



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Julia H. Cooper

**SUBJECT: INVESTMENT REPORT FOR
THE QUARTER ENDED
DECEMBER 31, 2020**

DATE: January 31, 2021

Approved

Date

2-4-21

Transmitted herewith is the City's Investment Report for the quarter ended December 31, 2020. 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 February 18, 2021 and will be agendaized through the PSFSS Committee to the City Council meeting on March 9, 2021.

Summary of portfolio performance and compliance for quarter ended December 31, 2020:

- Size of total portfolio: \$1,854,000,295
- Earned income yield: 1.74%
- Weighted average days to maturity: 723 days
- Fiscal year-to-date net interest earnings: \$18,292,631
- No exceptions to the City's Investment Policy during this quarter

If you have questions on this investment report, please do not hesitate to call me at (408) 535-7011, or via email at Julia.Cooper@sanjoseca.gov.

/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
DECEMBER 31, 2020**



Prepared by
Finance Department
Debt and Treasury Management Division

Julia H. Cooper
Director of Finance

**Investment Report for
The Quarter Ended
December 31, 2020**

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

Julia H. Cooper
Director of Finance

Luz Cofresi-Howe
Assistant Director of Finance

Nikolai J. Sklaroff
Deputy Director, Debt & Treasury Management

Qianyu Sun
Principal Investment Officer

Investment Staff

Cesar Blengino, Financial Analyst
Frances Tao, Accounting Technician

Special Assistance by

Katie Su, Accountant
Rebecca Todd, Administrative Assistant

**CITY OF SAN JOSE
INVESTMENT REPORTS FOR
THE QUARTER ENDED DECEMBER 31, 2020
TABLE OF CONTENTS**

LETTER OF TRANSMITTAL

SECTION A. PORTFOLIO STATISTICS

Portfolio Statistics – Quarter-to-Date

Portfolio Statistics – Year-to-Date

SECTION B. TOTAL EARNINGS REPORTS

Total Earnings – Quarter-to-Date

Total Earnings – Year-to-Date

SECTION C. PORTFOLIO HOLDINGS AT COST

Investment Status Report

SECTION D. MARKET VALUE OF PORTFOLIO

Portfolio Details - Investments

SECTION E. DETAIL OF INVESTMENT ACTIVITY

Transaction Activity Report

Reconciliation of Investment Activities

Purchase Report

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January 31, 2021

HONORABLE MAYOR and CITY COUNCIL

INVESTMENT REPORT FOR THE QUARTER ENDED DECEMBER 31, 2020

I am pleased to present this report of investment activity for the quarter ended December 31, 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 December 31, 2020, as well as provides a comparison to the quarters ended September 30, 2020, and December 31, 2019.

INVESTMENT SUMMARY			
For the Quarter Ended	December 31, 2020	September 30, 2020	December 31, 2019
<u>Total Portfolio</u>			
Portfolio Value ^{(1) (2)}	\$1,854,000,295	\$1,960,107,295	\$1,900,695,333
Earned Interest Yield	1.740%	1.946%	2.286%
Dollar-weighted average yield			
Purchases	0.568%	0.370%	1.935%
Maturities	2.126%	1.427%	2.276%
Called Securities	2.421%	2.293%	2.647%
Weighted avg. yield at end of period	1.535%	1.691%	2.254%
Weighted avg. days to maturity	723	718	641
<u>Portfolio Fund 3</u>			
Portfolio Value ^{(1) (2) (3)}	\$1,832,944,880	\$1,939,052,376	\$1,879,750,962
Earned Interest Yield	1.759%	1.966%	2.292%
Dollar-weighted average yield			
Purchases	0.568%	0.370%	1.935%
Maturities	2.126%	1.427%	2.276%
Called Securities	2.421%	2.293%	2.647%
Weighted avg. yield at end of period	1.562%	1.710%	2.259%
Weighted avg. days to maturity	731	726	648

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 (\$487,741,890.80).

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

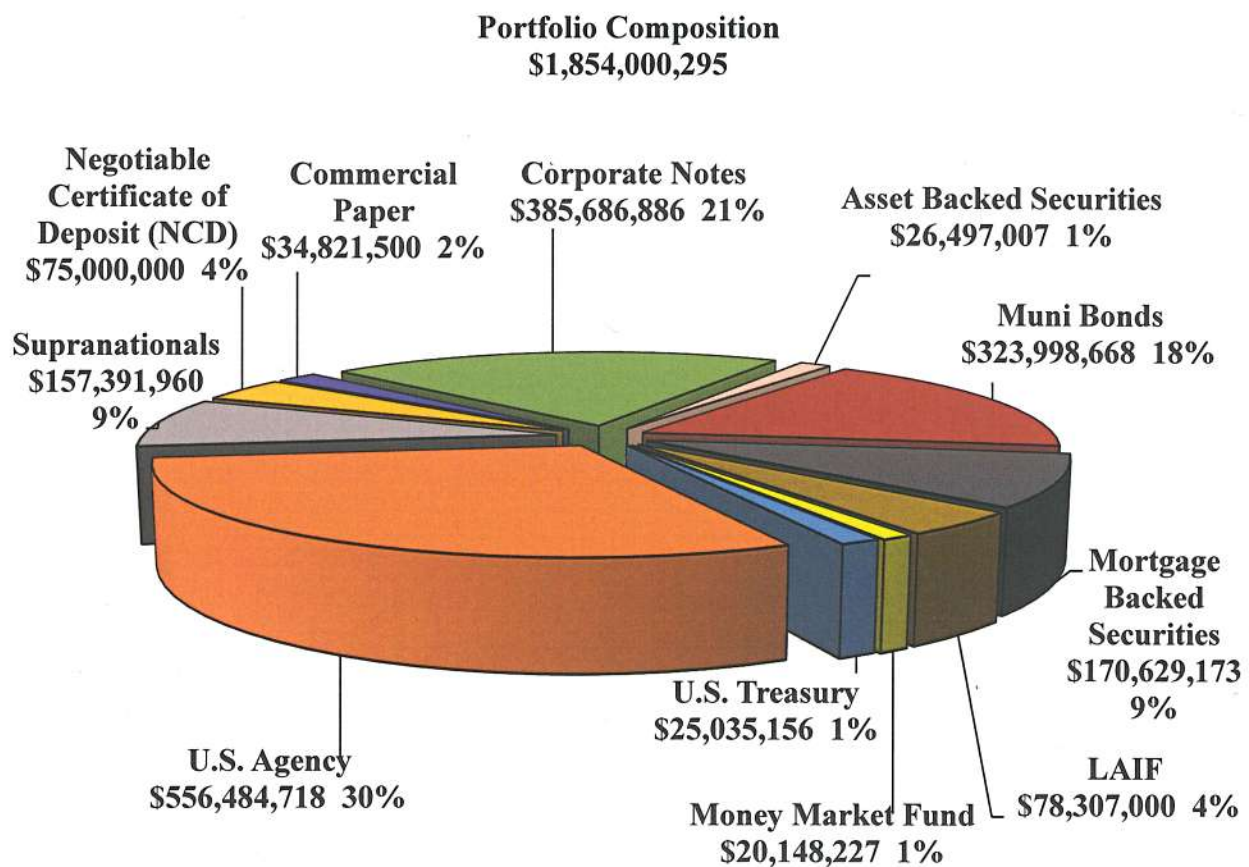
PORTFOLIO STATISTICS

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

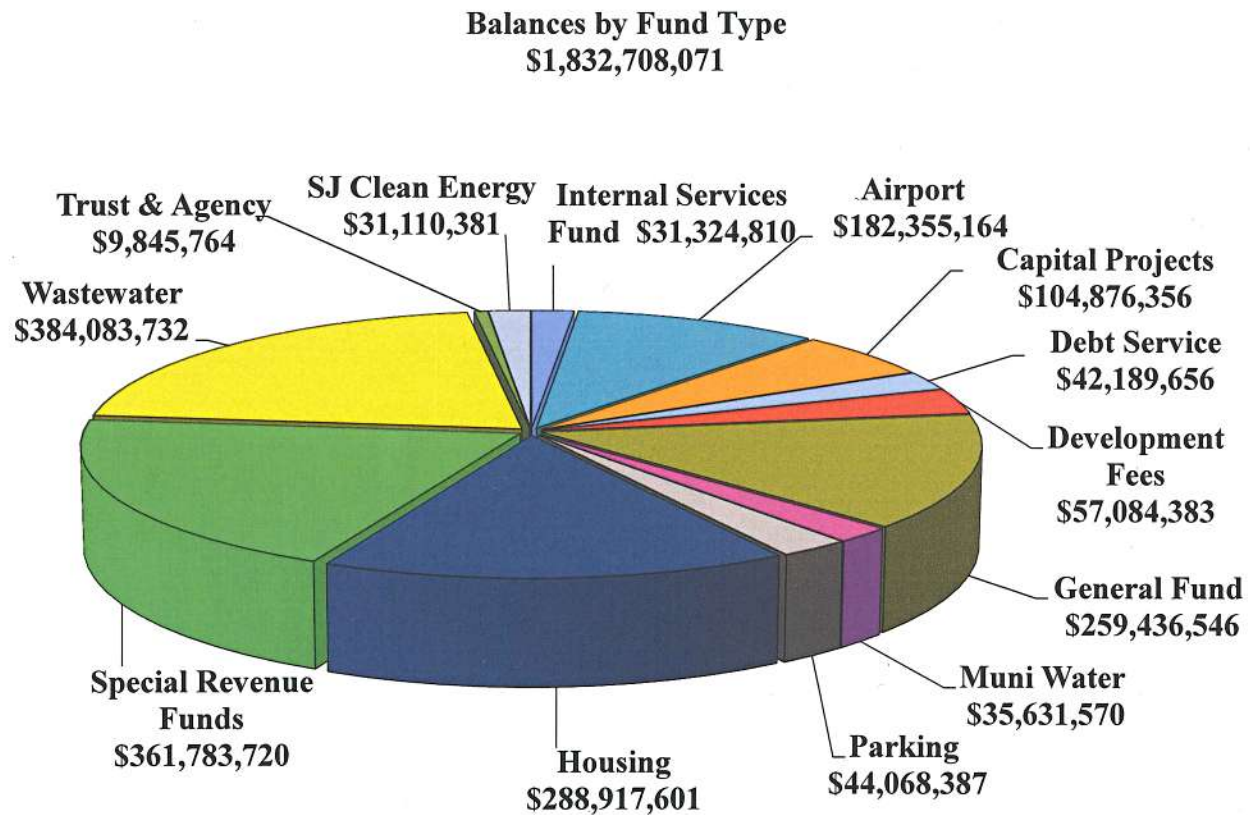
Portfolio Composition

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



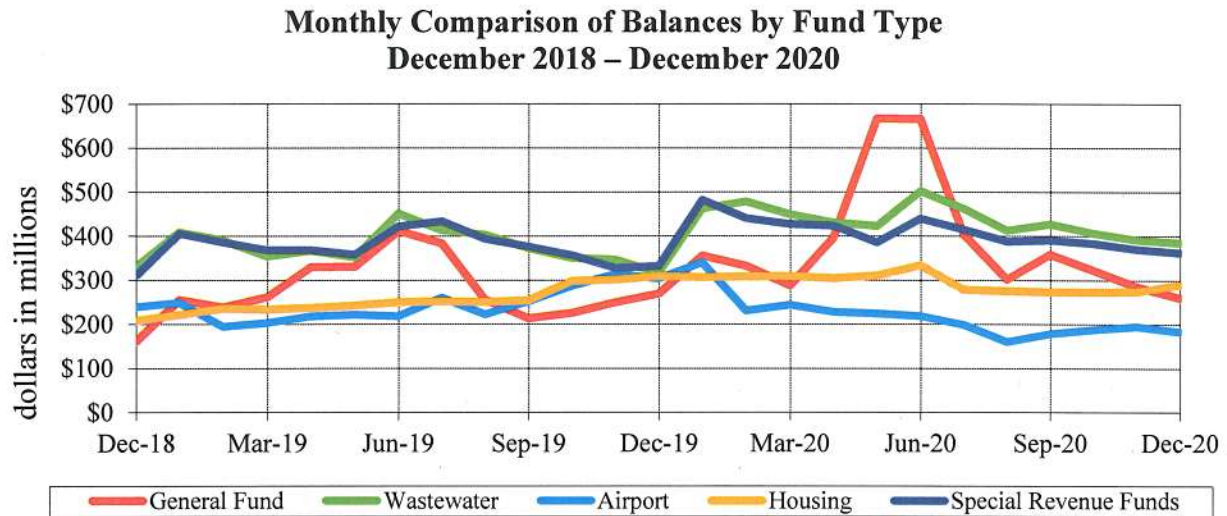
Portfolio Balance	\$1,854,000,295
General Banking Balance	2,149,609
Deposit-in-Transit, Outstanding Checks ¹	(23,441,833)
Total Balances per FMS	\$1,832,708,071

General Fund Balances

The General Fund balances decreased by \$98 million during the quarter and ended with a balance of \$259 million as of December 31, 2020. This decrease is attributed to operational expenditures. The General Fund balance typically declines during the summer and fall when revenues received are less than expenditures.

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.

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 December 31, 2020, the City has repaid \$52 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 December 31, 2020, SARA reported cash balances as outlined in the table below:

SARA CASH SUMMARY	
	Pledged for Bond/Enforceable Obligations
LAIF	\$5,798,501
Wells Fargo:	
General Account	\$804,472
Total Wells Fargo Funds	\$804,472
Wilmington Trust:	
Total Wilmington Trust Funds	\$223,986 (A)
	\$223,986
TOTAL	\$6,826,959
(A) Funds restricted for tax allocation bond debt service payments	

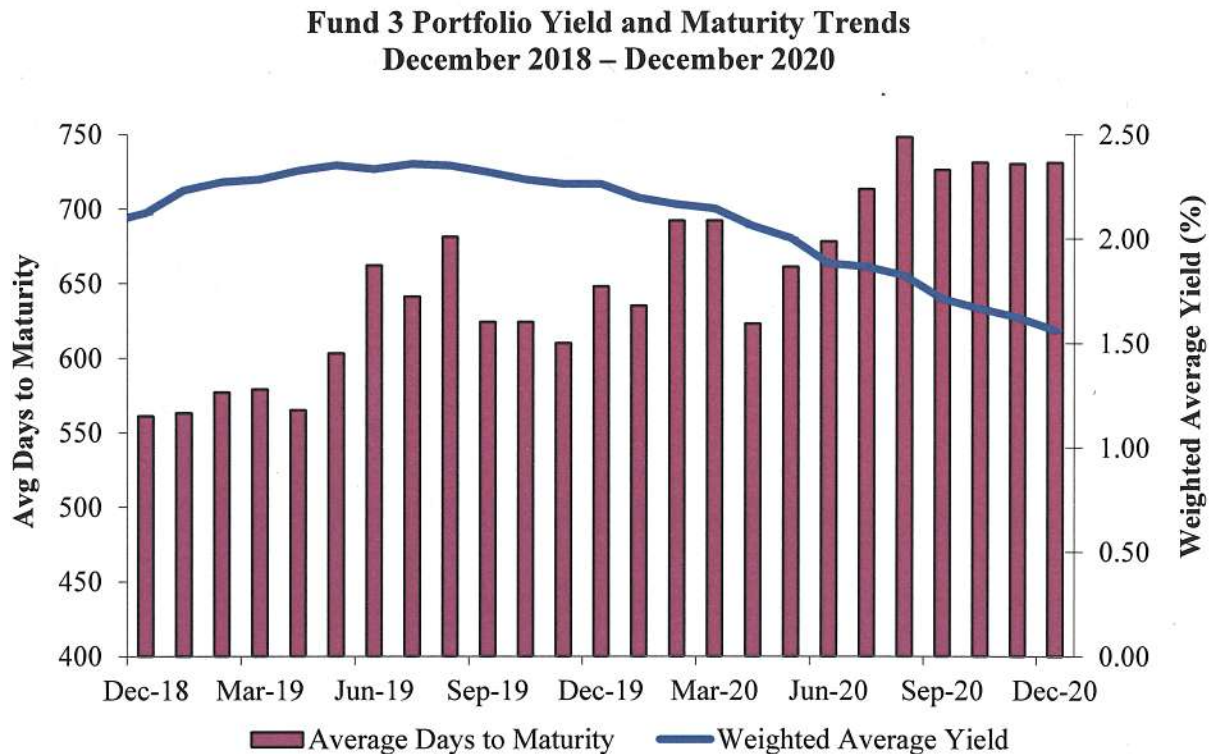
PORTFOLIO PERFORMANCE

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	December 31, 2020	September 30, 2020	December 31, 2019
<u>Quarter-End</u>			
Total interest earnings	\$7,767,462	\$9,291,551	\$10,938,514
Realized gains (losses)	\$510,176	\$723,442	\$160,294
Total income recognized	\$8,277,638	\$10,014,993	\$11,098,808
<u>Fiscal Year-to-Date</u>			
Total interest earnings	\$17,059,013	\$9,291,551	\$22,826,586
Realized gains (losses)	\$1,233,618	\$723,442	\$288,367
Total income recognized	\$18,292,631	\$10,014,993	\$23,114,953

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 726 days as of September 30, 2020, to 731 days on December 30, 2020. The weighted average yield decreased from 1.710% as of September 30, 2020 to 1.562% on December 31, 2020.

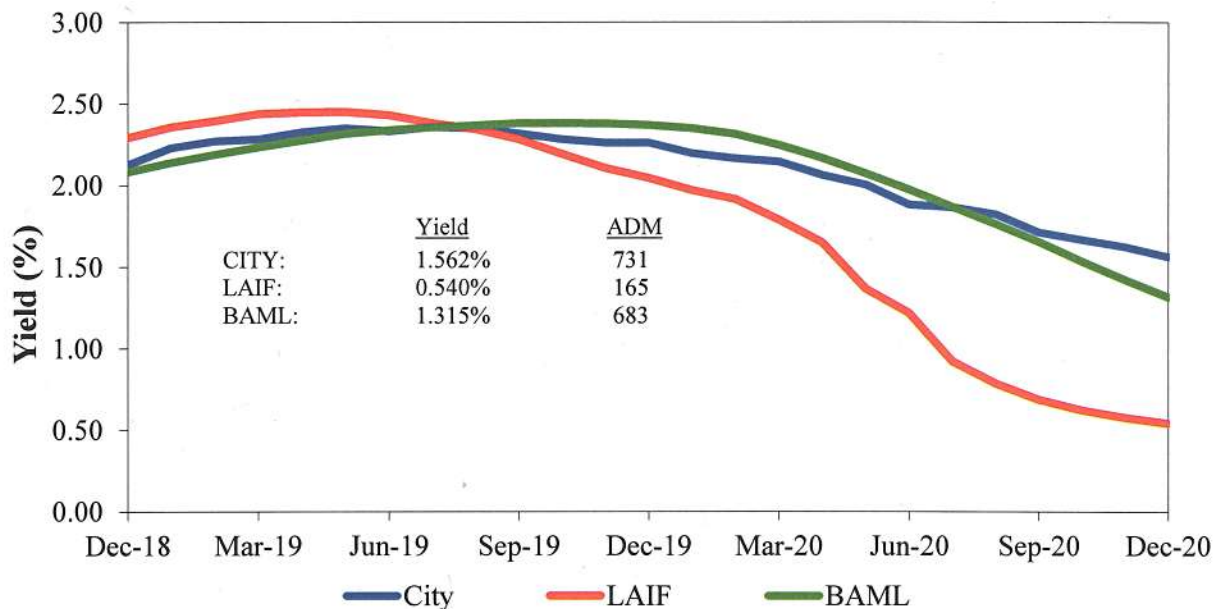
Compared with the previous quarter (the quarter ended September 30, 2020), the yield curve steepened moderately during this quarter and the front end slid even lower. Relative to LAIF, short-term investments available became less and less appealing to the City. After ensuring that the City’s liquidity needs were met, staff shifted focus towards longer-term (4-5 years) investments especially when the municipal market became active with new issuances, in an effort to capture as much yield as possible under the Investment Policy objectives. In total, staff purchased over \$58 million of municipal bonds during the quarter.

However, interest rates were still at historical lows and \$84 million of bonds were called before maturity during the quarter. New investments were purchased at much lower yields, compared with matured and called securities. As a result, the aggregate portfolio yield decreased while the ADM increased slightly.

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 2018 to December 2020.

**Portfolio vs. Benchmarks
December 2018 – December 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 165 days as of December 31, 2020, much shorter than the City portfolio's ADM (731 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. 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 and within Policy objectives. When the yield curve steepens and follows a normal shape, the City's portfolio would be expected to outperform the BAML Index.

Unrealized Losses and Gains

As shown in the Investment Summary Table on page one of this report, the total portfolio size as of December 31, 2020, was approximately \$1.85 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	\$1,876,355,813	Market Value	\$1,876,355,813
Original Cost	(1,854,000,295)	Amortized Cost	(1,852,442,660)
Net Unrealized Gain	\$ 22,355,518	Net Unrealized Gain	\$ 23,913,153

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 December 31, 2020 was 1.74%, 0.206% lower than the previous quarter and 0.546% lower than a year ago.

COMPLIANCE REPORTING REQUIREMENTS

Cash Management Projection

Based on the Finance Department's cash flow projection as of December 31, 2020, total revenues and investment maturities for the next six months are anticipated to be approximately \$1.93 billion. This is sufficient to cover projected expenditures of approximately \$1.55 billion.

Statement of Compliance with the Policy

There were no exceptions or violations outstanding for the quarter ended December 31, 2020. The investment portfolio meets the requirements of the City's Investment Policy and California Government Code section 53601.

S&P downgraded the Walt Disney Company from "A-" to "BBB+" on November 18, 2020, citing continued negative effects from the coronavirus pandemic. The outlook is negative. Disney was removed from the City's approved credit list immediately after the downgrade was announced. The City decided not to liquidate any remaining investment in Disney at this time.

As of December 31, 2020, the City held \$16.4 million in Disney bonds with maturities in 2021 and 2022. Staff continues to exercise due diligence and monitor Disney's financial status.

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 December 31, 2020. The interest earning rates are less than the forecast for the quarter and for the fiscal year.

BUDGET COMPARISON	
<u>Net Investment Earnings</u>	<u>Yield</u>
<i>Quarter Ended</i>	
Budget ^(a)	1.75%
Actual ^(b)	<u>1.61%</u>
Variance	(0.14%)
<i>Fiscal Year to Date</i>	
Budget ^(a)	1.75%
Actual ^(b)	<u>1.72%</u>
Variance	(0.03%)
(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 holds all securities to maturity. On rare occasions, the City may liquidate holdings to raise cash. In October 2020, staff noticed an error in the cash flow forecast and identified a potential cash shortfall. To ensure sufficient liquidity, staff sold \$10 million Coca-Cola Company bonds on October 19, realizing a gain of \$998.

INVESTMENT STRATEGY AND MARKET UPDATE

The Investment Program continues to focus on its core mandates of safety, liquidity, and yield. Staff continues effort to matched known cash flow outlays in the next 24-month horizon with investment maturities. Beyond the 24-month horizon, staff selectively invests in various assets

classes and maturity buckets to diversify the portfolio structure and maximize the portfolio's earnings potential, as allowed by the Investment Policy.

Global economies continued to be negatively affected by the coronavirus pandemic. A surge in infection rates late in the year and mutations of the coronavirus restarted many shelter-in-place directives that had been eased around the country in previous months. The national unemployment rate declined to 6.7% in December 2020 from a high of 14.7% in April 2020. Equity markets continued to trade at record highs with fresh new optimism over the distribution of the Pfizer-BioNTech coronavirus vaccine and the election of Joe Biden as the new President of the United States. Interest rates hovered around historical lows. The Fed reaffirmed its commitment to support the U.S. economy with its asset purchase program until it sees "substantial further progress" in employment and inflation.

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, 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 December 31, 2020 was \$1,854,000,295, a decrease of approximately \$106 million from the previous quarter. For the quarter ended December 31, 2020, the earned interest yield was 1.740%, a decrease from 1.946% reported for the previous quarter. The average days to maturity increased from 718 days on September 30, 2020, to 723 days on December 31, 2020. As of December 31, 2020, approximately 31% of the total portfolio was invested in U.S. Treasuries and agency securities.

/s/
JULIA H. COOPER
Director of Finance