TO:    HONORABLE CITY COUNCIL
FROM:  CITY MANAGER              DEPARTMENT: ADMINISTRATIVE SERVICES
DATE:  JULY 19, 2004            CMR: 358:04
SUBJECT:  CITY OF PALO ALTO’S INVESTMENT ACTIVITY REPORT FOR THE FOURTH QUARTER, FISCAL YEAR 2003-04

This is an information report and no Council action is required.

BACKGROUND
The purpose of this report is to inform Council of the status of the City’s investment portfolio as of the end of the fourth quarter of fiscal year 2003-04. The City’s investment policy requires that staff report to Council on the City’s: portfolio composition compared to Council-adopted policy, portfolio performance, and other key investment and cash flow information.

DISCUSSION

Investment Portfolio as of June 30, 2004
The City’s investment portfolio is detailed in Attachment B. It is grouped by investment type and includes 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 as of June 30, 2004.

The par value of the City’s portfolio is $368.9 million; in comparison, last quarter it was $357.8 million and at the end of last fiscal year it was 351.3 million. Growth in the portfolio of $11.1 million since the last quarter is from a combination of lower utility power costs and the City’s continued efforts to constrain expenditures.

The portfolio consists of $25.4 million in liquid accounts and $343.5 million in U. S. government treasury and agency securities. The $343.5 million includes $111.8 million in investments maturing in less than two years, comprising 32.5 percent of the City’s investment in notes and securities. The current market value of the portfolio is 100.7 percent of the book value. Because the City’s practice is to hold securities until they mature, changes in market price do not affect the City’s investment principal. The market valuation is provided by Union Bank of California, which is the City’s safekeeping agent. The average life to maturity of the investment portfolio is 2.90 years. At the end of last fiscal year, the average life to maturity was 2.82 years.
Investments Made During the Fourth Quarter
During the fourth quarter, $26.1 million of government agency securities with an average yield of 4.9 percent matured. During the same period, government securities totaling $32.8 million with an average yield of 4.2 percent were purchased. The City’s short-term money market and pool account increased by $4.4 million or 21.0 percent compared to the third quarter of 2003-04. Investment staff continually monitors the City’s short-term cash flow needs and adjust liquid funds to meet those needs and to take advantage of investment opportunities.

Availability of Funds for the Next Six Months
The normal flow of revenues from the City’s utility billings and general fund sources is sufficient to provide funds for ongoing expenditures. Projections indicate receipts will be $145.7 million and expenditures will be $142.9 million over the next six months, indicating an overall growth of the portfolio of about $2.8 million.

As of June 30, 2004, the City had $25.4 million deposited in the Local Agency Investment Fund (LAIF) and a money market account that could be withdrawn on a daily basis. In addition, securities totaling $24.7 million will mature between July 1, 2004 and December 31, 2004. On the basis of the above projections, staff is confident that the City will have more than sufficient funds to meet expenditure requirements for the next six months.

Compliance with City Investment Policy
During the fourth quarter of 2003-04, staff complied with all aspects of the investment policy. Attachment C lists the restrictions in the City’s investment policy compared with the portfolio’s actual compliance.

Investment Yields
Interest income on an accrual basis for the fourth quarter of 2003-04 was $4.0 million while the total for the fiscal year was $16.3 million. This total is 6.3 percent less than what the City received last fiscal year even though the portfolio has increased by 5.0 percent. The decline in interest earnings results from interest rate declines over the past year. As of June 30, 2004, the yield to maturity of the City’s portfolio was 4.29 percent. This compares to a yield of 4.36 percent in the third quarter of 2003-04 and 4.75 percent as of June 30, 2003. Even though interest rates are slowly increasing, the City’s portfolio yield will decrease further in the first quarter of 2004-05 as a result of continued reinvestment of maturing securities at lower interest rates. The City’s portfolio yield of 4.29 percent compares to LAIF’s average yield for the quarter of 1.44 percent and an average yield on the two-year and five-year Treasury bond during the fourth quarter of approximately 2.74 percent and 3.92 percent, respectively.

Yield Trends
The Federal Open Market Committee (FOMC) increased the federal funds rate by 25 basis points to 1.25 percent in June 2004. This was the first rate increase in the last four years.

At its June 2004 meeting, the FOMC continued to maintain a “balanced” outlook on the economy. This outlook reveals an expectation that the upside and downside risks associated with
economic growth remain equal. The FOMC is expected to slowly increase the federal funds rate over the next few years. While the City can expect declining yields on its portfolio in the near future, it can expect yields to increase gradually if the FOMC continues to raise interest rates.

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 Bank of America. The bond proceeds, bond 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 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, 2004.

ATTACHMENTS:
A) Consolidated Report of Cash and Investments
B) Investment Portfolio, as of June 30, 2004
C) Investment Policy Compliance

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