CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: Making Government Work Better Committee

FROM: Scott P. Johnson

SUBJECT: **QUARTERLY SUMMARY - CITY'S INVESTMENT REPORT**

DATE: February 3, 2004

Approved

Date

RECOMMENDATION

It is recommended that the Making Government Work Better Committee take the following actions:

1. Accept the City's Investment Report for the quarter ended December 31, 2003; and

2. Recommend to the City Council that it adopt a resolution to revise the City of San Jose Investment Policy to change the frequency of the reporting of the investment activity from monthly to quarterly.

BACKGROUND

As part of its workplan for the six months beginning January 2004, the Making Government Work Better (MGWB) Committee has requested a quarterly report from the Finance Department on the City's investment activity. A summary of investment activity is included in this report that highlights the investment activity for the quarter ended December 31, 2003.

Consistent with the City's Investment Policy, the City's Investment Report is currently prepared on a monthly basis and distributed as an informational item to the Mayor, City Council, City Manager and City Auditor no later than the last day of the month for the preceding month's investment activity. Staff is recommending Council's approval to revise the City's Investment Policy, changing the frequency of the reporting of investment activity from monthly to quarterly. This recommendation, which meets the investment reporting requirements for local agencies as

required by the State of California Government Code Section 53646, streamlines the reporting process consistent with the MGWB Committee workplan while reducing the time requirements and expenditures associated with preparing a monthly report.

ANALYSIS

Summary of Investment Activity - Quarter Ending December 31, 2003

The information presented below highlights the investment activity for the quarter ending December 31, 2003. As a comparison, information for quarters ending September 30, 2003 (the immediately preceding quarter) and December 31, 2002 are also provided.

	Quarter Ending December 2003	Quarter Ending September 2003	Quarter Ending December 2002
Total Portfolio:			
Idle funds invested as of end of quarter	$1,349,105,290.37	$1,263,458,650.39	$1,360,526,551.10
Earned interest yield	2.769%	2.852%	3.595%
Portfolio effective yield	2.713%	2.801%	3.606%
Dollar-weighted average days to maturity	405	329	307
Portfolio Fund 1:			
Idle funds invested as of end of quarter	$1,097,262,879.42	$1,102,455,169.28	$1,182,847,374.06
Earned interest yield	2.971%	3.021%	3.778%
Portfolio effective yield	2.984%	3.008%	3.804%
Dollar-weighted average days to maturity	491	374	348
Total Portfolio Income Recognized:			
Net interest earnings	$8,809,835.94	$9,538,797.78	$13,104,416.71
Fiscal year-to-date interest earnings	$18,348,633.72	$9,538,797.78	$27,925,928.12

The City's total investment portfolio as of December 31, 2003 was $1.349 billion. This is an increase of approximately $85.6 million from September 30, 2003, primarily due to the sale of bonds by the Redevelopment Agency. The weighted average days to maturity as of December 31, 2003 was 405 days, representing an increase of 76 days from 329 days as of September 30, 2003. This increase is due primarily to extending additional investments of U.S. Treasury and Federal Agency securities maturing in a 2 to 5 year range. For the quarter ending December 31, 2003, the earned interest yield was 2.769% which was a decrease of 0.083% from the quarter ending September 30, 2003, reflecting continued volatility in the overall investment markets.

From quarters ending December 31, 2002 to December 31, 2003, the investment portfolio earned interest yield declined 0.826%, reflecting the overall trend of declining interest rates due to

uncertainty of global political conditions and the economic sectors cautious stance with respect to a recovery from the recession that began in 2001. In December 2003, the Federal Open Market Committee (FOMC) voted to leave the federal funds rate at 1%, the lowest level since 1958. In its statement, the FOMC indicated that it will continue to maintain an accommodative monetary policy "for a considerable period" even as the risk of slowing inflation decreases.

The FOMC met again on January 27-28, 2004 to discuss federal monetary policy. During the meetings, there was considerable debate regarding a continued use of the "considerable period" language, primarily due to surging housing activity, robust demand for computers and software, and declining business caution, all of which are aiding in the current economic expansion. The FOMC agreed to remove the "considerable period" phrase from its statement, indicating a need for greater flexibility to raise interest in the future should the economy continue to expand. Removing the "considerable period" phrase from the FOMC statement led to a pullback in most equity markets and pushed bond yields higher in anticipation of a sooner-than-expected rise in interest rates. Recent trading action points to the expectation that the FOMC will raise interest rates by the latter half of 2004.

Investment Reporting and the City's Investment Policy

The City's Investment Policy, approved by the City Council on June 17, 2003, defines the purpose and composition of the City's monthly investment report currently being prepared and distributed by the Finance Department. The monthly investment report includes a transmittal letter summarizing the reporting month's investment activity. Several appendices are also provided, detailing the City's investment portfolio value and other portfolio statistics, to provide investment activity information for the reporting period as required by the City's Investment Policy. The Investment Report is due within 30 days following the end of the month covered by the report. In addition, consistent with current practice, notification requirements regarding any occurrences of exceptions to the Policy are to be presented to the City Council and the City Manager as outlined in the Policy and will also be fully explained within the report that is issued subsequent to the date of the exception event.

California Government Code Section 53646 outlines the investment-related reporting requirements for local agencies. The City's Investment Policy captures all State reporting requirements including investment portfolio composition and value, statement of compliance to the City's Policy, and 6-month cash flow activity requirements. The California Government Code requires the report to be made on a quarterly basis, while the City's Investment Policy currently requires a more frequent report, to be made on a monthly basis.

As a means of streamlining the reporting of the City's investment performance while reducing preparation costs for the investment report, staff recommends that the City's Investment Policy requirement for the reporting of investment activity be revised from monthly to quarterly, consistent with the State requirements. It should be noted that since fiscal year 1995-96, the State, as part of the SB90 Mandate Reimbursement Program, had reimbursed local jurisdictions for certain costs associated with the preparation of an investment report. However, during the past few years, the State has not made these reimbursements to local agencies, primarily as a result of lack of budgeted funds available. By not receiving these reimbursements, the City is forced to absorb all investment reporting-related preparation costs.

Changing the reporting period for the City's Investment Report will not affect the processes and procedures currently used by the Finance Department to facilitate the City's Investment Program. To assure the prudent investment of the City's assets, the Finance Director regularly meets with Treasury Division staff to discuss economic and investment trends, investment strategy and potential investment program enhancements for possible consideration by the City Council. Additionally, the City's Investment Committee meets on a quarterly basis to discuss investment strategy, investment and banking procedures and significant investment-related work projects being undertaken by the Finance Department.

It should be noted that the City's Investment Program has received the Association of Public Treasurer's (APT) Investment Policy Certification in May 2002, recognizing the Mayor and City Council's commitment to sound investment practices which comply with industry-defined standards. This certification demonstrates an organizations willingness to adhere to standards and guidelines for public sector agencies that national rating agencies use to gauge the general credit worthiness and investment practices of rated organizations. The City's compliance with the government industry defined standards will not be compromised by implementation of staff's recommendation to change the reporting frequency of the City's investment reports.

Should the recommendation to change the Investment Policy be approved, staff will continue to prepare the existing contents of the report as outlined in the Policy and distribute the report to all receiving parties as an information item consistent with current practice and within the 30-day timeline. The quarterly investment report distributed will provide the basis for the quarterly summary report of investment activity to the MGWB Committee as required by the committee workplan.

PUBLIC OUTREACH

N/A

COORDINATION

This report has been coordinated with the City Attorney's Office.

CEQA

Not a project.

SCOTT P. JOHNSON
Director, Finance Department