



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Julia H. Cooper

**SUBJECT: INVESTMENT REPORT FOR
THE QUARTER ENDED
JUNE 30, 2019**

DATE: July 31, 2019

Approved

Date

8/2/19

Transmitted herewith is the City's Investment Report for the quarter ended June 30, 2019. 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 the August 15, 2019 and will be agendaized through the PSFSS Committee to the City Council meeting on September 10, 2019.

Summary of portfolio performance and compliance for quarter ended June 30, 2019:

- Size of total portfolio: \$2,065,550,242
- Earned income yield: 2.348%
- Weighted average days to maturity: 661 days
- Fiscal year-to-date net interest earnings: \$35,501,942
- 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.

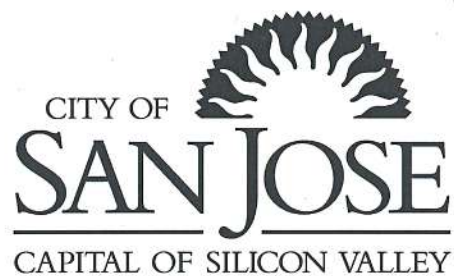
/s/

JULIA H. COOPER
Director of Finance

cc: David Sykes, City Manager
Joe Rois, Acting City Auditor
Richard Doyle, City Attorney

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**INVESTMENT REPORT FOR
THE QUARTER ENDED
JUNE 30, 2019**



Prepared by
Finance Department
Treasury Division

Julia H. Cooper
Director of Finance

**Investment Report for
The Quarter Ended
JUNE 30, 2019**

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

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Director of Finance

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Courtney Brown, Staff Technician

**CITY OF SAN JOSE
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July 30, 2019

HONORABLE MAYOR and CITY COUNCIL

INVESTMENT REPORT FOR THE QUARTER ENDED JUNE 30, 2019

I am pleased to present this report of investment activity for the quarter ended June 30, 2019 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 June 30, 2019, as well as provides a comparison to the quarters ended March 31, 2019, and June 30, 2018.

INVESTMENT SUMMARY			
For the Quarter Ended	June 30, 2019	March 31, 2019	June 30, 2018
<u>Total Portfolio</u>			
Portfolio Value ^{(1) (2)}	\$2,065,550,242	\$1,704,612,867	\$1,805,812,065
Earned Interest Yield	2.348%	2.289%	1.659%
Dollar-weighted average yield			
Purchases	2.424%	2.800%	2.793%
Maturities	1.767%	1.674%	1.419%
Called Securities	3.011%	2.571%	2.129%
Weighted avg. yield at end of period	2.330%	2.281%	1.812%
Weighted avg. days to maturity	661	579	520
<u>Portfolio Fund 3</u>			
Portfolio Value ^{(1) (2) (3)}	\$2,063,415,334	\$1,702,265,134	\$1,797,178,013
Earned Interest Yield	2.348%	2.281%	1.658%
Dollar-weighted average yield			
Purchases	2.424%	2.800%	2.794%
Maturities	1.762%	1.674%	1.419%
Called Securities	3.011%	2.571%	2.129%
Weighted avg. yield at end of period	2.330%	2.281%	1.811%
Weighted avg. days to maturity	662	579	522

¹ Reflects book value (principal plus any purchased interest) of investments.

² Total excludes bond proceeds held by trustees for the City of San José (\$223,924,302.76).

³ Total excludes other restricted funds required to be invested separately.

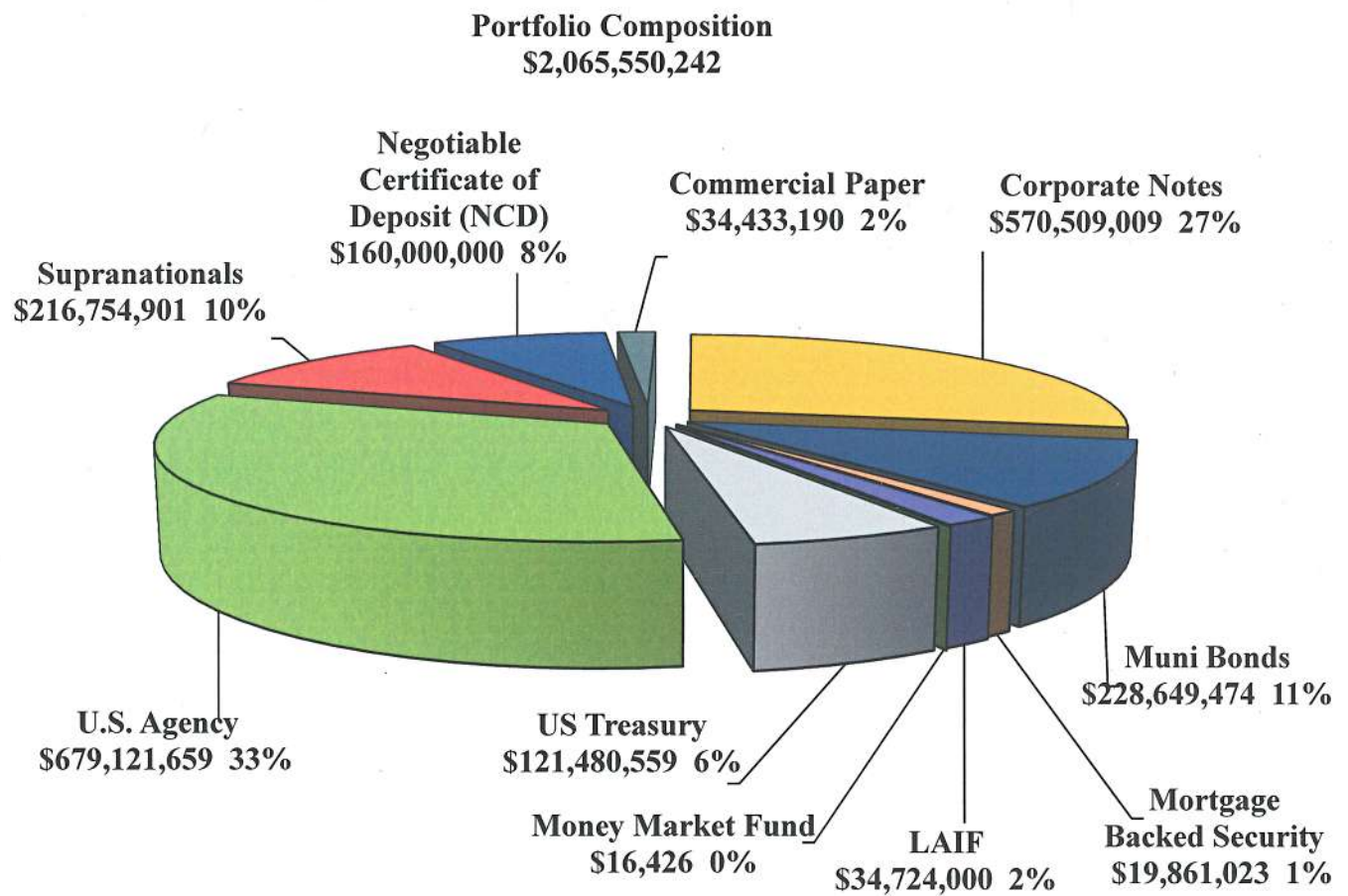
PORTFOLIO STATISTICS

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

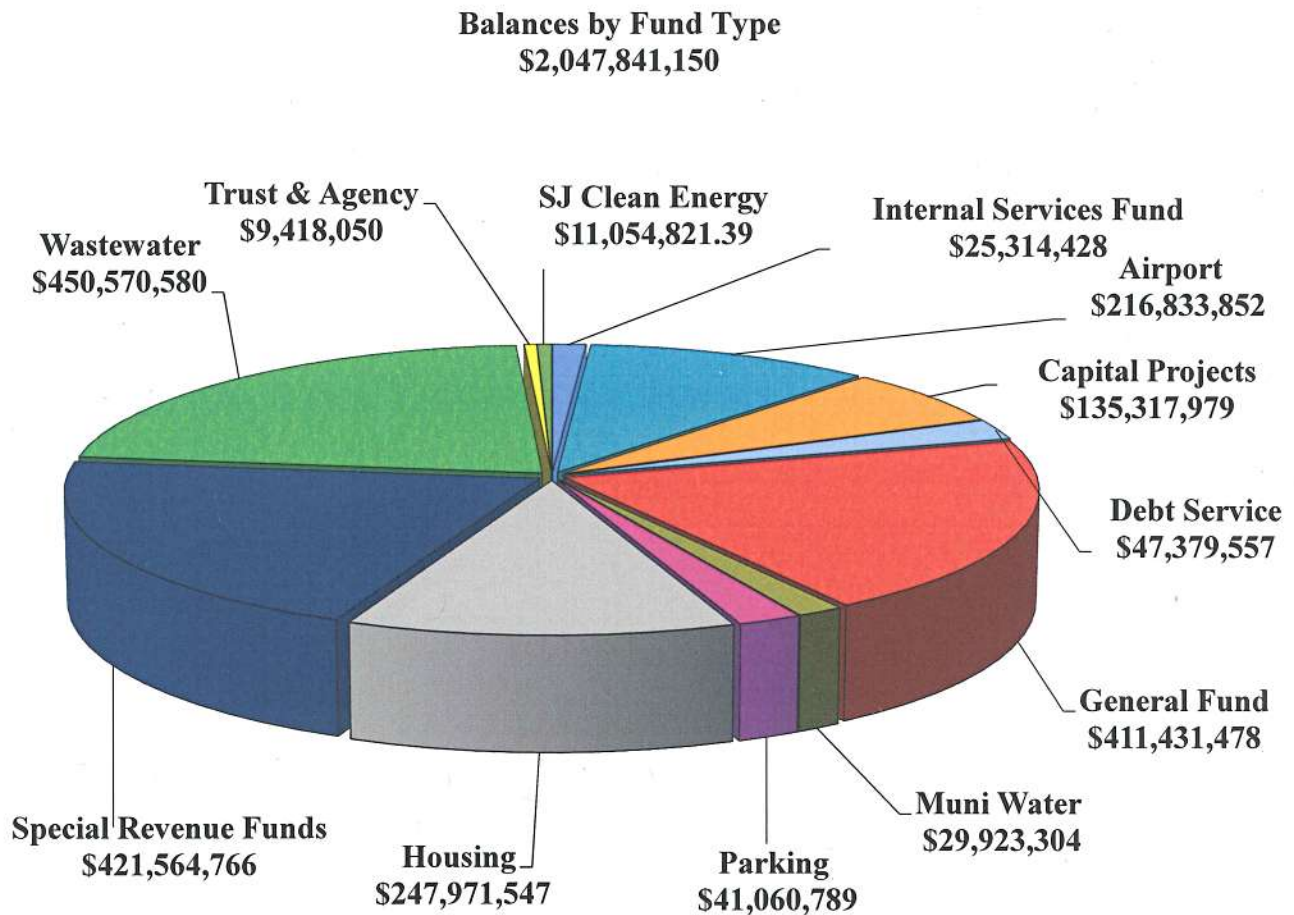
Portfolio Composition

Within this section are snapshots of the City's total investment portfolio as of June 30, 2019.

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).



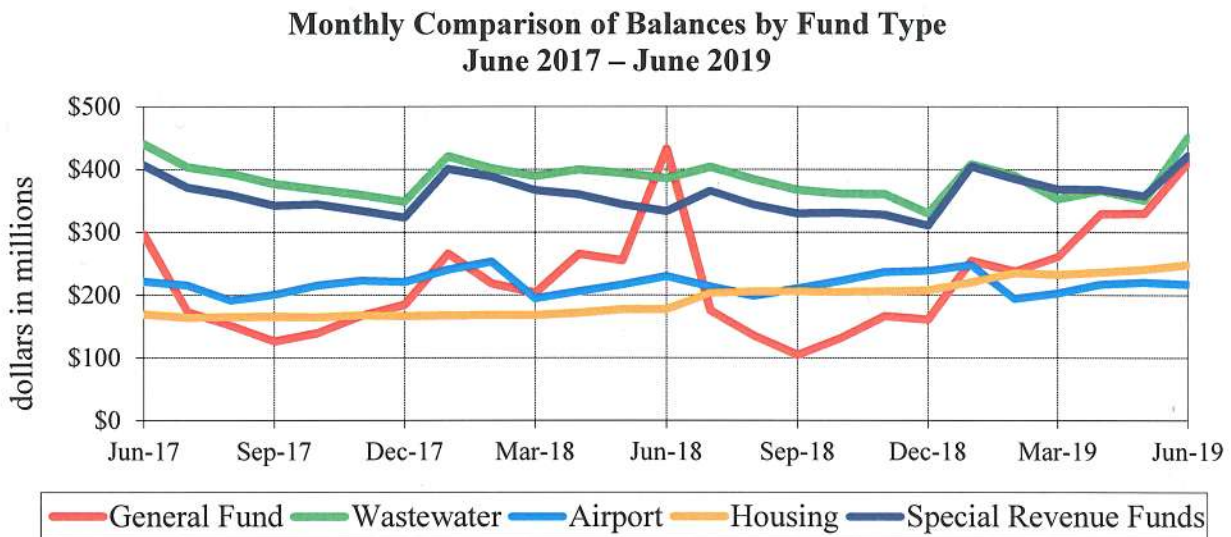
Total Balances per FMS	\$2,047,841,150
Deposit-in-Transit, Outstanding Checks ¹	17,709,092
Portfolio Balance Total	<u>\$2,065,550,242</u>

¹ 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 in June, General Fund balances increased by \$151 million during the quarter and ended with a balance of \$411.43 million as of June 30, 2019. 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

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 was redeemed in full on April 1, 2019.

The City ceased 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 June 30, 2019, SARA reported cash balances as outlined in the table below:

SARA CASH SUMMARY	
	Pledged for Bond/Enforceable Obligations
LAIF	\$ 56,336,586
Wells Fargo	
General Account-80 %	
Funds	\$ 173,428
Total Wells Fargo Funds	\$ 173,428
Wilmington Trust:	
Total Wilmington Trust	
Funds	\$ 117,986,598 (A)
	\$ 117,986,598
TOTAL	\$ 174,496,612

(A) Funds restricted for tax allocation bond debt service payments

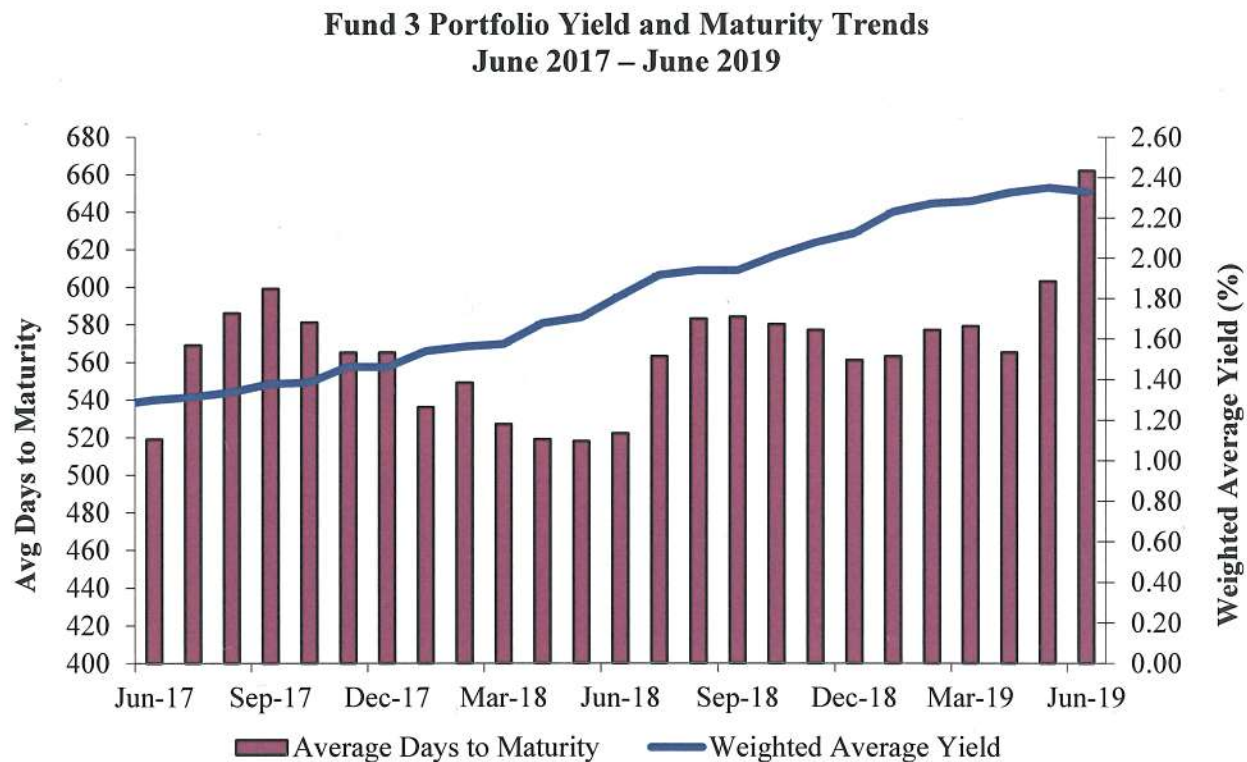
PORTFOLIO PERFORMANCE

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.

TOTAL PORTFOLIO INCOME RECOGNIZED			
	Accrual Basis		
Total Portfolio	June 30, 2019	March 31, 2019	June 30, 2018
<u>Quarter-End</u>			
Total interest earnings	\$10,567,307	\$9,566,487 (A)	\$6,837,329
Realized gains (losses)	0	0	0
Total income recognized	\$10,567,307	\$9,566,487	\$6,837,329
<u>Fiscal Year-to-Date</u>			
Total interest earnings	\$35,501,942	\$24,934,635 (A)	\$23,392,668
Realized gains (losses)	0	0	0
Total income recognized	\$35,501,942	\$24,934,635	\$23,392,668
(A) Total interest earnings in the quarter ending March 31, 2019 were revised down after staff made an interest rate correction			

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) increased from 579 days as of March 31, 2019, to 662 days on June 30, 2019. The weighted average yield increased from 2.281% as of March 31, 2019 to 2.330% on June 30, 2019.

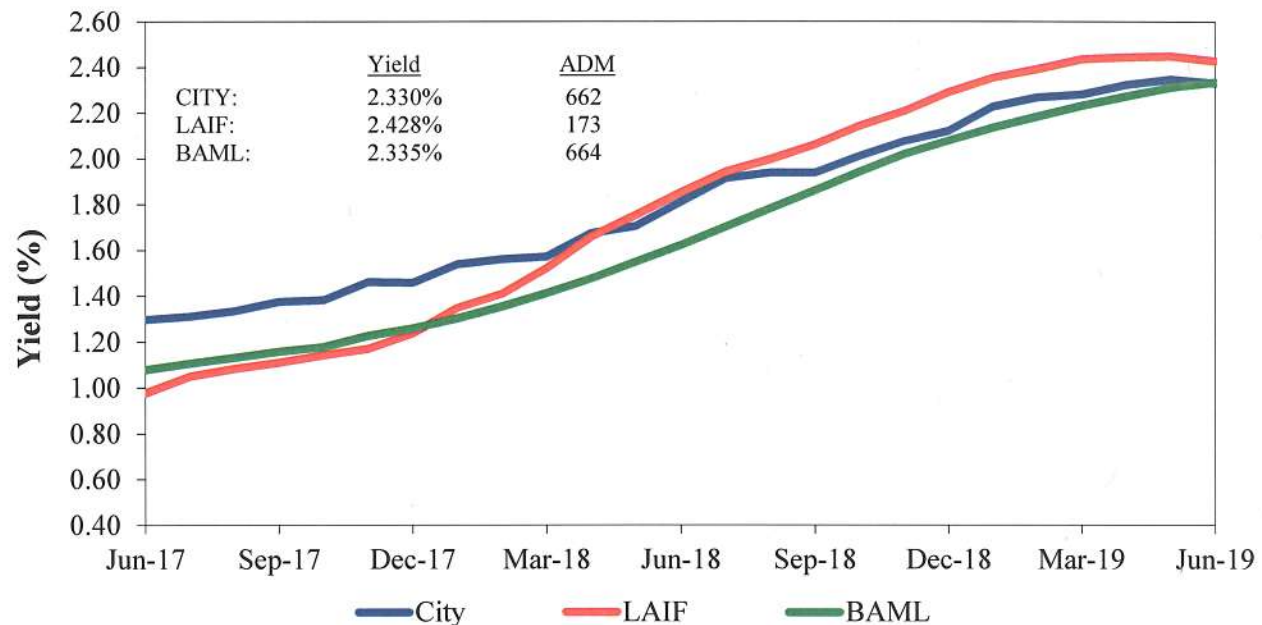
Yields continued declining during the quarter and the yield curve inversion started in March deepened. Anticipating falling interest rates, Investment staff purchased \$220.5 million federal agency and supranational papers with call options, which were issued with higher coupons and longer maturities. Staff carefully aligned call structures with anticipated cash outflow to mitigate potential reinvestment risks. This strategy contributed to the increase of the portfolio’s ADM and aggregate yield. In addition, staff also invested in bullet notes of various sectors and terms to maintain the diversification structure of the portfolio.

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 June 2017 to June 2019.

Portfolio vs. Benchmarks June 2017 – June 2019



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. LAIF has a high turnover ratio and its ADM was 173 days as of June 30, 2019. The City generally follows a buy-and-hold strategy and maintains a longer ADM, 662 days as of June 30, 2019. The majority of the City's holdings were purchased when interest rates were lower. When the yield curve is inverted, a much shorter portfolio like LAIF can reinvest more frequently and achieve higher yields than a longer portfolio like the City's portfolio. Nevertheless, the yield gap between the City's portfolio and LAIF tightened more this quarter, in comparison with the previous quarter. The gap will narrow further in the future, as interest rates are trending downward.

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 portfolio yield was 0.5 basis point lower than the BAML Index, with a slightly shorter ADM.

Unrealized Losses and Gains

As shown in the Investment Summary Table on page 1 of this report, the total portfolio size as of June 30, 2019, was approximately \$2.07 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.

UNREALIZED GAINS & LOSSES			
Cash Basis			
Market Value	\$2,074,153,841	Market Value	\$2,074,153,841
Original Cost	(2,065,550,242)	Amortized Cost	(2,066,076,365)
Net Unrealized Gain	\$ 8,603,599	Net Unrealized Gain	\$ 8,077,476

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 gain noted above are "paper gain" 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 June 30, 2019 was 2.348%, 0.059% higher than the previous quarter and 0.689% higher than the quarter ended June 30, 2018.

Cash Management Projection

Based on the Finance Department's cash flow projection as of June 30, 2019, total revenues and investment maturities for the next six months are anticipated to be approximately \$1.71 billion. This is sufficient to cover projected expenditures of approximately \$1.70 billion.

Statement of Compliance with the Policy

There were no exceptions or violations outstanding for the quarter ended June 30, 2019. The investment portfolio meets the requirements of the City's Investment Policy and California Government Code section 53601.

On June 20, 2019, the City received Certificate of Excellence Award from the Association of Public Treasurers of the United States & Canada for the success in developing a comprehensive written investment policy.

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 June 30, 2019. The interest earnings are greater than the forecast for the quarter and for the fiscal year.

BUDGET COMPARISON

<u>Net Investment Earnings</u>	<u>Yield</u>
<i>Quarter Ended June 30, 2019</i>	
Budget ^(a)	1.66%
Actual ^(b)	<u>2.20%</u>
Variance	0.54%
<i>Fiscal Year to Date</i>	
Budget ^(a)	1.66%
Actual ^(b)	<u>2.02%</u>
Variance	0.36%

(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 indicated earlier in July that the central bank is ready to cut interest rates to counter risks in the economic outlook. Equity markets remain at the historic high level and await second quarter corporate earnings release. U.S. economy shows no signs of substantial deterioration but faces risks of slowing global economy and trade policy uncertainty. Along with the U.S. central bank, European and Asian central banks are also poised to unleash monetary stimulus to extend the decade-long expansion amid cooling economy and trade tension.

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 June 30, 2019, 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 June 30, 2019.

CONCLUSION

The total investment portfolio as of June 30, 2019 was \$2,065,550,242, increased by approximately \$360.94 million from the previous quarter. For the quarter ended June 30, 2019, the earned interest yield was 2.348%, an increase from 2.289% reported for the previous quarter. The average days to maturity increased from 579 days on March 31, 2019, to 661 days on June 30, 2019. As of June 30, 2019, approximately 39% of the total portfolio was invested in U.S. Treasuries and agency securities.

/s/
JULIA H. COOPER
Director of Finance