. Annually, the Pooled Investment Fund covers expenditures of approximately \$3 billion. Significant items include vouchers payable of \$1.4 billion, payroll for the County and schools of \$900 million, and schools and County bond debt service of \$220 million. The ongoing liquidity needs are managed by investment staff through continual communication with participants to understand future expenditure requirements. Staff also utilizes a cash flow forecasting model that matches future revenues and investment maturities with projected expenditures.

Each day, staff reviews the cash needs and manages the movement of cash between various financial institutions to cover all expenditures, investments, and other obligations. After covering all other outstanding obligations, staff determines the level of cash available for investment and reviews the financial market for investment opportunities to safely optimize interest earnings.

The Investment Process

Pursuant to Sonoma County Ordinance 5037, Section 2-33-20, the County Board of Supervisors has delegated the authority to invest and reinvest funds of the County and other depositors to the County Treasurer. The Treasurer assumes full responsibility for the transactions. The Board of Supervisors is required to review this delegation annually and makes a determination to renew or revoke the delegation.

Primary guidance for the investment process is provided in the Policy. The main purpose of the IPS is to prescribe the permissible amounts and types of investments that the Pooled Investment Fund can purchase. The Policy provides a level of guidance and accountability for investment staff and promotes public trust. The Policy is an essential component of a disciplined approach to the investment process and when combined with quarterly reports as required by Government Code Section 53646(b)(2), helps to assure that the investment process adheres to a set of safe practices to aid in the protection of investments. The Treasurer is the Trustee of the Fund and is a fiduciary subject to the prudent investor standard. The stated investment objectives of the Policy are in order of importance: 1) Safety of Capital 2) Liquidity and 3) Maximum Rate of Return. Preservation of capital is the primary objective. Providing sufficient liquidity to meet all Fund depositor's operating requirements is secondary. After the first two objectives are met then maximizing the rate of return through careful consideration of market conditions, risk assessment, and consideration of economic cycles is

desirable. In 2019, the Board of Supervisors added criteria to foster positive social and environmental impacts when choosing investments, provided the mandates of Safety, Liquidity and Return are met.

Prior to purchasing securities, the investment process takes into consideration various types of risk and the condition of the financial markets. The most common types of risk affecting a fixed income portfolio are interest rate, market, and credit risk. To a lesser degree headline risk is also a concern. Interest rate risk is the risk that rates will rise or fall causing an adverse effect on the value of investments. Market risk (also known as systemic risk) is the adverse effect of recessions, political turmoil or other systemic issues that affect the entire market. Credit risk is the chance that a particular company will fail to meet their financial obligations resulting in possible non-payment of an obligation such as bond interest and principal due. Headline risk is the effect of news headlines negatively affecting the value of a company and their outstanding debt obligations.

Treasury Staff structures Pooled Investment Fund holdings using a modified ladder approach to provide a regular source of liquidity through a schedule of maturities and tax inflows that align with known future liabilities. Generally, investments are held to maturity and not actively sold.

In order to assess the most optimal investment opportunities, staff uses tools such as a Bloomberg computer terminal and a network of securities brokers to ascertain current market pricing for the different types of securities available for purchase. Investment decisions are made based on current market offerings from brokers who have a constantly changing supply of qualified securities available for purchase. As market conditions change, staff tracks the direction of interest rates and assesses various types of risk to make investment decisions that align with primary objectives. Throughout the year, staff performs several portfolio management functions including continuously monitor the market for advantageous investment opportunities; monitor the companies whose bonds we own and evaluate for credit worthiness based on ratings provided by major credit rating agencies such as Standard & Poor's, Fitch, and Moodys; monitor, and if needed rebalance the mix of investment types and holdings; and track the mix and level of sector diversification for owned corporate securities.

The main types of securities purchased by the Fund are:

- 1) United States Treasuries (bills and notes)
- 2) Fixed income bonds issued by the agencies/government sponsored enterprises (GSE), such as Freddie Mac (FHLMC), Federal Home Loan Bank (FHLB), Federal Farm Credit Bank (FFCB), and Fannie Mae (FNMA).
- 3) Medium term corporate notes
- 4) Mutual funds
- 5) Negotiable certificates of deposit
- 6) Obligations of the supranational issuers, such as the International Bank for Reconstruction and Development (IBRD)
- 7) Bonds and notes issued by California state and municipal issuers, including Sonoma County based agencies

Changes in Fund holdings from 6/30 2019 to 6/30 2020:

| Market Sector | Percent | Percent |
|-----------------------------|-------------|-------------|
| | <u>2020</u> | <u>2019</u> |
| Agency Bonds | 51.6% | 67.5% |
| Supranational Bonds | 10.8% | 0% |
| Corporate Notes | 20.4% | 12.4% |
| Certificates of Deposit | 13.5% | 11.7% |
| Money Market Funds | 3.3% | 6.7% |
| US Treasury Notes/Bills | 0% | 1.0% |
| Municipal Notes | 4.0% | 0.6% |
| Of which, Sonoma Issuers | 0.8% | 0.6% |
| Of which, Schools/Education | 1.6% | 0.0% |

Notes: 1. Green bonds comprise 2% of pool. 2. Average ESG rankings for Corporate notes and CDs are single-A from MSCI (<https://www.msci.com/esg-ratings>) and 88% from CSR (<https://www.csrhub.com/>). Lastly, there is a robust audit program in place and several periodic audits are performed each year to help assure that Treasury Investment staff comply with relevant Government Code requirements when administering the investment function and performing Treasury operations. An annual compliance audit is performed by an independent outside auditor who reviews the annual activity of the Pooled Investment Fund to assure compliance with all applicable State codes. Quarterly, an audit of Pooled Investment Fund assets are accounted for and reconciled. Finally, the County's independent auditor performs random testing of investment activity to check for compliance with relevant statutory requirements.

Environmental, Social & Governance Investing

Pursuant to guidance approved by the Board in 2019, Treasury staff has increasingly focused on incorporating principles of socially responsible Investing into the framework used to manage the Pooled Investment Fund. Environmental, social and governance (ESG) investing seeks to broaden and deepen the impact of focused investment by bringing certain portfolio concepts into the mix when considering socially responsible investments. Treasury staff has incorporated several of these concepts into the investment process.

First, in alignment with Board priorities, staff has continued to avoid investments in fossil fuel development corporations as well as companies involved in the private-for-profit prison industry. The Pooled Investment Fund does not have investments in any oil, gas or coal extraction or refining companies. Investment in green power providers continues to not be an option as participants do not have high enough credit ratings to comply with California Code or simply do not offer debt instruments. The Fund has a holding in Toyota, one of the leading manufacturers of electric and hybrid vehicles. This investment helps foster the continued growth of a company that has shown a commitment to transitioning to a sustainable future.

The Pooled Investment Fund has fully divested investments in Wells Fargo and BNP, and has avoided investing in other banks that finance private prison corporations.

Second, staff has incorporated the use of two third-party ranking systems when considering potential

investments. The two systems are offered by MSCI (<https://www.msci.com/esg-ratings>) and CSR (<https://www.csrhq.com/>) and utilize peer-industry group comparisons to rank corporations within their peer space. Both offer ratings on all Corporate issuers held by the Pooled Investment Fund, and MSCI scores the corporate portfolio as an "A" (on a scale of AAA to CCC), while CSR ranks the corporate portfolio in the 88th percentile (on a 100 scale).

Third, staff has actively sought to increase security holdings that make a positive impact. Treasury staff classify these as securities that are issued to finance economic and social development projects, climate change mitigation projects, and to support education. These holdings include supranational bonds, green bonds, and school and municipal bonds; and collectively make up 13.5% of the Fund.

Prior Board Actions:

12-10-19 - Board of Supervisors approved Resolution #19-1598 Authority to Invest and Reinvest Funds, Approval of the Statement of Investment Policy, and Auditor-Controller -Treasurer-Tax Collector Informational Treasury Report

12-11-18 - Board of Supervisors approved Resolution #18-0507 Delegating Authority to Invest and Reinvest

01-09-2018 - Board of Supervisors approved the Statement of Investment Policy and Resolution #18-0006 Delegating Authority to Invest & Reinvest

01-10-2017 - Board of Supervisors approved the Statement of Investment Policy and Resolution #17-005 Delegating Authority to Invest & Reinvest

12-15-2015 - Board of Supervisors approved the Statement of Investment Policy and Resolution #15-0489 Delegating Authority to Invest & Reinvest

These have been approved yearly prior, since 1997.

FISCAL SUMMARY

| Expenditures | FY 20-21 Adopted | FY21-22 Projected | FY 22-23 Projected |
|------------------------------------|---------------------|----------------------|-----------------------|
| Budgeted Expenses | | | |
| Additional Appropriation Requested | | | |
| Total Expenditures | | | |
| Funding Sources | | | |
| General Fund/WA GF | | | |
| State/Federal | | | |
| Fees/Other | | | |
| Use of Fund Balance | | | |
| Contingencies | | | |
| Total Sources | | | |

Narrative Explanation of Fiscal Impacts:

| Staffing Impacts: | | | |
|-----------------------------------------|------------------------------------|-----------------------|-----------------------|
| Position Title (Payroll Classification) | Monthly Salary Range (A-I Step) | Additions (Number) | Deletions (Number) |

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Narrative Explanation of Staffing Impacts (If Required):

Attachments:

Attachment 1 - Investment and Reinvestment Resolution

Attachment 2 - Statement of Investment Policy

Related Items “On File” with the Clerk of the Board: