



City of Sunnyvale

Agenda Item-No Attachments (PDF)

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REPORT TO COUNCIL

SUBJECT

Receive and File the City of Sunnyvale Investment Report - Second Quarter 2022

BACKGROUND

In accordance with California Government Code Section 53646, staff is submitting the attached investment report for Council's review. The report includes all investments held by the City of Sunnyvale. Chandler Asset Management (Chandler) manages funds not immediately needed for disbursement and held in an investment portfolio.

Funds for the City's Deferred Compensation Plan, the City's Retirement Plan, the City's Pension Trust, Other Post-Employment Benefits (OPEB) Trust, and any proceeds from debt issuance are not included in this report. Third party administrators and trustee custodial banks manage and hold these funds.

EXISTING POLICY

California Government Code Section 53600 et seq., strictly governs which investments public agencies can hold. In some cases, state law also governs what percentage of the portfolio can be invested in certain security types, maximum maturities, and minimum credit ratings by the major rating agencies (Standard & Poor's and Moody's Investors Service). Public agencies can only invest in fixed income securities. The purchase of stock is prohibited. Therefore, the City primarily invests in highly rated securities such as U.S. Treasury, federal agencies, and government sponsored enterprise debt as well as high credit quality, non-governmental debt securities.

The California Government Code also requires investment objectives of safety, liquidity, and return in that order. As such, safety of principal is the foremost objective of the City's investment program. The portfolio must remain sufficiently liquid to enable the City to meet all cash requirements.

The City Council first adopted a policy (7.1.2 Investment and Cash Management) governing the investment of City funds on July 30, 1985. The City Council reviews and adopts this policy annually. Council adopted an updated policy for FY 2021/22 at its October 26, 2021 meeting. The City's investment policy follows the Government Code and includes additional restrictions beyond state law on some investments such as a lower allowable percentage per investment type or issuer.

ENVIRONMENTAL REVIEW

This action does not require environmental review because it is not a project that has the potential for causing a significant impact on the environment. (CEQA Guideline 15061(b)(3)). Furthermore, 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

This report provides information on the values (par, book and market), the type of investment, issuer, maturity date and yield of each investment. The par value of a bond is the amount that the issuer agrees to repay the City by the maturity date. The book value is what the City initially paid for the bond. It changes gradually if a premium or discount is amortized. The market value is what the bond is worth now.

The City’s funds continue to be actively managed in the City’s portfolio of investment securities, with maturities ranging between 0 and 7 years. The City’s main investment portfolio of securities continues to target a duration of 2.32 years. As of quarter end, the portfolio had a duration position of 2.22 years, or 98% of its duration target and captures higher rates now available in the market as a result of rising interest rates. Purchases for the portfolio during the quarter continued to maintain diversification across all sectors allowed by California Government Code. Early in the quarter, the majority of purchases comprised high credit quality asset-backed securities in the three- to five- year range to extend duration and take advantage of higher yields now being offered. Purchases also included U.S. Treasury obligations and negotiable certificates of deposit purchased at a competitive yield. The portfolio of securities totaled \$695,773,413 at quarter end. The yield to maturity of the portfolio of securities alone was 1.73%.

Additional liquid funds needed to meet short-term cash needs (liquid investments) are held in the Local Agency Investment Fund (LAIF), which totaled \$74,918,359 as of June 30, 2022. LAIF is a program created by statute as an investment alternative for California’s local governments and special districts.

The Report provides a summary and detailed information on each security. Also included is an activity report of sales, purchases and maturities for the three-month accounting period as required by Government Code section 53607. Total investments (portfolio of securities and LAIF) had a value of \$770,691,772 as of June 30, 2022. This amount does not include \$2,809,139 of accrued interest, which has been earned but not yet received. The portfolio’s average yield to maturity (the income expected to be earned over the next twelve months if portfolio holdings do not change) was 1.68% as of June 30, 2022. This yield includes the yield earned on assets invested in LAIF. The value of the portfolio is impacted by market forces in the bond market such as the movement of interest rates, credit quality, fiscal policy, and economic growth. It is also affected by property tax revenues; development related activity such as park impact fees, housing impact fees, developer contributions, and building and planning fees; utility enterprise funds revenues and other City financial activities.

The portfolio manager primarily focuses on following the long-term duration investment strategy. Staff continue to monitor cashflow needs regularly and communicate actively with the portfolio manager regarding operational and capital projects funding needs.

Economic Update and Outlook

Financial markets are experiencing heightened volatility and tighter conditions as central banks employ more restrictive monetary policies to combat inflation. The conflict between Russia and Ukraine has exacerbated inflationary pressures, particularly with energy and commodities. Strict COVID lockdowns in China are intensifying distressed supply chains. Inflation is weighing heavily on consumer sentiment and beginning to impact discretionary spending. Labor markets remain strong, but wage gains are not keeping up with inflation. It is expected that the Fed will continue to tighten monetary policy; the Federal Open Market Committee (FOMC) has very little margin for error as it attempts to combat inflation without pushing the economy into a recession. The risk of an economic slowdown later this year has increased. Over the near-term, it is expected that financial market volatility will remain intense, and conditions will remain tighter with persistent inflation, geopolitical risk, supply chain bottlenecks, and the Fed's shift to a more hawkish monetary policy.

At the June and July meetings, persistently high inflation led the FOMC to announce two separate 0.75% federal funds rate increases. The Fed will continue shrinking its \$9 trillion balance sheet by \$47 billion per month as of June, increasing to \$95 billion in September. Additional rates hikes are expected as the Fed remains "committed" to the 2% long-term inflation target. In the second half of the year, monetary policy will be dependent on how the economy responds to tighter conditions.

In June, yields rose, and the curve flattened. The 2-year Treasury yield soared 40 basis points to 2.96%, the 5-year Treasury yield increased 22 basis points to 3.04%, and the 10-year Treasury yield rose 17 basis points to 3.02%. The spread between the 2-year and 10-year Treasury yield fell to 6 basis points at June month-end, down from 29 basis points at May month-end, and down significantly from 122 basis points one year ago. The spread between 3-month and 10-year treasuries is wider at about 135 basis points but continues to compress with each Fed rate hike. The shape of the curve bears watching but does not indicate a high probability of an imminent recession.

FISCAL IMPACT

Overall, the City's investment income remained strong for the second quarter, totaling \$3,286,838. In comparison, the investment income for the same period last year was \$3,331,815.

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 Public Library, Senior Center, Community Center and in the Department of Public Safety Lobby. In addition, the agenda and report are available at the Sunnyvale Public Library, Office of the City Clerk, and on the City's website.

RECOMMENDATION

Receive and file the City of Sunnyvale Investment Report - Second Quarter.

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Reviewed by: Jaqui Guzmán, Deputy City Manager
Approved by: Kent Steffens, City Manager

ATTACHMENTS

1. City of Sunnyvale Second Quarter Investment Report