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 2001-02. 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 December 31, 2001

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, 2001.

The face value of the City’s portfolio is $323.6 million; in comparison, last quarter it was $321.1 million. Growth in the portfolio of $2.5 million results from a combination of the effects of the Electric and Gas Fund rate increases, funds received from Northern California Power Agency (NCPA) for the sale of the City excess load, offset by the City’s effort to constrain expenditures.

The portfolio consists of $16.3 million in liquid accounts and $307.3 million in U. S. government agency securities. The $307.3 million includes $133.5 million in investments maturing in less than two years, comprising 43.4 percent of the City’s investment in notes and securities. The current market value of the portfolio is 103.2 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 2.40 years.

**Investments Made During the Second Quarter**
During the second quarter, $13.0 million of government agency securities with an average yield of 5.5 percent matured. During the same period, government securities totaling $11.2 million with an average yield of 4.5 percent were purchased. The City’s short-term money market and pool account increased by $4.4 million compared to the first quarter of 2001-02. Investment staff continually monitors the City’s short-term cash flow needs and adjusts its liquid funds to meet those needs and to take advantage of investment opportunities. During the second quarter of 2001-02, the money market and pool account balances were increased to meet potentially higher Utility obligations.

**Availability of Funds for the Next Six Months**
The normal flow of revenues from the City’s utility billings, sales and property taxes, transient occupancy taxes and general user fees is sufficient to provide funds for ongoing expenditures. Projections indicate receipts will be $138.4 million and expenditures will be $141.0 million over the next six months, indicating an overall decline of the portfolio of about $2.6 million. The decline is attributable to an increase in infrastructure spending.

As of December 31, 2001, the City had $16.3 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 $40.0 million will mature between January 1, 2002 and June 30, 2002. 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 2001-02, 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 2001-02 was $4.7 million. As of December 31, 2001, the yield to maturity of the City’s portfolio was 5.79 percent. This compares to a yield of 5.88 percent in the first quarter of 2001-02. The City’s portfolio yield is expected to decrease in the third quarter of 2001-02 as a result of reinvestment of maturing securities at lower interest rates. The City’s portfolio yield compares to LAIF’s average yield for the quarter of 3.26 percent and an average yield on the two-year and five-year Treasury bond during the second quarter of approximately 2.82 percent and 4.00 percent respectively.
Yield Trends
The Federal Open Market Committee (FOMC) has decreased rates three times or by 1.25 percent in the last quarter. Since it began cutting the federal funds rate and discount rate in January 2001, the FOMC has reduced both key rates by 4.75 percent to 1.75 and 1.25 percent respectively. There is a possibility that the federal funds rate will be lowered another 0.25 percent at end of January 2002.

There is an emerging perception in the marketplace that the economy has stabilized and a slow recovery will occur by the third quarter of 2002. Fed Chairman Alan Greenspan, however, has expressed skepticism about this perception. According to Greenspan, despite the early signs that the economy has stabilized, it is still too early to conclude that a recovery will materialize. Given lower interest rates and continued uncertainties of an economic recovery, the yield on the City’s portfolio is expected to decrease in the coming quarters.

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). U.S. Bank investments are in money market mutual funds that exclusively invest in U.S. Treasury securities. CAMP investments are also in money market mutual funds, banker’s acceptances, 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, 2001.

ATTACHMENTS:
A) Consolidated Report of Cash and Investments
B) Investment Portfolio, as of December 31, 2001
C) Investment Policy Compliance

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