TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER
DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: OCTOBER 23, 2006
CMR: 399:06

SUBJECT: CITY OF PALO ALTO’S INVESTMENT ACTIVITY REPORT FOR THE FIRST QUARTER, FISCAL YEAR 2006-07

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 2006-07. 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, 2006

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, 2006.

The par value of the City’s portfolio is $381.3 million; in comparison, last quarter it was $372.6 million. The growth in the portfolio of $8.7 million since the last quarter primarily results from the timing of cash flows: first quarter payroll expenditures were lower due to the way payroll periods fell and sales tax revenues were higher than the prior quarter. In addition, the Electric Fund’s cost for electricity purchases continues to be lower in the beginning of the first quarter due to the greater availability of hydropower.

The portfolio consists of $19.0 million in liquid accounts and $362.3 million in U. S. government treasury and agency securities. The $362.3 million includes $168.9 million in investments maturing in less than two years, comprising 46.6 percent of the City’s investment in notes and securities.

The current market value of the portfolio is 98.6 percent of the book value. It is important to note that 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 2.21 years compared to 2.22 years last quarter.

**Investments Made During the First Quarter**

During the first quarter, $18.0 million of government agency securities with an average yield of 5.4% percent matured. During the same period, government securities totaling $21.0 million with an average yield of 5.3% percent were purchased. The City’s short-term money market and pool account increased by $5.8 million compared to the fourth quarter of 2005-06. 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 $169.0 million and expenditures will be $162.0 million over the next six months, indicating an overall growth of the portfolio of $7.0 million.

As of September 30, 2006, the City had $19.0 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 $52.0 million will mature between October 1, 2006 and March 31, 2007. 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 2006-07, 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 2006-07 was $4.1 million. This total is 5.0 percent higher than what the City received last quarter. As of September 30, 2006, the yield to maturity of the City’s portfolio was 4.27 percent. This compares to a yield of 4.23 percent in the fourth quarter of 2005-06. As lower yielding securities are reinvested in higher yielding ones, staff expects the portfolio’s yield will continue to gradually rise in the coming quarters. The City’s portfolio yield of 4.27 percent compares to LAIF’s average yield for the quarter of 4.94 percent and an average yield on the two-year and five-year Treasury bond during the first quarter of approximately 4.92 percent and 4.85 percent, respectively.

**Yield Trends**

After two years of increasing the federal funds and discount rate by 4.25 and 4.50 percent, respectively, the Federal Open Market Committee (FOMC) has left rates unchanged in the last quarter. These rates currently are 5.25 and 6.25 percent.

In its last two meetings, the FOMC indicated that economic growth has moderated. The slowing housing market, rising interest rates and higher energy costs were cited as contributors to this slowdown. The FOMC continues to monitor inflationary risks closely and indicated future rate
changes are dependent on the future course of both inflation and economic growth. The City’s portfolio yields are expected to rise slowly as lower-yield instruments purchased over the past three years are re-invested in higher-yield instruments.

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 Wells Fargo. 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 federal agency and 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, 2006.

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ATTACHMENTS:

A) Consolidated Report of Cash and Investments
B) Investment Portfolio, as of September 30, 2006
C) Investment Policy Compliance