TO:       HONORABLE CITY COUNCIL

FROM:    CITY MANAGER      DEPARTMENT: ADMINISTRATIVE
             SERVICES

DATE:     JANUARY 24, 2005   CMR: 132:05

SUBJECT:  CITY OF PALO ALTO'S INVESTMENT ACTIVITY REPORT FOR
            THE SECOND 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 second 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 December 31, 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 December 31, 2004.

The par value of the City’s portfolio is $367.1 million; in comparison, last quarter it was $369.6 million. The decline in the portfolio of $2.5 million is attributable to the State’s takeaway of $1.54 million in revenues and delayed sales (“triple flip”) and property in-lieu vehicle license fee tax payments. Instead of receiving these payments on a monthly basis, as in the past, they will be paid in January and May of 2005. The takeaway and the delay in tax payments reduce interest income earnings as well.

The portfolio consists of $24.8 million in liquid accounts and $342.3 million in U. S. government treasury and agency securities. The $342.3 million includes $121.1 million in investments maturing in less than two years, comprising 35.4 percent of the City’s investment in notes and securities. The current market value of the portfolio is 100.8 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 2.80 years.

**Investments Made During the Second Quarter**
During the second quarter, $13.2 million of government agency securities with an average yield of 4.7% percent matured. During the same period, government securities totaling $17.5 million with an average yield of 4.2% percent were purchased. The City’s short-term money market and pool account decreased by $6.8 million compared to the first 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 $144.5 million and expenditures will be $141.4 million over the next six months, indicating an overall growth of the portfolio of about $3.1 million.

As of December 31, 2004, the City had $24.8 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 $29.2 million will mature between January 1, 2005 and June 30, 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 second quarter of 2004-05, 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 second quarter of 2004-05 was $4.0 million. As of December 31, 2004, the yield to maturity of the City’s portfolio was 4.27 percent. This compares to a yield of 4.21 percent in the first quarter of 2004-05. With interest rates moving upward, staff expects the portfolio’s yield to gradually increase in coming quarters. The City’s portfolio yield of 4.27 percent compares to LAIF’s average yield for the quarter of 2.0 percent and an average yield on the two-year and five-year Treasury bond during the second quarter of approximately 3.0 percent and 3.60 percent, respectively.

**Yield Trends**
The Federal Open Market Committee (FOMC) has increased the federal funds rate and the discount rate since June 2004 by 1.25 percent to 2.25 and 3.25 percent, respectively.

The FOMC continues to maintain a “balanced” outlook on the economy in its official pronouncements. This outlook reveals an expectation that the upside and downside risks associated with sustaining economic growth are equal. As revealed in the minutes of the last FOMC meeting, however, the FOMC concern over inflation has heightened. This means the FOMC may become more aggressive in raising rates this year and the City’s portfolio yields will rise.
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, 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 December 31, 2004.

ATTACHMENTS:
A) Consolidated Report of Cash and Investments
B) Investment Portfolio, as of December 31, 2004
C) Investment Policy Compliance

PREPARED BY: ________________________________
TARUN NARAYAN
Senior Financial Analyst

DEPARTMENT HEAD APPROVAL: ________________________________
CARL YEATS
Director, Administrative Services

CITY MANAGER APPROVAL: ________________________________
EMILY HARRISON
Assistant City Manager