CHARLES LOMELI
Treasurer-Tax Collector-County Clerk
calomeli@solanocounty.com

MICHAEL COOPER
Assistant Treasurer-Tax Collector-County Clerk
mrcooper@solanocounty.com

ttccc@solanocounty.com
www.solanocounty.com

TREASURER-TAX COLLECTOR-COUNTY CLERK

SOLANO COUNTY

LORI BUTLER-SLAPPY
Tax Collections Manager
leslappy@solanocounty.com

DENISE TOLSON
County Clerk Manager
dmtolson@solanocounty.com

675 Texas Street, Suite 1900
Fairfield, CA 94533-6342
(707) 784-7485
Treasurer (707) 784-6295
Fax (707) 784-6311

April 16, 2018

The Honorable Members of the Board of Supervisors
County of Solano County
675 Texas Street, Suite 6500
Fairfield CA 94533

Honorable Members of the Board:

It is my pleasure to present the quarterly report for the third quarter of FY2017/18.

State of the Treasury

California Government Code §53600.5 directs that the Treasurer's Pool be managed with the "primary objective" being "to safeguard the principal" being invested. The "secondary objective shall be to meet the liquidity needs." The final objective "shall be to achieve a return on the funds." These objectives and order of precedence are more commonly referred to as Safety, Liquidity, Yield (SLY) or the SLY principle for short. It is useful to review how managers apply this code section to investment selection and comply with SLY. Pool managers first consider the cash flow needs of the pool participants, which includes the county, local school districts, and other local districts and agencies that collectively deposit funds into the Pool. This consideration includes the expected timing of deposits, and a forecast that includes the need of depositors to pay obligations.

A critical element of safety is structuring investment maturities so it is not necessary to sell them for liquidity purposes, as doing so exposes the county to potential material losses because of interest rate risk. This analysis involves many units of government in the county, some with significant cash flow patterns. Two examples of this are school district bond issues that can collectively account for hundreds of millions in cash deposits, and semiannual collection and disbursement of property tax revenues in excess of $200 million annually. The department's accounting system provides a large data base of cash flow history that can be used to project liquidity requirements. Once an appropriate level of liquidity is determined and established, management focus shifts to consideration of the monetary policy efforts of the Federal Reserve Bank; and the underlying economic forces influence the policy.

Recognizing monetary policy, and the potential impact it can have on market interest rates, can be important in helping to determining an appropriate duration for the Pool. Duration is a risk measurement tool that provides pool managers an estimated change in the market price of the Pool or individual securities within it, based on a given degree of change in similar term market rates. Maintaining a duration that is within acceptable risk parameters, while not overly conservative, helps to ensure that the investment strategy is aligned with the needs of the depositors while still optimizing the return provided to them.

Credit risk dictates the mix and types of securities within the Treasurer's Pool. As of the current reporting period, the $1.1 billion Treasurer's Pool investment mix included 20.15% in US Treasury Securities, 45.42% in US Agency Securities, 12.22%

in Corporate Notes, 8.00% in Municipal Debt, and the balance of 14.21% in various Cash & Cash Equivalents, Mutual Funds, and other investments. The Treasury and cash investments provided the greatest security of principal, but do so at the greatest expense in terms of return on funds. US Agencies securities generally provide a slightly better return on investment, with an accompanying slightly higher level of risk in terms of their market liquidity. This tradeoff repeats itself with the other investment types. By maintaining appropriate investments in each of the various types, the Treasurer's Pool achieves an optimal rate of return within overall risk parameters and protecting principal from credit risk.

The SLY principle is also applied to the investment of the 115 Trust, which is included in this quarterly report. As a result of the differences in expected cash flows, allowable investments, and intended use of the funds; the securities within the 115 Trust may be different, but the underlying approach to management of the funds is the same.

Current Market Conditions Impacting the Treasury Pool

Before leaving office, prior Federal Reserve Chairperson Janet Yellen said the recovery is increasingly broad based across sectors in the US and worldwide, and that a tightening of monetary policy was warranted. It is anticipated that, at least for the near term, newly confirmed Federal Reserve Chairperson Jerome Powell will continue the previously announced monetary tightening policy of modest increases to the Funds Rate, and continued reduction of the balance sheet. It is not unreasonable to assume that continuing signs of a rapidly expanding economy may result in an increase in the frequency and degree of monetary tightening. Treasury Managers pay close attention to the policy and actions of the Federal Reserve, as its Federal Open Market Committee (FOMC) control interest rates on the short end of the yield curve where most of our investments are placed.

Given the information the FOMC continually evaluates with regard to setting federal funds rates as reported in the minutes and statements of the committee, Treasury Managers also monitor this information to remain abreast of changes and performance to insure the portfolio is properly positioned on the yield curve and not caught off guard by FOMC actions. This information includes the labor market data, economic activity, inflation, and the myriad of elements that include these data inputs. Much of this information is included in regional reports from the 12 Federal Reserve Districts and compiled in Beige Book reports published 8 times a year.

Expectations going forward

Rising market interest rates may result in a decline in market value of securities held in the portfolio. However, absent a sale, the Pool will continue to earn at the originally purchased yield to maturity and expects to receive a full return of principal at maturity.

In accordance with Generally Accepted Accounting Principles (GAAP), the pool is "marked to market" on an at least monthly basis. Marking to market is a process whereby a current market price of a given security is obtained from an independent third party source. This price is then used to determine a given investments current market value, which is compared to the same investments current book value to determine any net difference between the two. Differences are reported on the Treasury balance sheet as unrealized gains and losses. It is not uncommon for a given security to have periods of gains and periods of losses over its lifetime. With fixed income investments, as the security approaches maturity, these gains and losses tend to mitigate back toward par value. Typically, the longer period of time a security has before it matures the more interest rate risk it carries and therefore the higher yield it can potentially provide.

The FOMC has announced it expects funds rates to increase in 2018, which may cause a shift to higher interest rates across the maturity spectrum. If this happens, the market value of the portfolio may be lower than the book value until it is able to fully reprice. As securities mature daily and are reinvested, the new securities replacing them pay higher rates of interest and the investment pool produces more interest for the participants. For every 0.25% increase in Pool yield, the Pool earnings should increase by approximately $2.5 million dollars that will be apportioned to Pool participants based on their level of deposits.

Respectfully Submitted,
CHARLES LOMELI
Treasurer – Tax Collector – County Clerk