



Memorandum

TO: PUBLIC SAFETY, FINANCE AND
STRATEGIC SUPPORT COMMITTEE

FROM: Julia H. Cooper

SUBJECT: FY 2014-15 SECOND QUARTER
INVESTMENT REPORT

DATE: January 31 , 2015

Approved

Date

COUNCIL DISTRICT: City-Wide

RECOMMENDATIONS

Accept the FY 2014-15 Second Quarter Investment Report.

DISCUSSION

The FY 2014-15 Second Quarter Investment Report for the quarter ended December 31, 2014 has been transmitted electronically to the City Council to meet the reporting requirements set forth in the City of San Jose Investment Policy. This report can also be found on the City's website at <http://www.sanjoseca.gov/index.aspx?NID=759> and a hard copy has been filed in the City Clerk's Office located at 200 East Santa Clara Street.

Attached is a copy of the FY 2014-15 Second Quarter Investment Report focusing on:

- Quarterly Portfolio Statistics and Performance
- Policy Reporting Requirements
- Investment Strategy
- Significant Developments

Consistent with the Investment Policy requirements, staff from the Finance Department will make a presentation and will be available to answer questions at the Public Safety, Finance and Strategic Support Committee meeting on February 19, 2015. In addition, this report will be agendaized on the Consent Calendar for the March 10, 2015 Council meeting.

/s/
JULIA H. COOPER
Director of Finance

Attachment



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Julia H. Cooper

**SUBJECT: INVESTMENT REPORT FOR
THE QUARTER ENDED
DECEMBER 31, 2014**

DATE: January 31, 2015

Approved

Date

1/30/15

Transmitted herewith is the City's investment report for the quarter ended December 31, 2014. 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 19, 2015 and will be agendized through the PSFSS Committee to a subsequent City Council meeting.

Summary of portfolio performance and compliance for quarter ended December 31, 2014:

- Size of total portfolio – \$1,320,218,063
- Earned interest yield – 0.617%
- Weighted average days to maturity – 529 days
- Fiscal year-to-date net interest earnings – \$4,083,887
- No sale of securities prior to maturity dates, therefore no realized gains/losses from sales
- 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.

JULIA H. COOPER
Director of Finance

cc: Norberto L. Dueñas, Interim City Manager
Sharon Erickson, City Auditor
Richard Doyle, City Attorney

**INVESTMENT REPORT FOR
THE QUARTER ENDED
DECEMBER 31, 2014**



Prepared by
Finance Department
Treasury Division

Julia H. Cooper
Director of Finance

**Investment Report for
The Quarter Ended
December 31, 2014**

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

Julia H. Cooper
Director of Finance

Derek Hansel
Assistant Director of Finance

Ellen Hung
Deputy Director of Finance, Treasury

Qianyu Sun
Principal Investment Officer

Investment Staff

Udaya Rajbhandari, Financial Analyst
Francis Tao, Senior Account Clerk

Special Assistance by

Justine Nguyen, Accountant II
Shirley Keay, Administrative Assistant

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January 31, 2015

HONORABLE MAYOR and CITY COUNCIL

INVESTMENT REPORT FOR THE QUARTER ENDED DECEMBER 31, 2014

I am pleased to present this report of investment activity for the quarter ended December 31, 2014 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, 2014 as well as provides a comparison to the quarters ended September 30, 2014 and December 31, 2013.

INVESTMENT SUMMARY			
For the Quarter Ended	December 31, 2014	September 30, 2014	December 31, 2013
<u>Total Portfolio</u>			
Portfolio Value ^{(1) (2)}	\$1,320,218,063	\$1,292,921,008	\$1,188,674,576
Earned Interest Yield	0.617%	0.620%	0.656%
Dollar-weighted average yield			
Purchases	0.304%	0.259%	0.312%
Maturities	0.373%	0.218%	0.575%
Called Securities	1.500%	0.600%	0.779%
Sold Securities	N/A	N/A	N/A
Weighted avg. yield at end of period	0.606%	0.623%	0.607%
Weighted avg. days to maturity	529	558	640
<u>Portfolio Fund 1</u>			
Portfolio Value ^{(1) (2)}	\$1,252,332,218	\$1,224,145,436	\$1,101,577,967
Earned Interest Yield	0.644%	0.651%	0.703%
Dollar-weighted average yield			
Purchases	0.319%	0.259%	0.341%
Maturities	0.444%	0.218%	0.707%
Called Securities	1.500%	0.600%	0.779%
Sold Securities	N/A	N/A	N/A
Weighted avg. yield at end of period	0.632%	0.653%	0.650%
Weighted avg. days to maturity	548	590	679

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 (\$249,285,252).

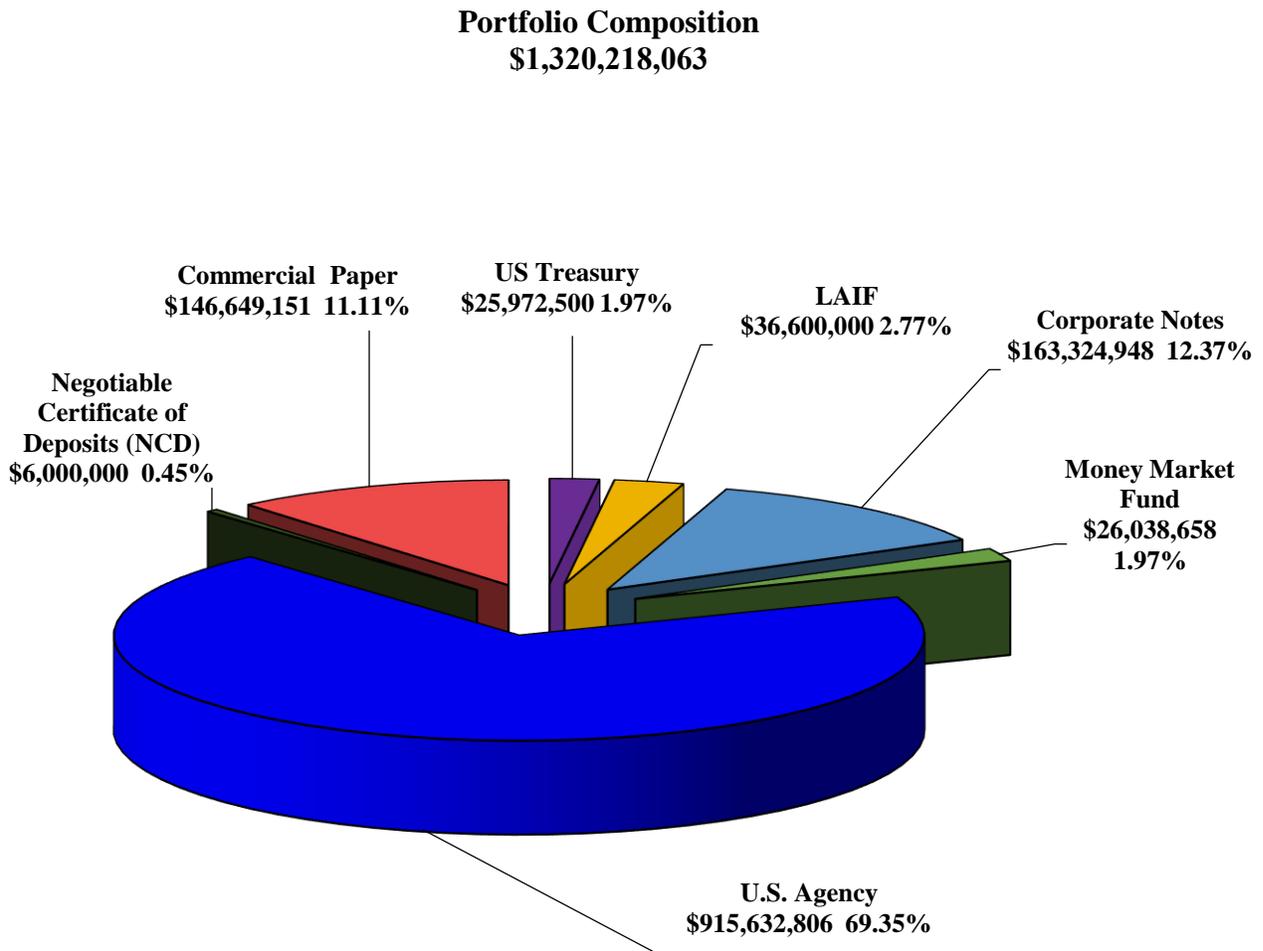
PORTFOLIO STATISTICS

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

Portfolio Composition

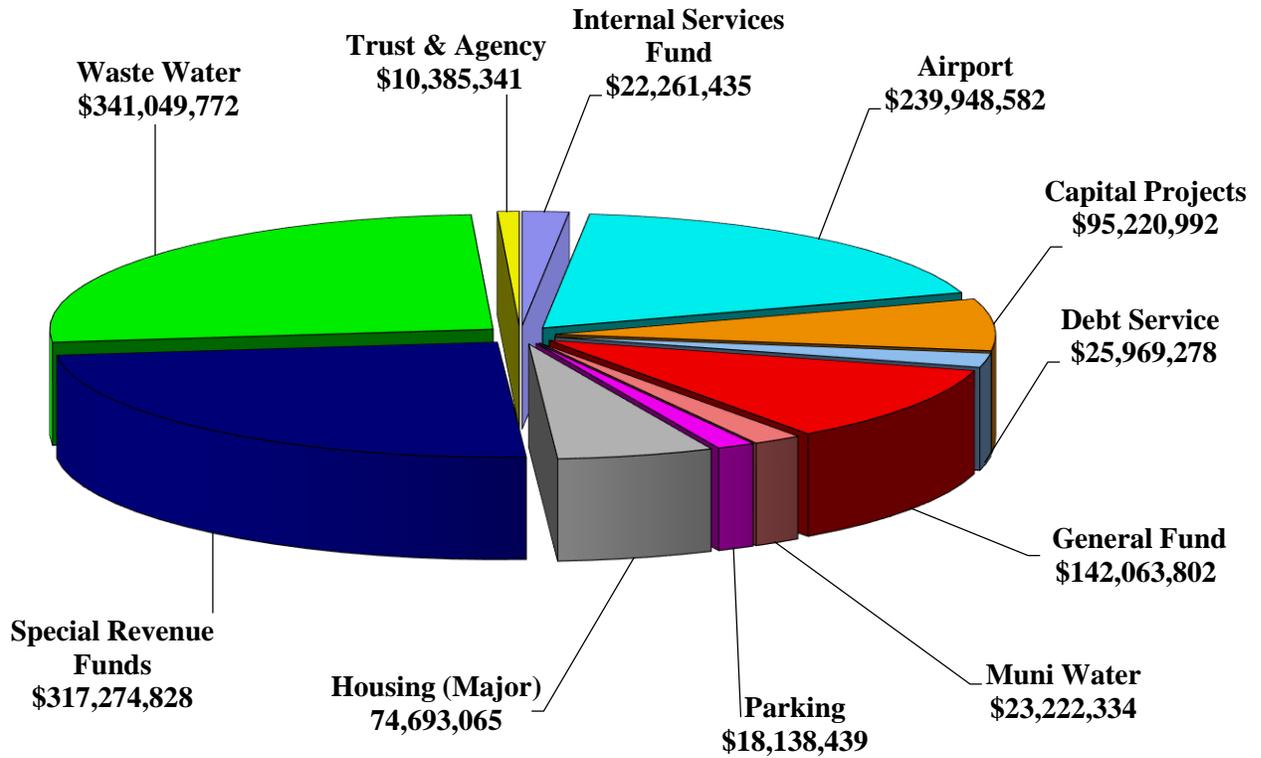
Within this section are snapshots of the City's total investment portfolio as of December 31, 2014.

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).

Balances by Fund Type
\$1,310,227,868

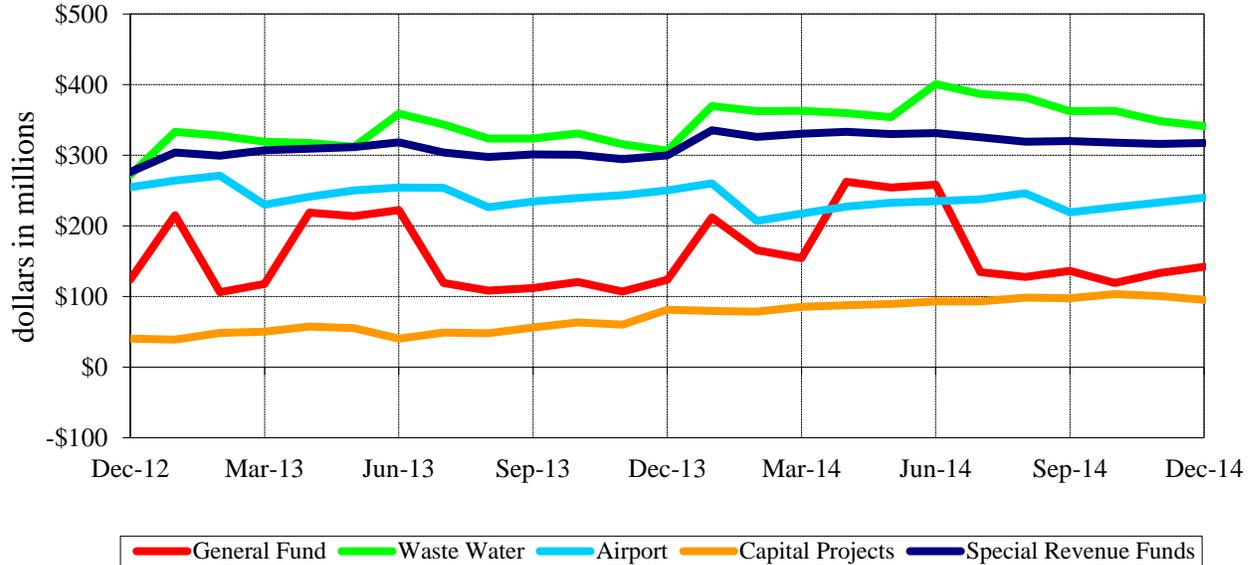


Total Balances per FMS	\$1,310,227,868
Deposit-in-Transit, Outstanding Checks ¹	<u>9,990,195</u>
Portfolio Balance Total	\$1,320,218,063

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.

**Monthly Comparison of Balances by Fund Type
Dec 2012 – Dec 2014**



General Fund Balances

General Fund balance increased approximately \$5.5 million from the September 30, 2014 ending balance of \$136.5 million to the December 31, 2014 ending balance of \$142 million. Cash balances usually peak during the months of January and June when the bulk of property taxes are received. The portfolio size and the General Fund balance typically experience declines in the summer months due to the retirement prefunding, debt service payments, and operational expenditures. These are also months when no property tax revenue is received.

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

The FY 2014-15 prefunding of the employer’s retirement contribution totaled \$279 million. To provide for retirement pre funding and to ensure the General Fund balance remains positive throughout the fiscal year, the City issued \$100 million Tax Revenue Anticipation Notes (“TRANS”) on July 1, 2014. Since the issuance, the City repaid \$70.15 million, including principal and interest as of January 2015. TRANS will be paid in full by June 30, 2015.

Successor Agency to the Redevelopment Agency of the City of San José Portfolio

Historically, the Redevelopment Agency participated in the City’s investment pool both with restricted bond proceeds and with 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”), began the administrative transition of funds out of the investment pool. The transition was completed in April 2012 at which time the former Redevelopment Agency’s participation in the City’s investment portfolio

ceased and its funds were transferred to SARA accounts held at the Bank of America, and a separate LAIF account was established to provide an investment vehicle for SARA funds. In September 2014, the City transitioned SARA's banking relationship from Bank of America to Wells Fargo Bank where the majority of the City's accounts are held. This transition was completed in January 2015.

As of December 31, 2014, SARA reported cash balances as outlined in the table below.

SARA CASH SUMMARY			
	<u>Restricted/Reserve</u>	<u>Pledged for Enforceable Obligations</u>	<u>Account Totals</u>
LAIF	\$0	\$6,988 ^(d)	\$6,988
Bank of America ^(e)			
General Account - 80% Funds	0	5,000 ^(d)	5,000
Bond Proceeds	0	0	0
20% Housing Account	0	0	0
Total BOFA	\$0	\$5,000	\$5,000
Wells Fargo			
General Account - 80% Funds	\$100,000 ^(a)	\$3,411,555 ^(d)	\$3,511,555
Bond Proceeds	341,001 ^(b)	0	341,001
20% Housing Account	30,866 ^(c)	0	30,866
Total WFB	\$471,867	\$3,411,555	\$3,883,422
TOTAL	\$471,867	\$3,423,543	\$3,895,410

^(a) Restricted per the Athletic Investment Group (AIG) Option and Purchase and Sale Agreement.

^(b) Restricted for expenditure on qualified capital expenditure (i.e. North San Pedro Housing Project).

^(c) 20% Housing funds reserved for debt service on senior and subordinate housing bonds and commercial paper.

^(d) Reserved for debt service in Recognition Obligation Payment Schedule 14-15B.

^(e) Bank of America account was closed as of January 5, 2015.

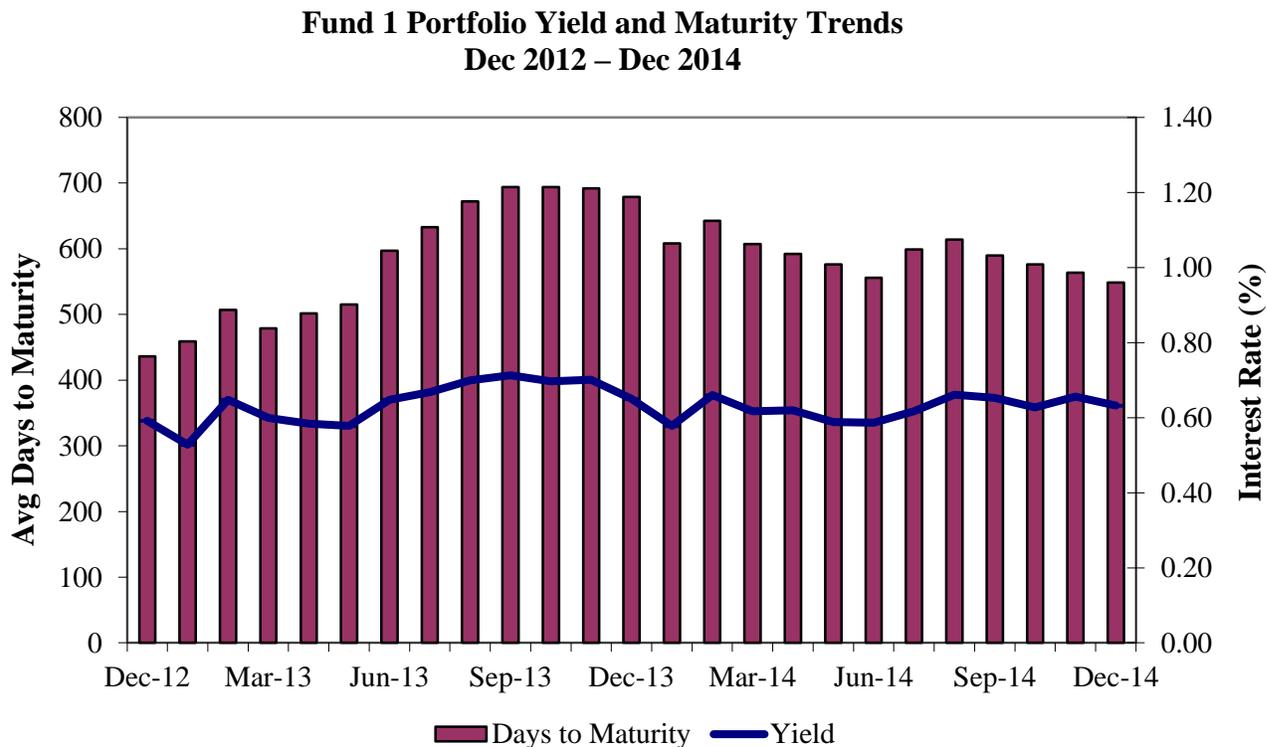
PORTFOLIO PERFORMANCE

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	<u>December 31, 2014</u>	<u>September 30, 2014</u>	<u>December 31, 2013</u>
<i>Quarter-End</i>			
Total interest earnings	\$ 2,019,387	\$ 2,064,500	\$ 1,929,691
Realized gains (losses) from sales	<u>0</u>	<u>0</u>	<u>0</u>
Total income recognized	\$ 2,019,387	\$ 2,064,500	\$ 1,929,691
<i>Fiscal Year-to-Date</i>			
Total interest earnings	\$ 4,083,887	\$ 2,064,500	\$ 3,892,498
Realized gains (losses) from sales	<u>0</u>	<u>0</u>	<u>0</u>
Total income recognized	\$ 4,083,887	\$ 2,064,500	\$ 3,892,498

Yield and Maturity Trend

The following graph illustrates monthly dollar-weighted average-days-to-maturity (“ADM”) of Fund 1 Portfolio (bar graph) along with the weighted average yield (line graph) for the past two years.



The portfolio’s weighted average days to maturity (ADM) decreased from 590 days on September 30, 2014 to 548 days on December 31, 2014. Consequently, the weighted average yield decreased from 0.653% as of September 30, 2014 to 0.632% on December 31, 2014.

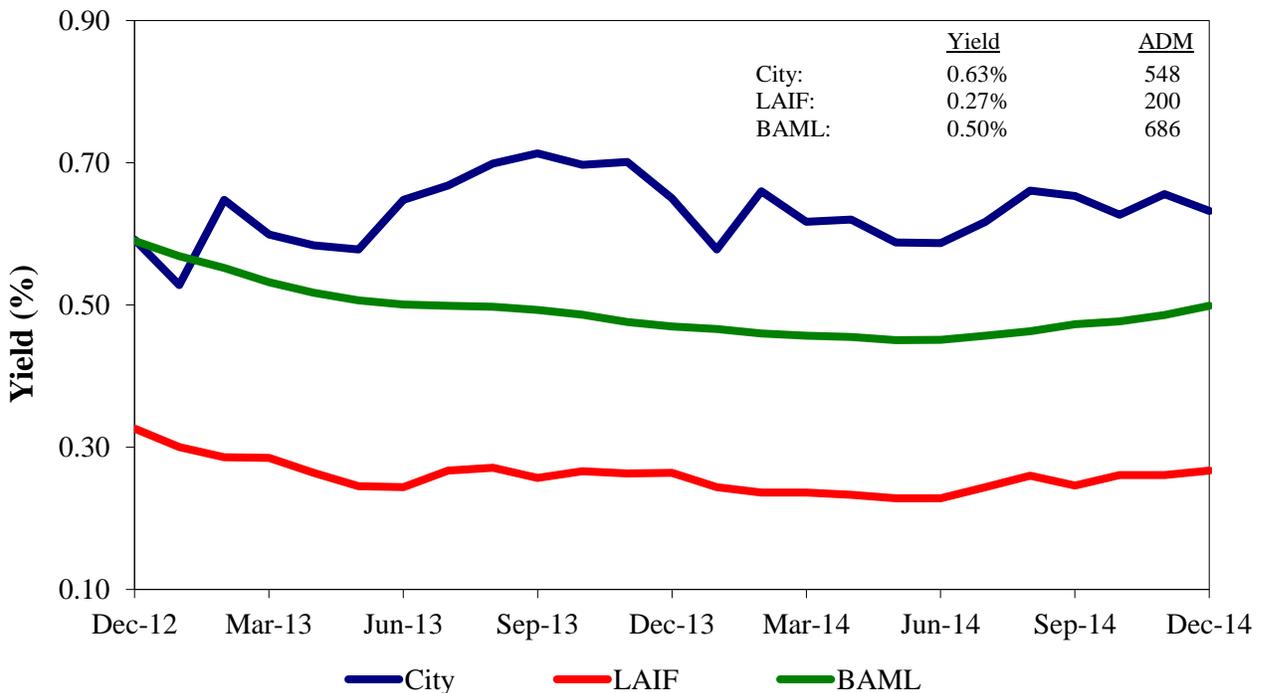
Throughout the quarter, staff strived to improve the liquidity of the portfolio. As longer investments matured and excess cash became available, staff reinvested in shorter terms to ensure that near-term cash outflows were met. Therefore, the portfolio experienced a decrease of 3 basis points in yield while the portfolio term was shortened by 42 days or 7.1%.

Comparison with Benchmarks

The City’s Total Portfolio is not compared against benchmarks because it includes various funds which are required to be invested apart from the pool and have their own separate cash flow needs. Only the City’s Fund 1 Portfolio is compared against benchmarks for performance purposes.

The following graph demonstrates a yield comparison by month among the City’s Fund 1 Portfolio, LAIF and the BAML Index for the period from December 2012 to December 2014.

**Portfolio vs. Benchmarks
Dec 2012 – Dec 2014**



Notes:

1. **City** refers to City's Fund 1 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. Its ADM is usually in the range of 180-280 days. The City has two accounts with LAIF, and in recent years staff has been using LAIF as a floor benchmark when making investment decisions. The City portfolio's ADM of 548 days is longer than LAIF's 200 days, which accounts for most of the yield difference between the two.

Since early 2011, staff began to extend investment maturities to increase portfolio yields. In recent years, staff placed some asset in the 3 to 5-year maturity range to add incremental yields when appropriate. In comparison, the BAML Index stays within 3 years. The compression of credit spreads over treasuries after the recession offered little or no pickup of yields for the Index. Therefore, as shown in the graph above, the City's portfolio outperformed the Index during the majority of last two years despite having a 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 December 31, 2014 was approximately \$1.3 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	\$1,319,436,468	Market Value	\$1,319,436,468
Original Cost	<u>(1,320,218,063)</u>	Amortized Cost	<u>(1,320,684,565)</u>
Net Unrealized Loss	\$ (781,595)	Net Unrealized Loss	\$ (1,248,097)

An inverse relationship exists between general changes in market interest rates and the value of investment securities. As general market interest rates decrease, the value of the City's investments increase as a result of the higher interest yields that these investments hold compared to market interest rates. Conversely, as market rates increase, the value of the City's investments decline as a result of the lower interest yields that these investments hold compared to market interest rates. 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 are only realized if securities are sold.

Earned Interest Yield

The earned interest yield of the total investment portfolio for the quarter ended December 31, 2014 was 0.617%. This is a slight decrease from 0.620% as reported for the quarter ended September 30, 2014. One contributing factor towards the decrease is intentional effort by the staff to lower the portfolio's ADM and improve liquidity. Additionally, the yield curve flattened considerably during the quarter and new investments were purchased at lower yields than matured investments with similar characteristics.

COMPLIANCE REPORTING REQUIREMENTS

As part of the reporting process outlined in the Investment Policy several compliance requirements shall be included in the quarterly report. These requirements include a statement of cash management projection, statement of compliance with the policy, and comparisons of budgeted investment earnings to actual investment earnings.

Cash Management Projection

Based on the Finance Department's cash flow projection as of December 31, 2014, total revenues and investment maturities for the next six months are anticipated to be approximately \$1,055 million. This is sufficient to cover projected expenditures of approximately \$842 million.

Statement of Compliance with the Policy

There were no exceptions or violations outstanding for the quarter ended December 31, 2014. The investment portfolio meets the requirements of the City's Investment Policy and the California Government Code section 53601.

Comparison of Portfolio Investment Earnings to FY 2014-15 Budget

The following is a comparison of actual General Fund investment earnings, on an accrual basis, to the fiscal year 2014-15 budget. Monthly budgeted apportionments for City funds are based upon historic cash balance averages and an assumed average return for the fiscal year. The 2014-15 budgeted interest earnings for the General Fund is \$425,000, and is based on a projected net interest yield of 0.37%. The schedule below compares the unaudited actual net investment earnings to budgeted amounts for the General Fund for the quarter ended December 31, 2014. The investment yield has exceeded the budget for the quarter and fiscal year-to-date.

BUDGET COMPARISON

(in thousands)

<u>Net Investment Earnings</u>	<u>Yield</u>
<i>Quarter Ended December 31, 2014</i>	
Budget ^(a)	0.44%
Actual ^(b)	<u>0.37%</u>
Variance	0.07%
<i>Fiscal Year to Date</i>	
Budget ^(a)	0.45%
Actual ^(b)	<u>0.37%</u>
Variance	0.08%

(a) Reflects the FY 14/15 Adopted Budget as approved by the Council on June 10, 2014.

(b) Reflects net investment yield which is the earned interest yield less costs to administer the investment program, adjusted for funds with negative cash balances at month-end.

INVESTMENT TRADING ACTIVITY

Attachment E provides a detailed summary of the Investment Activities during the quarter, including any realized gains or losses from interest received on trading activity. Since the City is currently not involved in active trading, this report is only relevant when a security is sold prior to maturity as defined in Section 4.0 (2) of the Investment Policy.

INVESTMENT STRATEGY

The Investment Program continues to focus on its core mandates of safety, liquidity, and yield. Prior to 2011, the City's investment strategy was to invest short-term (18 months or less) in order to cover liquidity needs. In early 2011, staff began to extend maturities in order to provide income and structure to the portfolio. Investments have been matched to known cash flow outlays in the 18-24 month horizon. This strategy is expected to continue throughout FY 2014-15. Additionally, staff will increase portfolio's credit exposure cautiously and pick up incremental yields on the front end of the curve without jeopardizing the Investment Program's mandates of safety, liquidity, and yield.

Future Commitments – As of December 31, 2014 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, 2014.

Municipal Bonds – No municipal bonds were purchased during the quarter ended December 31, 2014.

CONCLUSION

The total investment portfolio as of December 31, 2014 was \$1,320,218,063. This represented an increase of approximately \$27 million from September 30, 2014, primarily due to higher revenues. For the quarter ended December 31, 2014 the earned interest yield was 0.617%, a decrease from 0.620% reported for the quarter ended September 30, 2014. The average days to maturity decreased from 558 days on September 30, 2014 to 529 days on December 31, 2014. As of December 31, 2014 approximately 71% of the total portfolio consisted of U.S. Treasuries and agency securities.


JULIA H. COOPER
Director of Finance