

Mr. Jason Britt  
County Administrative Officer, Tulare County  
Tulare County Administration Building  
2800 West Burrel Avenue  
Visalia, CA 93291-4582

Dear Mr. Britt:

As required annually by the Program Administration Agreement, PFM Asset Management LLC (“PFMAM”), in its role as Administrator, is providing this report to update the County of Tulare (the “County”) on the status of the Millennium Fund Program (the “Program”) and the associated Refunding Bonds, Series 2006 (the “Bonds”).

### Executive Summary

Since inception in 1999, the Program has generated earnings sufficient to cover its costs and has provided over \$69.7 million in appropriations to the County—funds the County has used to provide services to the community. In December 2006, the bonds that support the Program were refinanced as a private placement, which allowed the County to reduce costs and served to isolate the Program from the credit crisis and liquidity crunch that gripped the markets in 2007 and 2008. As of April 1, 2024, the market values of cash and investments totaled over \$55.0 million.

### Market Valuation

Tulare County Millennium Fund Program Market Valuation as of April 1, 2024	
Fund Name	Market Value
Bond Fund	\$ 616,664
Millennium Fund	\$ 54,463,743
Tobacco Settlement Fund (TSR)	\$0
<b>Total</b>	<b>\$55,080,407</b>



### Unwind Position

The table below shows that the market value of the Millennium Fund Program exceeds the outstanding par value of the bonds by \$29.6 million, which is the amount of proceeds that would remain if the Program were collapsed, and the Bonds completely paid off using balances in the Fund (excluding any costs associated with collapsing the Program).

Unwind Position as of April 1, 2024	
Market Value of Millennium Fund Program	\$55,080,407
Principal of Bonds Outstanding	<u>\$25,390,000</u>
Unwind Position – Favorable	\$29,690,407

### Appropriations

As of April 1, 2024, the County has appropriated a total of \$69,723,359 from the Program for capital expenditures. For FY 2023-24, the County requested and received a disbursement of \$3,000,000 on August 23, 2023.

In accordance with Section 5.03(c) of the Trust Indenture, the County has the option to withdraw an amount equal to the lesser of (i) \$3,500,000 or (ii) the amount by which the aggregate market value of assets exceeds the outstanding principal amount of Bonds (currently \$29.6 million). In the current fiscal year, the available amount for withdrawal is \$3,500,000 and will be available on July 1, 2024.

#### Millennium Fund Program Appropriations

Year	Allowable Appropriations	Actual Appropriations
2000	\$2,500,000	\$2,500,000
2001	\$2,500,000	\$2,500,000
2002	\$2,500,000	\$2,500,000
2003	\$2,500,000	\$1,223,359
2004	\$2,500,000	\$2,500,000
2005	\$2,500,000	\$2,500,000
2006	\$2,500,000	\$2,500,000
2007	\$4,500,000	\$4,500,000
2008	\$3,500,000	\$3,500,000
2009	\$3,500,000	\$2,500,000
2010	\$3,500,000	\$3,000,000
2011	\$3,500,000	\$2,500,000
2012	\$3,500,000	\$3,000,000
2013	\$3,500,000	\$2,500,000

Year	Allowable Appropriations	Actual Appropriations
2014	\$3,500,000	\$2,500,000
2015	\$3,500,000	\$2,500,000
2016	\$3,500,000	\$3,500,000
2017	\$3,500,000	\$3,500,000
2018	\$3,500,000	\$3,500,000
2019	\$3,500,000	\$3,500,000
2020	\$3,500,000	\$3,500,000
2021	\$3,500,000	\$3,500,000
2022	\$3,500,000	\$3,000,000
2023	\$3,500,000	\$3,000,000
<b>Total</b>		<b>\$69,723,359</b>

### Tobacco Settlement Receipts

The County deposited the 2024 annual tobacco settlement payment of \$4,116,151 into its TSR Fund at Bank of New York Mellon on April 23, 2024. Since it was received after April 1, this amount was not included in the market value summary above.

The payments received by the County to date are less than projected by the California Attorney General in 2007<sup>1</sup> primarily due to some tobacco companies, specifically Philip Morris USA Inc., R.J. Reynolds Tobacco Co., and Lorillard Inc., withholding a portion of their respective Master Settlement Agreement payments as they dispute the obligations.

Year	Actual Payments <sup>2</sup>	State Projections <sup>1</sup>	Variance
2001-2023	\$92,607,449	\$102,883,959	(\$10,276,510)
2024	\$4,116,151	\$5,725,108	(\$1,608,957)
<b>Total</b>	<b>\$96,723,600</b>	<b>\$108,609,067</b>	<b>(\$11,885,467)</b>

### Annual Lease Payment

Section 403 of the Lease Agreement requires a deposit into the Bond Fund on June 1 to cover estimated Gross Lease Payments (estimated debt service and Program fees) for the following fiscal year.

The gross borrowing rate averaged 5.57% between April 2023 and April 2024. The rate increased slightly during the year, rising from 5.10% for April 2023 to 5.69% for April 2024.

<sup>1</sup> Updated State projections used for periods following April 2007. Projection document is no longer available on the Attorney General's website.

<sup>2</sup> Historical payment data is available at <https://oag.ca.gov/tobacco/msa>

The interest rate on the Bonds is reset monthly at 1-month SOFR (previously LIBOR) plus 25 basis points (0.25%), so the exact amount of debt service cannot be determined in advance. To estimate next year's debt service, the Program's bond documents require an additional 100 basis points (1.00%) be added to the most recent reset rate. Given the expectation that short-term interest rates are expected to remain at the current level or move lower over the next year, 100 basis points (1.00%) is a sufficient cushion.

The reset rate for the Bonds for May 2024 was 5.68%; therefore, debt service for the following fiscal year is estimated using a rate of 6.68%. The projected debt service amount includes the \$1,700,000 principal payment due on August 1, 2024. Because of the 2006 private placement refunding, the County no longer pays fees for remarketing, ratings, or a letter of credit.

Tulare County Millennium Fund Program Fiscal Year 2024–2025 Estimated Debt Service and Fees		
Type of Fee	Payee	Estimated Cost
Debt Service	Bondholders	\$3,323,142
Trustee Fees	The Bank of New York Mellon Global Corporate Trust	\$2,300
Management & Administration	PFM Asset Management LLC	\$68,901
<b>Total Gross Lease Payment for FY 24–25</b>		<b>\$3,394,343</b>

On June 1, funds from the TSR (Tobacco Settlement Receipts) Fund were transferred to the Bond Fund to cover estimated Gross Lease Payments for the upcoming fiscal year. Excess funds in the TSR Fund were transferred to the Millennium Fund for longer-term investment. Details of the June 1, 2024, transfers are shown in the following table.

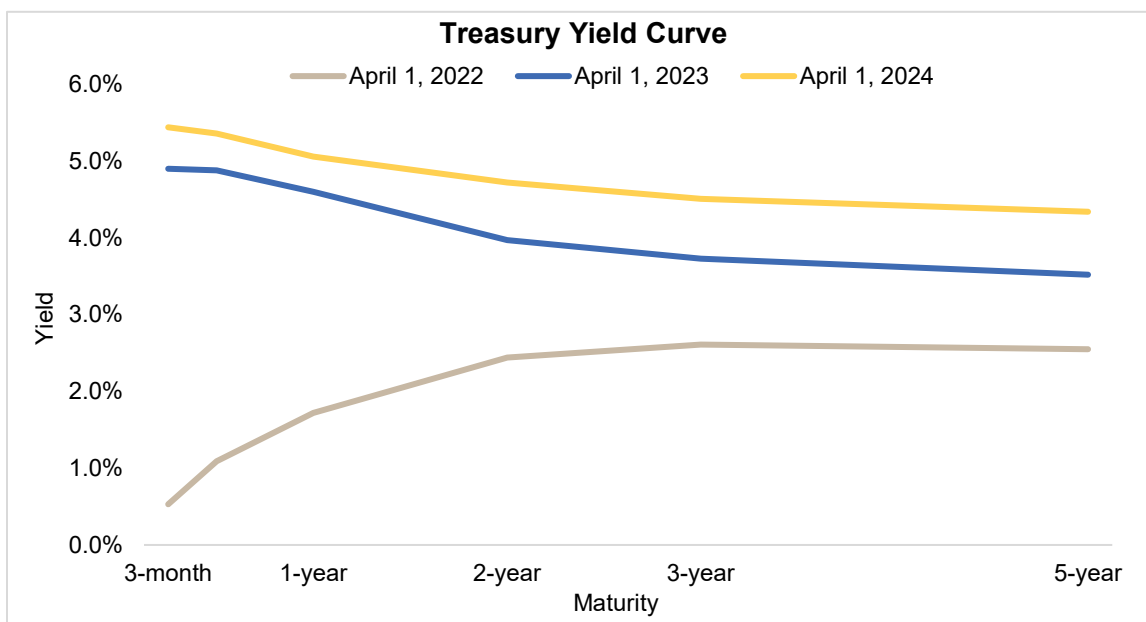
Net Transfers to Millennium Fund	
FISCAL YEAR 2024–25 LEASE REQUIREMENT	
Gross Lease Payment Requirement	\$3,394,343
Minus: June 1 Bond Fund balance after Debt Service Payment and Fees	<u>- \$ 209,637</u>
Net Requirement/Deposit to Bond Fund on June 1, 2024	\$3,184,706
FISCAL YEAR 2023-24 TOBACCO RECEIPTS	
April 2024 Payment	\$4,116,151
NET TRANSFER TO MILLENNIUM FUND	
TSR Fund balance on June 1, 2024	\$4,134,321
Less: Net Requirement/Deposit to Bond Fund	<u>- \$3,184,706</u>
Transfer to Millennium Fund on June 1, 2024	\$949,615

## Economic and Interest Rate Update (April 1, 2023 – April 1, 2024)

Over the year ended April 1, 2024, the U.S. economy showed surprising strength and resilience, with strong GDP growth and consumer spending amid a tight labor market and elevated inflation. Since July 2023, the Federal Reserve has held the overnight fed funds rate at a target range of 5.25% to 5.50% in its continuing efforts to fight inflation. U.S. Real GDP growth averaged 2.9% from 2023 Q2 through 2024 Q1, the economy added 2.9 million jobs during that 12-month period, the unemployment rate rose modestly from a near 70-year low of 3.5% to 3.8%, while inflation (measured by the core personal consumption expenditure (PCE) price index) fell from 4.8% to 2.8%. Market participants generally expect economic and financial conditions to support a “soft-landing” over the next year, where growth and inflation moderate without driving the unemployment rate materially higher.

The Fed had repeated its resolve to bring inflation down to the 2% target level, consistent with its dual mandate of achieving maximum employment and price stability. After 4 hikes of 25 basis points (0.25%) each through the first five Federal Open Market Committee (FOMC) meetings of 2023, the Fed has remained on pause, holding the target rate steady at the current range of 5.25% to 5.50%. The Fed's Summary of Economic Projections from June indicated a median estimate of 5.00%-5.25% for the overnight rate for calendar year end 2024. This implies just one  $\frac{1}{4}$  percent rate cut over the balance of 2024, down sharply from the market's pricing of 6-7 cuts at the beginning of the year.

Interest rates moved higher across the Treasury yield curve during the year ended April 1, 2024; however, rate increases were much less than what occurred during the prior year ended April 1, 2023. Rates remained elevated in response to Fed guidance regarding a “higher for longer” outlook for the fed funds target rate. After a difficult prior year, returns on fixed-income investments were generally positive for the year ended March 31, 2024, as the increased income from higher rates partially offset the negative impact of rising rates, but cash outperformed longer strategies for the 4<sup>th</sup> consecutive year.



Source: U.S. Treasury

## Investment Strategy

The investment strategy for each of the Program's funds is described below:

**Tobacco Settlement Fund (TSR).** This account is funded once a year, typically around April 15. Funds in the TSR account are transferred to the Bond Fund on June 1 each year in an amount sufficient to cover the next year's estimated Gross Lease Payments, as described above. All remaining funds in the TSR are transferred to the Millennium Fund. Funds received this April in the TSR account were invested in a U.S. Treasury bill, maturing on May 30, in advance of the June 1 transfer date. Once transferred, funds are invested in accordance with the strategy for the respective fund.

**Bond Fund.** Funds in the Bond Fund are used to pay debt service and administrative costs for the program. Each year, a portion of the annual settlement is transferred into the Bond Fund so that sufficient funds are available to cover Program expenses for the upcoming year, including monthly debt service, quarterly management and administration fees, and the trustee fee which is paid annually. Funds are typically invested in high quality short-term securities, with maturities targeted to monthly debt service payment dates—the first business day of each calendar month. This strategy is designed to ensure that funds are available to pay debt service and other fees, to maximize the return on the investment, and to minimize “basis risk”—the difference between the investment rate and the borrowing rate on the Bonds. During the year ended April 2024, funds in the Bond Fund were invested in U.S. Treasuries and agency discount notes with maturities ranging from one month to eleven months.

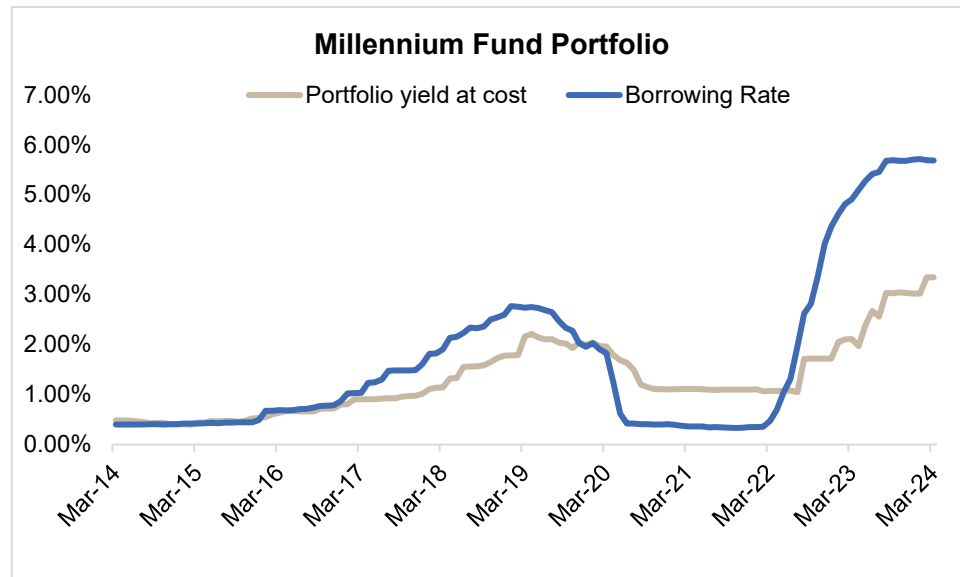
**Millennium Fund.** The management of the Millennium Fund is guided by several long-term objectives that were established at the Program's inception date:

- (1) Achieve and maintain parity, so the County has the necessary resources to unwind the transaction if tobacco settlement proceeds are interrupted;
- (2) Maximize the earnings spread on the Millennium Fund, consistent with the liability requirement of the Fund, in order to grow the Fund over time and provide annual appropriations;
- (3) Carefully control Program risk to ensure its ongoing success; and
- (4) Invest in accordance with the trust indenture, which specifically defines and limits what sectors each of the Program funds can invest in.

Each of these four objectives has been met. At the same time, the since inception spread between the borrowing rate and the Millennium Fund's investment return narrowed as the borrowing rate surged along with rising short-term rates. By the end of the most recent reporting year, the spread was a slightly negative -0.01%.



The chart below shows the Millennium Fund portfolio's yield on cost and the borrowing rate on the bonds over the past ten years. Throughout this time, we have seen periods where the portfolio is yielding more than the borrowing rate, and other times where the borrowing rate is higher.



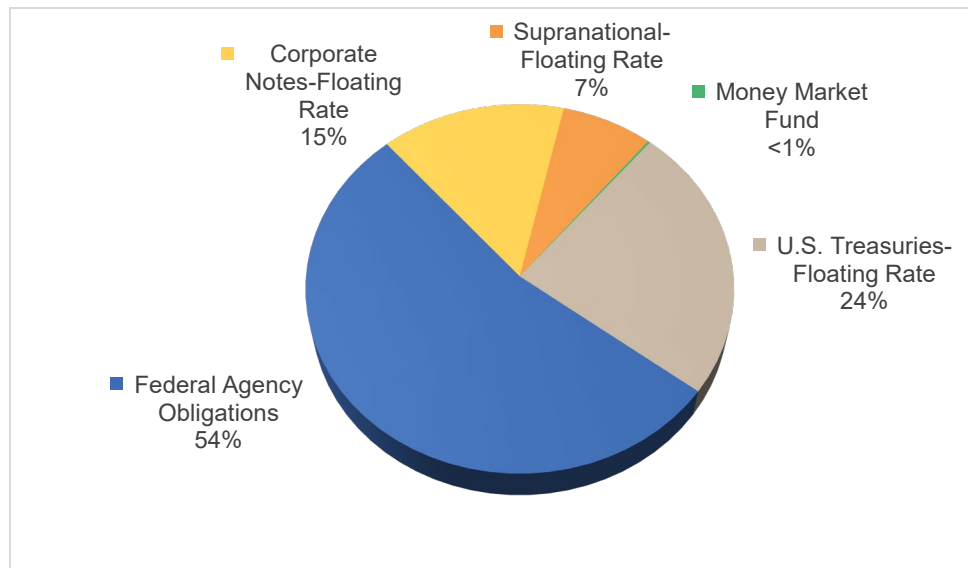
In January 2003, the Program achieved parity. This means that even if there were to be a significant shortfall of tobacco revenues, the Millennium Fund itself could be used to pay off the Bonds.

In an effort to safely achieve favorable earnings, PFAM looks to purchase high quality investments with yields at or above the borrowing rate while carefully managing interest rate and credit risk. A strategy that invests in high quality bonds is designed to add value while safely maintaining the positive unwind position.

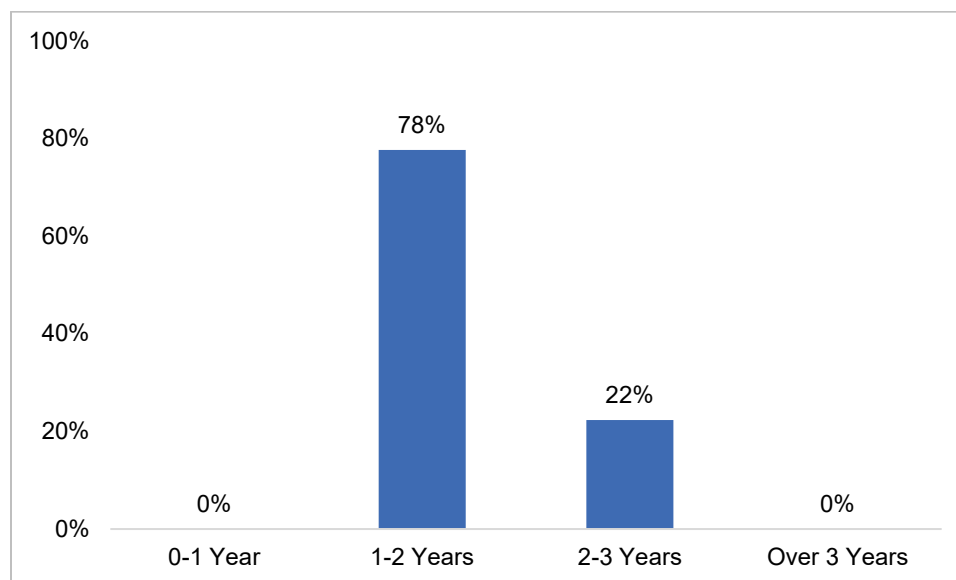
During the year ended April 1, 2024, interest rates continued to rise. At the same time, the Treasury yield curve remained inverted, reducing the value of longer-term fixed rate investments. Because the interest rate on the bonds adjusts monthly based on then current short-term rates, as interest rates began to rise, so did the borrowing cost. As a result, we shifted the focus of the portfolio to floating rate securities to offset that risk. Purchases over the past year were primarily made in floating-rate securities, including U.S. Treasuries with maturities of two-years, three-year corporate notes, and a supranational with a maturity of three years. Approximately 65% of new purchases were floating rate securities, with the remainder in very short-term U.S. Treasuries.

A sector breakdown and maturity distribution of the Millennium Fund portfolio as of April 1, 2024, is as follows:

**Millennium Fund Sector Allocation  
April 1, 2024**



**Millennium Fund Maturity Distribution  
April 1, 2024**



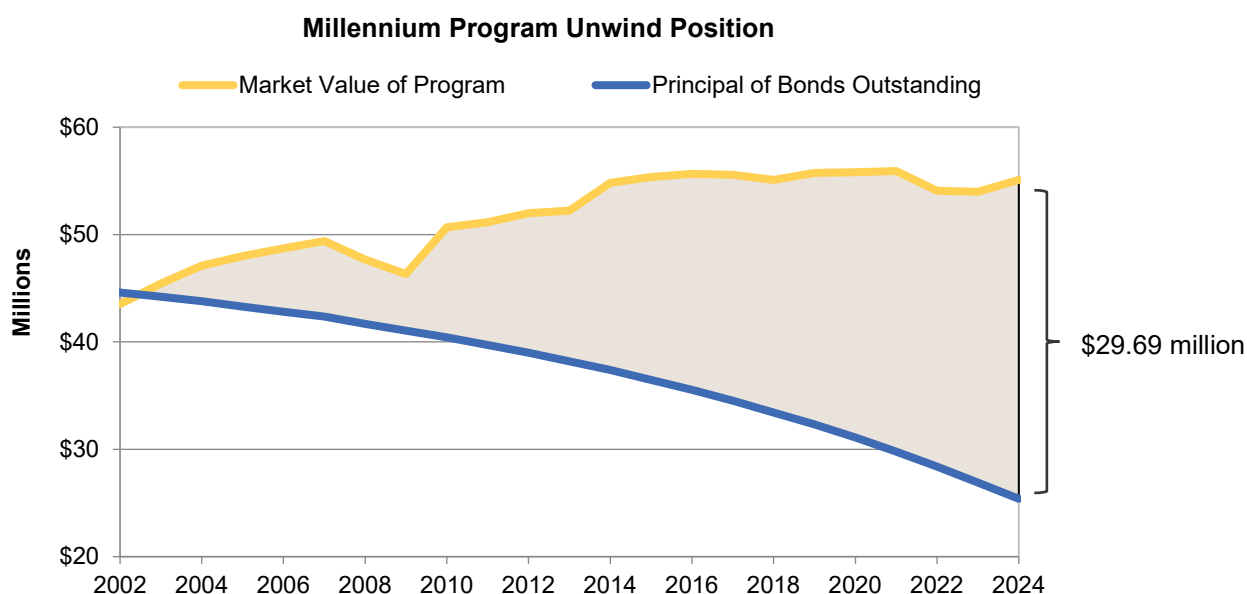


## Investment Results

The since inception spread between the portfolio's return and the borrowing rate tightened further over the past year as the borrowing rate increased more quickly than the portfolio yield due to the sharp surge in interest rates since 2022.

Investment Results December 17, 1999 – April 1, 2024	
Average Investment Return	2.16%
Average Borrowing Rate	2.17%
<b>Earnings Spread</b>	<b>-0.01%</b>

Despite the slightly negative earnings spread, the portfolio generated earnings which continued to grow the favorable unwind position. As shown in the chart below, after declining slightly in 2022 due to the negative impact of the sharp rise in interest rates on the market value of the portfolios' securities, the Program's unwind position increased over the past two years and is at its highest level since program inception.



## Outlook

Looking ahead, the Federal Open Market Committee's (FOMC) latest economic projections from June show a reduction in the number of possible rate cuts in 2024 with progress on inflation to achieve the Fed's 2% target taking longer than previously expected. Markets continue to adjust to the "higher for longer" mindset, rates remain elevated from a historical perspective, but the yield curve is sharply inverted, creating a challenging investment environment.

The County is currently undergoing conversations with its advisors and lender regarding a payoff plan for the outstanding bonds. Upon completion of the payoff, the Millenium Fund Program funds will continue to serve the County over the long term.

If you have any questions, please call Lauren Brant at 503-979-8591 or me at 717-232-2723.

Sincerely,  
**PFM Asset Management LLC**



Kenneth Schiebel, CFA  
Managing Director

cc: John Hess, Assistant County Administrative Office, Tulare County  
Paul Guerrero, Principal Administrative Analyst, Tulare County  
Cass Cook, CFIP, Auditor-Controller/Treasurer-Tax Collector, Tulare County  
Lena Chan, Senior Analyst, Client Services, The Bank of New York Mellon