SAN MATEO COUNTY TREASURY OVERSIGHT COMMITTEE

MINUTES

Monday, October 28, 2024

1. **CALL TO ORDER**
   The meeting, in person and via MS Teams, was called to order at 12:04 p.m. by Daneca Halvorson.

2. **ROLL CALL**
   Members and guests were asked to introduce themselves by name and title during roll call.

   MEMBERS IN ATTENDANCE:
   Daneca Halvorson, Chair (City of Daly City)
   Sandie Arnott (Treasurer-Tax Collector)
   Virginia Chang Kiraly (San Mateo County Harbor District and Menlo Park Fire Protection District Board)
   Helen Fisicaro (Town of Colma)
   Stephanie Osaze (Bay Area Air Quality Management District)
   Connie Mobley-Ritter (Public Member)
   Robert Manchia (San Mateo County Manager's Office)

   STAFF IN ATTENDANCE:
   Tiffany Htwe (Treasurer's Office)
   Gerimar Tabbay (Treasurer's Office)

   MEMBERS OF THE PUBLIC IN ATTENDANCE:
   Ken Schiebel (PFM)
   Meredith LaBuda Sullivan (PFM)

3. **APPROVAL OF MINUTES-March 25, 2024**
   Helen Fisicaro made a motion to approve minutes from the March 25, 2024 meeting, seconded by Virginia Chang Kiraly. The meeting minutes were unanimously approved.

4. **TREASURER'S REPORT – Sandie Arnott (Treasurer-Tax Collector, SMC)**
   Sandie Arnott reported on the annual audit that was conducted by Macias Gini & O'Connell LLP, there were no exceptions noted.

5. **INVESTMENT REPORT - Tiffany Htwe (SMC), Ken Schiebel & Meredith Sullivan (PFM)**
   Tiffany Htwe provided an update on the County's investment pool. Following the Federal Reserve's rate cuts, the County successfully reinvested some funds at a 5% interest yield between September and October 2024. Part of these funds are also being used for current expenses. Tiffany works closely with Meredith LaBuda Sullivan's (PFM) team to identify the best reinvestment opportunities, ensuring compliance with County policy to protect principal and maintain liquidity when funds are needed. Since the County operates a Local Government Investment Pool (LGIP), it is not possible to allocate specific funds for individual organizations or partners.

Additional security measures are being implemented with all banking accounts for County departments, special districts, and schools to prevent unauthorized transactions. Security of our funds remain a top priority. As part of our investment policy, we have been effectively managing and reducing administrative fees through cost-saving strategies to optimize our budget and expenses.

The administrative fee basis points were adjusted at year-end: 6.3 basis points in 2022, 5.9 in 2023, and 5.2 in 2024. These reductions reflect cost savings for all participants, along with improvements in the fair market value gaining factor. Starting in August 2024, the value reached 1 percent, marking the first time it exceeded 1 percent since June 2021, following the pandemic. After a previous decline, the value has been steadily increasing since August 2024.

Our cash flow has been in line with historical data, and it is consistently being monitored with no significant change in cash flow impacts. As of September 30, PFM is managing $4.5 billion, and SMC is managing $3.2 billion.

Ken Schiebel from PFM provided a market update, stating that the U.S. economy is still in a strong position. He explained that the Federal Reserve is closely monitoring various economic indicators and is currently comfortable with where things stand to begin cutting rates. The two key areas the Federal Reserve is focusing on are inflation and the labor market. Ken presented a chart on payrolls, highlighting that in September 2024, 250,000 jobs were added. Historically, the 10-year average was around 180,000, and prior to the large release in September, we were on trend. Ken mentioned that when the economy and labor market began recovering after the pandemic, we experienced a very strong labor market. At one point, there were two job openings for every unemployed person, which led to upward pressure on wages.

Ken continued to present the following updates:

- Consumer Price Index (CPI):
  - The overall CPI spiked just over 9 percent in mid-2022 before declining shortly after.
  - CPI has been improving recently but at a slower pace.
  - As of September 2024, inflation has dropped to 2.4 percent, which is close to the Federal Reserve's 2 percent target.
  - The overall CPI data is made up of two components, housing costs and all other costs, with the focus on housing costs over the past one and a half to two years.
  - Housing rates have reached a record high due to low supply in the housing market and a significant increase in rents, which has contributed to high inflation.
  - The housing component is currently around 4.8 percent, but it could potentially fall below the Federal Reserve's 2 percent target if there are improvements in the rent and housing market.
- Changes that took place after the Federal Reserve began cutting rates:
  - The current GDP growth rate is just over 3 percent.
  - The unemployment rate is at 4.1 percent, which is historically low.
  - The 50-year average for the unemployment rate is 6 percent.
  - The current unemployment rate represents one of the strongest job numbers we've seen since the Federal Reserve began its rate cuts.
  - The recent rate cut is to normalize the relationship between economic growth, inflation and short-term interest rates.
  - Market pricing for rate cuts has been volatile. It adjusts daily based on incoming data, so predicting the exact rate with certainty is not possible.

- Short-term rates:
  - The Federal Reserve lowered their expectation for the appropriate level of short-term rates because the labor markets are better balanced, and inflation readings are moderate, moving toward their 2 percent target.
  - Federal Reserve reduced the rate by 0.5 percent during the September meeting, which indicates a total of decline of about 100 basis points in short-term rates this year.
  - There will be two more quarter-percent rate cuts, one in November and another in December.
  - In 2025, there will be a full percentage point of cuts, approximately 0.25 percent every other meeting throughout the next calendar year, ultimately bringing short-term rates down to around 3 percent.
  - GDP is currently at 3 percent, but the Federal Reserve is forecasting GDP to eventually converge at 2 percent level.
  - The rate is expected to gradually decrease toward the economy's long-term potential growth rate.
  - Unemployment rate is projected to rise slightly over the next three to six months but will remain below 4.5 percent.
- Long-term rates:
  - Long-term rates have trended sharply lower than short-term rates throughout summer and early fall.
  - The two-year treasury yield dropped more than a full percentage point along with longer term, 10-year yields.
  - The two-year treasury yield is currently at 4 to 4.3 percent. It has fluctuated between 3.4 percent and 5.25 percent.
  - The market was pricing not only the 50 basis points in September, but all additional rate cuts coming this year and next may have further cuts as much as 75 to 100 points in 2024.
  - The rates have been increasing over the past two to three weeks.
  - Rates for treasuries at around 4 percent, or 4.20 to 4.30 percent for corporate bonds, are still quite attractive compared to where the rates have been over the past 20 years.
  - Prior to the last 15 to 20 years, such attractive yields produced excellent investment income for the County and pool participants.
  - Ken suggests looking into corporate bonds or other options that offer higher yields than treasuries. If we believe the Fed is going to cut rates as much as the market expects, or more, then we would feel comfortable investing in long-term securities over time.
  - We will continue to invest in longer-term securities as long as it aligns with our strategy and makes sense.
- Overall portfolio structure managed by PFM and the San Mateo County Treasurer's Office:
  - Key components of the long-term core portfolio include Corporate Bonds and Other Securities, a small portion allocated to short-term opportunities such as commercial paper and certificate of deposit (CDs), and excess liquidity reserved for emergency purposes.
  - Treasurer's Office manages the short-term portfolio and liquidity, ensuring daily operational needs are met.
  - PFM overs the CAMP term, short-term and core portfolios.

- PFM views the core portfolios as the long-term foundation of the structure, with a focus on high-yield, long-term investments.
- While PFM bases its strategy on the overall balance of the portfolio, driven by historical tax receipts, the Treasurer's Office focuses on more granular, short-term factors such as expected inflows and outflows on a day-to-day or week-to-week basis.
- Treasurer's Office ensures sufficient liquidity to manage daily cash flow needs and provides the necessary float for all transactions.
- Overall, the approach has resulted in a balanced and effective portfolio structure to date.

Meredith Sullivan from PFM proceeded to present to the committee the overall allocation of the aggregate portfolio and the core portion that PFM manages. PFM views the County's assets on an aggregate basis, and Meredith's team manages the core portfolios on behalf of the County. The duration for the core portfolio is currently 1.83 years, which is slightly longer than when everyone last met in February.

The current core yield cost is 2.99 percent, which is the highest yield it has been on this portfolio in the four years. Meredith's team is consistently looking for opportunities to lock in long term earnings for the County and to reinvest at higher yields that are available in the marketplace. We remain well diversified in the sector allocation using the broad scope of permitted investment types. Our primary focus has been reinvesting in treasuries over federal agencies, and we continue to find value in quality high investment grade corporates and CDs. When we review the activities of what we're reinvesting, we can see the maturity of most of the dollars that we're redeploying are in treasuries, corporates, and high-quality CDs.

Additionally, we are doing well in maturity distribution. Meredith continues to show a snapshot of the historical allocation of the County's portfolio over the past year. There haven't been huge changes in the makeup of the portfolio from an allocation standpoint. We value in corporate notes and CDs, so the two sections are getting larger. When we did have sales or maturities, most of the funds are redeployed in treasury's corporate notes and CDs. There have been a few purchases, but the value remains on a security-by-security basis and not as much as in the other sectors.

Lastly, Meredith presented a chart showing the duration of the core portfolio over time, which is a longer portfolio her team manages for the County. Currently, we are trending upward and try to extend the duration as much as it makes sense. As the lower yielding securities mature, we will continue to reinvest and the divergent between the book yield and market yield will continue to get smaller.

6. **<u>ORAL COMMUNICATIONS AND PUBLIC COMMENT</u>**

Virginia Chang Kiraly thanked Sandie and all the staff for working hard on the investments and portfolio for the County.

7. **<u>OTHER BUSINESS</u>**

A doodle poll regarding dates for 2025 meetings will be circulated.

8. **<u>ADJOURN</u>**

The meeting was adjourned at 12:44 p.m.

Daneca Halvorson (Chair)

Sandie Arnott (Treasurer-Tax Collector)