SAN MATEO COUNTY TREASURY OVERSIGHT COMMITTEE

MINUTES
Monday, February 24, 2025

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. Sandie Arnott introduced the County's new deputy treasurer-tax collector, Angela Moreno.

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)
Robert Manchia (San Mateo County Manager's Office)

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

MEMBERS OF THE PUBLIC IN ATTENDANCE:
Ken Schiebel (PFM)
Meredith LaBuda Sullivan (PFM)
Nancy Jones (PFM)
Richard Babbe (PFM)

3. **APPROVAL OF MINUTES-October 28, 2024**
Virginia Chang Kiraly made a motion to approve minutes from the October 28, 2024, meeting and seconded by Helen Fisicaro. The meeting minutes were unanimously approved.

4. **TREASURER'S REPORT – Sandie Arnott (Treasurer-Tax Collector, SMC)**
Sandie Arnott reported the investment policy and delegation of authority were approved in January 2025. We also had an audit completed, and 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. Overall, we have the following:
   - Approximately $9.04 billion as of December 2024.
   - Earnings for Q1 and Q2 of fiscal year 2024–25 averaged about $80 million.
   - We anticipate bringing in about $86 million in the third quarter.

- Annual earnings could exceed $300 million for this fiscal year, thanks to high-quality yield bonds we invested in alongside the PFM team.

We align our investments with our cash flow needs, and we still need to reinvest to meet the County's future cash flow requirements. The April 2024 and December 2024 tax collections will cover the areas requiring reinvestment. Since our last meeting, we have reinvested approximately $1.6 billion, which includes $697 million from matured investments and $1 billion from property tax collections and some school bonds. All of these investments carry interest rates between 4% and 5.5%, helping us maintain strong and stable returns.

Our investments are spread across government agencies, U.S. Treasury notes, and local government investment pools (LGIPs) such as CalTRUST and CAMP. PFM has invested in Treasury notes, certificates of deposit (CDs), commercial paper, corporate bonds, and some agency securities. This balanced approach allows us to earn steady returns while ensuring liquidity for County needs. The pool's average balance is $8.2 billion, though this may vary depending on the pool size.

As of December 31, 2024, the County manages $4.5 billion, which consists of investments in government agencies, CalTRUST, CAMP-Terms, CAMP, Treasury notes, Dreyfus, and U.S. instrumentalities. Given the unpredictable geopolitical environment, we must continue to adjust our strategy to protect principal and generate revenue for all participants.

Helen Fisicaro asked about the geopolitical climate and recent stock market volatility.

Tiffany responded that all investments are high-quality and strictly governed by the investment policy, and that have only a few percentages of corporate bonds. With current market volatility, any price fluctuations are considered unrealized losses. The principal remains protected, which continues to be our primary objective.

Helen suggested informing participants about how well-positioned the County's investment pool is. Sandie and Tiffany will work on putting this together. However, we want to ensure that our communications focus on education and transparency, rather than offering any form of assurance or guarantee, as investment outcomes can be influenced by various external factors.

Robert Manchia clarified that cities are interested in this topic because they are currently using these funds for their ongoing operations. However, the County pool has not fallen below a 3% return for the past three years—compared to 1.8% in earlier periods—which is considered a stable return.

Ken Schiebel and Meredith Sullivan, reported on investments that PFM manages and provided context around interest rates and overall economic conditions. PFM's priority with the Treasurer's Office is to maintain the highest degree of safety and liquidity as part of the County's investment policy, which follows the California government code.

Ken noted one of the most important things that they follow on a regular basis is the action of the Federal Reserve (Feds), and the Feds is focused on what they call as their dual mandate, which is full employment and price stability. Inflation went through a period of high spikes due to supply chain challenges coming out of the COVID pandemic, but it has declined since then and remained above the Fed's 2% target. The two measures they look at are the consumer price index (CPI) and core personal consumption expenditures (PCE). CPI is the items consumers purchased at the stores, while CPE is the price across the whole economy and all gross domestic products (GDP). CPI and PCE measures are around 3% but are expected to decline from 2.8% to 2.6%, which is still about the

Fed's target. The later half of 2024, the Federal Reserve was pushing short-term rates lower by about 1% or 100 basis points.

The labor market/unemployment rate had an increased over the past year and is currently at a historical low rate of around 4%. Eighteen months prior, the rate was at a generational low of 3.5%. However, we are still in a strong robust labor market that has come into a better balance at 3.5% unemployment rate.

Ken proceeded to highlight the areas of policy uncertainties such as taxes, tariff policies, immigration regulation and government spending that could have positive or negative impacts on inflation, growth or corporate profits. Tax cuts and deregulation might have a positive impact for corporate earnings, but less taxes are directly a savings for corporations. However, it may also lead to higher deficits and interest rates such as tariffs causing higher inflation. The market's expectation for inflation over the next year has surged from under 3% to 4%, which will affect consumer behaviors, business investments and more. Additionally, companies like Standard & Poor (S&P) 500 are discussing more about tariffs and their earnings report during their recent fourth quarter earnings conference call, and the increase in discussion around tariffs have created many policy uncertainties.

In the fourth quarter of 2024, the Federal Reserve's forecast was for four rate cuts in 2025, but in December 2024 they decreased it to two cuts. The market thought the Feds might cut as many as five times at 0.25% each. The market is between one and two rate cuts with the first cut likely to occur in July 2025. The Feds is expected to be on a longer term pause at this moment, but they are worried about the policy uncertainties particularly the inflationary impact. We are at a stable rate environment for the first half of the year, but what the Fed does for the second half is dependent on the policies and how they impact economic growth, inflation, labor market, etc.

Ken continued with presenting the longer-term interest rates explaining the County's investment portfolio is typically for plenty of short-term funds, which also include investments that have about five years maturity market. The two-year treasury yield has changed quite a bit over the past year. In 2024, it was around 4.25%, then it increased to 5%, down to 3.5% and as of today a little under 4.2%. The two-year treasury yield has a lot of volatility because it is the market's expectation of what they think short-term rates will average over the next two years. One-year rates are currently lower than they were three months ago because the Federal Reserve cut rates in the fourth quarter affecting short-term rates, but longer-term yields are higher due to the potential of higher inflation and the Feds' decrease in rate cuts.

Overall, the economy is in a pretty decent place despite the policy uncertainties. GDP growth has remained quite positive. Unemployment rate is in a good place, and inflation has been progressing. Nevertheless, there are signs of weaknesses in: the housing market; consumer behavior; business pulling back on investments; and consumer and business activities. Ken explained that in the last couple of years, the Feds aggressively raised interest rates causing the cost of home ownership to increase. Long term 30-year mortgages are currently around 7% compared to the previously low rate of 3.5% to 3.75%. While the mortgage rates have increased to the highest they have been since 2008, the average price of a home has also increased to a record high. Home affordability is the poorest it's been in the past 15 years, which impacts home building, housing start and home sale. The activities in housing market have been weak, and they may not change until the interest rate environment eases.

Ken added the County's investment portfolio is structured to prioritize safety and liquidity. It includes both long-term investments managed by PFM and short-term, liquid investments managed internally by the County Treasurer's staff. The internally managed portion supports daily cash flow needs, such as tax receipts and payments, ensuring funds are always available to meet obligations. This design allows the County to effectively handle monthly and seasonal financial fluctuations while maintaining a stable and responsive investment strategy.

Meredith Sullivan from PFM reiterated that the priority is safety and to ensure adequate liquidity for the County to meet any of its obligations. Even though the targets are in longer maturity investments, the remainder of the investments are strategically in shorter maturity securities. Meredith noted that while PFM manages the short-termed portfolio, PFM is in constant communication with Tiffany Htwe to lock in opportunities in front end credit such as commercial papers or CDs. CAMP-terms is a relatively newer product, but it's another option to position funds in attractive higher yielding investments targeting short-term maturity. Tiffany and Meredith connect regularly about the County's excess liquidity or if PFM sees good yields in high quality issuers, so they can lock in values for the County.

Meredith continued presenting the characteristics of the aggregate portfolio as well as the core portfolio, which is the longer-term investments, as of January 31, 2025.

- Aggregate portfolio is currently at $8.8 billion.
- Core portfolio is about $4.1 billion.
- Aggregate and core portfolios were at 1.97 years.
- Core portfolio yield cost has increased to 3.23%.

As we continue to invest in the current higher prevailing market rates, the yield measure continues to rise. We continue to be well diversified in our allocation and credit quality. We utilize broad scope of permitted investment types and focus on high quality issuers because we are emphasizing safety and liquidity but also lock in attractive yields for the County.

PFM has been working diligently to lengthen the core portfolio duration. The maturity distribution chart demonstrates the efforts they have made transitioning assets from the front end of the curve into longer maturity. Ultimately, the high rates that are available have been locked in for three to four years. Since January 31, 2025, we have:

- 185 million in maturities that occurred.
- Reinvested maturities went from 1.97 years to 2.06 years.
- Maturities will likely increase to 2.5 years.

Meredith further explained the changes in historical sector allocation for the core portfolios. The availability of the market environment and opportunities dictate how the allocation changes. The current allocation for treasuries is slightly higher than it was in the past because of the spreads (additional yield benefits) in many of the other sectors are tight. When the spreads are tight, we focus many of our reinvestments on treasuries as alternatives. We stopped reinvesting in commercial paper in the current core portfolio because they are short maturity instrument with maturities from zero to 270 days. Since we are trying to extend the duration of the portfolio, PFM feels that commercial paper was a better fit for the PFM short-term managed portfolio that they use to secure credit opportunities. The current core portfolio also doesn't include asset backed securities (ABS). Due to ABS's complex accounting for cash flows, PFM and the Treasurer's Office agreed to place the ABS reinvestment on hold.

Over the past quarter, the reinvestments have been in longer maturity U.S. treasuries, which are still at a pretty attractive all-in yield. The average yield treasuries that matured was 75 basis points, and the average yield of what we reinvested is 4.18%. The remainder of the purchases were primarily in federal agencies and corporate notes. The yields that are rolling off naturally through maturity and purchased are much higher.

The next chart presented the spread of one to five years A to AAA corporate index and additional yield benefits that all the constituents in this benchmark offered over the 10-year period. On average the index of corporates offered about 65 basis points, and spreads are at the 11th percentile of their range over the past 10 years. Fundamentals are stable, and all-in yields are high with lots of demand. Corporates will almost always have some yield advantages over treasuries, but if the yield advantage is too small then it means we may temporarily favor treasuries until the corporate spreads widen back where we can capture more yield for longer periods. Currently, the spread is unusually narrow compared to their historical pattern.

Furthermore, the book yield has increased to 3.23%, and the current market rate is at 4.48%. The more maturity we have, the more things roll out of the portfolio at ultra-low yields that we could reinvest in higher yields. The expectation for 2025 is that book yield will continue to rise to the market yield, and our earnings will continue to increase as well.

6. **ORAL COMMUNICATIONS AND PUBLIC COMMENT**
None

7. **OTHER BUSINESS**
None

8. **ADJOURN**
The meeting was adjourned at 12:50 p.m.

Daneca Halvorson (Chair)

Sandie Arnott (Treasurer-Tax Collector)