



ADMINISTRATIVE SERVICES DEPARTMENT

CITY HALL

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AUDIT COMMITTEE STAFF REPORT

Meeting: January 27, 2021

Subject

Treasurer's Investment Report for period ending December 31, 2020

Recommended Action

Accept staff report and provide recommendations.

Discussion

Background

The City retained Chandler Asset Management (Chandler) through a formal Request for Proposal (RFP) process in 2018. Chandler began their work with the City in the winter of 2018, conducting multiple meetings with staff to determine an investment structure and strategy. Using an assumption for the compound annualized growth rate (CAGR) of 2% over the next three years and a continued 10% liquidity cushion, the initial core portfolio was estimated to total at approximately \$121 million, leaving the City with liquid funds ranging between \$13-\$20 million. Additionally, Chandler performed a comprehensive review of the City's investment policy. Although the policy was sufficient for operational purposes, significant recommended changes were made for completeness and clarification purposes. These changes were approved by City Council on May 21, 2019. Beginning in March 2019, Chandler began forming the City's portfolio by purchasing agency (FHLB), corporate medium-term notes, and negotiable certificates of deposit.

Portfolio Report Overview

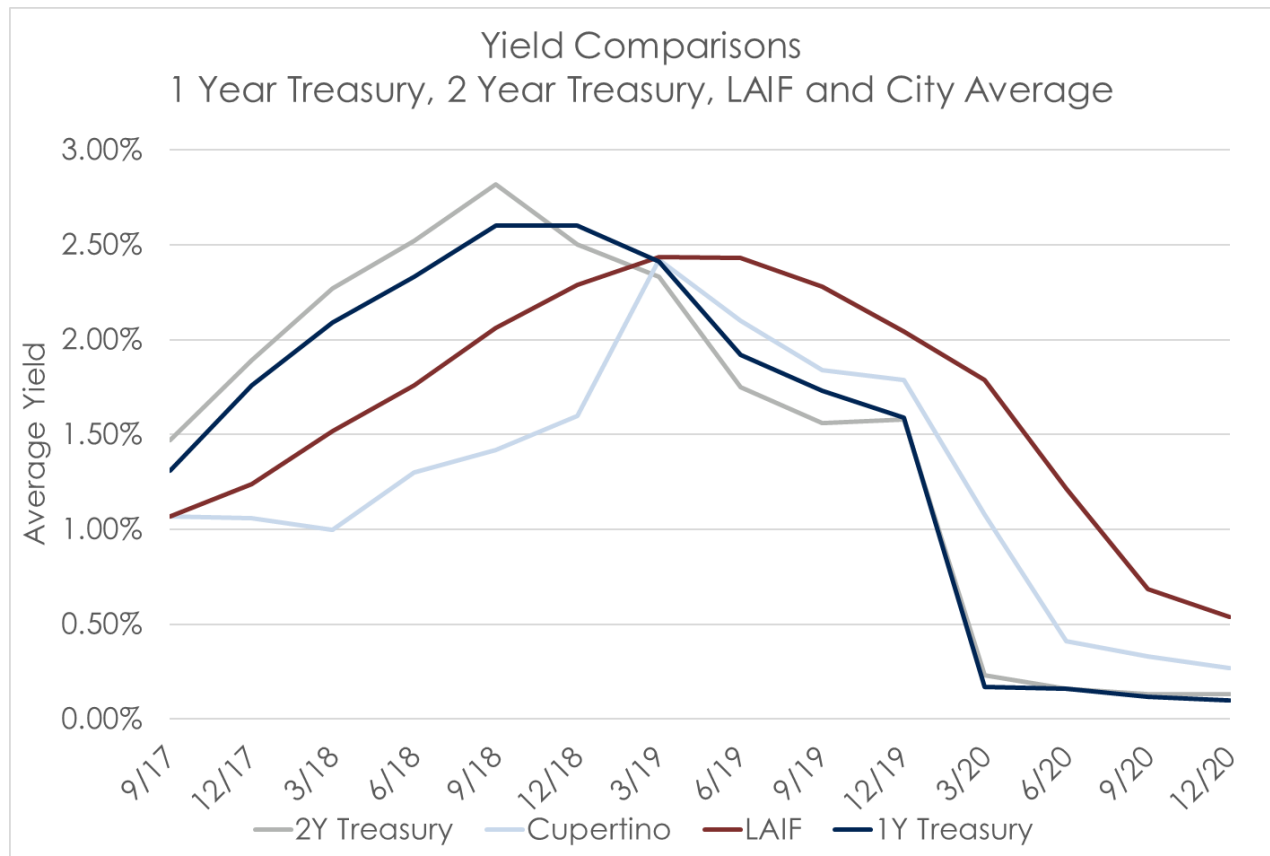
As of and for the quarter ending December 31, 2020, the City initiated \$14,378,805 in corporate, and treasury purchases. The City also made treasury dispositions of \$3,481,552. Ending book and market value for the portfolio was \$117,119,487 and \$121,152,642, respectively. In accordance with California Government Code §53646 (b)(3), the City maintains the ability to meet its expenditure requirements for the next six months. City's holdings were as follows:

Wells Fargo – Workers Comp Checking	\$ 23,536
Wells Fargo – Regular Checking	\$ 19,639,482
LAIF State Pool	<u>\$ 20,945,081</u>
Total Cash & Cash Equivalents	\$ 40,608,099
Total Investments	<u>\$121,152,642</u>
TOTAL	<u>\$161,760,741</u>

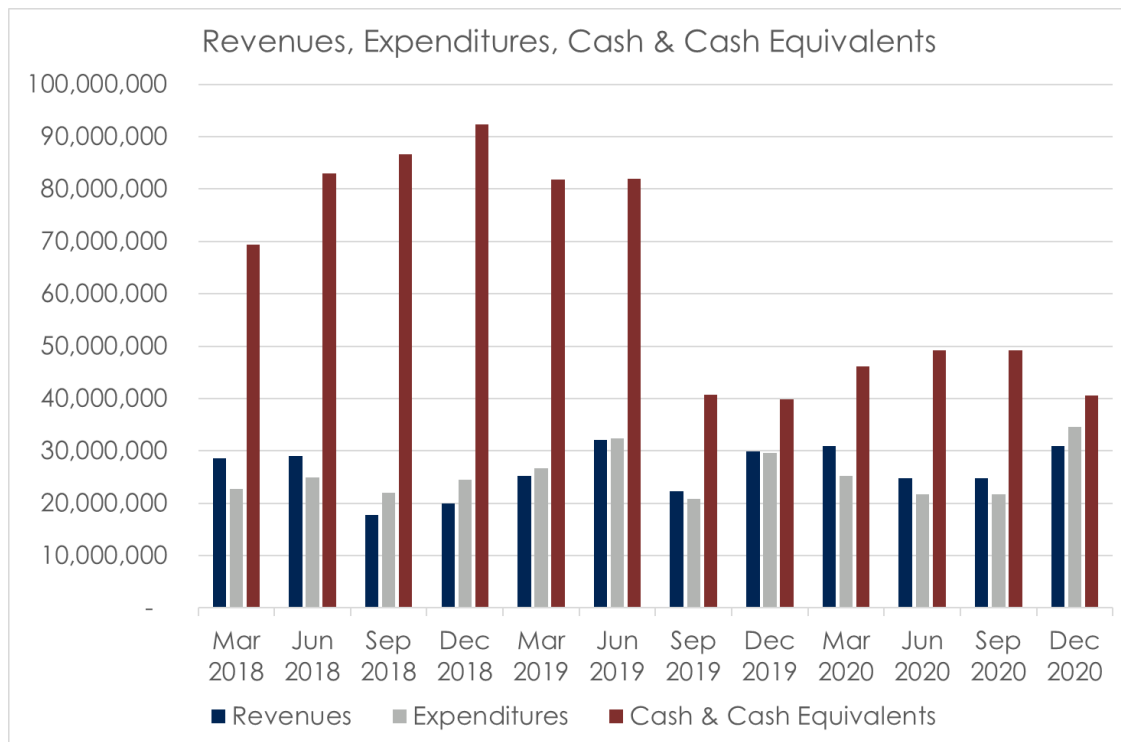
Below are some historical quarterly comparisons for the City's portfolio:

- Total cash and investment balance increased approximately \$6.7 million over previous quarter to \$161.8 million
- Average maturity decreased from 2.89 years to 2.78 years
- Average purchase yield decreased from 1.78% to 1.60%
- Average market yield decreased from 0.33% to 0.27%
- Duration decreased from 2.57 to 2.50

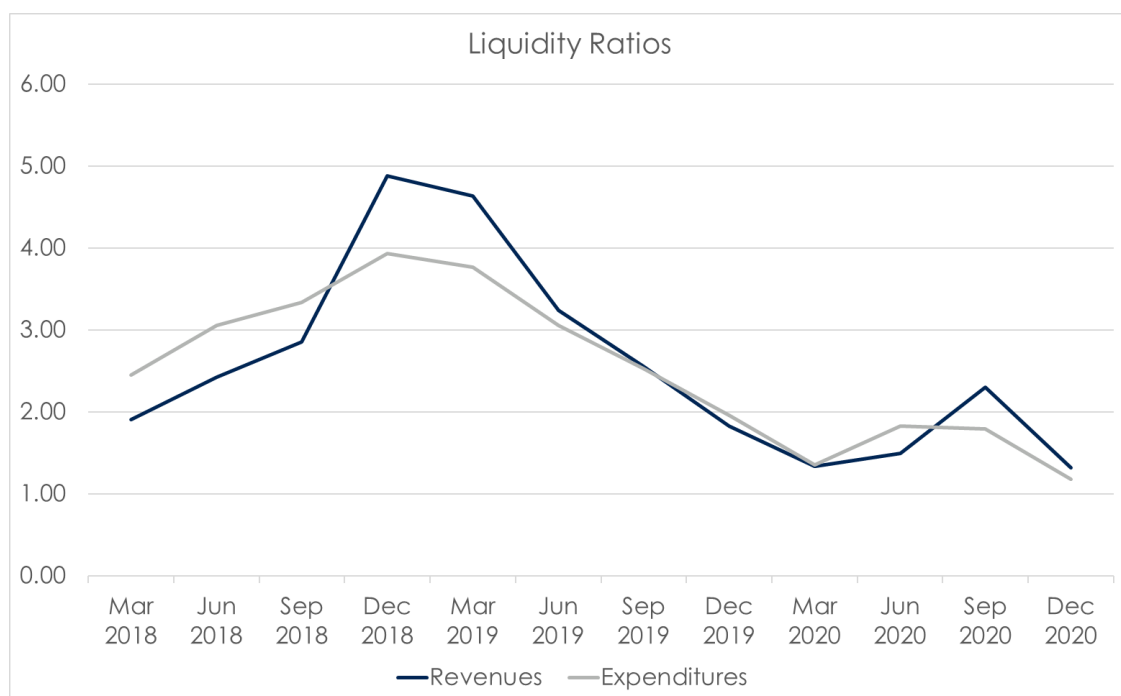
Yield comparisons for the 1Y Treasury, 2Y Treasury, LAIF, and City average are presented below:



Historical revenues, expenditures, and liquidity ratios are presented below:

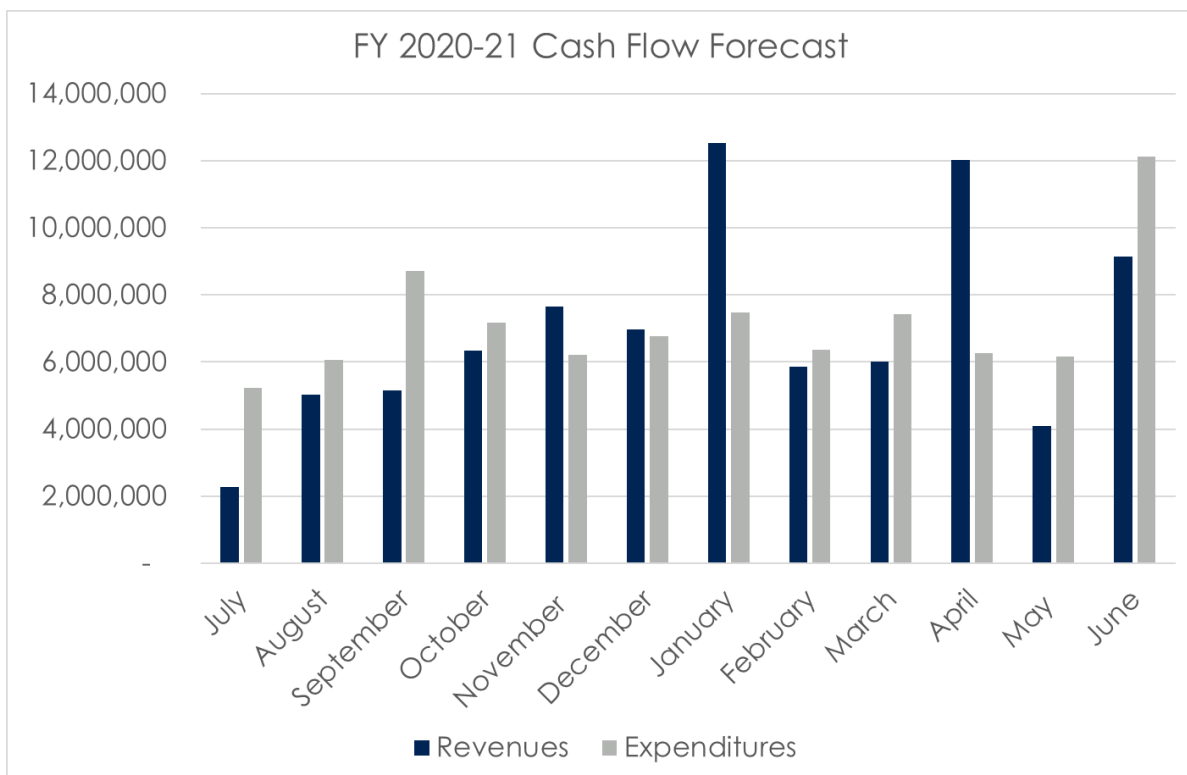


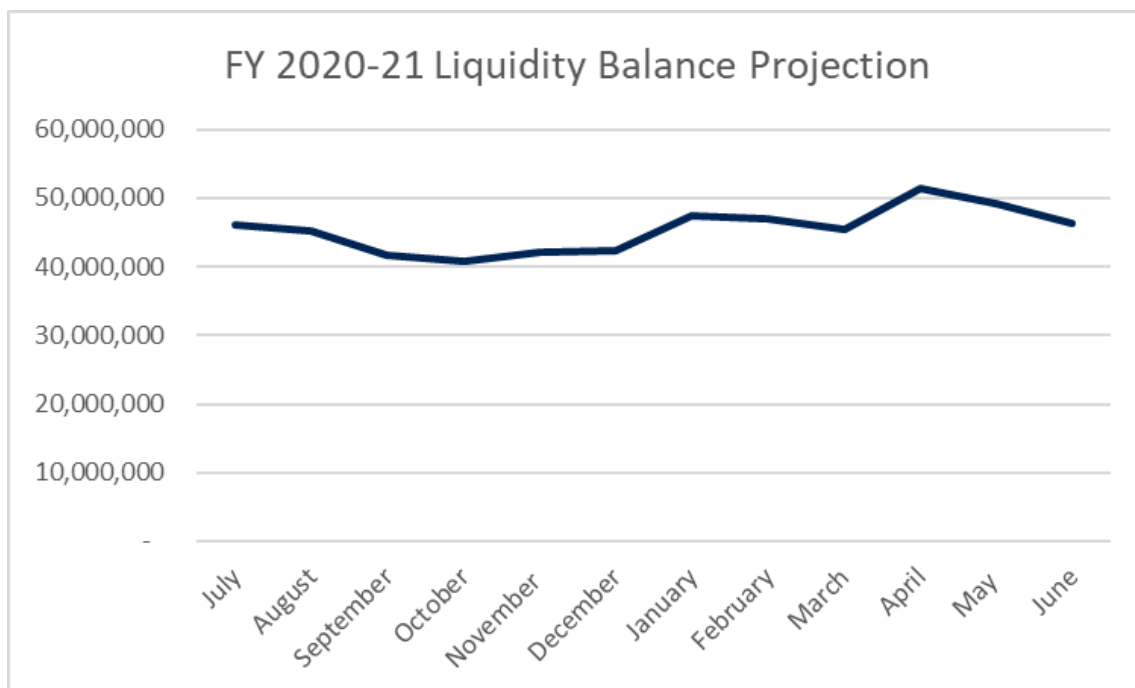
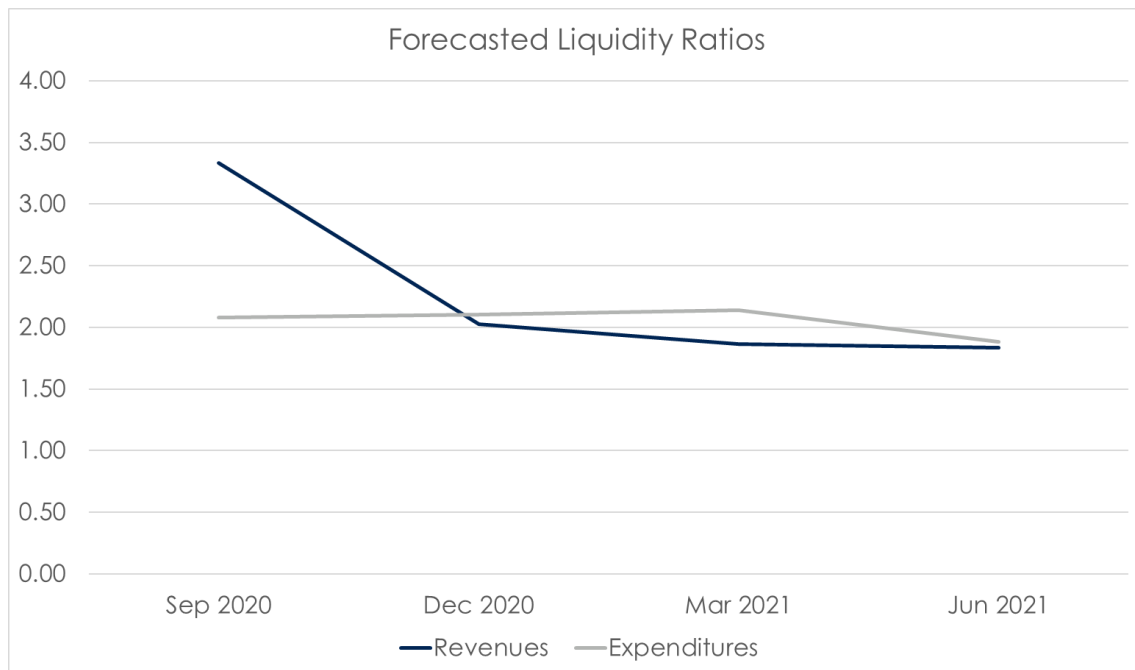
Using three-year historical trend data, the City estimates revenues of \$28.3 million and expenditures of \$24.9 million, resulting in an ending cash and cash equivalent balance of \$44.0 million for the period ending March 31, 2021.



As the City's portfolio becomes less liquid over time, the ratio of cash and cash equivalents to revenues and expenditures will continue to decrease. The portfolio's benchmark structure is reasonably complete as we will anticipate the City's revenues, expenditures, and cash equivalents to continue to flatten out moving forward. While a formal liquidity level has yet to be established or desired, significant and consistent fluctuations in the ratio may provide indication that additional funds could be invested or conversely that investments should be liquidated. In recent years, sufficient liquidity levels in respect to operating revenues and expenditures have approximated a ratio of 1.0. City staff recognize the increasing liquidity over the previous nine months and as a result, have transferred \$10,000,000 from its operating account to the City's investment portfolio. With the COVID-19 pandemic continuing to impact the City's revenues and expenditures, City staff will continue to monitor these impacts and ensure consistent levels of liquidity moving forward.

Using three-year historical trend data for each of the City's revenue and expenditures line-items and applied to the FY 2020-21 Adopted Budget, the City estimates the following cash flow forecast for FY 2020-21:





The purpose of this cash flow and liquidity forecast is to illustrate the timing of the City's revenues and expenditures throughout a fiscal year using historical trend data. The first quarter of the fiscal year experiences expenditures exceeding revenues which is reasonable since the City begins receiving its property tax distributions in November and again in April of the respective fiscal year. The month of June tends to experience higher activities, particularly expenditures, due to the year-end close/accrual process. From one fiscal year to the next, the City typically

incurs one-time special project or capital expenditure costs and the timing of these costs is more difficult to pinpoint to a particular month.

From a cash flow analysis perspective, the Adopted and Amended Budgets are efficient planning tools in determining cash flow needs for a single fiscal year. If a budget is adopted at a position in which revenues and expenditures are balanced, then it's reasonable to conclude cash flow is unlikely to be of a concern. Beyond one fiscal year, a City requires a multi-year forward-looking forecast using historical as well as prospective assumptions. This forecasting model is incorporated and presented to the City's Fiscal Strategic Planning Committee as well as the City Council as part of the City's Adopted Budget process.

COVID-19 has been having significant impacts on the City's revenues. Sales tax figures are having a positive experience over expectations due to business-to-business industry and the related distance learning requirements. While sales tax figures are coming in higher than originally anticipated, transient occupancy taxes are coming in much lower than originally expected. The City's Adopted Budget incorporated reduction to mitigate the impact of COVID-19 and the City plans to continue monitoring the effects of COVID-19 into the uncertain future. Conservatively estimating the cash flow needs for the third quarter of FY 2020-21, the City anticipates increasing its operating cash balance from \$19.6 million to approximately \$22.7 million.

While the extreme uncertainty surrounding COVID-19 and the long-term impacts on the City continue to loom, the City remains financially well-positioned with healthy cash balances and strong, intact fund balance reserves to move forward as the situation continues to evolve.

Investment Trust Portfolio

A Section 115 Trust is a tax-exempt investment tool that allows local governments to pre-fund pension and retiree health costs. Once contributions are placed into the trust, assets from the trust can only be used for retirement plan purposes. Withdrawals may be made to either reimburse the City for retirement system contributions or to directly pay CalPERS. The benefits of a Section 115 Trust include the following:

- Local control over assets: The City controls the contributions, withdrawals, investment strategy, and risk level of assets in the Trust.
- Pension rate stabilization: Assets can be transferred to CalPERS at the City's discretion to pay for Normal Cost or UAL contributions, and can be used to reduce or eliminate large fluctuations in the City's pension costs.
- Potential for higher investment returns than General Fund: Investment requirements that apply to the City's General Fund assets under Government Code 53601 are not applicable to Trust assets.
- Diversification: Trust assets will be diversified from CalPERS investments.

Given that pension obligations are one of the City's largest financial obligations, the City has taken proactive steps to reduce the impacts of pension cost volatility. In March 2018, the City provided options to Council on address rising pension costs and in April 2018, the City presented a long-term pension funding strategy to the Fiscal Strategic Plan Committee. In May 2018, the City implemented a Pension Rate Stabilization Program (PRSP), also known as a Section 115 Trust, to reduce the effect of pension rate volatility on the City's budget. The City contributed \$8.0 million in FY 2018-19 and \$4.0 million in FY 2019-20. This brings total contributions to \$12.0 million and investment earnings of \$3.2 million for a total balance of \$15.2 million as of December 31, 2020.

As a fiscal sustainability measure, the City funds the Section 115 Trust using a more conservative discount rate of 6.5%. The City plans to accumulate sufficient funds in the Section 115 Trust to fund the difference between a 6.25% and a 7% discount rate. By using a more conservative discount rate than CalPERS, the City is able to allocate more funds towards pensions each year than required by CalPERS.

With the \$15.2 million set aside for pension funding, the City is in a strong position to withstand the effects of pension cost increases. If CalPERS investment returns fall short of their assumptions and expectations, the City will be better prepared for future pension cost increases. If the discount rate is lowered in the future, which is a distinct possibility, the City will be better prepared to absorb these costs.

The table below illustrates CalPERS' historical performance with similar date ranges as presented by US Bank in their quarterly performance reports:

Market Value (6/30/2020)	Year to Date (6 months)	1 Year	3 Years	6 Years	10 Years
\$ 389,000,000,000	-1.50%	4.70%	6.30%	5.60%	8.50%

The CalPERS Public Employees' Retirement Fund (PERF) ended the previous fiscal year with a market value of \$389 billion (as of 6/30/2020). For the current fiscal year, PERF ended the second quarter with a market value of \$430.5 billion (as of 11/30/2020).

While performance comparisons can be made from one financial institution to the next, it is important to understand that investment portfolios are not all designed equally. While two portfolios can have similar target rates of return, the size of the portfolio, available resources, regulation and oversight, and stakeholder interests may differ. These variations result in fluctuations in performance and return through time. While City staff monitor the performance of CalPERS and the City's investment trusts, diversification, General Fund stabilization, and local control over assets remain key factors for continuing to fund the City's Section 115 Pension Trust.

Reviewed by: Kristina Alfaro, Director of Administrative Services
Approved by: Deborah L. Feng, City Manager

Attachments:

A1 – Staff Report

A2 – Treasurer’s Report 12-31-2020

A3 – Wells Fargo Custodial Statement 12-31-2020

A4 – Wells Fargo Operating Statement 12-31-2020

A5 – Wells Fargo Workers’ Compensation Statement 12-31-2020

A6 – LAIF Statement 12-31-2020