COUNCIL AGENDA 06/09/09
ITEM 2.6

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: City Council

FROM: Mayor Chuck Reed
Councilmember Sam Liccardo
Councilmember Madison Nguyen

SUBJECT: **Annual Review and Update of the City's Investment Policy**

DATE: June 5, 2009

APPROVED: Chuck Reed 6-5-09
Sam Liccardo RH Madison P. Nguyen NV

RECOMMENDATION

1. Return to appropriate Council committees with analysis of the feasibility of altering the City's Investment Policy to permit the Director of Finance to consider, as one factor in his decision for making an investment or savings decision, the extent of a financial institution's commitment to or effectiveness in assisting homeowners facing foreclosure within the City of San José in addition to the already existing objectives of safety, liquidity and yield.
    a. Such consideration would be limited to decisions involving those savings or investment vehicles--such as a banker's acceptance (BA), time deposit, certificate of deposit (CD), or other instrument—offered by institutions that engage in those financials services as well as mortgage lending.
    b. The financial institution's commitment may be demonstrated by specific outcomes, or if staff finds that an outcome-based approach too difficult to implement, it may evinced by active participation in specified state or federal foreclosure-relief programs.
2. If the City Manager finds such an approach to be feasible, return to council with a revised Investment Policy that would contain a new paragraph "D" to ¶4.0, "Objectives," relating to an additional objective: foreclosure mitigation, considered only after safety, liquidity and yield.
3. Ensure that any investment vehicles or instruments selected by the Director of Finance continue to comply with the objectives, procedures and internal controls of the City's Investment Policy.

BACKGROUND

As of early 2009, about 1.7% of our San José households sat in some state of foreclosure—either receiving a default notice, facing auction sale, or in repossession. In the lower-income neighborhoods of Central and East San José the problem increases with foreclosure filings ranging from 3% to 5%. Additionally, the foreclosure crisis has broader impacts, with spillover impacts on struggling neighborhoods beset by falling home values. Municipalities suffer as property values depreciate, tax revenues decline and public services wane.

Although federal mitigation programs have emerged, substantial gaps still leave many San José residents without relief. The 2008 HOPE for Homeowners legislation assisted only homeowners that could meet a 90% loan-to-value requirement. President Obama's Homeowner Affordability and Stability Plan broadened the scope to families needing to restructure or refinance their mortgages, but it does not help families who are already facing foreclosure. It also does not help those who are so "underwater" as to have a higher than 105% debt-to-value ratio on their home.

As we look forward, the problem may only worsen as the number of "resets" of adjustable mortgages peaks in 2011, corresponding with a sudden escalation in the monthly mortgage burdens of thousands of San José families. Financial industry analysts predict an imminent increase of nationwide commercial real estate foreclosures that will drive additional tightening in our barely-thawing credit markets. For these and other reasons, the Center for Responsible Lending projects that 2.4 million foreclosures will occur in 2009, but as many as 9.0 million during the entire period from 2009 - 12.

These unique circumstances call for unconventional approaches. We recommend staff analysis for leveraging the City's role as a consumer of banking services, to obtain commitments from those banks for "workouts" and refinancing of mortgages of struggling San José homeowners.

After staff analysis, implementation would likely require a small revision to the City's investment policy, to include "foreclosure mitigation" as an additional objective among the objectives described in Section 4.0. The existing Investment Policy objectives—consisting of safety, liquidity, and yield—would continue to remain the primary and secondary objectives. Where savings vehicles appear nearly identical among those criteria, we would create some incentive for banks to commit to assisting homeowners. For example, the Director of Finance might determine that where yields on competing short-term certificates of deposit (CD's) lie within 10 basis points, the City will choose to invest with the bank that makes a foreclosure mitigation commitment of some predetermined type. Alternatively, the Finance Director might announce that a particular batch of time deposits or bankers' acceptances (BA's) will be restricted to those banks that participate in a federal loan refinancing program within San Jose.

This policy would not expand the universe of financial institutions eligible to do business with the City (See ¶7.0.A. and B. of the proposed Investment Policy), nor would it impose any risks on the City or its taxpayers. The scope of application appears limited; likely only a few tens of millions of dollars out of the billion-plus in the City's reserves are invested in any investment or savings vehicle that implicates a lending institution.

A minor alteration of the City's Investment Policy to benefit local residents has precedent. The current policy already requires that Time Deposits must be invested in federally-insured institutions "with offices located in the San José area," a provision intended to boost local business. The fact that some social or broader economic factors play a role should not give hesitation, since far more attenuated social goals have traditionally played a role in municipal investment policies--such as the widespread refusal of many municipalities to invest in companies doing business in South Africa in the 1980's, or in those cities with "socially responsible investor" requirements. We look forward to staff study of this issue, in the hope that we can take concrete steps to improve a troubling economic period for thousands of San José families.