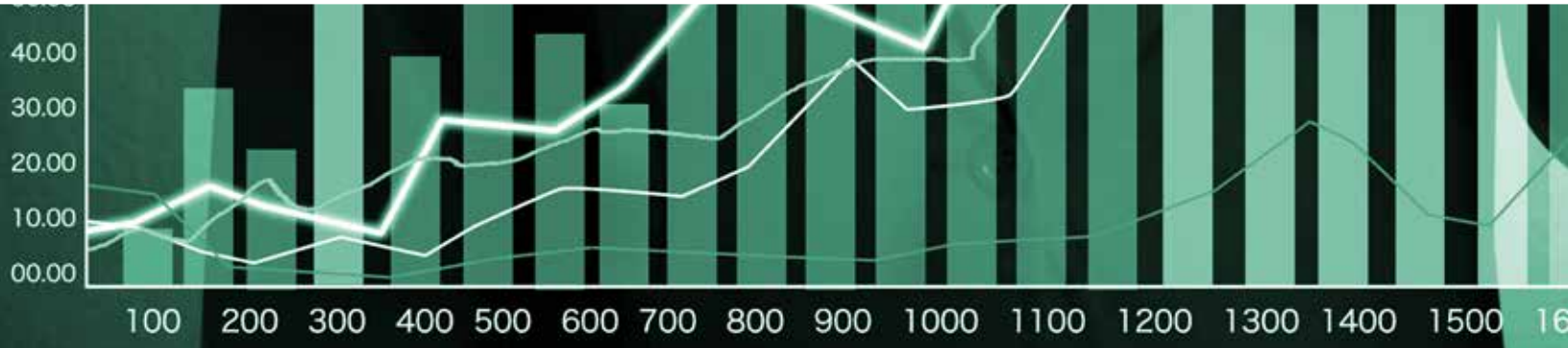
Annual Investment Guide

Palm Beach County, Florida
Fiscal Year Ended September 30, 2014



Prepared by the Clerk & Comptroller, Palm Beach County

Sharon R. Bock
Clerk & Comptroller
Palm Beach County

Clerk & Comptroller Sharon R. Bock, Esq., holds a Juris Doctorate, has earned insurance and securities licenses Series 7, 63 and 65 and has been certified as an Accredited Investment Fiduciary®. Elected to office in 2004, one of Clerk Bock's top priorities is to educate the public about how tax dollars are managed and spent.

Dear Residents,

As your elected Clerk & Comptroller, I am the County Treasurer and one of my most important responsibilities is safeguarding and managing taxpayer dollars. This includes overseeing the County's $1.5 billion investment portfolio (see **Portfolio Allocation**, *page 3*).

During Fiscal Year 2014, my office achieved a total return of 1.24 percent, continuing to be one of the best performing counties throughout the state of Florida. My highly skilled team of Accredited Investment Fiduciary® professionals earned $31.1 million in interest income, saving each property owner $49 (see **Portfolio Income**, *page 5*).

We ensure your hard-earned tax dollars are protected by using the same diligent management strategies as industry leaders (see **Investment Strategy**, *page 9*). These strategies incorporate Bloomberg, a state-of-the-art financial system that allows access to real-time financial, market and economic information; and Clearwater Analytics, an independent source for web-based investment accounting and reporting, including performance measurement and risk analysis.

As a taxpayer, I encourage you to read this guide to become familiar with how your tax dollars are invested. In addition to this *Investment Guide,* my office also produces *Checks & Balances: Your Guide to County Finances*, the *Annual Debt Guide* and the *Comprehensive Annual Financial Report*. These award-winning publications can be accessed online at www.mypalmbeachclerk.com/countyfinances.

It is an honor and a privilege to serve as your Clerk & Comptroller, and I remain committed to promoting transparency in how your tax dollars are managed, invested and spent.

Best regards,

Sharon R. Bock, Esq.
Constitutional Clerk & Comptroller, Palm Beach County

About This Guide

As Palm Beach County's Chief Financial Officer, the Clerk & Comptroller is charged with safeguarding all county funds and providing the necessary checks and balances on the County's budget, revenue and spending. As Treasurer, the Clerk is responsible for investing and earning revenue on your tax dollars until that money is needed to pay County expenses.

In this *Annual Investment Guide*, you will get an in-depth understanding of the County's investment portfolio and an overview of how the Clerk's office managed the portfolio during the fiscal year that ended on September 30, 2014, and previous fiscal years. This guide outlines portfolio composition and its growth, income, the markets and the economy, risk management strategies and depository banking. The Clerk's management of the portfolio is in accordance with regulations set forth in Palm Beach County's Investment Policy (see *page 8*).

As part of our ongoing commitment to transparency in government, this *Annual Investment Guide* is one of the Clerk's many financial publications made available to the public. It is derived in part from the award-winning *Comprehensive Annual Financial Report* (CAFR) for the fiscal year that ended on September 30, 2014, and other financial reports. All Clerk financial reports including the *Annual Debt Guide*, CAFR and its condensed and simplified version, *Checks & Balances: Your Guide to County Finances*, are available online at www.mypalmbeachclerk.com/countyfinances.

The Clerk maintains an accurate and complete set of financial records in order to produce all required financial statements and reports to comply with state and federal laws and generally accepted accounting principles. The management of public funds is markedly different than that of private funds. The Clerk & Comptroller's investment management activities are restricted by specific investment policy guidelines related to investment types (no equities, only fixed-income), risk diversification, maturity, investment quality, performance measurement, selection of qualified dealers and issuers, safekeeping of securities and reporting requirements. A copy of the County Investment Policy is available at www.mypalmbeachclerk.com/investments.

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The Palm Beach County Investment Ordinance, adopted in 1987, built flexibility into the County's investment program by establishing a framework for a formalized investment policy that expanded investment alternatives and set standards beyond those as dictated by state statute. The ordinance also provided for the creation of the Palm Beach County Investment Policy Committee (IPC).

The Clerk & Comptroller of Palm Beach County was the first county government office in the country to become certified by the Centre for Fiduciary Excellence (CEFEX) indicating that fiduciary best practices are used when managing County funds. The Clerk's office has been certified for five consecutive years, reaffirming the office's commitment to fiduciary best practices in the areas of recordkeeping, investment policies, investment committee and portfolio management.

Clerk & Comptroller's Internal Investment Advisory Committee

The Clerk & Comptroller's Internal Investment Advisory Committee meets regularly to review the portfolio, discuss broad issues and consider performance. The committee includes the Clerk, members of the treasury team, legal counsel and the Investment Compliance Officer. The committee increases the degree to which investment management decisions are based on a consensus approach to meeting stated goals and objectives. For FY 2014, membership of the committee was as follows:

Sharon R. Bock, Esq.
Clerk & Comptroller,
Palm Beach County

Shannon Ramsey-Chessman,
CPA, CGFO
Chief Operating Officer of Finance

Darlene Malaney, CIMA
Director of Finance Services

Felicia Landerman, AIF, CTP
Investment Manager

John Burford,
Investment Analyst

Steve Weiss,
Compliance Officer

Investment Policy Committee

The Board of County Commissioners appoints members of the Investment Policy Committee from the public and private sectors. The committee works in conjunction with the Clerk & Comptroller to develop and evaluate the County's investment policies. For FY 2014, membership of the committee was as follows:

Hal R. Valeche, Chair
Palm Beach County Commissioner

Stephen Freilich, CFA, Vice-Chair
Senior Fixed Income Portfolio
Manager, Suntrust Bank

Liz Bloeser
Director, Office of Financial
Management & Budget,
Palm Beach County

Jim Davis
Director of Administrative Services,
Palm Beach County Sheriff's Office

Joseph D. Hill, Jr.
Citizen-At-Large

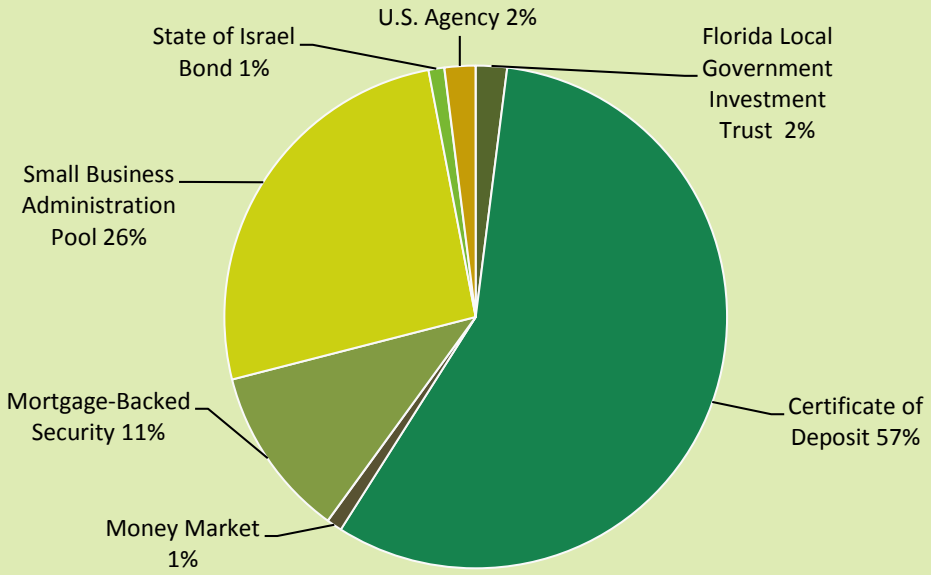
William Moore
Citizen-At-Large

Ned Nashban, Esq.,
Partner Akerman, LLP

Portfolio Allocation & Performance

During FY 2014, the Clerk-managed investment portfolio averaged $1.5 billion and ended the fiscal year totaling $1.31 billion. During the fiscal year, the book yield averaged 1.91 percent, the market yield averaged 1.39 percent and the duration on average was .72 years. The portfolio earned approximately $31.1 million in interest income during the fiscal year, exclusive of any realized or unrealized gains or losses. The portfolio allocation at fiscal year-end is depicted in the chart below. More details on portfolio holdings are available under the Public Funds section of the Clerk's website at www.mypalmbeachclerk.com/investments.

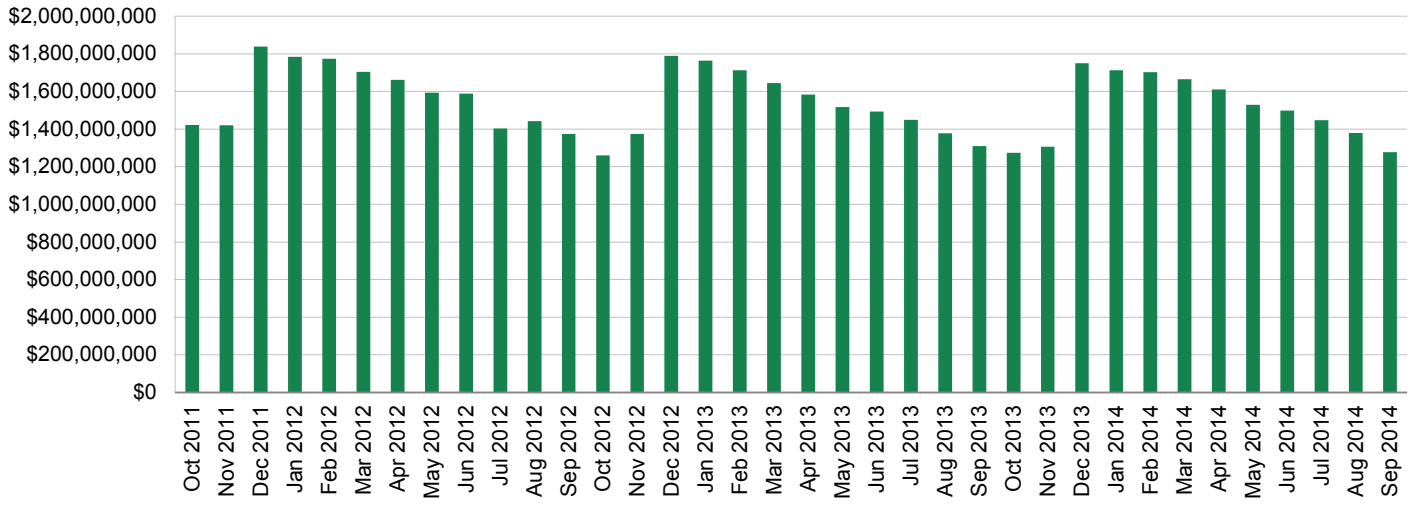
Portfolio Allocation as of September 30, 2014



Portfolio Growth

The graph below illustrates the County investment portfolio's size during the past three fiscal years. Changes from month to month reflect net cash flow as well as growth due to investment income. The trend of high portfolio balances in December of each year is a result of the timing of citizen property taxes payments. Portfolio balances decline throughout the year as the County pays its financial obligations.

Investment Portfolio FY 2012-FY 2014



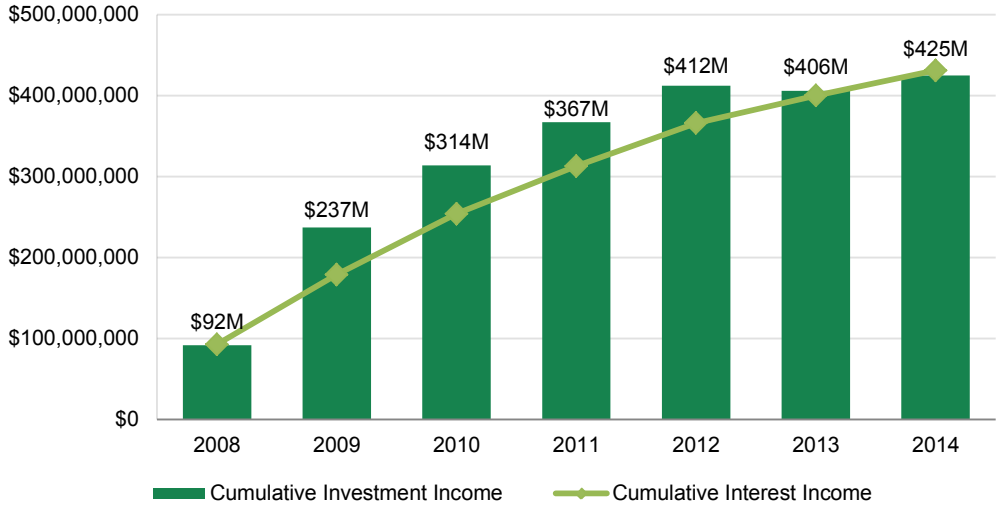
Portfolio Income

The Clerk's office invests idle County funds that are not currently being used to earn investment income and decrease the burden on taxpayers. Despite a weak economy and persistently low interest rates during FY 2014, the Clerk-managed portfolio earned $31.1 million in interest income, which is $49 per property owner.*

Income generated by County investments is dependent upon many factors such as the interest rate environment, economy and size of the portfolio. The graph below illustrates the amount of interest and investment income (including realized and unrealized gains/losses) generated over the past seven fiscal years. Performance over this period is measured on a total return basis.

**Based upon 629,345 parcels on which taxes were paid in Palm Beach County.*

Cumulative Investment Income By Fiscal Year



Sources of County Funds

Palm Beach County's overall investment portfolio contains funds that come from a variety of sources. During FY 2014, 53 percent of the County's total revenue came from property taxes, also known as ad valorem taxes. Other major sources included charges for services (20 percent), grants and other (12 percent), state-shared revenue (8 percent), other local taxes (7 percent) and franchise fees (2 percent).

Funds are fiscal and accounting units that record cash and other financial resources as well as related liabilities and equities. When revenues come in, they are recorded into individual funds, which are classified according to their purpose. The investment portfolio is comprised of numerous fund types, including Governmental Funds, Enterprise Funds, Agency Funds and Internal Service Funds.

Governmental Funds have the largest share of the investment portfolio and include the General Fund (County's main operating fund), Debt Service Funds, Special Revenue Funds, and Capital Project Funds. Enterprise Funds participating in the investment pool include the Department of Airports and the Water Utilities Department. Agency Funds represent the Sheriff, a constitutional officer and Internal Service Funds include risk management insurance funds.

Depository Banking

When the County's revenues are collected, such as property taxes or parks and recreation fees, they are temporarily deposited into a main bank account. Just as individuals earn interest on savings accounts, the County earns interest on funds reserved for current and future expenses. When the funds are not being used for a particular service, the Clerk's office invests them to earn interest income from higher yielding assets. In order for the County to pay its expenses, such as payroll or vendor payments, the Clerk's office ensures that the portfolio is adequately liquid to meet all payment obligations. In order to maximize interest earnings on very short-term cash, the Clerk either invests overnight funds in a competitive money market account, or keeps them in the bank depending on the earnings credit rate offered.

A large percentage of local governments that lack the professional staff, skill and sophistication to implement an effective investment program will invest most, if not all, of their funds in the local depository or a Local Government Investment Pool. Unfortunately, these local governments do not maximize the earnings potential on idle funds.

Wells Fargo Bank, N.A. serves as Palm Beach County's main depository bank. A portion of the County's portfolio is invested in certificates of deposit and money market accounts at other financial institutions. In accordance with Florida Statute 280, all public deposits must be secured in Qualified Public Depositories (QPD). Wells Fargo Bank, N.A. is a QPD and all deposits are collateralized pursuant to state law. The collateral requirement for QPDs is determined by the chief financial officer of the State of Florida.

The Clerk & Comptroller created the Investment Council of the Palm Beaches in 2012. This is a group of government finance professionals who wish to share ideas and learn best practices. The council meetings are held quarterly to semi-annually, and are hosted by the Clerk & Comptroller's office. The meetings are open forums to discuss techniques to help manage investment portfolios.

Investment Policy

The County Investment Policy is very specific in terms of its stated investment objectives. The primary objective is to prevent any loss of principal and, secondarily, to meet the County's needs to pay budgeted expenses as they are due throughout the year. After meeting these two objectives, the Clerk consistently and actively seeks opportunities to maximize investment income in order to reduce the financial burden on the taxpayers of Palm Beach County. This formal document, approved by the Board of County Commissioners, addresses issues such as authorized instruments, risk diversification methods, internal controls, program monitoring, performance measurement, qualified dealers and competitive bidding.

The Markets and the Economy

The U.S. economy continued to recover throughout the year. Real Gross Domestic Product (GDP) increased at a 2.8 percent annual average pace in the four quarters ending September 2014. On the same basis, revised data show that the average pace of quarterly growth was 2.3 percent in FY 2013, 2.8 percent in FY 2012 and 1.2 percent in FY 2011. The uneven pattern of growth was supported by all sectors: consumers, business, exports and government spending.

The Federal Reserve (Fed) is forecasting normal real GDP growth of around 3 percent over the next year, a medium-term return to 2 percent inflation and full employment. The Fed defines full employment as an unemployment rate in the range of 5.2 percent to 5.5 percent accompanied by rising wages near the 3 percent level annually. The Fed has hinted that short-term interest rates will be increased in mid-2015 and has forecast a 1 percent level by the end of 2015. However, consumer spending remains restrained and uneven, rotating from vehicles to clothes, to food, to fuel, but not strong in all areas simultaneously. Tighter credit criteria and high legacy debt levels from the recent 2005-2006 boom continue to curb spending. Corporate profit margins have hit a record high of 10 percent, but business investment remains confined to technology with quick payback intervals and not long-term capacity-increasing projects or innovations research with uncertain long-term payoffs. Most investment is aimed at reducing the need for labor to enhance productivity. Federal government spending restraint from the caps imposed by the budget compromise of 2011 have reduced fiscal stimulus to the economy. State and local spending has increased, but very slowly as finances improved. The strong dollar and slowing global growth suggest that U.S. exports may weaken. Overall, a persistent 2.5 percent trend growth in real GDP, low inflation (below 2), and labor market slack (limited wage gains) imply low interest rates for an extended period before they tilt slightly higher.

Modest growth and low inflation trends are likely to mean limited fixed-income investment returns for the next fiscal year. It seems unlikely that the current mix of economic and financial market trends will lead to inflation, an economic boom and a surge in interest rates.

Investment Strategy

In FY 2014, the Clerk's investment strategy was designed to maximize performance during a period of low interest rates with increased risk that short-term interest rates and bond yields might move higher as the economy recovered. During FY 2014, yields rose and then declined, while remaining in a low return range. The current low rate environment and the potential for Fed rate increases in the middle of 2015 provide incentives for a short duration, low volatility strategy. These investment strategies fall within the guidelines of the County Investment Policy, whereas safety of principal is paramount.

The Clerk actively monitors the financial markets and global economy to identify value in the market consistent with the investment policy's foremost objective of safety, followed by liquidity and earning a market rate of return. All tactical measures employed are in accordance with the risk parameters as set out in the investment policy. Asset allocation decisions are fluid and change with evolving market conditions.

Investment Tools

While implementing industry best practices, the Clerk's office utilizes numerous tools in order to effectively implement strategies. The office subscribes to Bloomberg, which is a state-of-the-art financial system that allows access to real-time financial, market and economic information. The system is also a tool to perform complex and detailed analyses of investment securities of all asset classes. As an independent source for web-based investment accounting and reporting, including performance measurement and risk analysis, the office uses Clearwater Analytics.

The Clerk's investment professionals use other complex software and systems that assist in determining the resulting effects of fluctuating interest rates and in performing horizon analysis. These systems and tools may provide in-depth analysis of the collateral characteristics on asset-backed investments such as mortgage-backed securities and Small Business Administration pools. Portfolio optimization models are employed to analyze which securities may perform best, taking into consideration risk tolerance and constraints while adhering to the investment policy. A brief explanation of relevant investment risks and how the Clerk's office addresses these risks follows on page 10.

Strategic Risk Management

The Clerk & Comptroller's office achieves a balance between certain types of risk and portfolio return. These different risks fall into four basic categories:

CREDIT RISK is the possibility that the security issuer defaults and does not return the investor's principal. The Clerk addresses credit risk by primarily focusing on either explicitly guaranteed U.S. government debt or highly rated Government Sponsored Enterprise (GSE) debt. The portfolio may contain minimum exposure to corporations that are also highly rated.

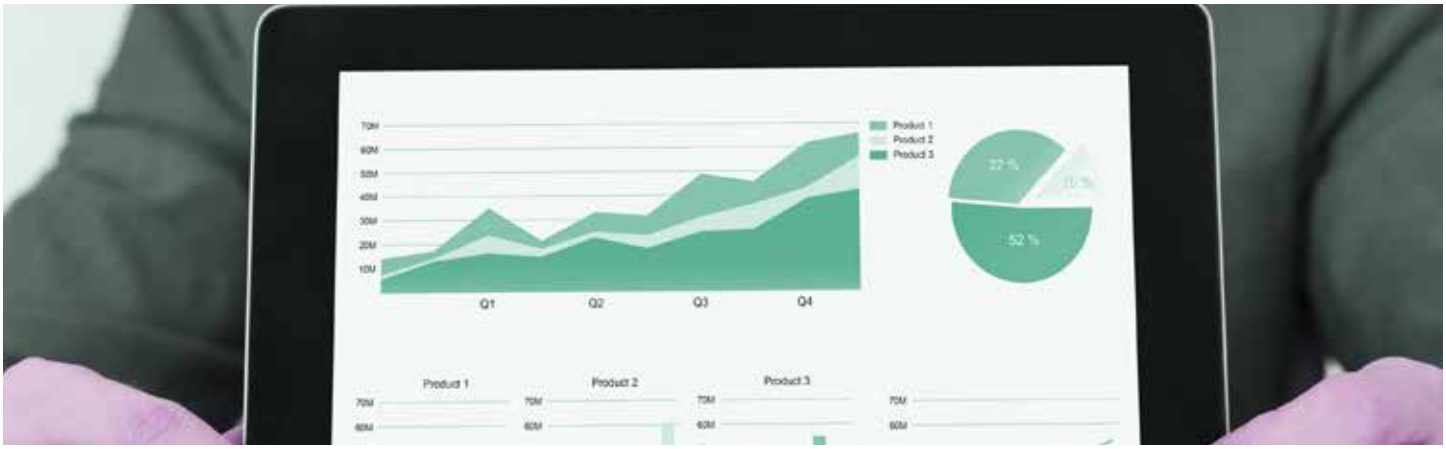
DIVERSIFICATION RISK is the potential for loss resulting from over-weighting investments in a specific maturity, issuer, instrument or a class of instruments. The Clerk spreads exposures broadly among many of the U.S. government agencies, Government Sponsored Enterprises (GSEs), AAA-rated money market accounts and Qualified Public Depositories. Diversification exists within the issuing entities by varying the maturity and other characteristics of the investment structures, such as the underlying collateral.

INTEREST RATE RISK comes from the market price volatility that fixed-income investments experience due to changing market interest rates. The Clerk structures the County's portfolio to maintain an average effective duration appropriate to market conditions, relative investment yields and the economic outlook in order to manage this uncertainty. The effective duration is a measurement of the price sensitivity of the principal value of investments due to changes in interest rates. With rates continuing to remain at historic lows, the focus has been to dramatically reduce interest rate risk to mitigate portfolio volatility by emphasizing shorter duration fixed income investments.

LIQUIDITY RISK is the cost associated with converting any investments to cash. The Clerk works with the County's Office of Financial Management and Budget to lower this risk by effectively forecasting cash flow needs and ensuring a steady flow of cash into the portfolio as needed, from maturing and amortizing assets to the general revenues of the County. In addition, a predetermined level of cash is invested in money market accounts to address any unanticipated liquidity needs that may arise during the fiscal year.

Investment Compliance

In order to maintain an internal control structure that allows for the segregation of duties and authority, the Clerk has an internal investment compliance officer that is independent from the investment management process. The role of the compliance officer is to review each and every trade from the bottom-up to ensure compliance with the County Investment Policy. Additional responsibilities include reviewing performance reporting, risk analysis and monitoring authorized broker/dealers. The compliance officer ensures independent oversight, fiduciary responsibility, transparency, disclosure and prudent checks and balances.



Investment Sector Descriptions

U.S. AGENCY securities are the debt obligations issued by Government Sponsored Enterprises (GSEs) created by Congress to fund loans to certain groups of borrowers such as homeowners. They include bonds issued by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) among other lending instutions. These bonds are sponsored, but not guaranteed, by the U.S. government. In 2008 both FNMA (Fannie Mae) and FHLMC (Freddie Mac) were placed into U.S. government conservatorship with the Treasury taking controlling ownership.

MORTGAGE-BACKED SECURITIES are backed by the U.S. government and represent ownership interests in mortgage loans made by financial institutions to finance borrowers' purchases of homes or other real estate. Mortgage-backed securities are created when these loans are packaged, or "pooled," by issuers or servicers for sale to investors. As the underlying mortgage loans are paid off by the homeowners, the investors receive payments of interest and principal. At various times, the investment portfolio has included three types:

Fixed-Rate Mortgage-Backed Securities are pooled groups of mortgage loans that have a fixed interest rate. Maturities vary from 15 to 30 years with principal and interest payments paid to investors, typically monthly.

Variable Mortgage-Backed Securities are groups of mortgage loans in which the interest rate changes at regular intervals to reflect fluctuations in general market interest rates. The adjustments are based on an index such as the interest rate on U.S. Treasury bills or the London Interbank Offered Rate (LIBOR). There are often limitations on the interest rate change from one period to the next with rate caps for either the period, the life of the loan, or both.

Collateralized Mortgage Obligations are pools of mortgage-backed securities that are structured and separated into short, medium and long-term positions called tranches. Tranches are designed to pay different rates of interest to investors depending upon their maturity and priority of cash flows. Interest payments are usually paid monthly. The County Investment Policy specifically addresses the classes of tranches that may and may not be purchased.

Investment Sector Descriptions

SMALL BUSINESS ADMINISTRATION (SBA) POOLS represent ownership interests in assembled pools of small business loans guaranteed by the SBA. The U.S. government guaranteed portion is bought and sold on the secondary market to form these pools. The yields on the pools adjust either monthly or quarterly to the prime rate, providing excellent interest rate sensitivity.

STATE OF ISRAEL BONDS are backed by the full faith and credit of the State of Israel, which is rated A by the S & P ratings service. Maturities on these investments are limited to a maximum of 3 years or less. No more than 1 percent of the total portfolio at market value at the time of purchase may be invested in these securities.

FLORIDA LOCAL GOVERNMENT INVESTMENT TRUST A Local Government Investment Pool (LGIP) organized in 1991 through the joint efforts of the Florida Association of Court Clerk and Comptrollers (FACC) and the Florida Association of Counties (FAC). This short-term bond fund seeks to maintain safety of principal and maximize yield through a balance of quality and diversification. The fund has a fluctuating net asset value (NAV) and provides returns generally in excess of money-markets instruments. The fund is professionally managed by the investment management firm Payden & Rygel.

CERTIFICATE OF DEPOSIT

A certificate of deposit (CD) is similar to a savings account in that the investor is paid interest on money deposited in a financial institution. However, greater interest is earned on CDs in exchange for agreeing to leave the money on deposit for a set period of time. Funds may be withdrawn early, although there is usually a penalty associated with this action. CDs are a safe investment and are made in Florida Qualified Public Depositories. All deposits are fully collateralized pursuant to Florida law.

About the Clerk & Comptroller's Office

As the third largest of the 67 Clerk's offices in Florida, the Clerk & Comptroller of Palm Beach County serves a local population of nearly 1.4 million residents. The office performs more than 1,000 different functions and provides services from several locations throughout Palm Beach County and online at www.mypalmbeachclerk.com.

More than 170 years ago, the Florida Constitution established the Clerk & Comptroller as an independent public trustee, directly elected by the public to serve four major functions:

CHIEF FINANCIAL OFFICER, TREASURER, CLERK OF THE BOARD OF COUNTY COMMISSIONERS

- Serves as an independent check and balance on Palm Beach County's revenue, debt and spending.
- Invests and earns interest income on County funds, reducing the tax burden on the residents.
- Maintains financial records and produces financial statements and reports.
- Documents and maintains the minutes, records and activities of government meetings, including Palm Beach County Commission meetings, and is Clerk to the County's Value Adjustment Board.

CLERK OF THE CIRCUIT COURT

- Protects the integrity of public records and public funds as an independent impartial third party, directly accountable to the citizens.
- Electronically receives, processes and files all civil and criminal court documents; protects evidence; disburses all court fees, fines and costs; and provides the public with access to court records in paper and online.
- Manages the County's jury system, issues marriage licenses and provides a state-of-the-art Self Service Center for residents representing themselves in court.

COUNTY RECORDER

- Maintains the Official Records of the County dating back to 1909.
- Electronically records documents such as mortgages, deeds, liens, judgments and marriage licenses and makes images available online.

INSPECTOR GENERAL/AUDITOR

- Provides independent and objective auditing and investigative services to the County ensuring the efficiency of operations and uncovering waste, fraud and abuse.
- Audits court-appointed guardianships and operates the Guardianship Fraud Hotline to detect and deter financial abuse and mismanagement.
- Audits all County funds ensuring expenses are lawful, serve a public purpose and have a sufficient budget.

The Clerk & Comptroller's website at www.mypalmbeachclerk.com makes many services available online, including court case record searches, Official Record searches, Value Adjustment Board petitions, foreclosure sales, County financial information and County Commission meeting minutes and video.

SHARON R. BOCK
Clerk & Comptroller
Palm Beach County

www.mypalmbeachclerk.com

The independent Clerk & Comptroller serves a local population of nearly 1.4 million residents from several locations throughout Palm Beach County and online at www.mypalmbeachclerk.com

ONLINE SERVICES:

- County Financial Information
- Court & Official Records Searches
- Traffic Ticket Payments
- Online Foreclosure & Tax Deed Auctions
- myMinutes
- myVAB
- Self Service Court Forms
- Guardianship Fraud Hotline
- Marriage License Information
- Passport Applications
- Domestic Partnership Information
- eRecording & E-Filing of Documents