



CITY OF
**PALO
ALTO**

City Council Staff Report

From: City Manager

Report Type: INFORMATION REPORTS

Lead Department: Administrative Services

Meeting Date: August 19, 2024

Report #:2404-2847

TITLE

Investment Activity Report for the Fourth Quarter, Fiscal Year 2024

RECOMMENDATION

This is an informational report and no City Council action is required.

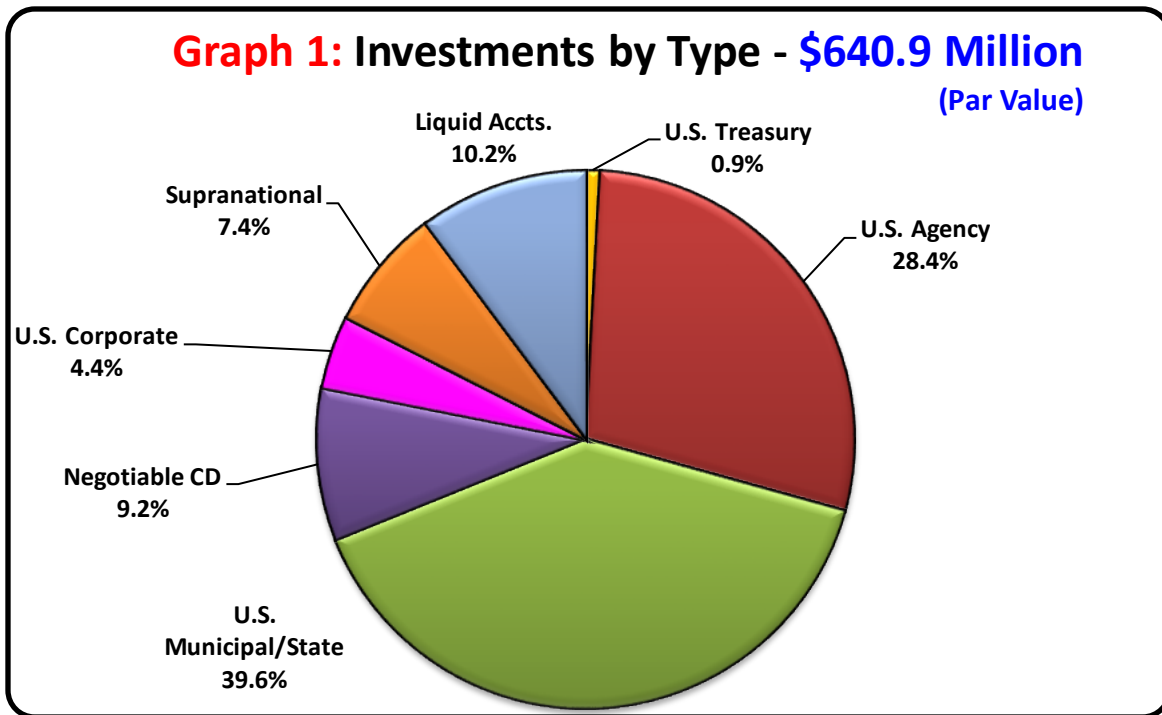
EXECUTIVE SUMMARY

The City's [Investment Policy](#)¹ (Policy) requires that staff report out to Council quarterly on the City's portfolio composition and performance compared to the Council-adopted Policy; discuss overall compliance with the City's Investment Policy; and provide recommendations, if any, for Policy changes. In addition, staff provides a detailed list of all securities and reports on the City's ability to meet expenditure requirements over the next six months. This report is to inform Council of the City's investment portfolio performance as of the fourth quarter ending June 30, 2024 and to disclose staff's cash flow projections for the next six months. Staff expect that the City will have sufficient funds or liquidity to meet expenditure requirements for the next six months. The portfolio details, activities, and performance are discussed below, and additional information is provided in the attachments. During the fourth quarter staff complied with all aspects of the Investment Policy and no significantly notable activity or changes in value occurred in this reporting period.

ANALYSIS

The City's investment portfolio is summarized in Graph 1 and detailed in the Investments by Fund Report (Attachment B). The Investments by Fund Report groups the portfolio's securities by investment type and includes details of the investment issuer, date of maturity, current market value, the book and face (par) value, and the weighted average maturity of each type of investment and of the entire portfolio.

¹ City of Palo Alto website, Administrative Services Department, Money Management & Treasury:
<https://www.cityofpaloalto.org/files/assets/public/v/1/administrative-services/investment-policies/adopted-investment-policy-1-39-asd.pdf>



Due to rounding, the above graph's percentage total is greater than 100 percent.

The par value of the City's portfolio is \$640.9 million; in comparison, last quarter it was \$634.3 million. The \$6.6 million portfolio growth since the last quarter results from timing of cash flows, major revenue receipts due to seasonality timing, and one less pay period costs in the fourth quarter compared to the third quarter. Property taxes and related receipts begin the second, third, and fourth quarters and major revenues such as sales, transient occupancy and utility user's taxes are historically higher in the fourth quarter. Partially offsetting these timing in cash gains are extra ordinary capital expenditures such as in the Wastewater Treatment capital projects and additional contribution to the Pension Trust Fund, managed by Public Agency Retirement Services (PARS).

The portfolio consists of \$65.3 million in liquid accounts and \$575.6 million in various investment types, as detailed in Table 1. The Investment Policy requires that at least \$50 million be maintained in securities maturing in less than two years. The portfolio includes \$215.7 million in investments maturing in less than two years, comprising 33.7% of the City's investment portfolio. In addition, the Investment Policy allows up to 30% of the portfolio to be invested in securities with maturities beyond five years; actual at the end of the fourth quarter is 27.4% of the portfolio.

Table 1: Investment Type	FY 2024 Q4 Maturities - Par Value (millions)						
	Up to 1 Year	1 to 2 Years	2 to 3 Years	3 to 5 Years	Over 5 Years	Portfolio Total *	% of Portfolio
U.S. Treasury	\$ 1.0	\$ 3.0	\$ 1.5	\$ -	\$ -	\$ 5.5	0.9%
U.S. Agency Bonds	4.6	57.1	13.3	13.3	94.0	182.3	28.4%
U.S. Municipal/ State Bonds	33.7	37.7	55.3	47.2	80.1	254.0	39.6%
Negotiable Certificates of Deposits (NCD)	15.4	14.3	12.1	15.7	1.2	58.7	9.2%
U.S. Corporate Bonds	7.5	9.0	6.7	4.8	-	28.0	4.4%
Supranational Organizations Bonds	0.2	32.2	6.0	8.8	-	47.2	7.4%
Liquid Accounts (LAIF & Fidelity)	65.3	-	-	-	-	65.3	10.2%
Grand Total	\$ 127.7	\$ 153.3	\$ 94.9	\$ 89.8	\$ 175.3	\$ 641.0	100%
% of Portfolio	19.9%	23.9%	14.8%	14.0%	27.3%	100.0%	

* \$111.3 million or 18.7% are in investments that support Environmental, Social, and Governance (ESG) Activities (aka "Green", local banks, and Supranational Bonds)

The current market value of the portfolio is 93.9% of the book value, which fluctuates depending on the market and how interest rates perform. The Investment Policy states "Should the ratio of the market value of the portfolio to the book value of the portfolio fall below 95%, the Administrative Services Department will report this to the City Council within a reasonable time frame and evaluate whether there is any risk of holding any of the securities to maturity." In the prior eight quarters the market value fell below 95%; ranging from 89% to 94% during these periods. Interest rates on new investments have fluctuated and the expectation is the market value of the portfolio is expected to stay in the current range in the coming quarters.

As interest rates decrease, the market value of the City's portfolio will likely increase, and vice versa. There are inherent principal risks when actively buying and selling securities; reporting on market values a reporting requirement that informs staff of the portfolio's overall position. The market valuation is provided by U.S. Bank, the City's safekeeping agent. The average life to maturity of the investment portfolio is 3.11 years compared to 3.38 years as reported in the third quarter.

To minimize investment principal risk of loss due to lower market values, the City's investment practice is to buy and hold investments to maturity. In the instances where there is a need to sell securities for contingency cash flow planning, the City's practice is to sell securities that are at or above the market value.

Investment Activity During the Fourth Quarter

During the fourth quarter, \$15.2 million of securities with an average yield of 3.8% matured. The City's short-term money market and pool account increased by \$21.8 million compared to the third quarter of FY 2024. Staff continually monitors the City's short-term cash flow needs and adjusts liquid funds to meet them. The planned increase is attributable to the prepayment of the FY 2025 Unfunded Accrued Liability (UAL) pension cost that will be paid in July 2024. UAL is the future cost of pension benefits, minus plan assets.

In addition, per California Government Code Section 53607, the Administrative Services Department shall provide a monthly report of transactions (investments, reinvestment, sold, and exchanged securities) made during the month to the Council. Though not required by this code, included in this report are security maturities and cash movement activity in the City's two liquid operating cash pool accounts (Local Agency Investment Fund and Fidelity accounts. This reporting requirement is separate and distinct from the quarterly investment report submitted under Code Section 53646, however, these activities for the quarter are also being provided in this quarterly report as well (Attachment D).

Availability of Funds for the Next Six Months

Staff expects that the City will have sufficient funds or liquidity to meet expenditure requirements for the next six months.

Projections indicate that for the City's cashflow, an overall decline in the portfolio of \$14.8 million is expected over the coming six months due to routine business activities. This reflects expected receipts of \$344.6 million and expenditures of \$359.4 million over the next six months. The expected cash decline is attributed to the lump-sum prepayment of the FY 2025 pension UAL, which results in approximately \$1.6 million pension expense savings that is offset by the loss of \$1 million in interest income in the City's investment portfolio. This results in net citywide savings of \$0.6 million because PERS has the ability to earn interest earlier and at a higher rate than the City could realize.

As of June 30, 2024, the City had \$65.3 million in liquid accounts with Local Agency Investment Fund (LAIF) and a money market account. In addition, investments totaling \$29.9 million will mature between July 1, 2024 and December 31, 2024. Staff expect that the City will have sufficient funds or liquidity to meet expenditure requirements for the next six months.

Compliance with City Investment Policy

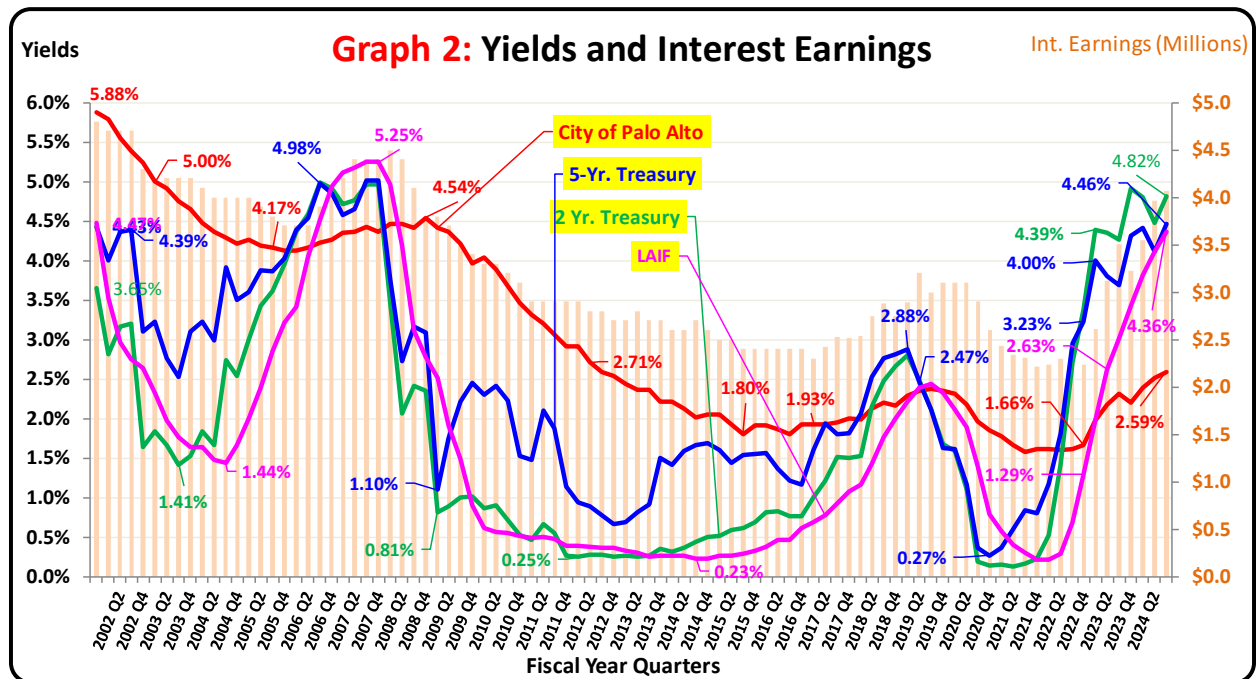
During the fourth quarter, staff complied with all aspects of the Investment Policy. Attachment C lists the major restrictions in the City's Investment Policy compared with the portfolio's actual performance.

Investment Yields

Interest income on an accrual basis, for the General Fund, for the fourth quarter was \$4.1 million, \$0.6 million higher than the prior year's fourth quarter, which totaled \$3.5 million. This increase is due to a higher yield investment environment and higher cash balance. As of June 30, 2024, the yield to maturity of the City's portfolio was 2.59% (in the prior quarter it was 2.52%), while LAIF's average yield was 4.36% and the two-year and five-year Treasury bonds had an average yield of approximately 4.82% and 4.46%, respectively. In comparison, in the prior quarter LAIF had 4.12% yield and the two-year and five-year Treasury bonds yields were higher at 4.48% and lower at 4.12%.

The City's portfolio yield is lower than the two-year and five-year Treasury bond due to the high interest rates environment. It is expected that as the City's investments mature in the next few

years, funds will continue to be reinvested and will follow the economic patterns. Graph 2 shows the City's yields and interest earnings for the past 22+ years.



City's portfolio duration is 3.11 years.

Yield Trends

The Federal Open Market Committee (FOMC), since March 2020, has raised the federal funds rate 11 times totaling 5.25% with the first occurring on March 16, 2022. Prior to this the rate was near zero. This was to mitigate the persistent elevated inflation rate from the peak of 9.1% in June 2022 to 3% in June 2024, slightly higher than the prior month with a 2% target.

After the FOMC not raising the rate in the last eight meetings, the expectation is they are likely to do modest rate increase(s) in the near future. The FOMC has stated that "inflation has eased over the past year but remains elevated. In recent months, there has been modest further progress toward the Committee's 2% inflation objective."

Funds Held by the City or Managed Under Contract

Attachment A is a consolidated report of all City investment funds, including those not held directly in the investment portfolio. These include cash in the City's regular bank account with US Bank and Wells Fargo. A description of the City's banking relationships can be found in City

Council Staff Report ID #7858² and ID #11402³. Bond proceeds, reserves, and debt service payments being held by the City's fiscal agents are subject to the requirements of the underlying debt indenture. The trustees for the bond funds are U.S. Bank and California Asset Management Program (CAMP). Bond funds with U.S. Bank are invested in federal agency and money market mutual funds that consist exclusively of U.S. Treasury securities. Bond funds in CAMP are invested in banker's acceptance notes, certificates of deposit, commercial paper, federal agency securities, and repurchase agreements. The most recent data on funds held by the fiscal agent is as of June 30, 2024.

In January 2017, the City established a Section 115 Irrevocable Trust (Public Agencies Post-Employment Benefits Trust) administered by Public Agency Retirement Services (PARS). This fund is governed by the City's Retiree Benefit Policy as opposed to the Investment Policy; however, it is discussed in this report to present the full picture of the City's investments. It is the City's intent to prefund pension costs and began to address the Net Pension Liabilities (NPL) as calculated by Governmental Accounting Standards Board Pronouncement No. 68 (GASB 68). The Section 115 Trust offered by PARS has five portfolios from which to choose in making investments of City funds. In February 2023, the City Council revised the City's portfolio selection from "Moderately Conservative" to "Moderate", shifting from the second most conservative to third. Additional information on the establishment of this trust can be found in City Council Staff Report ID # 7553⁴. Through June 30, 2024, principal investment contributions of \$73.2 million made over time since May 2017, has increased to \$84.7 million and the net return for one and five years has been 1.2% and 4.9% respectively. Since inception or May 2017 to June 2024, \$11.5 million net earnings have been realized with \$0.7 million in administrative expenses.

FISCAL/RESOURCE IMPACT

This is an information report.

² City Council, April 11, 2017, under "Additional Information", CMR 7858:

<https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/reports/city-manager-reports-cmr/year-archive/2017/7858.pdf>

³ City Council, September 21, 2020 Item #2, CMR 11402:

<https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/reports/city-manager-reports-cmr/year-archive/2020-2/id-11402.pdf>

⁴ City Council, January 23, 2017 Item #5, CMR 7553: <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/reports/city-manager-reports-cmr/year-archive/2017/7553.pdf>

STAKEHOLDER ENGAGEMENT

Staff works internally and with external parties (U.S. Bank's custodial, U.S. Bank's bonds, Wells Fargo and U.S. Bank's banking, California Asset Management Program (CAMP), and Public Agency Retirement Services (PARS)) statements to prepare this report.

ENVIRONMENTAL REVIEW

This Council informational report is not a project under California Environmental Quality Act (CEQA) as defined in CEQA Guidelines, section 15378, because it has no potential for resulting in either a direct or reasonably foreseeable indirect physical change in the environment.

ATTACHMENTS

Attachment A: Consolidated Report of Cash Management

Attachment B: Investment Portfolio

Attachment C: Investment Portfolio Compliance

Attachment D: Investment Activities in the Report Period

APPROVED BY:

Lauren Lai, Administrative Services Director