

# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Julia H. Cooper

**SUBJECT: INVESTMENT REPORT FOR  
THE QUARTER ENDED  
SEPTEMBER 30, 2020**

**DATE:** November 19, 2020

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Approved

Date

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## REPLACEMENT

Transmitted herewith is the City's Investment Report for the quarter ended September 30, 2020. This transmittal replaces a previous transmittal of the Investment Report that did not include all of its attachments. 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 <https://www.sanjoseca.gov/your-government/departments/finance/reports/-folder-450> 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 November 19, 2020 and will be agendaized through the PSFSS Committee to the City Council meeting on December 8, 2020.

Summary of portfolio performance and compliance for quarter ended September 30, 2020:

- Size of total portfolio: \$1,960,107,295
- Earned income yield: 1.946%
- Weighted average days to maturity: 718 days
- Fiscal year-to-date net interest earnings: \$10,014,993
- No exceptions to the City's Investment Policy during this quarter

On September 15, the City Council approved a temporary amendment to the Investment Policy to increase the average weighted maturity of the investment portfolio from 2 years to 2.5 years. This amendment expires on July 1, 2021. During the quarter, the City's external auditor, Macias, Gini, & O'Connell LLP, evaluated the City's investment program for the six months ended June 30, 2020. The Independent Accountant's Report on Applying Agreed-Upon Procedure is included herewith. The report noted no exceptions to the Investment Policy.

If you have questions on this investment report, please do not hesitate to call me at (408) 535-7011.

/s/

JULIA H. COOPER  
Director of Finance

Attachment

cc: David Sykes, City Manager  
Joe Rois, City Auditor  
Nora Frimann, City Attorney

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**INVESTMENT REPORT FOR  
THE QUARTER ENDED  
SEPTEMBER 30, 2020**



Prepared by  
Finance Department  
Debt and Treasury Management Division

Julia H. Cooper  
Director of Finance

**Investment Report for  
The Quarter Ended  
September 30, 2020**

**City of San José  
Department of Finance  
Debt and Treasury Management Division**

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Rebecca Todd, Administrative Assistant

**CITY OF SAN JOSE  
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THE QUARTER ENDED SEPTEMBER 30, 2020  
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November 2, 2020

HONORABLE MAYOR and CITY COUNCIL

## INVESTMENT REPORT FOR THE QUARTER ENDED SEPTEMBER 30, 2020

I am pleased to present this report of investment activity for the quarter ended September 30, 2020 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 September 30, 2020, as well as provides a comparison to the quarters ended June 30, 2020, and September 30, 2019.

INVESTMENT SUMMARY			
For the Quarter Ended	September 30, 2020	June 30, 2020	September 30, 2019
<b><u>Total Portfolio</u></b>			
Portfolio Value <sup>(1) (2)</sup>	\$1,960,107,295	\$2,392,587,214	\$1,939,703,093
Earned Interest Yield	1.946%	1.974%	2.363%
Dollar-weighted average yield			
Purchases	0.370%	0.938%	2.035%
Maturities	1.427%	1.981%	1.848%
Called Securities	2.293%	2.433%	2.635%
Weighted avg. yield at end of period	1.691%	1.864%	2.314%
Weighted avg. days to maturity	718	672	621
<b><u>Portfolio Fund 3</u></b>			
Portfolio Value <sup>(1) (2) (3)</sup>	\$1,939,052,376	\$2,371,534,344	\$1,928,805,923
Earned Interest Yield	1.966%	1.991%	2.364%
Dollar-weighted average yield			
Purchases	0.370%	0.939%	2.035%
Maturities	1.427%	1.980%	1.848%
Called Securities	2.293%	2.433%	2.635%
Weighted avg. yield at end of period	1.710%	1.880%	2.316%
Weighted avg. days to maturity	726	678	624

<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 (\$369,474,972.95).

<sup>3</sup> Total excludes other restricted funds required to be invested separately.

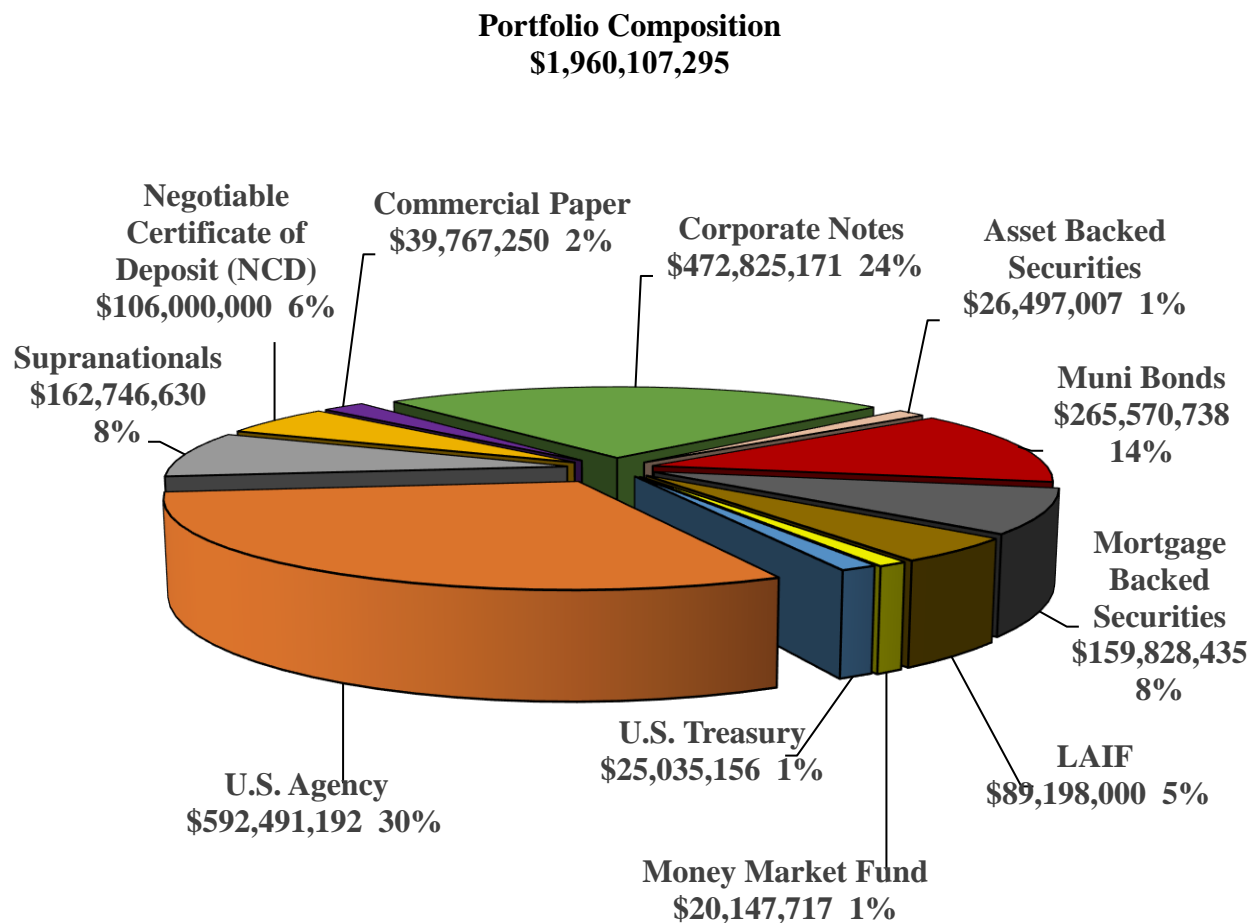
## **PORTFOLIO STATISTICS**

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

### **Portfolio Composition**

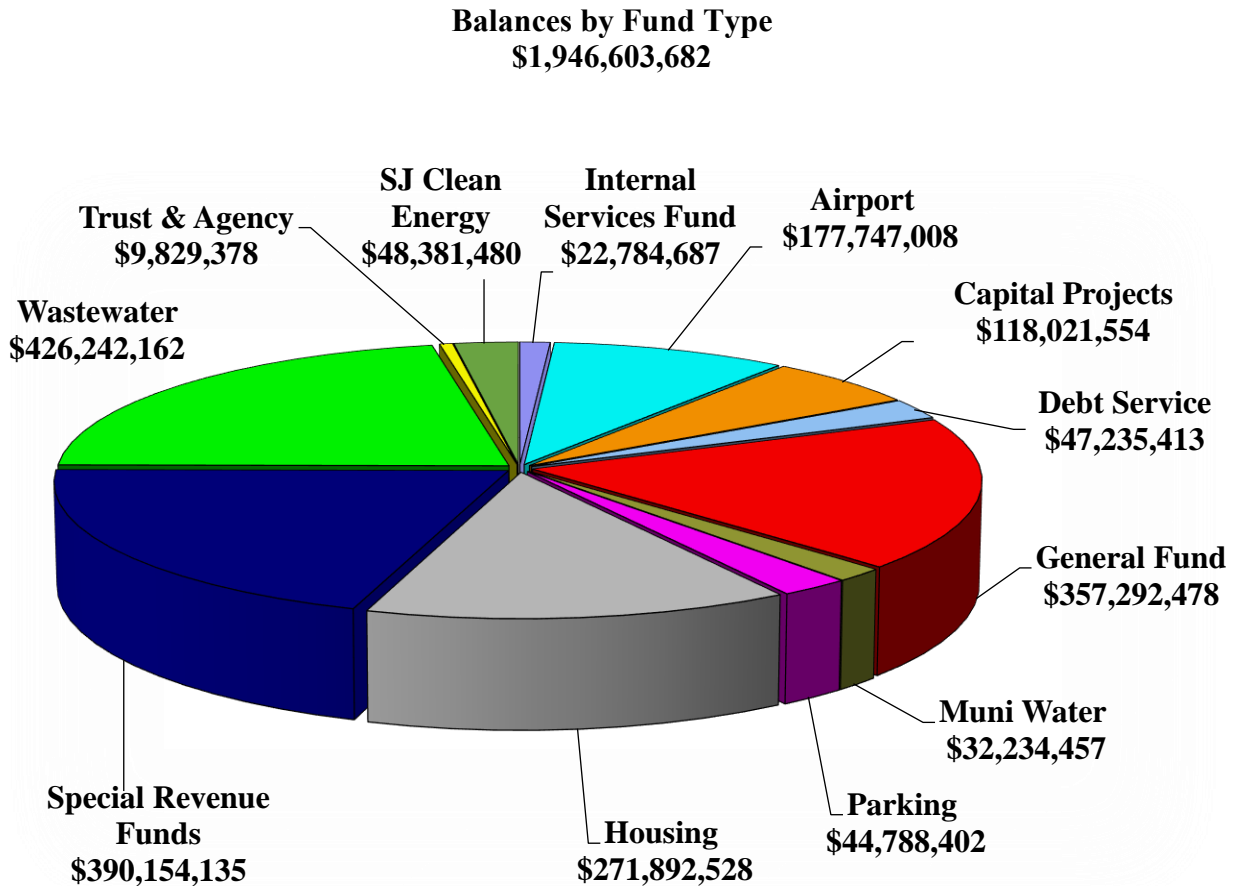
Within this section are snapshots of the City's total investment portfolio as of September 30, 2020.

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).



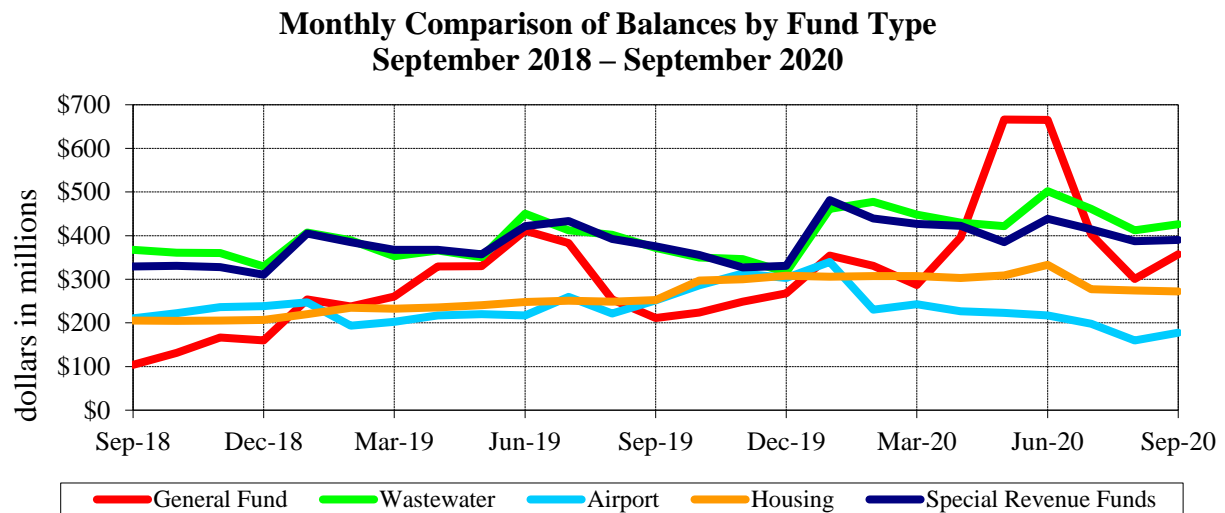
Portfolio Balance	\$1,960,107,295
General Banking Balance	5,033,883
Deposit-in-Transit, Outstanding Checks <sup>1</sup>	(18,537,496)
<b>Total Balances per FMS</b>	<b>\$1,946,603,682</b>

<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**

The General Fund balances decreased by \$308 million during the quarter and ended with a balance of \$357 million as of September 30, 2020. This decrease is attributed to prefunding of employer retirement contributions, debt service payments and other 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 Tier 1 the annual employer retirement contributions for Fiscal Year 2020-21. The prefunding amount was \$359 million. In anticipation of this cash outflow, the City set aside \$229 million in cash and matured investments and issued \$130 million Tax Revenue Anticipation Notes (TRANs) on July 1, 2020. The cash, matured investments and TRANs proceeds were sufficient to prefund the retirement contribution. As of September 30, 2020, the City has repaid \$13 million of TRANs and the remaining balance will be redeemed in full no later than June 2021.

### **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 September 30, 2020, SARA reported cash balances as outlined in the table below:

<b>SARA CASH SUMMARY</b>	
	<b>Pledged for Bond/Enforceable Obligations</b>
LAIF	\$5,786,221
Wells Fargo:	
General Account	\$338,141
Total Wells Fargo Funds	\$338,141
Wilmington Trust:	
Total Wilmington Trust Funds	\$223,979 (A)
	\$223,979
<b>TOTAL</b>	<b>\$6,348,341</b>
(A) Funds restricted for tax allocation bond debt service payments	

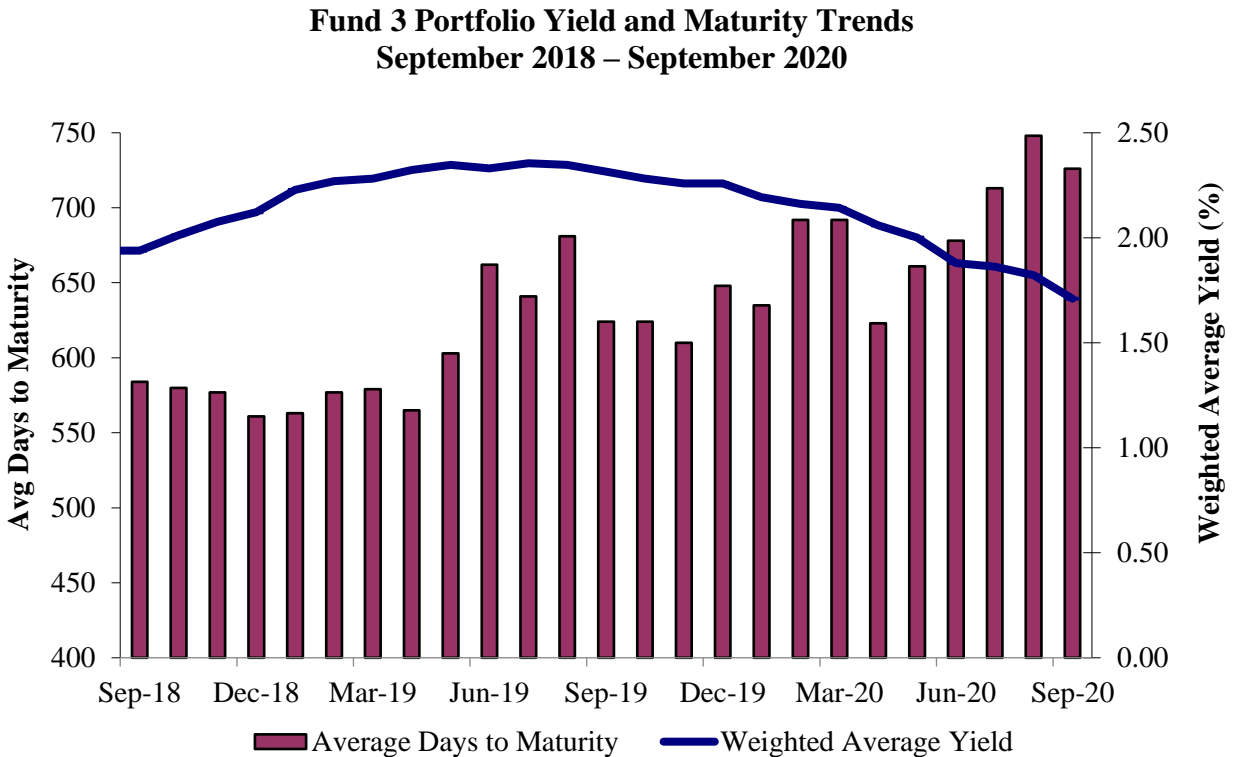
## **PORTFOLIO PERFORMANCE**

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.

<b>TOTAL PORTFOLIO INCOME RECOGNIZED</b>			
	<b>Accrual Basis</b>		
<b>Total Portfolio</b>	<b>September 30, 2020</b>	<b>June 30, 2020</b>	<b>September 30, 2019</b>
<b><u>Quarter-End</u></b>			
Total interest earnings	\$9,291,551	\$10,940,721	\$11,888,072
Realized gains (losses)	\$723,442	(\$138,009)	\$128,073
Total income recognized	\$10,014,993	\$10,802,712	\$12,016,145
<b><u>Fiscal Year-to-Date</u></b>			
Total interest earnings	\$9,291,551	\$45,020,776	\$11,888,072
Realized gains (losses)	\$723,442	\$866,314	\$128,073
Total income recognized	\$10,014,993	\$45,887,090	\$12,016,145

### **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 678 days as of June 30, 2020, to 729 days on September 30, 2020. The weighted average yield decreased from 1.880% as of June 30, 2020 to 1.710% on September 30, 2020.

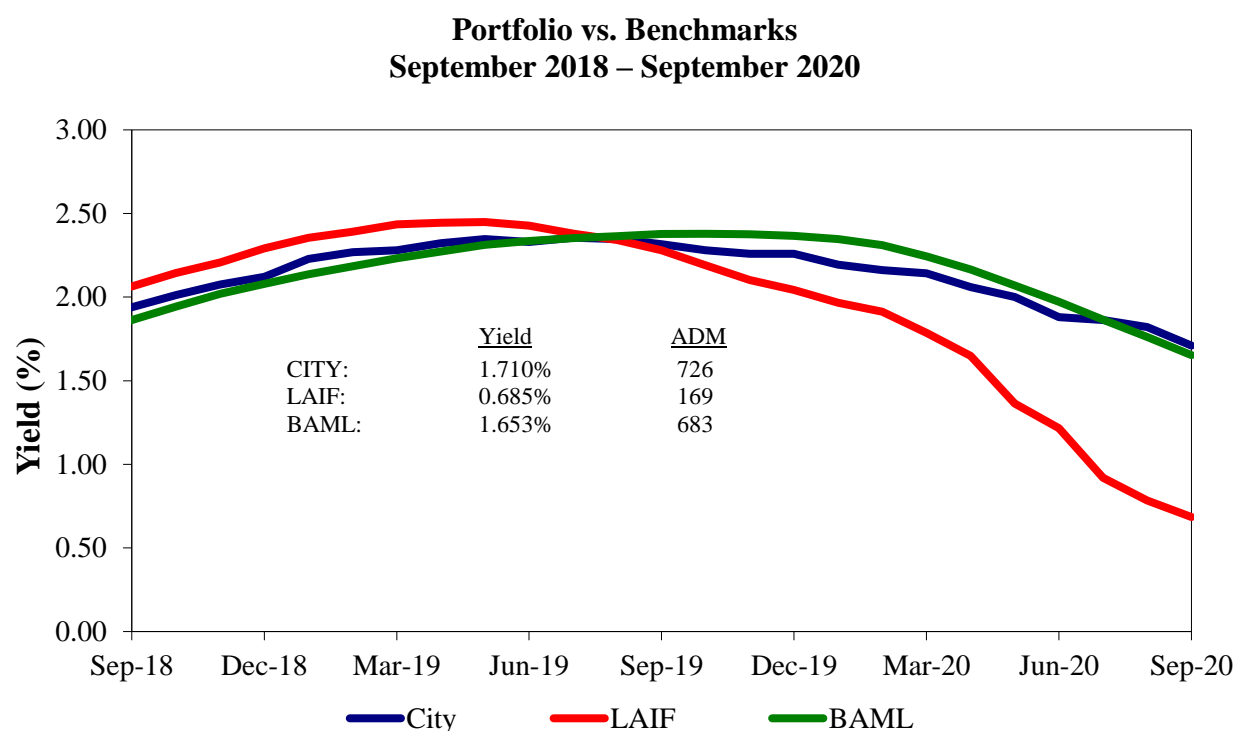
The increase of portfolio’s ADM was mainly due to withdrawals from the investment pool. As the balance of the portfolio decreased, the aggregate portfolio maturity increased. The City had large cash outflows in the summer for retirement prefunding, debt service payments and other expenditures. Revenues received were far less than anticipated expenditures. The investment pool plays a pivotal role in sustaining liquidity for the City’s operations. A majority of the portfolio is invested for a fixed term and the ADM increases when maturing investments are used to meet current cash flow needs. By the end of August 2020, the portfolio’s ADM reached to 741 days. Considering the unprecedented market conditions caused by the coronavirus, the City Council approved on September 15<sup>1</sup> a temporary amendment to the Investment Policy to increase the portfolio ADM maximum from 2 years to 2.5 years. The amendment expires on July 1, 2021.

<sup>1</sup> <http://sanjose.legistar.com/gateway.aspx?M=F&ID=6cab18b5-ac11-47e5-bff0-b8ed7e2c095b.pdf>

Bond yields continued to fall and hit historic lows during this quarter. As a result, bonds totaling \$133 million were called before maturity. New investments were purchased at much lower yields, compared with matured and called securities. As a result, the aggregate portfolio yield decreased.

### **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 September 2018 to September 2020.



**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's ADM was 169 days as of September 30, 2020, much shorter than the City portfolio's ADM (726 days). Therefore, LAIF has a higher turnover of security holdings and its yield decreases faster than the City's when interest rates are falling.

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. The BAML Index yield rose above the City's portfolio

in the summer of 2019 and has been trending downwards since March 2020. The BAML Index yield dropped below the City's portfolio in August 2020.

### **Unrealized Losses and Gains**

As shown in the Investment Summary Table on page one of this report, the total portfolio size as of September 30, 2020, was approximately \$1.96 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>	\$1,988,894,347	<b>Market Value</b>	\$1,988,894,347
<b>Original Cost</b>	<u>(1,960,107,295)</u>	<b>Amortized Cost</b>	<u>(1,959,397,118)</u>
<b>Net Unrealized Gain</b>	\$ 28,787,052	<b>Net Unrealized Gain</b>	\$ 29,497,229

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 gains noted above are "paper gains" 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 September 30, 2020 was 1.946%, 0.028% lower than the previous quarter and 0.417% lower than a year ago.

## **COMPLIANCE REPORTING REQUIREMENTS**

### **Compliance Audit**

Pursuant to Section 21.0 of the City's Investment Policy, "No less than semi-annually each year, a compliance audit shall be conducted of the City's investment program to determine whether the City's investments within the City's pooled portfolio are in compliance with the City's Investment Policy, internal controls and department procedures." These compliance audits per the Investment Policy can be included in the City Auditor's work plan, or can be conducted by an external auditor at the request of the Director of Finance. During the quarter, the City Auditor's Office engaged the services of Macias, Gini, & O'Connell LLP ("MGO") to audit the City's investments within the pooled portfolio.

MGO completed its evaluation for the six months ended June 30, 2020 and found the City's investment program to be in compliance with the City's Investment Policy, internal controls and department procedures. The report noted no exceptions to the Investment Policy. A copy of the

Independent Accountant's Agreed-Upon Procedures Report is attached to this quarterly report (Section F).

### **Cash Management Projection**

Based on the Finance Department's cash flow projection as of September 30, 2020, total revenues and investment maturities for the next six months are anticipated to be approximately \$1.70 billion. This is sufficient to cover projected expenditures of approximately \$1.45 billion.

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

There were no exceptions or violations outstanding for the quarter ended September 30, 2020. The investment portfolio meets the requirements of the City's Investment Policy and California Government Code section 53601.

On September 15, the City Council approved a temporary amendment to the Investment Policy to increase the average weighted maturity of the investment portfolio from 2 years to 2.5 years. This amendment expires on July 1, 2021.

### **Comparison of Portfolio Investment Earnings to FY 2020-21 Budget**

The following is a comparison of actual General Fund investment earnings, on an accrual basis, to the fiscal year 2020-21 budget. The fiscal year 2020-21 budgeted interest earnings for the General Fund is \$5.9 million, and the forecasted net interest yield is 1.75%. The schedule below compares the unaudited actual net investment earnings to the General Fund budget for the quarter ended September 30, 2020. The interest earning rates 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 June 30, 2020</i></b>	
Budget <sup>(a)</sup>	1.75%
Actual <sup>(b)</sup>	<u>1.82%</u>
Variance	0.07%
<b><i>Fiscal Year to Date</i></b>	
Budget <sup>(a)</sup>	1.75%
Actual <sup>(b)</sup>	<u>1.82%</u>
Variance	0.07%
(a) Reflects the 2020-2025 General Fund Forecast Information submitted by Finance on May 27, 2020.	
(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.

In general, the City buys and holds all securities to maturity. On rare occasions, the City may liquidate holdings to raise cash.

## **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 to provide income and structure for the portfolio when appropriate.

Global economies continued to be adversely affected by the coronavirus pandemic. After shelter-in-place directives were lifted around the country in limited scope, economic activity increased. Over 3 million nonfarm payroll jobs were added in July and August and the national unemployment rate declined to 7.9% in September 2020 from a high of 14.7% in April 2020. Equity markets made a significant recovery with the S&P 500 and NASDAQ indices hitting all-time highs on September 2, 2020. Despite of the improvements in equity markets, many Americans are not realizing the economic benefit of improved financial markets. Some key industries, such as travel, hospitality, and tourism, are still experiencing significant decreased activity. Interest rates hovered around historical lows. The Federal Reserve expects to maintain the Fed Funds Target Rate near zero until at least 2023 in an effort to support the nation's economic activity.

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 September 30, 2020, 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 this quarter.



## **CONCLUSION**

The total investment portfolio as of September 30, 2020 was \$1,960,107,295, a decrease of approximately \$432 million from the previous quarter. For the quarter ended September 30, 2020, the earned interest yield was 1.946%, a decrease from 1.974% reported for the previous quarter. The average days to maturity increased from 672 days on June 30, 2020, to 718 days on September 30, 2020. As of September 30, 2020, approximately 31% of the total portfolio was invested in U.S. Treasuries and agency securities.

JULIA H. COOPER  
Director of Finance