MINUTES OF THE INVESTMENT ADVISORY COMMITTEE
THURSDAY, APRIL 26, 2007 AT 2:00 P.M.
TOWN COUNCIL CHAMBERS

I. CALL TO ORDER

The Investment Advisory Committee Meeting was called to order on April 26, 2007 at 2:00 p.m.

II. ROLL CALL

PRESENT:
Chair Michael F. Andrews
Stephen L. Brown
William J. Mikus
Bernard R. Panfel
Dustin Heintz, Florida League of Cities
Greg Coleman, Atlanta Capital Management
Jane Struder, Finance Director
Cheryl Somers, Assistant Finance Director
Betty Cotton, Recording Secretary

ABSENT:
Vice Chair Edward L. Hennessy, Jr.

III. PLEDGE OF ALLEGIANCE

Chair Andrews led the pledge of allegiance.

IV. APPROVAL OF AGENDA

MOTION BY MR. PANFEL FOR APPROVAL OF AGENDA.
MOTION SECONDED BY MR. MIKUS.
MOTION CARRIED UNANIMOUSLY.

V. COMMUNICATIONS FROM CITIZENS (3 MINUTE LIMIT PLEASE)

No citizens attended.

VI. APROVAL OF MINUTES FROM THE FEBRUARY 16, 2007 AND MARCH 14, 2007 MEETINGS

MOTION BY MR. BROWN FOR APPROVAL OF THE MINUTES.
MOTION SECONDED BY MR. MIKUS.
MOTION CARRIED UNANIMOUSLY.

VII. INDEMNIFICATION UPDATE

Chair Andrews asked Mr. Brown to give the indemnification update.

Mr. Brown reported that Bill Guttman developed a draft ordinance and the Civic Association hired a Florida lawyer to help with this. The Civic Association's Executive Committee had voted unanimously to support the idea of a strong ordinance for the elected and appointed officials in Town. They went back and forth with Skip Randolph on the ordinance on a number of issues that Mr. Randolph brought up. They tried very hard to meet those issues with the appropriate changes and Mr. Brown thinks they did. They made a lot of changes and still kept the primary purpose of the ordinance and met Mr. Randolph's concerns.

However, they still were not through for the April Town Council meeting. In talking with the Town Council members individually, he recommended that they wait until November to present the ordinance because he will be out of Town before the May meeting. The Town Council was very supportive of the idea of indemnification and they did not want to wait for at least a discussion and a conclusion as to direction by the Town Council. In April, the Town Council did discuss the situation and they unanimously supported the idea of having an ordinance drawn up with a strong indemnification. They indicated to the Town Attorney and the Town Manager that is what they wanted.

The Town of Manalapan actually passed an ordinance for indemnification that was not as strong as what the Town is recommending but much stronger than anything seen from a Florida town until now and certainly was going in the right direction. So the Town of Palm Beach is not quite as much of a pioneer as before Manalapan acted.

When they indicated to Mr. Randolph that they would like to dot the i's and cross the t's before leaving for the season, he stated he wanted to draft his own ordinance. In conversations between Mr. Randolph and Mr. Guttman, it was clear that Mr. Randolph still was not happy with some of the directions that the draft ordinance written by Mr. Guttman was going in. They are meeting on May 1 in Mr. Randolph's office on the issue again. If there is no agreement, he is inclined to go back to the Town Council members and talk to them about maybe a different approach than the one currently being used.

He said he would be happy to accept suggestions from the committee.

Chair Andrews asked who would be in the meeting?

Mr. Brown replied Mr. Randolph, Mr. Guttman, and Bill Capko, the Florida lawyer that has been retained by the Civic Association, and himself.

Chair Andrews asked if it would be possible to get someone from the Town Council to attend the meeting? He said it seems like it is the four of them against Mr. Randolph. There doesn't seem to be a neutral person that the group could go to.

Mr. Brown said that might be a good idea but he honestly does not think the Town Council is neutral. He thinks they are very much in favor of a strong indemnification provision. He will talk to Mr. Guttman about it and he will probably talk to the Mayor or one of the Town Council members to see what they think. The Mayor often has a pretty good feel for what might be a good approach and he is a lawyer. He has utilized the Mayor before in this whole chapter in trying to get things going. The Mayor could be helpful but in the end the Town Council has made a policy decision and somebody has to carry it out. It is a good suggestion and he will take it under advisement and talk to the Mayor about it.

VIII. UPDATE ON INVESTMENT ADVISORY COMMITTEE APPOINTMENTS

Ms. Struder reported that Dr. Andrews, Mr. Brown and Mr. Hennessy were all reappointed to the Board.

IX. MONTHLY INVESTMENT REPORTS – FEBRUARY AND MARCH 2007

Ms. Somers reported between January and February, there was a gain of $120,000 and then it went the other way. As of the end of March, the Town still had $112,500,000 in investment accounts.

Ms. Struder said the six month Treasury is due to mature in July. Since there will not be another meeting by July, she needs direction on what to do with that when it does mature.

Mr. Brown asked what the rate is?

Ms. Somers said the rate is 5.15%.

Mr. Brown asked if renewed today, would the rate be about the same?

Mr. Coleman said yes, 90 day T bills and six month's paper would be about the same.

Chair Andrews said he would prefer to roll it over. The committee agreed.

Ms. Somers said also dollar wise fiscal year to date compared to prior fiscal year to date, the investments are ahead by about $800,000 in interest earnings so that is good.

Chair Andrews said it would be nice if that could be incorporated on the front page of the report.

Ms. Somers said she could incorporate that in the memo.

Mr. Mikus said that is due to high interest rates.

Ms. Somers said right.

Chair Andrews asked what were assets this time last year?

Ms. Struder said they were similar maybe slightly less.

Mr. Brown said in this first data page, at the bottom there is a yield to maturity indicator. The yield to maturity is lower for the Florida League investments than for the SBA so one would have to conclude that the only way to really outperform the SBA from here in the short to intermediate duration is for short rates to go down. Is that a fair conclusion?

Mr. Coleman said for short rates to go down or for two year maturities to go down even more.

Mr. Brown said that is true, there could be an even more inverted yield curve in the two year period than now and that would get some capital gains into the intermediate portfolio. This is a difference from in the past where the yields to maturity have generally been higher than the SBA.

1. CASH FLOW REPORT

Ms. Struder said a cash flow analysis was handed out that was requested at the last meeting. They prepared this cash flow analysis to show the balances in the funds that have readily available cash to invest. This does not include the OPEB Trust which is in a different investment vehicle. The liquidity requirements are shown underneath and the potential amount that would be available for longer term investment.

The one caveat she would like to put on this is with the current state of property tax reform, all bets are off. They are not sure how much that will impact the Town's budget and how much they may have to dip into reserves to possibly cover shortfalls from the property tax reform. At this point, she does not want to commit to anything longer term until they know the results of what the state is planning on doing with property tax reform. This report can be given to the committee this fall once they have a better idea of what the requirements will be and then they can make some investment assumptions based on a report similar to this.

Mr. Brown asked if this adds up to $73,000,000 of the $112,000,000, what is the rest of it?

Ms. Struder said the OPEB Trust is $16,000,000 that is invested separately. There is some Leisure Services money but a lot of that is committed to Capital Projects.

Mr. Brown asked by property reform if she is talking about the possibility of real estate taxes being replaced by sales tax?

Ms. Struder said there are a lot of changes that will most likely have a negative effect on budgeting and the ability to balance.

Chair Andrews asked if she believes something like this can happen before November?

Ms. Struder said it is very likely. There is a Senate plan and a House plan and they are trying to meet in the middle. At this point it is changing by the hour because they are in session. The House plan would cut the Town's budget by $11,000,000 which is about 20% of the budget. She said Mr. Heintz may have more information.

Mr. Brown asked what is the House plan?

Mr. Heintz said to roll back to 2001 and then to replace that difference with a sales tax increase.

Ms. Struder said because the current distribution for sales tax is per capita for the Town of Palm Beach community, the Town would not get much of anything unless they change that.

Mr. Mikus said revenues to the Town have increased dramatically as real estate assessments have increased in the last five years. It has almost been a windfall so it probably is not going to be that difficult to go back to more realistic spending habits as far as cash.

Ms. Struder said to cut $11,000,000 would require the Town to cut services, Police, Fire, Public Works, and everywhere. Approximately 70% of the Town's budget is personnel expenses. Capital projects will have to be cut.

Mr. Brown asked if the roll back they are talking about would apply just to homesteaded or to everybody?

Mr. Heintz said the roll back rate as it relates to the budget of the Town is to roll back to that specific revenue period. It has nothing to do with actual homestead. It is going to go back to a previous budget year.

Ms. Struder said but in the House plan and the sales tax replacement, they want to eliminate property taxes entirely for homesteaded property owners. Most of these plans seem to benefit more homesteaded property owners than snowbirds or businesses. The Senate plan seems to take more of that into account.

Mr. Heintz said that is part of the timing, as well. The roll back part of it can happen immediately once the legislation is passed. But changing anything to do with homestead taxes will have to be voted on by the general population of Florida. If they have three quarters of approval on the bill, they could have a special election in September or November of this year. If it is less than three quarters approval, which is very likely, it will happen in November of 2008.

Chair Andrews asked if he heard someone say it is a two part, one is for the individual homeowners who have a homestead exemption and they roll that back to 2001, and is the other one that municipalities have to roll back to a budget of the 2001 year?

Ms. Struder said the House plan is a roll back to what property taxes were in 2001. The Senate plan has it rolling back to 2005-2006.

Mr. Heintz said the Senate plan of 2005-2006 has some very unique parts to the plan.

Ms. Struder said yes, there are personal income numbers, etc. She has not tried to keep up with some of the gyrations because literally they change day by day and it is hard to put numbers on it.

Mr. Brown asked Ms. Struder if the bottom line is that she is cautious because of all this uncertainty.

Ms. Struder said correct. If major budget cuts have to be made, the Town may have to use some reserves. She would hate to commit some of this long term at this point until she knows more.

Chair Andrews said since the committee probably will not meet over the summer and there will be some things going on, could the Finance Department keep the committee up to date if there are changes?

Ms. Struder said yes. Once she knows how it is going to affect the Town, it will definitely be in the press and she will also advise the committee.

Chair Andrews asked her to do that in their monthly updates because they like to be informed going forward.

Ms. Struder asked if the committee finds the Cash Flow Analysis helpful?

Chair Andrews asked if the $32,000,000 could be broken down a little further for the committee? Is this going to static year by year or is it linear year by year?

Ms. Somers said it has already been factored into the liquidity section. The primary liquidity covers normal and foreseeable future based on the history and then the secondary liquidity factors in unforeseen, unexpected events is already factored into that second blue section.

Chair Andrews said so in the secondary liquidity, nothing would happen, the secondary liquidity would switch over to the potential amount at some point in time?

Ms. Somers said right.

Chair Andrews said that was a good idea to keep a secondary liquidity average.

Ms. Somers said they can factor that up and make it higher.

Ms. Struder said this cash flow analysis will be presented again at the next meeting based on that.

Chair Andrews suggested if there are any major changes that happen based upon information that might come down from the legislature, that the committee be updated earlier.

X. **<u>FLORIDA LEAGUE OF CITIES AND ATLANTA CAPITAL PRESENTATION</u>**

Mr. Heintz introduced himself. He is the Investment Services Manager for the Florida League of Cities. He has been with the League since June. He works with Ms. Struder on the League's Investment Advisory Committee. She is a member on that committee. He thanked the Committee for the opportunity to speak to them today. He turned the meeting over to Mr. Coleman since he is the expert on this information.

Mr. Coleman thanked the committee for having him again and said it is good to see familiar faces. He stated he would like to review the performance for the quarter, the year, and since inception. He will give Atlanta Capital's view of what is going on in the economy and how that affects their position in the portfolio. With a little bit of the recent past and what they think is going to happen, he will develop from the macro a sense in terms of GDP, inflation and those kinds of things. Then he will look specifically at the Town's portfolio. There was a question from the committee particularly since they have a fair amount of mortgage AAA in Fannie Mae and Freddie Mac securities. For a while there, CNBC had some new horror story every hour about the sub prime market. He wants to put that into perspective in general and also specifically as it relates to the portfolio which he is happy to say it does not. Then he will be happy to answer any questions.

The performance for the most recent quarter was a pretty good quarter both in absolute and relative terms. To bring everyone up to date on some of the accounting on investment performance, Atlanta Capital does not annualize. He spent his first two careers in the banking business and everything was on an annualized basis.

Most money market returns are always on an annualized basis. These are not annualized. They are the AIMR standard.

Note, at the 1.47%, they are outperforming the benchmark which is the Merrill Lynch 1 – 3 year. Those are roughly two year average maturities. If the portfolio yields less than 6%, returns on an annualized basis would be something a little less than that, and that can't be done without some capital gains or some appreciation. They had a little bit of both. The Federal Reserve has stopped tightening since last June 30, so the one year number is the same story. It was a good year for the short term and the intermediate. With 6.5% investing in the index, which has lower quality securities in there, they are pleased with that and investing in the cash alternative.

On T-Bills, it is a little easier to get historical numbers. That runs about 10 to 15 basis points below the SBA since it is just made up of treasury bills and the SBA has other things in it. They run pretty close because remember the T-Bills are usually a little bit longer than the SBA. The four year numbers are annualized. The lexicon of money managers is, if over a year, the numbers would typically be annualized.

The good news is they have beaten the benchmarks in all the periods but it is hard to get too excited about returns of less than 3%. He understands that. Those are not equity like returns. That was largely in a period of rising interest rates. The Federal Reserve raised interest rates seventeen straight times in their meetings and from the very low level starting at 1%. All of the fixed income returns, investment grade, were pretty low in that period and they are pleased that they beat the benchmark. The numbers are notably higher in the intermediate over that same period.

Mr. Brown asked if the period 3/31/03 through 3/31/07 is the period that the Town has been with Atlanta Capital?

Mr. Coleman replied yes.

Mr. Brown asked so the SBA would probably be 10 to 20 points higher than the Merrill Lynch treasury bill?

Mr. Coleman said correct, they are just in the low 3's on an annualized basis. In fact, if a hundred dollars was invested in each of the investments, FMIvT intermediate, SBA, and FMIvT 1-3 year, this is what it would look like, compounded, cumulative, non annualized. In the 1-3, largely because the rates were rising, there was negative price appreciation but recently, it has certainly closed the gap. They are quite a bit ahead of the SBA in the intermediate and the 1-3 is just trailing. Also, it is timing. The Federal Reserve's last tightening was June 29th and 30th of 2006 so it corresponds to the end of a quarter. Since they have at least stopped tightening, the return for the intermediate is 6.25% non annualized, the return for the 1-3 is 4.73%, and the return for the SBA is 3.96%. That's since June 30, 2006 in the trailing nine months.

Mr. Brown said in just looking at the chart, even though he knows the Town has less in the intermediate than in the 1-3, shouldn't this be about even overall with the SBA but clearly the FMIvT is still behind $300,000, right?

Mr. Coleman said this is gross of fees, not net of fees. The other part would be roughly three times more in the asset class that has underperformed the SBA.

Mr. Brown said the fee part is interesting. He said some additional money was put into the intermediate about a year ago.

Ms. Struder said she thought the money was taken out.

Mr. Brown said they may have pulled money out but he thought some time ago they also put another several million dollars into the intermediate.

Ms. Somers said that was a couple of years ago. They recently pulled the $16,000,000 out for the OPEB Trust.

Chair Andrews said they have not added anything to keep the original percentages in line. He said they have not had any movement in interest rates but the economy has lately been showing pretty good signs. He asked how Atlanta Capital is going to do relative to everybody else if there is no movement in the Fed rate and the economy still continues to grow?

Mr. Coleman said if the Federal Reserve maintains their 5.25% interest rate and if the economy continues to grow at the present rate, which is only 2%, his guess would be pretty much all of these returns would look pretty similar. They would all be around 5% annualized, 5.25% in the SBA's case and plus or minus a quarter of one percent off of that because the economy is growing at 2% not slowing and the Federal Reserve is not in any hurry to ease. Cash returns would look pretty good and bond returns would still look okay but no great shakes.

Chair Andrews said following Mr. Brown's comment, it looks like the investments are going to have a hard time looking good until rates actually start to lower and the SBA has to start tracking downward a little bit.

Mr. Coleman said he would not disagree with that in a one year time horizon. He thinks the economy is going to grow a little slower, not a recession, still positive, but slower in such that the Federal Reserve probably will have to ding the Fed funds rate a couple of times, probably June or later. The Federal Reserve needs to be concerned about inflation. Inflation is not really going up and really has not come down. Basically, they want it at 1 to 2% and if it is growing at 2.2 or 2.3%, it cannot really ease. It could be at 5.25% for a long time.

The house price appreciation really is over nationwide. There are two pieces on the chart shown. The blue line is the best measure. It actually tries to measure the price appreciation or equivalent of the same house. A lot of numbers have come out on single family homes, the median price fell 10% or was up 6% on median prices of homes sold, but it is not the same house. The government does a good job of estimating where price appreciation is going. This is just year over year. The good news about the blue chart is it is for the entire country, all 250 odd metropolitan areas. The bad news is, it does not include condos, and it does not include those with mortgages above $417,000. It has lagged about four months since December.

The good news about the red line is it includes all the things that the blue line excluded but it is only in the 20 largest metropolitan areas. The housing market has rolled over, certain states are still going up, but most have rolled over. That does a couple of things. It reduces consumer spending, it reduces the amount of refinancing that happens when homes are sold, and also reduces the amount of money that is being tapped from home equity, all of which should slow consumer spending. That is a function irrespective of whether the sub prime issue is in there. This phenomenon would happen anyway.

On page 6, superimpose a rising delinquency and default loss because sub prime lending reduces some of those factors even more. This is sort of the bad news part of the economic presentation. Note the mortgage delinquencies across the entire spectrum not just commercial banks or Fannie and Freddie. The biggest reason for the rise in defaults and delinquencies, even though they have been higher in the past, is because of the increased amount of sub prime lending. Sub prime is where the credit worthiness is largely determined by your FICO score, typically 600 or lower. In addition, the loan values are higher. And then in the perfect storm, let's go ahead and give those same individuals adjustable rate mortgages and start them at a 4% payment rate and then bump it in a year or two. That is the reason for the high default and delinquencies.

Chair Andrews asked if he could estimate what would happen because the insurance rates have gone up substantially, the tax rates which are not factored in here have gone up. That makes the perfect storm more perfect.

Mr. Coleman said that is true depending on what part of the country. Certainly, in Florida that would be the case. It is also a higher concentration of second homes for investments and that would also dramatically impact.

Mr. Mikus asked if he remembers what caused delinquency rates to rise so dramatically in 2000 and 2002?

Mr. Coleman said it was poor underwriting and the economy was just about to go into a recession. It was the early version of the sub prime market. Those vintages were poor. The consumer spending never really slowed down. The last recession was kind of a capital spending tech bubble recession. One of the reasons he does not think a recession is anywhere near is that it is really hard to have a recession when the prime rate is 4.4%.

Mr. Mikus said on page 5 Mr. Coleman was absolutely right for adjusting this for like houses because a house built in 1985 is completely different from a house built in 2005 but it was not adjusted for inflation, correct?

Mr. Coleman said correct.

Mr. Mikus said if it was adjusted for inflation, these numbers would be dramatically lower because inflation rates in the early to late 80's were at 10%. So the whole chart drops down fairly dramatically.

Mr. Coleman said that's correct but it would still end up with the real returns.

Mr. Mikus said the real returns are not that much higher.

Mr. Coleman said that's absolutely correct. Fortunately, in the last five years since inflation has been reasonably low, not low house inflation, the real returns would be better the last couple of quarters.

Mr. Mikus said but that may be making up for the lack of real increases in real estate prices from the 80's.

Mr. Coleman said correct. One thing different about this housing bubble is the amount of vacant homes. If an individual sells his/her house finally, that individual is probably going to buy another house. The million vacant homes exacerbated this and is one thing that is going to lengthen this problem. Vacant homes are near an all time high because people are speculating that they were hoping to close before this.

He said the good news is on page 7. First, the sub prime market is only about 9%. It really only began in earnest in 2001and 2002 and there is no problem with a lot of those homes because they went up a lot in value and they do have a lot of equity in them. Notice also that the sub prime has never been exactly terrific bull players relative to the population as a whole. The good reason is because the blue, the prime, for the typical mortgage homeowner, is really unmoved. Just because an individual house went down 2%, the owner does not want to throw in the keys. He can understand how sub prime reduces housing, construction, the number of mortgage appraisers, and the number of real estate agents. The largest sub prime lender in the country is Wells Fargo Bank but that is just a small portion of their portfolio. One has to realize too that even with the sub prime, as poorly as some of those have been underwritten versus the past, 81% are current.

The other side of the argument would be if somebody had a drug that showed an 81% cure rate, and it was going to be taken off the market because 19% of it was little better than the placebo, the country would be up in arms. While all real estate is local, the financing arm of that, the mortgage market is completely homogeneous. He is concerned about the effects on the mortgage market across the country and how it affects the country, how it affects GDP, and at the end of the day it is meaningful. It is a housing recession, it is important but it is unlikely to draw us into a recession. In the housing market itself, the primary is only 5% of GDP.

Commercial real estate is still pretty good. The defaults and delinquencies that are the highest are not in the states necessarily that have had the highest run up. The state with the worst home appreciation is Michigan with the second highest unemployment rate of 7.7%. The states with the highest delinquency are Michigan and Mississippi. Low appreciation and high unemployment is the ticket to defaults and delinquencies. Florida has an unemployment rate of 3.3%. They have a lot of vacant houses but they do have a low unemployment rate. California is at the national average. Those are all good things as it relates to somewhat stabilizing effects.

Mr. Mikus said the two states that everybody is speculating about holding real estate, Florida and California, are nowhere as interesting.

Mr. Coleman said correct. He is not saying that they do not exist but across lots of iterations, it isn't the case. It does filter into appraisers, real estate, consumers spending less because they are not tapping their houses anymore, and it is already having an effect.

Page 9, retail sales is a very volatile number, but this is retail sales year over year. Retail sales do not include services. The retail sales number that the government publishes are dining establishments and goods purchased but no services. Nontheless, it has had a meaningful impact already. The Fed tells us that the fundamental non inflation rate of growth in this economy is 3 to 3.75%. If running higher than that, they would be worried about inflation. If running lower than that, full non-inflationary for employment is not being maximized, so they are concerned about it. The last three quarters in a row have been in the 2.2, 2.5%. The quarter just ended, March 31, which the data is not available on, will be right around 2%, maybe a little less. The consensus is about 2.2% which is a little stronger. What he is showing here, because of the high gas prices, is that the corporations have stopped having record profits spending 10%, 10%, 10% in capital goods. They are buying back stock but they are not making any rigid making machines. What is meaningful is it is going to drive the economy below potential. It has already and he thinks it is going to continue but not enough.

On page 10, the good news is, it is certainly not enough to throw the economy into a recession. At the end of the day, how many people are working? The chart shown is the average monthly increase in new jobs. In 2005, 211,000 jobs were added on average per month. In 2004, it was a 172,000. The first quarter of 2007, 152,000 new jobs were added. Only 120,000 are needed to keep the unemployment rate unchanged. He thinks that number is going down and part of the reason is that's how many construction related jobs were in that. For example, 47,000 of the 252,000 on average per month were construction related. It makes sense, look out the window and it is evident that is the case. It detracted in the fourth quarter of 2006, added slightly in the first quarter, but he thinks that is coming down. Anyway, it is not bleak and there is a ways to go before overall consumer spending drops more than he is showing.

On page 11, the flat real estate market in the fourth quarter was more than offsetting consumer balance sheets by equities. Now just more than 50% in the country owns some form of stock. The first quarter is going to look even better. Housing will look a little worse. The first quarter will look almost equally as good as another balance to some of the bleak housing numbers.

Page 12 shows the 2007 Atlanta Capital Forecast. He has shown a little bit of history and then their forecast. This was done mid March. If done today, he probably would move it down a tenth on each in terms of GDP inflation. Presumably, Atlanta Capital's belief would be that if the economy does grow some potential for five quarters in a row, the unemployment rate will start to pick up a little bit and it will take a little pressure off. It is not that inflation is bad but it is not good enough to get the Federal Reserve to lower rates. It is a little bit of a mixed bag if the consensus view of the economy is at 2 or 2.2% and the consensus view of inflation is at 2.2%, there will be no change in Fed policy. If he knew that the economy was going to go at .9 for three quarters in a row, inflation was going to stay at 2.2%, he thinks the Federal Reserve would ease because they would say, "our job is to forecast". The unemployment rate is now at those numbers probably 5.2 or 5.3%, and they would ease. If inflation fell below 2% and the economy grew at 2.5% and then 3%, it would probably stay the same because they would say "well, it is a bit over 2%, that's fine". A couple of quarters of 1% something or a long series of barely 2% and the Federal Reserve would ease.

On page 13, one of the things he wanted to add is if forecast today, it is generally impossible to be proven wrong at this second. It could happen shortly thereafter but probably not today. In this business, it is really tough to forecast and certainly Atlanta Capital has rules for their forecast. He tried to outline the major ones on one page. First, the upside risk leaning toward what if they really are not that tight. There is an inverted yield curve but yield spreads on risky assets are not all that high. Phasing remains easily obtainable. That would mean that the economy is really strong and also what if the unemployment stays low? That also could mean that growth could be a surprise to the upside. That is not their forecast but it is possible.

Conversely, in a sub prime mortgage crisis, he does not think it is a contagion but it proves more pervasive. Historically, there has never been this many vacant homes. He does not know what that leads to, maybe in some of the feeder industries, it has a bigger impact and it could be worse. The upside is inflation is still above 2% working very slowly down back toward that. If it stays above, the Federal Reserve could just stay where they are. Then also if gasoline stays at $3.00 a gallon and the housing malaise is a little stronger there could be a weaker economy. Most models do have gas at $3.00 a gallon.

Mr. Brown said let's stay on that downside risk of the sub prime mortgage prices a little bit more. One of the things he has read about is a possible scenario. He thinks Mr. Coleman has addressed this. Is the possible impact in fact in the economy? If there is a substantial enough financial problem, the rating agencies have to actually start writing down some of these mortgage pass through securities that have different tranches. They may be rated even AAA, AA or A, or whatever, and the bottom part is hurt enough so that the higher quality tranches are also hurt, pretty soon it is kind of a roller coaster event on the financial side. That makes the whole area more difficult for mortgages in the future because there is not as many people who are willing to buy these tranches in the future. He asked Mr. Coleman if they see that as any kind of a possibility?

Mr. Coleman said they have looked at that and when all the sub prime mortages are packaged and AAA securities are made out of them, if everybody shared in a make believe world, it would not be AAA but the credit loss would be distributed unequally to different tranches and the guy at the bottom who is maybe only rated B, a junk bond, is going to have a super equity like return, if things work out well. But if things are marginally worse, the return might be 7% on a dollar, etc. In the bulk of those mortgages, if they are underwritten by Countrywide or Wells Fargo, the AAA piece will likely withstand the default delinquencies at 13 or 14%. He does not think with the AAA's, unless there is fraud involved, that will be a problem.

In some of the other sub pieces, there has not been a lot of defaults yet because enough time has not passed. There will be downgrades and defaults. Largely, the ultimate end user investors that hold those securities are the norm. They are hedge funds, they are junk bond funds. The banks that underwrote them have sold them. They are servicing the loans but they are not holding them. The hedge funds may be ticked at the rating agencies but they do see that as a material impact on the financial system because of the players that largely hold this. The people that they reinvest for, both in the public and private sector, cannot go below BBB. If you can go below BBB, it is only 10% of your assets in which case could be merging markets, high yield bonds and leveraged sub prime mortgages but it is not enough to put somebody under.

Mr. Mikus asked when Mr. Coleman said the canary of the mind is credit spreads and credit spreads are not widening to any significant rate at all, that really surprised him. They are really tight and narrow.

Mr. Coleman said they are very tight. Atlanta Capital manages A and higher and will tend to outperform when credit spreads are widening. At least, they have stopped widening but with each passing event, whether it is Thailand again, they thought maybe that was the event that would be some financial crisis, and it did not happen. There is a sub prime web site, mortgageimplode.com, that keeps track of these things. They started talking about this a year ago and it seems like that has been forever. He does not quite know what to make of it, whether it is international flows, whether it is coming back in with a higher appetite for risk, they are puzzled by it and they think maybe things are not that tight and that is evidenced in the spreads. Because it is a surprise, it is tough to predict.

Page 15 shows how Atlanta Capital is structuring the portfolio today. The committee has heard him drone on about the economy and therefore their average maturity of duration is a little big longer than the benchmark. If rates rise, they will tend to underperform their benchmark, everything else being equal. But they are not because they have again identified those risks, it is not like they are in a maximum long position. They do not think the world is going to end tomorrow and the risks are pretty equally balanced, and Chairman Bernanke, appropriately so, does not appear to be in any hurry. They are a little big longer but not way longer. That has helped them meet the benchmarks the last nine months. It has helped them get back some of the margin that they would have otherwise lost in the SBA. Surprisingly, they are not favoring highest credit quality securities because the spreads are so tight. They do own A rated corporates or can own them but they are lowering their position in all corporates and have not added to those positions in several quarters.

Theoretically, sub prime mortgage securites are AAA. They do not own any anyway so the committee should feel good about that. Tab IV, page 17, will get specific about the Town's portfolio as it relates to mortgages. They get a lot of their yield from the mortgage sector. The 1 – 3 year portfolio is over 35% in mortgage-backed securities. It has not really changed much over time.

He is not fundamentally against corporates per se. It is just that he likes them to have more value and Atlanta Capital has about $8,000,000,000 of equities. They love leverage buyouts, and they love stock buybacks. But as the bond guy, the Rodney Dangerfields of the financial structure, he does not like them. They are kind of tight and narrow spreads and so they continue to be light in those. The intermediate portfolio has not changed much over time as well.

Page 19 is maybe the best chart to show why he does not think that the current sub prime mortgage malaise has anything to do with the portfolio. First of all, he showed the chart that the sub prime has overall but looking at the Town's portfolio, the CMO's and the Agency Backed Mortgages at 88% are backed by Fannie and Freddie. Fannie and Freddie have really small exposure to sub prime anyway and their loss after recovery principally is because they always have mortgage insurance that is less than 1 basis point.

The other AAA rated securities that Atlanta Capital owns that are not backed by Fannie and Freddie are 100% fixed rate loans. Most of the sub primes that are a problem are in the adjustable rate mortgages. Atlanta Capital has had no downgrades let alone defaults. The average loan-to-value of non-agency CMO's is 66%. They accumulate these over time. The average life of non agency backed mortgage bonds is 2.2 years. To the extent that people need mortgage representation, they want to match the index and they want to stay away from sub prime. He stated they feel very good about the securities they hold and if there is anything on the horizon to be downgraded or defaulted because of the mortgage holder, the answer is no. He said he would be glad to answer any additional questions.

Ms. Struder said the first page of the investment report shows out of the total portfolio 15% is in the FMIvT 1-3 year and 5% is in the intermediate. She asked if, based on the performance of the intermediate, the committee feels that they should maintain the ratio in FMIvT going forward through November or should that be modified in any way? She asked Mr. Coleman if he feels the intermediate will continue to outperform the SBA based on the way the portfolio is positioned?

Mr. Coleman said his best guess because of the forecast would be yes. He asked if at the end of the day the Town is long or short of the benchmark? From Atlanta Capital's position, they are longer in maturity. Since the Fed stopped tightening, they have been longer.

Mr. Brown said to the question the committee was just asked by Ms. Struder, would it be better to move some money from the 1 – 3 to the intermediate so there is more of a balance there instead of a 3 to 1 ratio. He asked Mr. Coleman if he has any insight?

Mr. Coleman said he would say that would be more balanced since the bulk of the reserves are still in the SBA. As a portfolio manager, he would like to up the diversification. In some sense, the committee has a large bet and could be right, that it is going to stay at 5.25% for a while. If the committee wants to take some of the chips off the table as they are going through the cycle, that really is a fair thing to do.

Mr. Brown said if Atlanta Capital's economic projections were to come true presumably the intermediate portfolio would outperform the 1 – 3 year portfolio.

Mr. Coleman said it would because the value of the basis point is worth more there. If two year rates go down 10 basis points and 5 year rates go down 8 basis points, the Town will still get more on the 8 but also will get a pretty good price action. Presumably, the short rates will fall more than the long rates do. He thinks all rates are going to come down, and that the maturities closest to cash will come down the most. He still thinks the intermediate will outperform. The average maturity of the intermediate portfolio is out 5 years. The biggest thing is if they are all reserves, just recognize that the committee has a large bet and so far a very accurate bet that rates are stable to increasing.

Chair Andrews thanked both Mr. Higman and Mr. Coleman for the very good presentations.

Chair Andrews asked what the percentages were when the committee started out?

Ms. Somers said 75/25.

Chair Andrews said so they are down from that. He asked what the 5% that was taken out came out of?

Ms. Struder said she thought they pulled the money from the intermediate.

Chair Andrews said he would not be adverse to going out a little bit on the longer side. He asked the committee for suggestions.

Mr. Mikus said he does not have a problem with that. The committee can't get into too much trouble no matter which decision is made because the yield curve is so flat. He does not see any dramatic changes from here. He does not see the yield curve dramatically steepening.

Chair Andrews said he thinks Mr. Coleman is right that they are betting on the Feds for the next six months.

Mr. Brown said he was in charge when the committee first decided to put money away from SBA and that has been wrong. He stated he does not know why the committee would listen to him. Nevertheless, he thinks if the economic projection is right, the Town would get better returns in the intermediate portfolio because the higher rates relative to short term rates would last for a longer period of time. One of the things they could do is to keep the distribution between SBA and Florida League the same as it is today but move some money from the 1 – 3 year to the intermediate and kind of equal them out. If $5,000,000 was moved from the 1 – 3 to the intermediate, that would be about 12 in the 1-3 and about 11 in the intermediate. He would have no problem with it if a modest change like that was made.

Chair Andrews asked Ms. Struder for her opinion about taking some money currently that the Town has to invest and putting it in the intermediate to bring the total percentages with the Florida League of Cities back up since they had a higher total percentage in other investments in the SBA.

Ms. Struder asked if he meant from the SBA into the Florida League?

Chair Andrews said yes.

Ms. Struder said both are fairly liquid even if property tax reform caused them to dip into reserves, they can access intermediate or any of the FMIvT monies within 15 to 30 days notice. It is not like they would be tying up the money for any length of time even though it is a longer term investment.

Mr. Brown said if additional funds from the SBA are going to be put into an alternative investment, he thinks the treasury should be considered as an alternative rather than the SBA.

Mr. Mikus said that would have a higher yield because it is a mix of agency and mortgages, right?

Mr. Brown said right, it will have a higher yield. He asked the Chairman if he is talking about taking $5,000,000 or $6,000,000 from the SBA and put it back into the intermediate?

Chair Andrews said correct. He does not want to reduce their bet too much on the 1 – 3. He does not think they have any problem going up to where they originally were when Mr. Brown was Chairman. One thing it does for the committee is it says they are proactively doing something to position as well as possible under the economy and the information that they have.

MOTION BY MR. BROWN TO MOVE $5,000,000 FROM THE SBA INTO THE FLORIDA LEAGUE INTERMEDIATE PORTFOLIO.
MOTION SECONDED BY MR. MIKUS.
MOTION CARRIED UNANIMOUSLY.

XI. NEXT MEETING DATE

Ms. Struder said she will contact everyone and try to schedule a meeting in November. If the markets change in some way, she will have a meeting in the summer, otherwise, she will plan for November. The quota for meetings has certainly been satisfied this year.

Ms. Struder said she ordered the books, The Politics of Public Fund Investing, for the committees' summer reading enjoyment. The author of this book, Ben Finkelstein, has offered to come and speak to this committee as well. If, after reading the book, the committee would like to have him come and give a presentation, please let her know and she will invite him to come.

She updated the committee on the OPEB. Mr. Randolph is reviewing all the contracts that have come in and he is pretty close to finalizing that. She does have a couple of documents that she needs Chairman Andrews' signature on today that have to do with the State Street Custody Agreement which Mr. Randolph has approved. Chair Andrews will have to come in the next week or so to sign the rest of the documents as Chairman. Hopefully, in the next few weeks, those funds will be invested once all the contracts are finalized.

Chair Andrews asked if that will be part of their normal investment committee meeting going forward?

Ms. Struder said for the retirement boards, Mr. Prime and Mr. Higman come in quarterly so this committee is a little different than that. When the board meets in November, she could make sure Mr. Prime or Mr. Higman will be there for that first meeting to give an update on the status of the investments.

Chair Andrews suggested that be coordinated for the first meeting.

Ms. Struder said she doesn't know if they would need to come monthly but probably to the first meeting and the last meeting.

Mr. Brown said in terms of reporting, the committee has had this conversation before about what they should be reporting on a monthly basis. Basically, they have been reporting how they have done compared to if the money had been left in the SBA. He is not suggesting changing that but he wondered if they might add to it.

Chair Andrews asked if the committee asked for something to be added last time?

Ms. Struder said they talked about the investment policy. It does talk about using the SBA as a benchmark. That was one thing discussed earlier about possibly changing maybe down the road. The consensus was not to make a change now.

Mr. Brown said there was discussion about making a change possibly if they had a fundamental change in the investment policy which he does not think has happened. He thinks it is fine to continue that but there was discussion about the investment income earlier today. There are some very interesting charts in this material like the one that gives the long term comparison with the SBA. It might be a good idea to think about not eliminating that piece of information but supplementing it with additional information so it is not the only piece of information.

Chair Andrews said that is a good idea to be more positively supported with the committee.

Mr. Brown said yes and why the committee is doing what they are doing. The same thing might apply when the opportunity arises, which is not going to be until November now, to report to the Town Council. There are quite a few things that could be said in support of what the committee is doing other than if they had not done anything, the Town would have been better off.

Chair Andrews asked Mr. Brown to tell the committee again his suggestion. Was it to add anything specifically for the next monthly reports?

Mr. Brown said he has not thought through exactly what it should be but he is just saying some additional data on some of the material that the committee gets such as discussed earlier about the total investment income compared, or is that included already?

Ms. Struder said it is on that chart but a section could be added in the cover letter that says year to year.

Mr. Brown said he was thinking that some information should be highlighted in the cover letter. It might not be the same information every month, other than that one piece of information.

Chair Andrews said that what they were talking about with Ms. Somers was the possibility of saying over the last twelve months, they have done considerably better than prior. He asked the committee members to go over this information received from Atlanta Capital, and anything else that they have in the packet. Talk to Ms. Struder about any ideas that they may have and the Finance staff can do that at their leisure and forward to the committee.

Ms. Struder said they can tweak them month by month and the committee can give feedback on whether they thought it was productive.

Chair Andrews said he wants Ms. Struder standing next to him when he gives the presentation to the Town Council in case some of the arrows miss him.

Ms. Struder said maybe by November or December, there will be dramatic improvement.

Chair Andrews said he is ready for that.

Mr. Brown said given the number of new applicants for the committee, they are stuck with us.

XII. ANY OTHER MATTERS

There were no other matters for discussion.

XIII. ADJOURNMENT

MOTION BY MR. BROWN TO ADJOURN THE MEETING.
MOTION SECONDED BY MR. MIKUS.
MOTION CARRIED UNANIMOUSLY.