



# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Julia H. Cooper

**SUBJECT: INVESTMENT REPORT FOR  
THE QUARTER ENDED  
DECEMBER 31, 2018**

**DATE:** January 31, 2019

Approved

Date

2/6/19

Transmitted herewith is the City's Investment Report for the quarter ended December 31, 2018. To meet the reporting requirements set forth in the City of San Jose Investment Policy, an electronic version of this report will be posted on the City's website at <http://www.sanjoseca.gov/index.aspx?NID=759> and a hard copy will be on file at the City Clerk's Office located at 200 East Santa Clara Street.

This report will be distributed to the Public Safety, Finance and Strategic Support Committee (PSFSS) for discussion during its meeting on February 21, 2019 and will be agendaized through the PSFSS Committee to the City Council meeting on March 12, 2019.

Summary of portfolio performance and compliance for quarter ended December 31, 2018:

- Size of total portfolio: \$1,523,155,876
- Earned income yield: 2.070%
- Weighted average days to maturity: 559 days
- Fiscal year-to-date net interest earnings: \$15,368,148
- No exceptions to the City's Investment Policy during this quarter

If you have any question on this investment report, please do not hesitate to call me at 535-7011.

/s/

JULIA H. COOPER  
Director of Finance

cc: David Sykes, City Manager  
Sharon Erickson, City Auditor  
Richard Doyle, City Attorney

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**INVESTMENT REPORT FOR  
THE QUARTER ENDED  
DECEMBER 31, 2018**



Prepared by  
Finance Department  
Treasury Division

Julia H. Cooper  
Director of Finance

**Investment Report for  
The Quarter Ended  
December 31, 2018**

**City of San José  
Department of Finance  
Treasury Division**

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Director of Finance

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Katie Su, Accountant  
Courtney Brown, Staff Technician

**CITY OF SAN JOSE  
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January 31, 2019

HONORABLE MAYOR and CITY COUNCIL

**INVESTMENT REPORT FOR THE QUARTER ENDED DECEMBER 31, 2018**

I am pleased to present this report of investment activity for the quarter ended December 31, 2018 in compliance with the reporting requirements set forth in the City of San José Investment Policy. The report presents information in the following major categories: Portfolio Statistics, Portfolio Performance, Compliance Reporting Requirements, Investment Trading Activity, and Investment Strategy.

The information presented in the table below highlights the investment activity for the quarter ended December 31, 2018, as well as provides a comparison to the quarters ended September 30, 2018, and December 31, 2017.

<b>INVESTMENT SUMMARY</b>			
<b>For the Quarter Ended</b>	<b>December 31, 2018</b>	<b>September 30, 2018</b>	<b>December 31, 2017</b>
<b><u>Total Portfolio</u></b>			
Portfolio Value <sup>(1) (2)</sup>	\$1,523,155,876	\$1,475,387,992	\$1,482,612,432
Earned Interest Yield	2.070%	1.936%	1.417%
Weighted avg. yield at end of period	2.123%	1.941%	1.458%
Weighted avg. days to maturity	559	581	562
<b><u>Portfolio Fund 3</u></b>			
Portfolio Value <sup>(1) (2) (3)</sup>	\$1,515,330,209	\$1,467,600,521	\$1,473,193,292
Earned Interest Yield	2.068%	1.935%	1.419%
Weighted avg. yield at end of period	2.122%	1.939%	1.459%
Weighted avg. days to maturity	561	584	565
<sup>1</sup> Reflects book value (principal plus any purchased interest) of investments. <sup>2</sup> Total excludes bond proceeds held by trustees for the City of San José (\$229,454,656.48). <sup>3</sup> Total excludes other restricted funds required to be invested separately.			



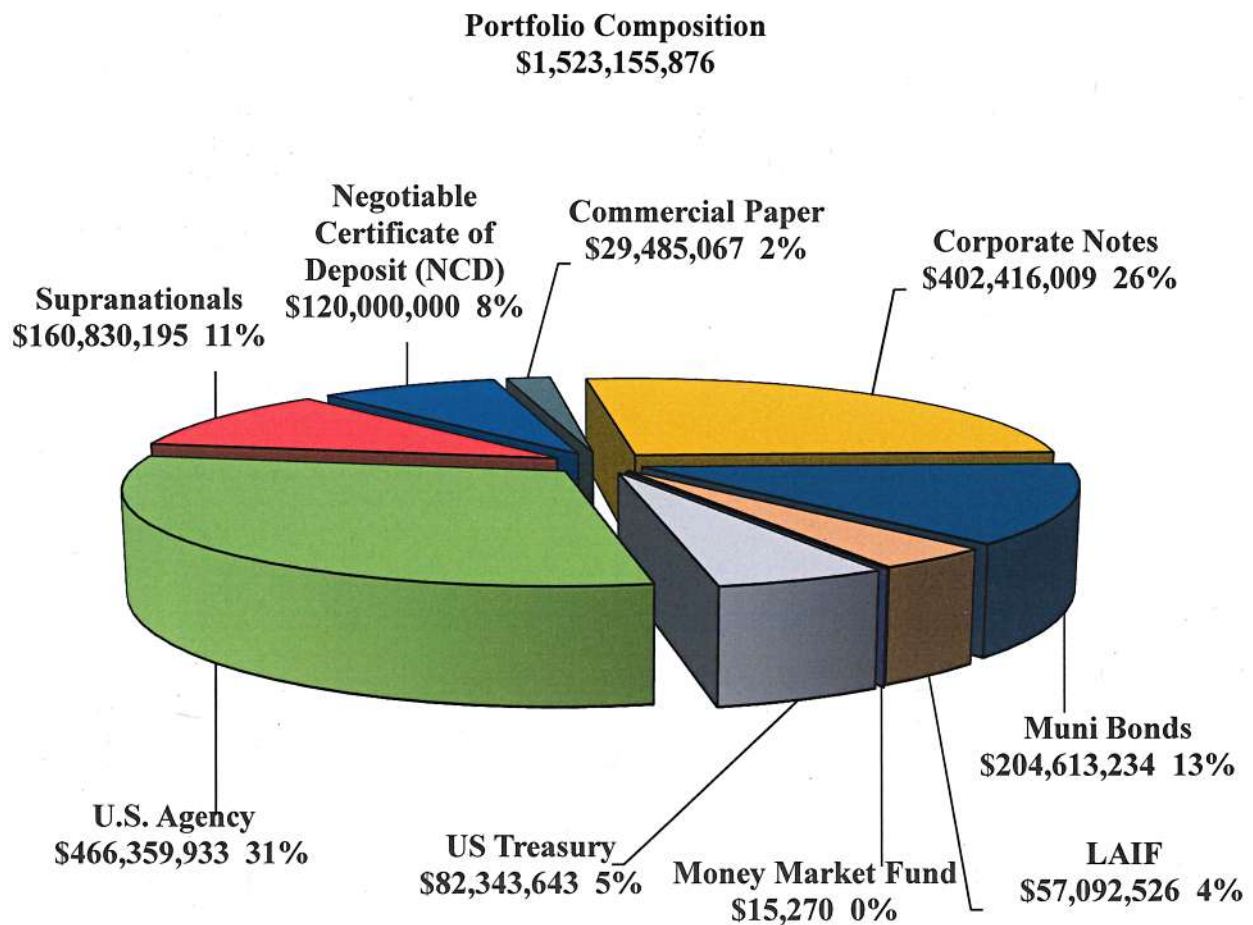
## **PORTFOLIO STATISTICS**

Detailed information can be found in the attachments while summaries are provided below.

### **Portfolio Composition**

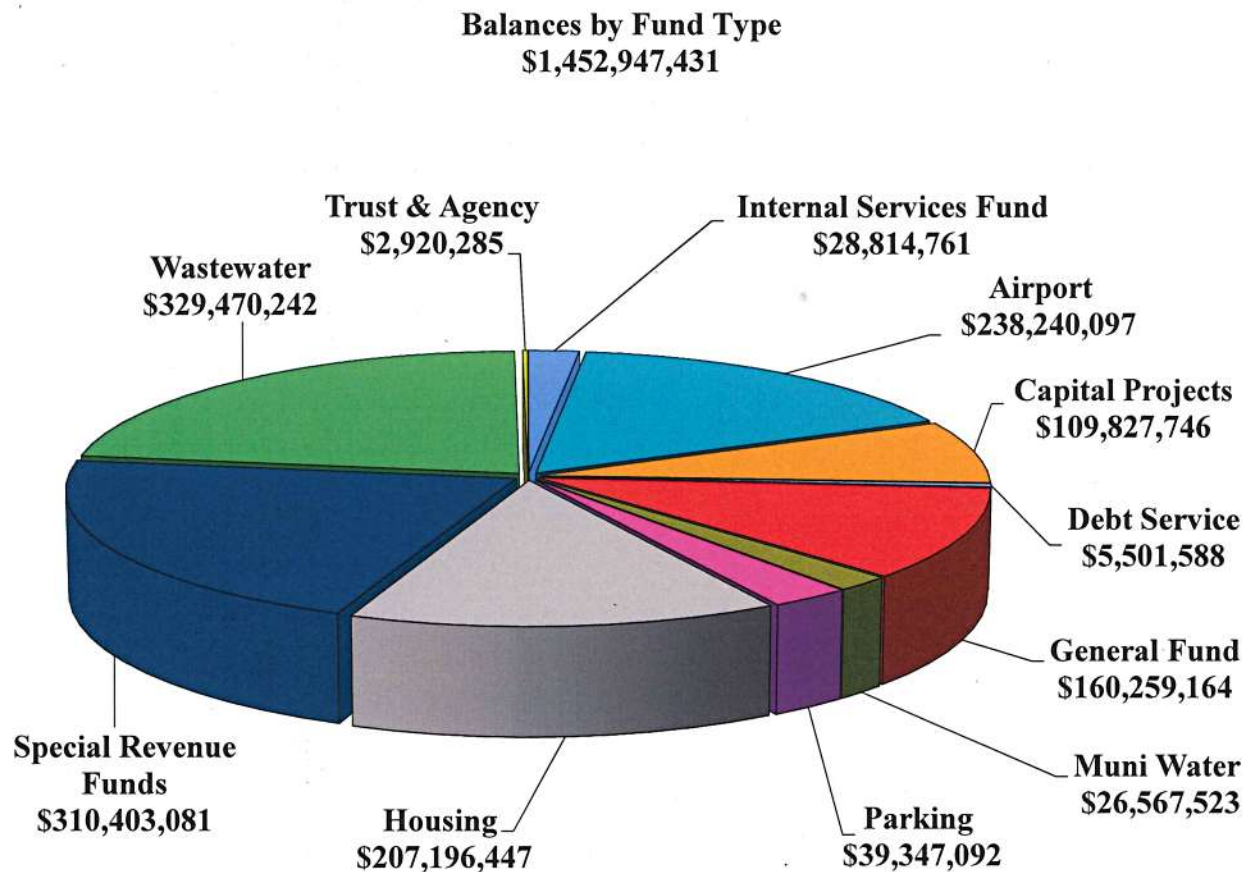
Within this section are snapshots of the City's total investment portfolio as of December 31, 2018.

The first graph shows the portfolio composition by investment type.





The graph below reflects the reconciliation of total balances reported by the investment program's record-keeping system to the City's Financial Management System (FMS).



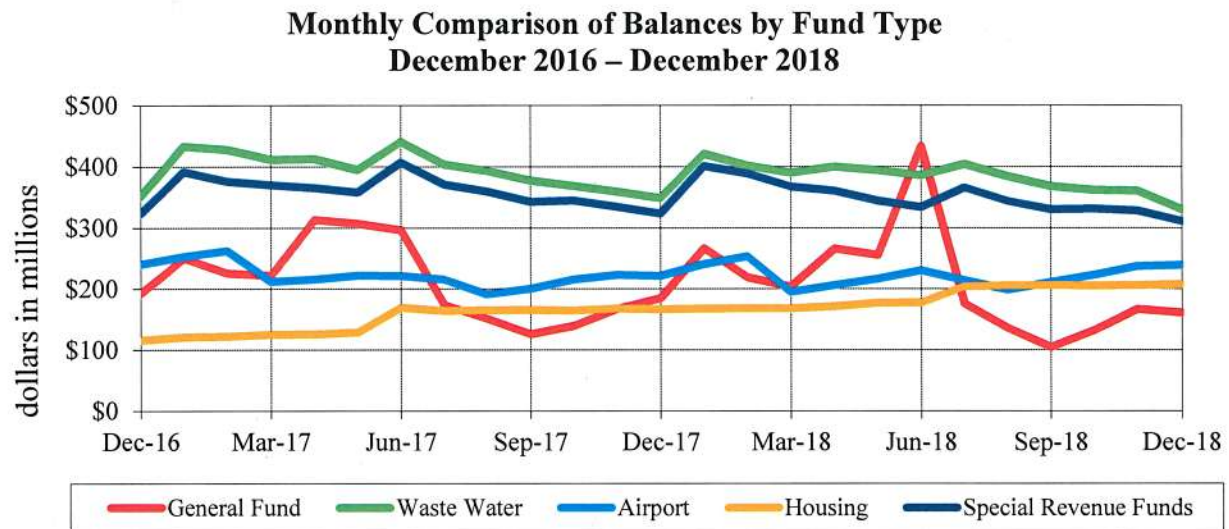
Total Balances per FMS	\$1,452,947,431
Deposit-in-Transit, Outstanding Checks <sup>1</sup>	70,208,445
Portfolio Balance Total	<u>\$1,523,155,876</u>

<sup>1</sup> Reflects timing difference between when deposits are made and accounted for in FMS or when checks are written and not yet cashed by the receiving party

### **General Fund Balances**

With the receipts of property tax advances, General Fund balances increased by \$56.31 million during the quarter and ended with a balance of \$160.26 million as of December 31, 2018. General Fund cash balances usually peak during the months of January and June when the bulk of property taxes are received, and decline in the summer months due to retirement prefunding, debt service payments and operational expenditures.

The following graph compares monthly balances of five largest City funds as reported by FMS.



### **Prefunding of Annual Retirement Contributions and Issuance of Short-Term Notes**

The City opted to prefund a significant portion of the annual employer retirement contributions for Fiscal Year 2018-19. The prefunding amount was \$358.5 million at the beginning of the year. In anticipation of this cash outflow, the City set aside \$208.5 million in cash and matured investments and additional funding of \$150 million came from Tax Revenue Anticipation Notes (TRAN) issued on July 2, 2018.

The TRAN issuance ensures that cash balances in the General Fund remain positive throughout Fiscal Year 2018-19. Since issuance, the City has paid \$86.59 million in principal and interest on the TRANs. The TRAN will be redeemed in full by June 30, 2019. The City will cease prefunding retirement contributions in Fiscal Year 2019-20.

### **Successor Agency to the Redevelopment Agency of the City of San José**

Historically, the Redevelopment Agency participated in the City's investment pool with both restricted bond proceeds and operating cash balances. As of February 1, 2012, redevelopment agencies in California were dissolved by legislative action and the City, acting as the Successor Agency to the Redevelopment Agency ("SARA"), transferred Redevelopment Agency's funds from the investment pool to SARA's own bank accounts. In July 2018, the City entered into the

final stage of dissolution and absorbed the entire SARA operations into City operations. City staff will manage SARA's accounts until all assets are liquidated and bonds are redeemed.

As of December 31, 2018, SARA reported cash balances as outlined in the table below:

<b>SARA CASH SUMMARY</b>			
	<u>Restricted/Reserved</u>	<u>Pledged</u>	<u>Totals</u>
LAIF	\$ -	\$ 10,704,355	\$ 10,704,355
Wells Fargo			
General Account-80% Funds		534,820	534,820
CET Toxic Escrow	22,595 <sup>(a)</sup>	-	22,595
Prop 1C Grant	996,025 <sup>(b)</sup>	-	996,025
Total Wells Fargo Funds	1,018,620	534,820	1,553,440
Wilmington Trust:			
Debt Service Fund	-	541,626 <sup>(c)</sup>	541,626
Total Wilmington Trust Funds	0	541,626	541,626
<b>TOTAL</b>	<b>\$ 1,018,620</b>	<b>\$ 11,780,801</b>	<b>\$ 12,799,421</b>

<sup>(a)</sup> CET Toxic escrow reserved for CET Building.

<sup>(b)</sup> Grant funds for N. San Pedro Project

<sup>(c)</sup> Funds restricted for tax allocation bond debt service; new trustee for 2017 Refunding Bonds

## **PORTFOLIO PERFORMANCE**

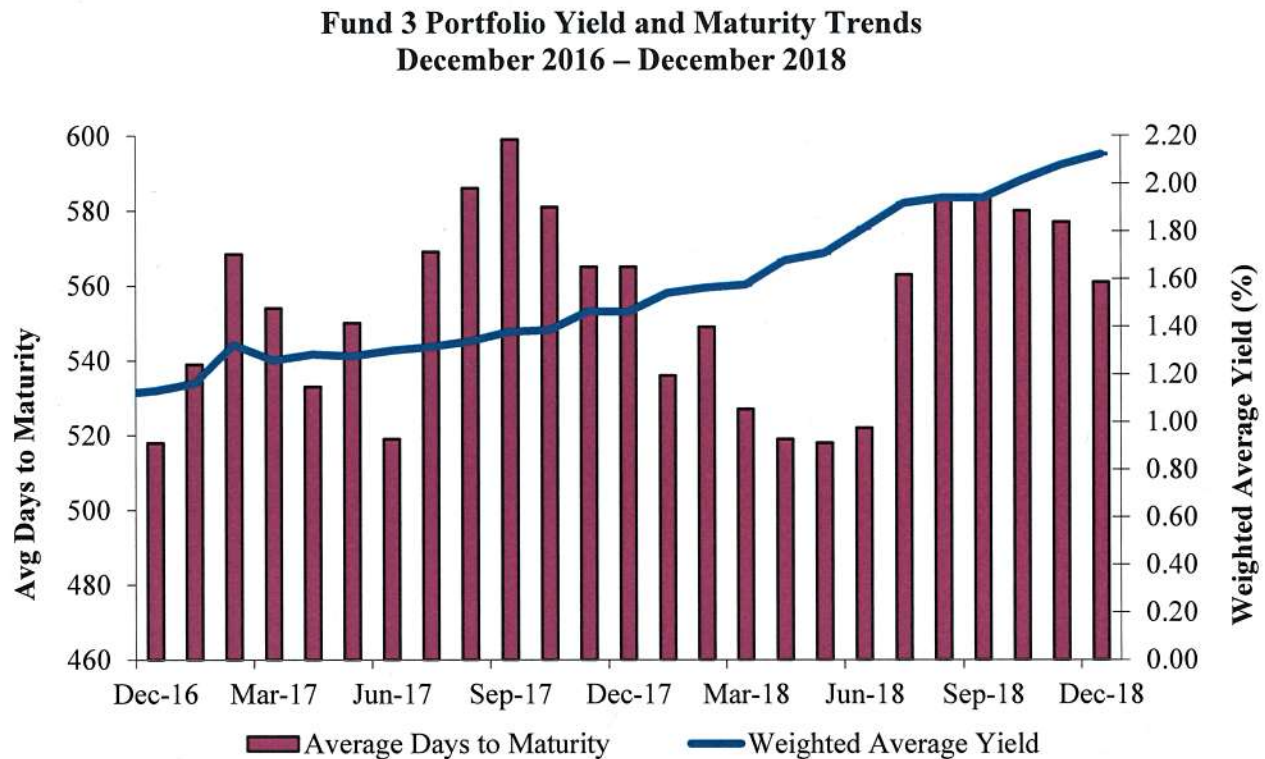
The following table illustrates the total portfolio income recognized for the last quarter as compared to the prior quarter and the same quarter one year ago.

<b>TOTAL PORTFOLIO INCOME RECOGNIZED</b>			
<b>Accrual Basis</b>			
<b>Total Portfolio</b>	<b>December 31, 2018</b>	<b>September 30, 2018</b>	<b>December 31, 2017</b>
<b><u>Quarter-End</u></b>			
Total interest earnings	\$ 7,746,397	\$ 7,621,752	\$ 5,210,138
Realized gains (losses)	0	0	0
Total income recognized	\$ 7,746,397	\$ 7,621,752	\$ 5,210,138
<b><u>Fiscal Year-to-Date</u></b>			
Total interest earnings	\$ 15,368,148	\$ 7,621,752	\$ 10,360,199
Realized gains (losses)	0	0	0
Total income recognized	\$ 15,368,148	\$ 7,621,752	\$ 10,360,199



### **Yield and Maturity Trend**

The following graph illustrates monthly dollar-weighted average-days-to-maturity (“ADM”) of Fund 3 Portfolio (bar graph) along with the weighted average yield (line graph) for the past two years.



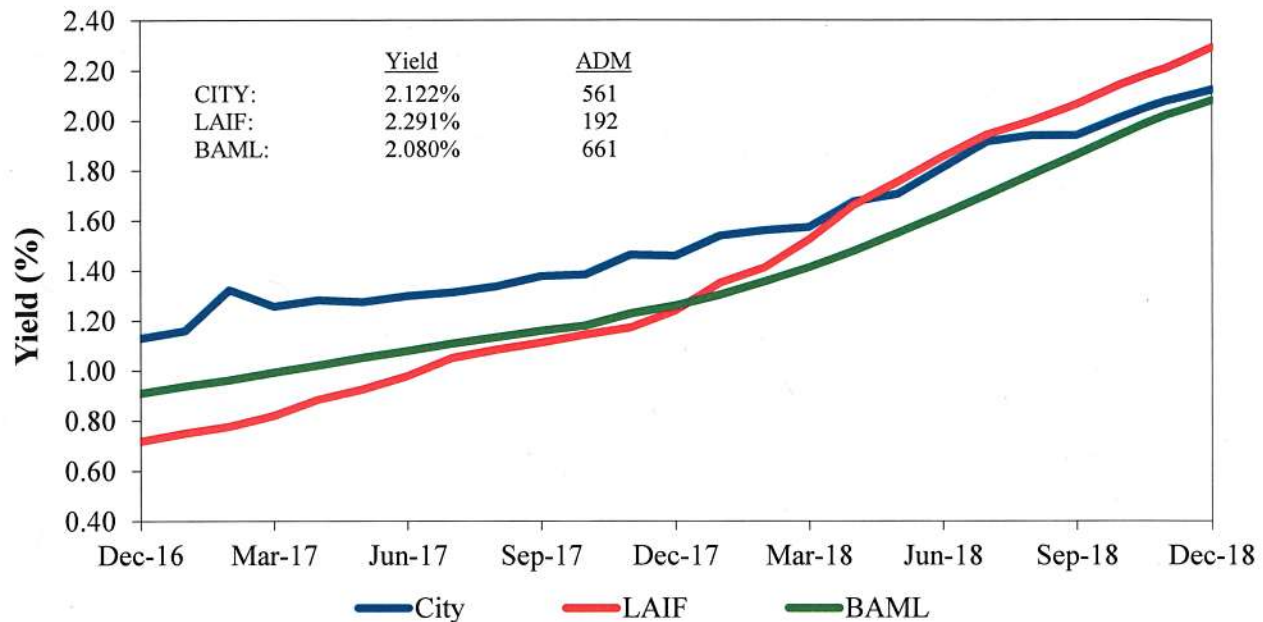
The Fund 3 Portfolio’s average days to maturity (ADM) decreased from 584 days as of September 30, 2018, to 561 days on December 31, 2018. The weighted average yield increased from 1.939% as of September 30, 2018 to 2.122% on December 30, 2018.

With a flattening yield curve, investment staff adopted a slight tilt towards the front end of the curve when making new investments during this quarter, which contributed to the decrease of the portfolio’s ADM. Yields rose through the first part of the quarter and a curve inversion occurred in mid-December where 2-year Treasury yield exceeded 5-year Treasury yield. Staff continued to purchase new investments at higher yields than matured ones. As a result, the overall portfolio yield increased by 18 basis points (bps).

### **Comparison with Benchmarks**

The City’s Total Portfolio is not compared to benchmarks because it includes various funds which have separate cash flows and investment requirements. Only the City’s Fund 3 Portfolio is compared against benchmarks for performance purposes. The following graph demonstrates a yield comparison by month of the City’s Fund 3 Portfolio, the California LAIF, and the BAML Index for the period from December 2016 to December 2018.

### Portfolio vs. Benchmarks December 2016 – December 2018



**Notes:**

1. **City** refers to City's Fund 3 Portfolio, and the yield data are month end weighted average yields.
2. **LAIF** refers to the State of CA Local Agency Investment Fund and yield data are average monthly effective yields.
3. **BAML** refers to Bank of America Merrill Lynch 1-3 Year AAA-A US Corporate & Government Index and yield data are rolling 2-year effective yield.

LAIF is a short-term investment option available to local agencies in California. The City invests most of its short-term funds in LAIF and often references LAIF as a floor benchmark when making investment decisions. LAIF has a high turnover ratio and its ADM was 192 days as of December 31, 2018. The City generally follows a buy-and-hold strategy and maintains a longer ADM, 561 days as of December 31, 2018. The majority of the City's holdings were purchased when interest rates were lower. Although \$184 million of new investments were purchased at current market rates, the quantity was insufficient to keep the City's portfolio yield on par with LAIF. The yield gap between the City's portfolio and LAIF widened. The Federal Reserve indicated that rate hikes may slow down in 2019. In that case, the City's portfolio may be able to narrow the yield gap with LAIF in the year. However, staff expects that the City portfolio performance will continue to lag behind LAIF, especially when the yield curve inversion persists.

The BAML Index is a broad market index and tracks dollar denominated investment-grade debt with a remaining maturity up to 3 years. The City's Investment Policy allows investments, in a few sectors, up to a 5-year final maturity. Although the City portfolio is mainly composed of investments shorter than 3 years, staff is making a conscious effort to place a portion of the



portfolio in the 3- to 5-year maturity range to add incremental yield when appropriate. As a result, the City's portfolio outperformed the BAML Index during last two years, despite having a shorter ADM. However, as the yield curve inverts and flattens, the performance gap between the BAML Index and the City's portfolio has narrowed considerably over time.

### **Unrealized Losses and Gains**

As shown in the Investment Summary Table on page 1 of this report, the total portfolio size as of December 31, 2018, was approximately \$1.52 billion. The following table illustrates the net unrealized gains or losses on the portfolio when comparing the portfolio's market value to both its original cost and amortized cost.

<b>UNREALIZED GAINS &amp; LOSSES</b>			
<b>Cash Basis</b>			
<b>Market Value</b>	\$1,511,363,441	<b>Market Value</b>	\$1,511,363,441
<b>Original Cost</b>	(1,523,155,876)	<b>Amortized Cost</b>	(1,520,446,200)
<b>Net Unrealized Loss</b>	\$ (11,792,435)	<b>Net Unrealized Loss</b>	\$ (9,082,759)

An inverse relationship exists between general changes in interest rates and the value of investment securities. As interest rates decrease, the value of the City's investments increases. Conversely, as interest rates increase, the value of the City's investments declines. The City's investment practice, per the Investment Policy, is generally to hold securities to maturity, with exceptions as noted in the Policy. The net unrealized losses noted above are "paper losses" and would only be realized if securities were sold prior to maturity.

### **Earned Interest Yield**

The earned interest yield of the total investment portfolio for the quarter ended December 31, 2018 was 2.07%, 0.134% higher than the previous quarter.

### **Cash Management Projection**

Based on the Finance Department's cash flow projection as of December 31, 2018, total revenues and investment maturities for the next six months are anticipated to be approximately \$1.72 billion. This is sufficient to cover projected expenditures of approximately \$1.49 billion.

### **Statement of Compliance with the Policy**

There were no exceptions or violations outstanding for the quarter ended December 31, 2018. The investment portfolio meets the requirements of the City's Investment Policy and California Government Code section 53601.

**Comparison of Portfolio Investment Earnings to FY 2018-19 Budget**

The following is a comparison of actual General Fund investment earnings, on an accrual basis, to the fiscal year 2018-19 budget. The fiscal year 2018-19 budgeted interest earnings for the General Fund is \$3 million, and the forecasted net interest yield is 1.66%. The schedule below compares the unaudited actual net investment earnings to the General Fund budget for the quarter ended December 31, 2018. The interest earnings are greater than the forecast for the quarter and for the fiscal year.

<b>BUDGET COMPARISON</b>	
<b><u>Net Investment Earnings</u></b>	<b><u>Yield</u></b>
<b><i>Quarter Ended December 31, 2018</i></b>	
Budget <sup>(a)</sup>	1.66%
Actual <sup>(b)</sup>	<u>1.92%</u>
Variance	0.26%
<b><i>Fiscal Year to Date</i></b>	
Budget <sup>(a)</sup>	1.66%
Actual <sup>(b)</sup>	<u>1.85%</u>
Variance	0.19%
(a) Reflects the 2019-2023 General Fund Forecast Information submitted by Finance on February 13, 2018.	
(b) Reflects the earned interest yield less costs to administer the investment program, adjusted for funds with negative cash balances at month end.	

**INVESTMENT TRADING ACTIVITY**

Section E provides a detail of the City's investment activities, including purchases, maturities, amortization, received interest, and realized gains or losses from trading activities.

**INVESTMENT STRATEGY**

The Investment Program continues to focus on its core mandates of safety, liquidity, and yield. Investments have been matched to known cash flow outlays in the next 24-month horizon. Beyond the 24-month horizon, staff extends maturities in order to provide income and structure for the portfolio when appropriate.

The Federal Reserve raised the Fed Funds Target Rate in December 2018 to 2.50% and will likely make fewer rate hikes in 2019. Equity markets were sold off in December and market volatility spiked. Although U.S. economy continues to grow and the job market stays strong, the prolonged partial government shutdown is posing increasing risk to the broader economy. Other factors, such as slowing global growth, ongoing trade tensions and higher interest rates, all threaten to slow down the US economy with the rest of the world.



The investment staff will closely monitor the market development, focus on the overall quality of the portfolio and invest with care, prudence and diligence.

**Future Commitments** – As of December 31, 2018, the City had no obligations to sell securities and no commitments to participate in securities trading.

**Executed Reverse Repurchase Agreements** – No reverse repurchase agreements were executed this quarter.

**Restructuring** – No restructuring activities took place during the quarter ended December 31, 2018.

## **CONCLUSION**

The total investment portfolio as of December 31, 2018 was \$1,523,155,876, increased by approximately \$47.77 million from the previous quarter. For the quarter ended December 31, 2018, the earned interest yield was 2.07%, an increase from 1.936% reported for the previous quarter. The average days to maturity decreased from 581 days on September 30, 2018, to 559 days on December 31, 2018. As of December 31, 2018, approximately 36% of the total portfolio was invested in U.S. Treasuries and agency securities.

/s/  
JULIA H. COOPER  
Director of Finance