



City of Sunnyvale

Agenda Item-No Attachments (PDF)

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REPORT TO COUNCIL

SUBJECT

Adopt the City's Investment Policy for Fiscal Year 2018/19 and Receive the Annual Performance Report for Fiscal Year 2017/18

BACKGROUND

The City Council first adopted a policy governing the investment of City funds on July 30, 1985. This policy has been reviewed and adopted on an annual basis since that time.

For the purposes of bringing on investment expertise not on staff, and supporting the management of an increasingly complex investment environment as well as a portfolio that is growing significantly, Council approved a three-year contract with Chandler Asset Management, Inc. (Chandler) to provide investment management services on April 24, 2018 (RTC No. 18-0281). Staff is currently on the final steps of transitioning the investment management process to Chandler investment managers and updating the policy is part of that transition.

EXISTING POLICY

Council Policy 7.1.2 Investment and Cash Management requires that the Investment Policy be reviewed and adopted annually within 120 days of the fiscal year to ensure consistency with the overall objectives of safety, liquidity, and yield and its relevance to current laws as well as financial and economic trends. A summary annual performance report on portfolio performance for the preceding fiscal year is also presented to the City Council as part of the annual investment policy review.

The key provisions of the existing Investment and Cash Management Policy are as follows:

1. Safety of principal is the foremost objective of the investment program. The City's portfolio is diversified by type of investment, issuer, and maturity date. Diversification is required to minimize exposure to any potential market and credit risk. The investment policy specifies the percentage of funds that can be invested in each investment type and issuer and the maximum maturity of each investment. The policy allows a maximum maturity of seven years for US Treasury, US Agency and Government Sponsored Enterprises (GSE) investments and shorter maturities for all other investments.
2. All investments in the portfolio are in accordance with the California Government Code requirements and authorized by the City's Investment Policy. The City is in compliance with the requirement that all investments be held in safekeeping by a third-party bank trust department. The City currently has a contract with Union Bank to provide this service.
3. Liquidity- the portfolio will remain sufficiently liquid to enable the City to meet all operating

requirements, which might be reasonably anticipated. A schedule of major revenues and expenditures for at least 12 months is maintained in order to determine liquidity needs. Liquidity requirements have been met through utilizing the State's Local Agency Investment Fund (LAIF) and the City's interest bearing bank accounts. Approximately 11.6 percent of the portfolio was invested in LAIF at the end of FY 2017/18.

4. Yield- the portfolio will be maintained with the objectives of safety and liquidity first, and then the objective of obtaining a reasonable market rate of return based on economic cycles, taking into account the City's investment risk approach and cash flow needs.

ENVIRONMENTAL REVIEW

The action being considered does not constitute a "project" with the meaning of the California Environmental Quality Act ("CEQA") pursuant to CEQA Guidelines section 15378 (b) (4) in that it is a fiscal activity that does not involve any commitment to any specific project which may result in a potential significant impact on the environment.

DISCUSSION

Staff invests funds not immediately needed for disbursement. Funds for the City's Deferred Compensation Plan, the City's Retirement Plan, Other Post-Employment Benefits (OPEB) Trust, Pension Trust, and debt issuance proceeds are managed by a third-party administrator and not invested by City staff and therefore are not covered by this Investment Policy. Funds needed for disbursement are maintained in a liquid checking account.

Annual Performance Report for FY 2017/18

In evaluating the portfolio performance for FY 2017/18 staff compares the City's performance with the investment policy objectives.

Yields are gradually rising from its historical lows, the City's investment strategy continues to be holding short-term investments in anticipation of rising interest rates. The current strategy is to gradually increase investing in higher yielding investments as interest rates continue to rise. Low interest bearing investments are held to maturity to prevent selling those investments at a loss, so that funds can be reinvested at a higher rate. When interest rates increase, investments existing in the portfolio with longer maturities, that were purchased when rates were low, will experience a decrease in their market value because the interest rate on those investments is lower than the current market's interest rate.

The following summarizes the City's performance compared to the Investment Policy objectives:

For FY 2017/18, the portfolio yield averaged 1.40 percent while the average yield of the benchmark (Treasury securities with an average life similar to the City portfolio) was 1.73 percent resulting in an average higher yield of 33 basis points than the benchmark. The average life of the portfolio during the last fiscal year was 320 days. The Federal Government raised the interest rate by 25 basis points three times during FY 2017/18. Consequently, the average benchmark yield substantially increased from prior year. The City portfolio follows a hold-until-maturity strategy for its investments and we will be able to reinvest at a higher interest rate after an investment matures.

Interest earnings for FY 2017/18 for all City funds totaled \$6,286,531. During FY 2017/18, the portfolio primarily added investments maturing in less than 360 days, which yielded higher interest

earnings benefitting from several interest rate increases. Thus, interest earnings increased by \$2.55 million or 69 percent from FY 2016/17. Interest earnings are allocated pro rata to each fund throughout the City based on the periodic cash balance held in each fund.

It should be noted that the portfolio balance has increased by 31 percent from \$420 million in June 2017 to \$551 million in June 2018. The portfolio increase is primarily due to higher revenues, such as development related fees, property tax, utility service fees and the sales of multiple City properties. Additional details on the City's Fiscal Year Ending performance will be provided with the Budgetary Year End Financial Report in December 2018.

Investment Policy

The City's Investment Policy has been reviewed and certified annually by the Association of Public Treasurers of the United States and Canada (APT US&C) since 1999. After assuming the investment management role, Chandler has reviewed the Investment Policy and recommended some modifications to update the Investment Policy with the latest California best practices and to enhance the clarity and readability of the Investment Policy. Recommended changes in summary are listed below:

- **Scope of the Investment Policy:** An inclusion or removal of language specific to Section 115 Pension Rate Mitigation Trust; referring to funds related to debt issuance and OPEB Trust; reliance on an investment adviser for the selection of broker/dealers; including an update to the current practice for the process to select investment brokers; and a listing of exceptions to funds kept with a third-party custodian.
- **Authorized Financial Dealers and Institutions:** Modified language to specify that the City may solicit RFP for brokers/dealers if not working with a registered investment adviser. The City may rely on its investment advisor for selection of brokers/dealers, and the investment adviser must provide a list of approved brokers/dealers upon request.
- **Safekeeping of Securities:** Investments in local government investment pools, certificates of deposit, and money market funds are excluded from funds held with a third-party custodian.
- **Authorized Investments:** Adding language to specify that noted discrepancies are solved by adhering to more restrictive parameters. Edits by investment type are summarized below.
 - Negotiable Certificates of Deposit: Increasing the concentration limit to 40% of the portfolio, requiring collateral for amounts exceeding the amounts insured by FDIC and clarifying language of the minimum credit quality based on the rating category.
 - Certificates of Deposit Placement Service: Inclusion of language limiting maturities to five years or less.
 - Commercial Paper: Increasing the concentration limit to 25%, limiting ownership of a single issuer to 10%, and clarifying language of the minimum credit quality based on the rating category.
 - Local Agency Investment Fund (LAIF): Revising the amount that the City may invest up to the amount permitted by LAIF.
 - Corporate Medium Term Notes: Clarifying language of the minimum credit quality based on the rating category.
 - Mortgage-backed, Mortgage pass-through Securities: Inclusion of all pass-through securities allowed by Government Code, including collateralized mortgage obligations. Limiting ownership of a single issuer to 5%, except pass-through securities issued by

the U.S. government, its agencies, and its sponsored enterprises. Updating language to specify a legal-final maturity of five years and Clarifying language of the minimum credit quality based on the rating category.

- **Money Market Mutual Funds:** Updating concentration limit to match Government Code (20%) and including language to match Government Code on the minimum credit requirement.
- **Municipal Securities:** Allowing for municipal securities from the other 49 states and limiting the concentration risk to 30%, ownership of a single issuer to 5%, and clarifying language of the minimum credit quality based on the rating category.
- **Local Government Investment Pools (LGIP):** Updating terminology from “JPA” to “LGIP.”
- **Supranational Securities:** Limiting ownership of a single issuer to 10% and clarifying language of the minimum credit quality based on the rating category.

- **Prohibited Investment Vehicles and Practices:** Removal of collateralized mortgage obligations from prohibited investments.
- **Mitigating Market Risk in the Portfolio:** Inclusion of a 20% limit on callable securities, a five-year maturity and a requirement that the portfolio duration will be within +/-20% of the selected benchmark duration.
- **Mitigating Credit Risk in the Portfolio:** Clarifying that the 5% issuer limit will apply to all securities unless otherwise specified. Including language outlining a plan to handle any securities downgraded below the minimum credit quality.
- **Investment Return Objectives:** Inclusion of language that the portfolio will be designed to attain an average market rate of return, taking into account the City’s risk constraints, cash flows, and laws ordinances that apply.

Proposed changes ensure compliance with the applicable provisions of the California Government Code and the inclusion of current industry best practices. Additionally, staff met with Chandler managers and reviewed the proposed changes in detail. Staff concurs with the edits and recommends accepting them. Edits are available in the redlined version of the Investment Policy (Attachment 1).

Once approved by Council, staff will submit the Investment Policy for FY 2018/19 to be re-certified by the APT US&C. Once adopted the proposed FY 2018/19 Investment Policy will be incorporated into the Council Policy Manual as Council Policy 7.1.2, replacing the Investment Policy for Fiscal Year 2017/18.

FISCAL IMPACT

There is no fiscal impact associated with adoption of the Investment Policy as recommended.

PUBLIC CONTACT

Public contact was made by posting the Council agenda on the City's official-notice bulletin board outside City Hall, at the Sunnyvale Senior Center, Community Center and Department of Public Safety; and by making the agenda and report available at the Sunnyvale Public Library, the Office of the City Clerk and on the City's website.

RECOMMENDATION

Adopt the City’s Investment Policy for FY 2018/19 (Council Policy 7.1.2).

Prepared by: Inderdeep Dhillon, Finance Manager
Reviewed by: Timothy J. Kirby, Director of Finance
Reviewed by: Teri Silva, Assistant City Manager
Approved by: Kent Steffens, City Manager

ATTACHMENT

1. Proposed Investment Policy for FY 2018/19