



Memorandum

TO: Making Government Work Better
Committee

FROM: Scott P. Johnson

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

DATE: February 9, 2005

Approved

Date

RECOMMENDATION

It is recommended that the Making Government Work Better Committee accept the City's Investment Report for the quarter ended December 31, 2004.

BACKGROUND

As part of the Making Government Work Better (MGWB) Committee's workplan, the Finance Department will present a quarterly report on the City's investment activity. Under separate cover, the MGWB Committee and City Council has received a comprehensive quarterly report for the period ended December 31, 2004. This report includes a summary of investment activity for the quarter ended December 31, 2004.

ANALYSIS

Summary of Investment Activity – Quarter Ending December 31, 2004

The information presented on the following page highlights the investment activity for the quarter ending December 31, 2004. As a comparison, information for quarters ending September 30, 2004 (the immediately preceding quarter) and December 31, 2003 is also provided.

For the quarter ended:	<u>December 2004</u>	<u>September 2004</u>	<u>December 2003</u>
<i><u>Total Portfolio:</u></i>			
Portfolio value*			
as of end of the quarter	\$1,093,963,392.27	\$1,283,592,576.10	\$1,349,105,290.37
Earned interest yield	2.580%	2.335%	2.769%
Portfolio effective yield	2.656%	2.381%	2.713%
Dollar-weighted average days to maturity	480	441	405
<i><u>Portfolio Fund 1:</u></i>			
Portfolio value*			
as of end of quarter	\$989,477,442.72	\$1,018,563,015.59	\$1,097,262,879.42
Earned interest yield	2.651%	2.519%	2.971%
Portfolio effective yield	2.725%	2.558%	2.984%
Dollar-weighted average days to maturity	527	551	491
<i><u>Total Portfolio Income</u></i>			
<i><u>Recognized:</u></i>			
Net interest earnings	\$7,318,820.97	\$7,808,369.64	\$8,809,835.90
Fiscal year-to-date Interest earnings	\$15,127,190.61	\$7,808,369.64	\$18,348,633.72

* Reflects book value (principal plus any purchased interest costs).

Portfolio Performance

The total investment portfolio as of December 31, 2004 was \$1.094 billion. This is a decrease of approximately \$189.6 million from September 30, 2004, primarily due to the transfer of bond proceeds as they relate to Airport capital projects to the City’s trustee, for placement into guaranteed investment agreements. The weighted average days to maturity as of December 31, 2004 was 480 days, representing an increase of 39 days from 441 days as of September 30, 2004, reflecting the transfer out of bond proceeds which had been in short-term investments in preparation for the transfer to the trustee. For the quarter ended December 31, 2004, the earned

interest yield was 2.580%, representing an increase of 0.245% from the quarter ended September 30, 2004, reflecting the increase in the portfolio’s average duration as well as an increase in market yields.

From the quarter ended December 2003 to the quarter ended December 2004, the investment portfolio earned interest yield declined 0.189%. As the economy continues its expansion, fuelled by federal tax cuts and accommodative monetary policy, the decline in the investment portfolio’s yield appears to be diminishing, as investments purchased in prior periods of lower market yields mature and are replaced by investments purchased in the current market of rising yields. As expected, the Federal Open market Committee (FOMC) raised the federal funds rate another 25 basis points to 2.50% at its February 2, 2005 meeting in its attempt to bring the rate to a level to keep inflation stable without restraining economic growth. The FOMC has raised the federal funds rate six times since June 30, 2004 for a total of 150 basis points and has indicated that it could continue raising rates at a “measured” pace.

Interest Earnings

Actual General Fund interest earnings were \$905,127 for the quarter ended December 2004 and \$1,897,561 for the fiscal year-to-date. Interest earnings were slightly greater than budgeted earnings estimates by \$16,043 for the quarter ended December 2004 and \$86,172 for the fiscal year-to-date.

Cash Flows by Major Funds

The monthly comparison of cash balances as reported in the City’s Financial Management System reveals the cyclical changes in balances which over time are reflected in the investment portfolio balances. The monthly balances for the Airport, Capital Projects and Redevelopment Agency reflect the influx of bond sale proceeds and the subsequent expenditures reducing balances over time. Recent fluctuation in the monthly balances for the General Fund reflect impacts of State budget actions, specifically the “triple flip”, whereby monthly receipts of Motor Vehicle License Fees and a portion of the Sales Tax are replaced by property-tax in-lieu payments received semi-annually in January and May.

Based on the Treasury Division cash flow projection of December 31, 2004, the total portfolio is expected to have approximately \$442 million in maturities and interest during the next six months, plus approximately \$845 million in revenues. These amounts are more than sufficient to cover the projected expenditures during the next six months.

Changes to the Investment Policy

In December 2004, the City Council approved the annual City of San Jose Investment Policy. In addition, Council approved proposed changes to the Policy, including giving the Director of Finance the authority to execute agreements and other forms of documentation which will allow the Director to quickly and prudently act on investment options which best benefit the City and

authorizing California municipal bonds as a permitted investment. No municipal bonds were purchased during the quarter ended December 2004.

PUBLIC OUTREACH

N/A

COORDINATION

This report has been coordinated with the City Manager’s Office.

CEQA

Not a project.

SCOTT P. JOHNSON
Director, Department of Finance