

August 13, 2018

Mendocino County Governing Body and Pool Participants

**RE: Impact on GASB 31 Adjustments**

Interest rates have risen steadily over the past two years due to a number of economic and federal reserve policy factors. This rise in interest rates has impacted the County's portfolio in two significant ways. Reinvestments of maturities into the increasing interest rate environment have resulted in an increase in interest income, providing the County with higher revenues than previous years. At the same time, the increase in interest rates has also negatively impacted the underlying value of the existing securities in the portfolio, as values for fixed-income securities fall when interest rates rise. The rise in rates will result in a non-cash charge on the County's year-end audit and CAFR to the investment earnings at fiscal year-end, as required by GASB 31 reporting requirements. The non-cash charge involves "paper losses," since the majority of the losses are unlikely to be realized because the securities are likely to be held to maturity. It may be of interest to note that in the past, we have observed drops in market value due to rising rates are generally made back over time from higher interest earnings and/or as the pace of the interest rate increases subsides in the future.

At the inception of our relationship with the County, Chandler worked with Shari Schapmire, Treasurer of Mendocino County, and her staff to develop a strategy to ensure adequate cash flow while increasing the earnings of the portfolio. The Limited Maturity strategy was selected to meet those goals along with mitigating negative market value impacts resulting from higher rates while increasing the earnings of the portfolio. As mentioned above, the accounting impact from the GASB 31 adjustment is a non-cash charge and is calculated as the difference between the portfolio's current fiscal year-end market value minus the previous fiscal year-end market value. Since the County has a strategy with a higher average maturity than investment vehicles with very short maturities, such as LAIF, its portfolio's market value is more sensitive to changes in interest rates. Despite the lower current valuations due to the recent rise in interest rates, on average, the County has greatly benefitted from a longer average maturity strategy since inception. Chandler believes the current strategy has served the County well, and we will continue to work with the Treasurer and her staff to ensure the strategy remains in line with the County's goals.

We recognize the GASB 31 non-cash charge can negatively impact the County's financial statements in the short-term, but the ability to focus on the long-term will help the County to optimize its portfolio earnings over time.

Sincerely,



Jayson Schmitt, CFA  
*EVP, Portfolio Manager*