



# Memorandum

**TO:** PUBLIC SAFETY, FINANCE, AND  
STRATEGIC SUPPORT COMMITTEE

**FROM:** Julia H. Cooper

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

**DATE:** February 3, 2021

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Approved  Date 2-4-21

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## RECOMMENDATION

- 1) Approve the City of San José Investment Policy, as amended.
- 2) Refer the City of San José Investment Policy as well as the appropriate resolution to the full City Council for consideration at the March 9, 2021 Council Meeting.

## OUTCOME

Acceptance of this recommendation complies with the City of San José Investment Policy.

## BACKGROUND

The City of San José Investment Policy ("Policy") requires that the Finance Department perform an annual review of the Policy and submit any proposed changes to the Public Safety, Finance and Strategic Support Committee for its review and subsequent consideration and approval by the entire City Council.

## ANALYSIS

In accordance with Section 23 of the Policy, the Finance Department staff has completed its annual review of the Policy and recommends the following three (3) substantive revisions as follows, as well as several technical clean-ups:

- 1) Increase the Sector Limit of Municipal Bond Investments;
- 2) Amend Social Responsibility Language; and
- 3) Extend Temporary Modification of the Investment Portfolio Weighted Average Maturity to July 1, 2022.

The proposed revisions as redlined in Exhibit A (City of San José Investment Policy) continue to comply with the investment provision of the California Government Code, the Charter of the City of San José and the San José Municipal Code. The Policy and proposed revisions are consistent with the overall objectives of safety, liquidity and yield. They are also relevant to current laws and financial trends.

**1) Increase the Sector Limit of Municipal Bond Investments**

Staff recommends increasing the sector limit of municipal bond investments from 20% to 30%.

The current Policy allows the City to invest up to 20% of the portfolio in municipal bonds rated in “A” category or better. The California Government Code does not impose any limit on municipal bonds investment. As of December 31, 2020, the City held \$324 million in municipal bonds, over 17% of the pooled portfolio.

Municipal bonds are debt obligations issued by state, local governments and authorized agencies. Proceeds are often used to fund capital improvement projects, or to provide cash flow to operations. Debt services are typically backed by designated revenues or taxing authority of the issuing agency. Many government agencies are mandated to adopt a balanced budget and establish maximum debt limits. Conservative fiscal management policies allow many issuers to maintain quality credit ratings. In the current market, it is much easier to find “A” rated municipal bonds than corporate bonds. Municipal bonds add valuable credit diversification and yields to the City’s portfolio. Staff recommends increasing the sector limit of municipal bonds to the same level as corporate bonds, at 30%.

The Finance Department, Debt & Treasury Management division staff has used underwriter syndicate policies to increase demand and promote purchase of the City’s own municipal bonds by other state and local government agencies. Increasing the sector limit in municipal bonds signals the City’s willingness to support building demand for municipal bonds from other state and local governments, to the City’s benefit as both an issuer and buyer of municipal bonds.

See Section 9.13 of the attached redlined Investment Policy for the recommended changes.

**2) Amend Social Responsibility Language**

On March 10, 2020, the City Council referred staff to return to Council with language for a potential amendment to Section 22 (Social Responsibility) that includes a provision that “*The City shall make no new direct investments in entities that directly engage in the exploration, production, refining or marketing of fossil fuels.*”

**a. Investment Activities Promoting Social Responsibility**

The Policy’s requirements on social responsibility go beyond greenhouse gas reduction. The Policy encourages staff to invest in i) entities that support community well-being through



safe and environmentally sound practices and fair labor practices; ii) entities that support equality of rights regardless of sex, race, age, disability or sexual orientation; and iii) entities that serve all members of the local community and promote community economic development.

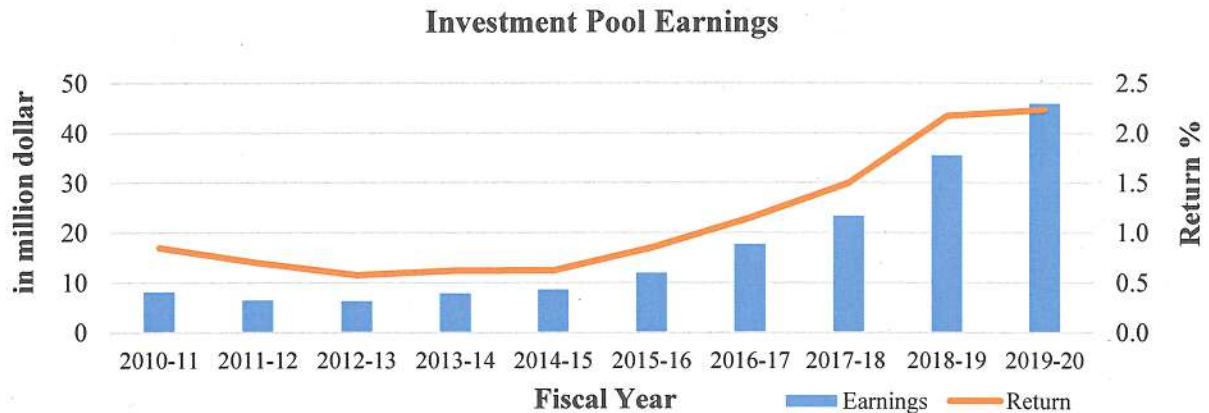
In practice, Investment staff makes a conscientious effort to make socially responsible investments. As of December 31, 2020, the City invested over \$157 million in Supranational bonds, many of which were issued to provide finance to middle to low income sovereign states, reduce poverty and promote development in many parts of the world. The City also held almost \$172 million of mortgage-backed securities, of which some are directed to help low income housing. As an active participant in the municipal bond market, the City invested \$324 million in municipal bonds issued by state and local governments, financing the needs of many communities across the nation.

#### **b. Prohibit Direct Investment in Fossil Fuels**

Among the City's approved credit names, only Chevron Corp is known to engage directly in fossil fuel exploration, production, refining and marketing. The City's Policy caps investment in a single issuer to 5% of the portfolio. In practice, staff limits the single issuer exposure in credit sectors to much lower levels. After the City Council unanimously adopted a Climate Emergency Resolution in September 2019, staff did not make any new investment in Chevron Corp. The current holdings (\$16 million, 0.86% of the portfolio) will mature in May 2021.

The City invests in various industries and multiple asset classes. Only a few companies in the fossil fuel industry have met the City's credit guidelines. The aggregate investment the City has made in the fossil fuel industry has not weighed significantly in the portfolio. Losing opportunities in fossil fuel investment does not present great harm to the City's portfolio. However, carbon footprint reduction takes a number of actions, big and small. Therefore, staff supports the City Council's initiative to prohibit future direct investment in entities that directly engage in the exploration, production, refining or marketing of fossil fuels.

The investment portfolio is an economic resource for the City, benefiting all residents of San José. During the last 10 fiscal years, the portfolio earned over \$171 million in total interest earnings. The following chart illustrates the portfolio annual returns by dollar and percent for the last ten (10) fiscal years.



See Section 22.0 of the attached redlined Investment Policy for recommended changes.

**3) Extend Temporary Modification of the Investment Portfolio Weighted Average Maturity to July 1, 2022**

On September 15, 2020, in response to market changes resulting from the impact of the coronavirus pandemic, the City Council approved a temporary modification to the Policy, increasing the weighted average maturity of the investment portfolio from the existing Policy maximum of two (2) years to two and a half (2.5) years (or 931 days) for a limited time. The current temporary modification is set to expire on July 1, 2021.

Although the equity market has more than recovered its losses since March 23, 2020, the bond market trades on extremely thin spreads. Ten-year Treasury yields only recently moved above 1% and many securities trade through Treasuries. Yields on the front end of the curve are extremely depressed. The Federal Reserve announced in December that it would increase Treasury security holdings by at least \$80 billion and agency mortgage-backed securities by at least \$40 billion every month. These massive asset purchases promote market liquidity while keeping bond yields at historical lows. This situation is likely to continue in the foreseeable future, possibly to 2023.

With the current market conditions in mind, after meeting the needs for safety and liquidity, staff needs to invest as much as possible in longer terms (4 – 5 years) to obtain meaningful returns and mitigate short term portfolio rate declines. This strategy will increase the weighted average maturity of the aggregate portfolio. Therefore, staff requests to extend the current temporary modification to July 1, 2022. This modification will be reviewed again during the annual Policy review in the spring of 2022.

See Section 26.0 of the attached redlined Investment Policy for recommended changes.



### **Technical "Clean-ups"**

Several technical clean-ups are recommended with the proposed Policy revisions. These clean-ups address minor changes to the Policy and the Glossary and are shown in the attached redlined Policy. There is no change to the list of primary dealers since the last Policy revision.

### **CONCLUSION**

The proposed revisions to the Investment Policy are consistent with the overall objectives of safety, liquidity and yield, and comply with the investment provision of the California Government Code, the Charter of the City of San José and the San José Municipal Code.

### **EVALUATION AND FOLLOW-UP**

Finance Department staff will be available to answer questions about the Annual Policy Review at both the Committee meeting on February 18, 2021 and the City Council meeting on March 9, 2021.

### **CLIMATE SMART SAN JOSE**

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

### **PUBLIC OUTREACH/INTEREST**

This item will be posted on the City's website for the February 18, 2021, Public Safety, Finance, and Strategic Support Committee meeting and the March 9, 2021 Council agenda.

### **COORDINATION**

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

### **COMMISSION RECOMMENDATION/INPUT**

No commission recommendation or input is associated with this action.

PUBLIC SAFETY, FINANCE, AND STRATEGIC SUPPORT COMMITTEE

February 3, 2021

**Subject: City of San José Investment Policy Annual Review**

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**CEQA**

Not a Project, File No. PP10-068 (b), General Procedure & Policy Making.

/s/

JULIA H. COOPER

Director of Finance

For questions, please contact Nikolai J. Sklaroff, Deputy Director, Debt and Treasury Management, at (408) 535-7832.

Attachment: Exhibit A- City of San José Investment Policy