TO: HONORABLE CITY COUNCIL
FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES
DATE: OCTOBER 25, 2004 CMR: 447:04
SUBJECT: CITY OF PALO ALTO’S INVESTMENT ACTIVITY REPORT FOR THE FIRST QUARTER, FISCAL YEAR 2004-05

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 first quarter of fiscal year 2004-05. The City’s investment policy requires that staff report quarterly 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 September 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 September 30, 2004.

The par value of the City’s portfolio is $369.6 million; in comparison, last quarter it was $368.9 million. Growth in the portfolio of a slight $0.7 million is primarily due to utility rate increases.

The portfolio consists of $31.6 million in liquid accounts and $338.0 million in U. S. government treasury and agency securities. The $338.0 million includes $109.8 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 101.4 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 2.85 years.

Investments Made During the First Quarter
During the first quarter, $19.0 million of government agency securities with an average yield of 5.5% percent matured. During the same period, government securities totaling $13.5 million with an average yield of 4.4% percent were purchased. The City’s short-term money market and pool account increased by $6.2 million compared to the fourth quarter of 2003-04. Investment staff continually monitors the City’s short-term cash flow needs and adjusts 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 in those respective funds. Projections indicate receipts will be $140.6 million and expenditures will be $139.1 million over the next six months, indicating an overall growth of the portfolio of about $1.5 million.

As of September 30, 2004, the City had $31.6 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 $23.7 million will mature between October 1, 2004 and March 31, 2005. 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 first 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 first quarter of 2004-05 was $4.0 million. As of September 30, 2004, the yield to maturity of the City’s portfolio was 4.21 percent. This compares to a yield of 4.23 percent in the fourth quarter of 2003-04. Even though interest rates are slowly increasing, the City’s portfolio yield will decrease further in the second quarter of 2004-05 as a result of continued reinvestment of maturing securities at lower interest rates. The City’s portfolio yield of 4.21 percent compares to LAIF’s average yield for the quarter of 1.66 percent and an average yield on the two-year and five-year Treasury bond during the first quarter of approximately 2.54 percent and 3.50 percent, respectively.

Yield Trends
The Federal Open Market Committee (FOMC) has increased the federal funds rate and the discount rate three times in the last two quarters by 0.75 percent to 1.75 and 2.75 percent, respectively.
At its September 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 sustaining economic growth are equal. The FOMC has acknowledged that inflation remains under control and that, despite a major increase in energy prices, the national economy and the labor market continue to improve, albeit slowly. Silicon Valley continues to lag the national and state economic recovery and job growth here has been modest at best. The FOMC is expected to increase rates further this fiscal year. The City can expect the declining yields on its portfolio to
plateau in the near future; it can also 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 September 30, 2004.

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

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