



COUNTY OF HUMBOLDT

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Judge J. Hinrichs
Presiding Judge Humboldt County Grand Jury
Superior Court of County of Humboldt

May 13, 2015

Re: "The Headwaters Fund Charter" Report Dated 4/2/15

Dear Judge Hinrichs,

Per the above noted Grand Jury report requesting my response to Recommendations 3 and 4 I submit the following:

Recommendation 3 (R3):

I disagree because I believe all funds remaining as part of the Headwaters Liquidity Fund are subject to California Government Codes (GC) 53601 and 53635.

Recommendation 4 (R4):

I disagree that any action be taken to transfer the "Headwaters Fund Investment Portfolio" to the Humboldt Area Foundation unless a determination is made that these funds are not subject to GC 53601 and 53635.

My 2 cents:

As county treasurer I am required to prudently manage funds of the county according to GC 53601 and 53635; and to prioritize investments for safety, then liquidity, and last for yield. I have faithfully invested county funds according to these mandates for the entire period I have been delegated the authority to do so from the County Board of Supervisors (BOS).

The Headwaters Investment Portfolio (HIP) (referred to as the "Headwaters Fund investment portfolio" in R3) could be managed by the county treasurer in perpetuity provided the Headwaters Fund Board (HFB), as authorized by the BOS, did not spend money faster than is generated in interest each year from the corpus remaining.

The HFB loans and grants money from the Headwaters funds into what they believe will create jobs in the local economy. Those grants in particular have reduced the corpus of money

remaining for future use. The report states on page 6, paragraph 3, sentence 2, that: "As of 6/30/2013 the ending balance had dropped approximately \$ 3,300,000 in 3 years". This is a direct result of those Boards spending the Headwaters money faster than could be replenished by investment returns from the Headwaters Liquidity Fund and / or generated from interest on loans from the Headwaters Revolving Loan Fund and the Community Investment Fund.

Interest rates are at historically low levels due to the Federal Reserve's desire to stimulate the economy by making it cheap to borrow money. Unfortunately these unprecedented low rates have greatly reduced the yield available on safe investments such as those allowed by GC 53601 and 53635; hence the low returns shown in the quarterly apportionment rates below from the county pool.

Quarter End:	Rate:
9/30/2012	0.7290%
12/31/2012	0.5600%
3/31/2013	0.4800%
6/30/2013	0.4600%
9/30/2013	0.6700%
12/31/2013	0.7000%
3/31/2014	0.6000%
6/30/2014	0.6700%
9/30/2014	0.7600%
12/31/2014	0.6900%

These low apportionment rates reflect the U.S. interest rate environment and as that environment changes so too will the apportionment rates from the county pool.

Headwaters funds cannot continue to be expended faster than investment returns on the remaining Headwaters corpus and still be held for perpetuity. Expressed another way, investment returns must be greater than or equal to the Headwaters money being expended or the requirement that the money last for perpetuity cannot be met, no matter whether the funds remain in the county pool as part of the Headwaters Liquidity Fund, or are transferred to the Humboldt Area Foundation (HAF) and invested according to mandates under which they manage those funds.

The first determination to be made is whether the Headwater funds are 'public funds' and if so whether any of those funds may be invested outside the confines of GC 53601 and 53635. Public funds are generated by the government and used by the government to provide goods and services to the public.

If the BOS decides that it is appropriate and lawful to transfer the HIP to the HAF I will offer any assistance necessary to ensure a smooth transfer of those funds.

In response to the 'Perpetuity' section (page 6 and the top of page 7) of the report, I make the following comments:

The Grand Jury (GJ) either knows for a fact, or assumes, that the HIP may be invested outside the confines of California Government Code. I as County Treasurer must invest within those guidelines. I reiterate this again because the Grand Jury's premise in this 'perpetuity' section is that the HIP need not be invested within those same guidelines that I must follow; therefore they recommend it be transferred to HAF and be invested in a way so returns exceed the "cost-of-living index average".

The GJ also notes in this section that the BOS approved up to 10 million dollars of the Headwaters Fund be invested outside the county investment pool. This is correct, and at present 7 million dollars has been set aside in the HIP and tracked as a separate account from the county pool. The only investment related differences between the rest of the county pool and the HIP are that funds in the HIP are now authorized by the BOS to be invested in specific types of securities with longer maturities than 5 years (as is allowed in CG 53601) and as are designated in the County of Humboldt 'Statement of Investment Policy' dated June 3, 2014. No other funds in the county pool are allowed to be invested in securities with maturities longer than 5 years. In addition, the HIP money does not need to be managed for short term liquidity purposes because the HFB said the HIP is set aside strictly for perpetuity; meaning the entire 7 million dollars is fully invested and now generating approximately 2% interest on an annual basis. Those securities with longer than 5 year maturities allow the HIP to capture some extra yield and thereby increase the money available for Headwaters purposes or for rebuilding the principle balance.

In conclusion, I do not object to Headwaters Investment Portfolio funds being transferred to the Humboldt Area Foundation provided those funds are invested within the guidelines of California Government Code, or provided it is legally determined that the Headwaters Investment Portfolio funds do not need to be invested according to California Government Code; which would then allow Humboldt Area Foundation to invest those funds according to 'Prudent-Person Rule' guidelines and to invest in any way they believe appropriate.

Please let me know if there is a need for further clarification, or if there is any other way I may be of service.

Sincerely,

John Bartholomew