



## Financial Services Audit Committee Communication

**Date:** November 16, 2018

**To:** Great Lakes Water Authority Audit Committee

**From:** Deirdre Henry, Treasury Manager

**Re:** Investment Strategy and Related Proposed Contract Extension with PFM Asset Management LLC (GLWA Contract No. GLWA CS-022)

**Background:** In November 2015, Great Lakes Water Authority (GLWA) engaged PFM Asset Management LLC (PFM) as a registered investment advisor to assist with 1) identifying portfolio and cash management optimization opportunities, 2) overcome personnel resource constraints during the stand-up of both GLWA and DWSD-Retail, 3) expand the transparency and capacity of investment portfolio reporting, and 4) provide an added level of controls.

PFM has worked with the GLWA treasury staff to 1) negotiate and increase bank earnings credit rates, 2) invest debt service and debt reserve funds, 3) transition balances in bank deposit accounts to higher yielding government money market and local government investment pools, 4) invest funds in construction and trust accounts into longer term investment securities, 5) develop quarterly investment report package and 6) identify a portfolio strategy appropriate for GLWA. With PFM's assistance, GLWA earned \$4.3 million in investment income for fiscal year 2017 and \$13.2 million in fiscal year 2018. The projected investment earnings for fiscal year 2019 is \$19 million.

The original PFM contract amount in 2015, which did not contemplate PFM actively managing the portfolio, was \$250,000. As we have worked through the optimization of the portfolio, identifying cash management opportunities, development of the reporting package, and PFM's management of the portfolio, the contract has been extended and increased two times. The current contract total amount is \$700,000 and is scheduled to expire December 2018.

**Analysis:** The use of a registered investment advisor has proven to be a cost effective and efficient approach to portfolio management. The investment advisor allows GLWA to have direct access to financial market expertise while allowing the treasury team to focus on the development of cash flows, treasury internal controls, and process improvements.

We have now reached a steady state in identifying GLWA cash flows and fund balances. Based on the analysis and review of our portfolio we have identified an investment strategy for GLWA. This strategy segregates the funds into cash flow portfolios and benchmarked portfolios. The cash flow portfolios will be managed using the Earnings Target Approach which focuses on income stability and specific cash flow predictability. The benchmarked portfolios are proposed to be managed using a Total Return Approach with PFM having approval to actively manage the portfolio to

maximize investment returns while considering financial market conditions and GLWA goals of liquidity and safety. It should be noted that this change in strategy that achieves a desired outcome of increased investment earnings while preserving compliance with GLWA's investment policy and Michigan Public Act 20, *Investments of Surplus Funds of Political Subdivisions*.

GLWA Treasury recommends an investment strategy which includes active management of some of the funds. Given the timing for implementation of this investment strategy, it is recommended that the PFM contract be extended for a year to allow for stability of this investment approach. The contract extension would be through December 2019 and increase the contract amount by \$370,000. The total life-to-date PFM contract amount after this increase would be \$1,070,000 which requires approval action by the GLWA Board.

The fees charged by PFM are reasonable. As a measure of reasonableness, the total contract amount of \$1,070,000 is 2.9% of the total portfolio income for FY 2017, FY 2018 and FY 2019. In addition, the estimated annual fee of \$415,000 is .04% of the September 2018 investment portfolio balance of \$981,577,211.

<b>Portfolio Income</b>	
FY 2017	\$4,300,000
FY 2018	13,200,000
Projected FY 2019	<u>19,000,000</u>
Total Portfolio Income	<u>\$36,500,000</u>
<b>PFM Contract</b>	
Original Contract Amount - November 2015	\$250,000
Contract Extension & Increase - Approved November	350,000
Contract Extension & Increase - Approved June 2018	<u>100,000</u>
Total PFM Contract - ending December 2018	<u>\$700,000</u>
Proposed Contract Extension & Increase	<u>370,000</u>
New Total PFM Contract - ending December 2018	<u>\$1,070,000</u>
PFM Contract as % of Portfolio Income	<u>2.9%</u>
PFM Annual Fee as % of September 2018 Portfolio	<u>0.04%</u>

Calculation of Contract Increase - Invested Portfolio				
<u>Estimated Invested Portfolio \$</u>		<u>Rate</u>	<u>Fee \$</u>	
1st	100,000,000	0.08%	\$	80,000
2nd	100,000,000	0.06%		60,000
above 2nd	550,000,000	0.05%		275,000
Portfolio Balance	<u>\$ 750,000,000</u>		\$	<u>415,000</u>
			Monthly	<u>\$ 34,583</u>
Total Contract Amount through December 2018			\$	700,000
Projected billings through December 2018				<u>(647,000)</u>
Remaining Balance on Current Contract			\$	<u>53,000</u>
Projected billings through December 2019				<u>(415,000)</u>
Additional Contract Funds Needed			\$	<u>(362,000)</u>
Requested Increase				\$370,000

**Proposed Action:** The Audit Committee recommends that the Board of Directors for the Great Lakes Water Authority approve a contract extension with PFM Asset Management LLC in the amount of \$370,000 through December 2019 for a total life-to-date contract of \$1,070,000.