

Agenda Item-No Attachments (PDF)

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REPORT TO COUNCIL

SUBJECT

Adopt the City's Investment Policy for Fiscal Year 2022/23 and Receive Annual Performance Report for Fiscal Year 2021/22

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.

To support the management of an increasingly complex investment environment and a portfolio that is growing significantly, Council approved a three-year contract with Chandler Asset Management, Inc. (Chandler) on April 24, 2018 (RTC No. 18-0281). Chandler investment managers have been managing City investments since July 1, 2018. The City executed the option to extend the contact for two additional years.

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. This review ensures consistency with the overall objectives of safety, liquidity, and yield and its relevance to current laws as well as financial and economic trends.

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. 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. The daily checking account balance is also tracked to ensure sufficient funds available to pay operational expenses. Liquidity requirements have been met through utilizing the State's Local Agency Investment Fund (LAIF) and the City's interest-bearing bank accounts.

3. 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 while taking into account the City's investment risk approach and cash flow needs.

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 US Bank currently provides custodial service to the City.

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

The City's investment portfolio includes funds not immediately needed for disbursement. Third-party administrators manage funds for the City's Deferred Compensation Plan, Retirement Plan, Other Post-Employment Benefits (OPEB) Trust, Pension Trust, and debt issuance proceeds; therefore, they are not covered by this Investment Policy. Funds needed for disbursement are maintained in a liquid checking account.

Annual Performance Reporting for FY 2022/23

For FY 2021/22, total rate of return of the portfolio managed by Chandler was -4.64%. The return is on par with the City's performance measuring benchmark, ICE BAML 1-5 Years US Treasury Securities/Agency Index, which was -4.60% for the same period. Total return represents growth of the portfolio arising from both interest earnings and fair value appreciation achieved during the fiscal year. Interest earnings were strong for the fiscal year, but the fair value of the portfolio fell as interest rates rose dramatically over the past twelve months. This caused the fair value of the portfolio to drop sharply and overall total return to be negative. However, the drop in fair value is not realized unless the entire portfolio is sold. The majority of the City's investments are held to maturity, so the loss is never realized. The average duration of investments in the portfolio at fiscal year-end was 2.63 years. As investments mature, the proceeds are reinvested at higher interest rates. The return of the LAIF account, which comprises interest earnings only (no fair value adjustments) for the fiscal year was 0.37%, and the LAIF portfolio average life at fiscal year-end was 311 days.

Interest earnings for FY 2021/22 for all City funds totaled \$11,762,997. Interest earnings are allocated pro rata to each fund throughout the City based on the periodic cash balance held in each fund.

The portfolio balance was \$770.7 million as of June 30, 2022, which increased by 7.4% from \$717.5 million balance on June 30, 2021. This increase is mainly attributed to higher-than-expected revenue collections for property tax, development related fees and other City services while City expenditures came in under budget. During FY 2021/22, the local economy continued to improve from the negative economic impacts of the COVID-19 Pandemic. Additional details on the City's fiscal year ending performance will be available with the Budgetary Year End Financial Report in December.

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. As part of the investment management role, Chandler provides a review the City's Investment Policy and recommends minor modifications to update the Investment Policy with the latest best practices and to enhance clarity and readability.

The City's investment policy currently maintains a prohibition on purchasing 144a securities. 144a securities are securities issued in a private market that are only accessible to investors that the Securities and Exchange Commission (SEC) has classified as "Qualified Institutional Buyers" (QIB). The definition of QIB excluded local governments like the City. In order to ensure compliance with the SEC definition of QIB, the City opted to place this prohibition in the investment policy.

Recently, the SEC updated its definition of QIB, and included local governments with investable assets of \$100 million or more. Chandler is recommending the City update its investment policy and remove this prohibition so that the City's investment policy reflects the City's status as a QIB. This will allow the City to take advantage of investing in 144a securities.

144a securities are privately placed but are often issued by similarly rated issuers as public securities. By removing the prohibition on 144a securities, the City will broaden its investment opportunities, increase diversification in the City's investment portfolio, and enhance long-term returns, all while maintaining strong levels of credit quality and liquidity. Only investments that comply with California Code and the City's investment policy will be made.

Staff met with Chandler managers and reviewed the proposed change in detail. Staff recommends adoption of the updated definition in the Investment Policy. A redlined version of the Investment Policy is available as Attachment 1.

Once approved by Council, staff will submit the Investment Policy for FY 2022/23 to be re-certified by the APT US&C. Once adopted, the proposed FY 2022/23 Investment Policy will be incorporated into the Council Policy Manual as Council Policy 7.1.2, replacing the Investment Policy for Fiscal Year 2021/22.

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 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

Adopt the City's Investment Policy for FY 2022/23 (Council Policy 7.1.2) and Receive Annual Performance Report for Fiscal Year 2021/22.

Prepared by: Inderdeep Dhillon, Finance Manager
Reviewed by: Tim Kirby, Director of Finance
Reviewed by: Jaqui Guzmán, Deputy City Manager
Approved by: Kent Steffens, City Manager

ATTACHMENT

1. Proposed Investment Policy for FY 2022/23