



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Julia H. Cooper

SUBJECT: ANNUAL REVIEW OF
THE CITY OF SAN JOSÉ
INVESTMENT POLICY

DATE: March 12, 2019

Approved

D. D. SyL

Date

3/13/19

SUPPLEMENTAL

REASON FOR SUPPLEMENTAL

To provide additional information on Assembly Bill No. 1770 (“AB 1770”) and proposed changes to the City’s Investment Policy.

BACKGROUND

On February 21, 2019, the Public Safety, Finance and Strategic Support Committee reviewed the memorandum for the Annual Review of the City of San José Investment Policy along with proposed changes. This supplemental memorandum is intended to provide additional information on AB 1770 and further explain staff’s recommended changes to the Investment Policy.

ANALYSIS

AB 1770, effective January 1, 2019, modified Government Code Section 53601(o), changing in part the requirements for mortgage backed securities (“MBS”), collateralized mortgage obligations (“CMO”) and asset backed securities (“ABS”).

Previously, California law authorized investments in MBS, CMO or ABS, that had a maximum maturity of five years. California law further required that issuers of these securities be rated “A” (or its equivalent) or better by a nationally recognized statistical rating organization (NRSRO) and the security itself be rated “AA” (or its equivalent) or better by an NRSRO.

AB 1770 revised the maximum five-year maturity requirement to clarify that the securities must have a maximum remaining security of five years or less. The bill also eliminated the requirement that the issuer be rated “A” (or its equivalent) or better by an NRSRO.

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While reviewing AB 1770 and the proposed amendments to the Government Code, staff re-examined the City's existing requirements for MBS, CMO and ABS. MBS, CMO and ABS were first introduced into the City's Investment Policy in 2010, following a comprehensive policy review and recommendations by the City's consulting firm at the time, Main Street Capital Advisors. Since then, the City has set a rating requirement of "AAA" for these securities. Although permitted since 2010, the City has not invested in any mortgage or asset backed securities. Only recently, has staff started to explore the mortgage and asset backed sectors of the financial market as potential investments for the City's portfolio.

Recognizing that the City's Investment Policy has a higher rating requirement for asset backed and mortgaged backed securities than the California Government Code, staff took the opportunity to revise the Investment Policy to align it with the existing State law. While securities rated "AAA" carry the lowest degree of investment risk, both "AAA" and "AA" rated securities are known as high grade securities. Lowering the rating requirement from "AAA" to "AA" broadens the security selection pool with only a small increase in the City's overall risk exposure.

Staff also brought forward additional changes to reflect the changes in AB 1770, including clarifying that these securities have a remaining maturity of no longer than five years, and eliminating issuer restrictions.

COORDINATION

This memorandum was coordinated with the City Attorney's Office.

/s/

JULIA H. COOPER
Director of Finance

For questions, please contact Qianyu Sun, Principal Investment Officer, at (408) 535-7015.