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## Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Scott P. Johnson

**SUBJECT:** SEE BELOW

**DATE:** May 26, 2010

Approved

Date

5/26/10

### INFORMATION

#### SUBJECT: CITY'S RELATIONSHIP WITH LENDING INSTITUTIONS AND THEIR RESPONSE TO FORECLOSURES IN SAN JOSE

In recent months, several Council members have raised questions about the City's relationships with banking institutions as it relates to their response to foreclosures in San Jose. As expressed, there are concerns that banks are not committed to efforts to modify home loans. It has been suggested that the City work with the lenders we do business with to encourage increased participation in modification efforts. Some, including groups such as PACT, have suggested that the City halt business with any institution that shows an unwillingness to increase foreclosure mitigation.

The Administration has proactively attempted to work with those banks most active in the residential lending market and key players in providing financial services to the City, specifically Bank of America, Wells Fargo, and J.P. Morgan/Chase. In addition to the social responsibility provisions recently enacted by Council relating to the City's investment policy which proactively "rewards" banks that are actively working on foreclosure modifications, staff is also directly reaching out to bank leaders in an effort to talk to those in charge of mortgage modifications with the expectation to schedule meetings to take place in the next two months.

In the meantime, we want to respond to the suggestion that the City no longer do business, or somehow curtail or change the way we do business, with certain lenders. This informational memorandum provides the City Council with the broad perspective of financial services the City relies upon to administer our complex financial program. As the Nation and our City adjust to the post recession realities of the banking service industry, it is important to illustrate the scope of financial services the City's Investment, Debt, and Banking programs utilize to provide valuable services and savings to the San Jose community.

As the 10<sup>th</sup> largest city in the Nation, San Jose is a large financial organization with revenues approaching \$2.45 billion (all funds), a debt portfolio anticipated to average \$5.8 billion in FY

2010-11, and an investment portfolio of approximating \$1.6 billion, all of which require financial services to administer effectively. As Council addresses the challenges facing our community policy actions, it is important that the solutions are predicated on a "positive reinforcement" incentive for our financial partners. This strategy will help ensure that the City can continue to deliver a valuable service and continued savings to the community through high credit ratings and financial engineering. Without access to these financial service providers or limiting our access, the City would be placed in a difficult fiscal challenge and such actions would pose significant risks to our financial structure.

## **BACKGROUND**

The Country is currently emerging from its worst financial crisis since the great depression, and as the financial system regains its footing, there has been many conversations about the role of financial service firms. In addition to the well publicized effects of the financial crisis and the recession on our national economy and how they have impacted individuals and families, the City's financial operations have also been negatively impacted.

In February 2008, the City Council approved emergency powers for the Director of Finance to enable the City to react quickly to the unfolding impacts of the financial crisis on the City's extensive financial operations and debt obligations. Over the ensuing 12 months the City's Debt Program restructured 9 series of bonds totaling \$271.5 million as financial service firms left business lines entirely, curtailed their offerings, or their products were deemed worthless by the capital markets.

To illustrate this point, since 2008 investment banking firms Lehman Brothers and Bear Stearns have gone out of business and entities such as Bank of New York have exited the Line of Credit and Letter of Credit markets. The culmination of all these events resulted in a consolidated financial services sector which offers fewer financing options to the City. As the dialogue surrounding financial services evolves within the City, staff believes a discussion of the multitude of services the financial services industry provides to the City of San Jose and the critical nature of those products to our community is important. In addition, this informational memo updates the Council on recent policy actions to revise the City's Investment Policy to include a new section 16.0, "Social Responsibility – Foreclosure Mitigation" and implementation of the policy changes.

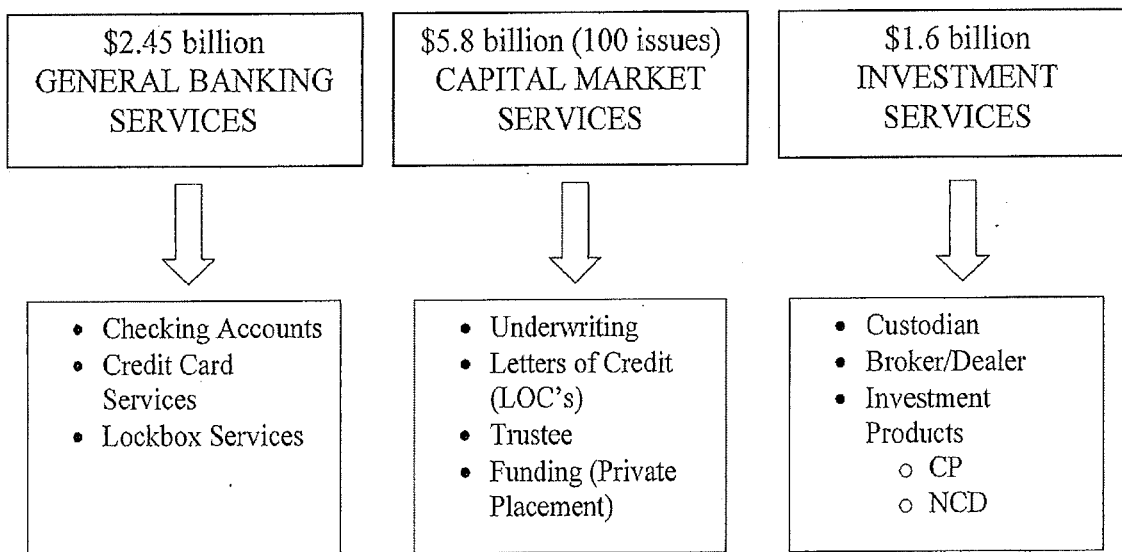
The complexity of the City's finances result in extensive and continuous use of financial services that extends well beyond the realm of traditional general banking services such as checking, lockbox, and merchant card. Discussions regarding the City's banking relationship should be viewed from this broader context of the totality of the City's financial service needs. The City's financial service needs can be classified in three broad areas including General Banking, Capital Market, and Investment services.

### General Banking Services

General Banking services are the traditional banking services envisioned when a discussion of banking ensues. In May 2009, the City Council approved staff's recommendation to enter into a contract with Wells Fargo Bank to provide the City's banking and financial services including General Banking Services, Merchant Card Processing Services and Lockbox Services for an initial term commencing with the execution of the agreements by the parties through June 30, 2012.

The diagram below illustrates the extent of financial services, beyond General Banking, necessary to effectively manage the City's finances.

## FINANCIAL SERVICES INDUSTRY



### Capital Market Services

The City's relationships with the financial markets for capital market services is key in maintaining the City's credit profile for long and short term borrowing needs. Between the City and the Redevelopment Agency, the debt portfolio consists of approximately \$5.8 billion representing over 100 debt issues. The types of capital market services necessary to facilitate the scope of the City's debt program include: underwriters, Letters of Credit (LOC's) providers, trustee's, and private placement funders. Attachment A of this report provides a detailed description of the types of capital market services the City utilizes and the extent to which they are deployed. In accordance with the City's Debt Management Policy, the Finance Department issues a Comprehensive Annual Debt Report (CADR) which discusses the debt activities undertaken and managed by the Finance Department. In addition, the Finance Department publishes a Quarterly Debt Report which is submitted quarterly to the Public Safety, Finance &

Strategic Support Committee. The CADR and quarterly debt reports can be accessed on the City's website at <http://www.csjfinance.org/>.

### **Investment Services**

The City currently maintains a portfolio totaling approximately \$1.6 billion in the City's investment portfolio as well as unspent bond proceeds currently residing with the City's trustees. The types of investment market services necessary to facilitate the scope of the City's investment program include: custodians, Broker Dealer relationships, and the actual investment products offered by financial institutions. – The securities purchased by the City per the City's Investment Policy, are issued by financial service firms and include: commercial paper, negotiable certificates of deposit, and medium-term corporate notes. The City often utilizes these products because of their relative credit quality and yield advantage they provide to the City. Attachment A of this report provides a detailed description of the types of investment services the City utilizes and the extent to which they are deployed. In accordance with the City's Investment Policy, the Finance Department issues monthly and quarterly investment reports which provide specific information on the City's investment program. The reports can be accessed on the City's website at <http://www.csjfinance.org/>.

### **RECENT POLICY ACTIONS APPROVED BY THE CITY COUNCIL**

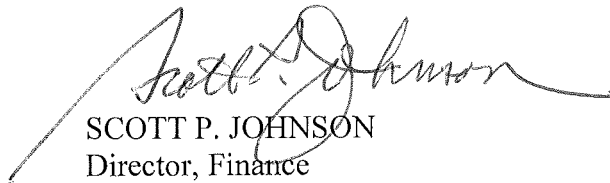
On December 8, 2009, the City Council authorized "positive reinforcement" revisions to the City's Investment Policy to include a new section 16.0, "Social Responsibility – Foreclosure Mitigation". The revision to the City's Investment Policy added a financial institution's commitment to foreclosure mitigation as one of several criteria used when evaluating which financial institutions the City of San José would use for short term investments. Consistent with the "prudent investor standard," which is to be used in administering the Investment Programs of public funds, the criteria of foreclosure mitigation is to be considered only after the Investment Program's primary objectives of safety, liquidity and yield. However, to the extent that competing financial institutions offer investment vehicles that are similar, their level of participation in the Federal Home Affordability Modification Program (HAMP) will be used as criteria.

During the month of January 2010, the Investment Program began implementation of the new Investment Policy criteria with the addition of JPMorgan Chase & Cos. (JPM) commercial paper program to the City's list of approved commercial paper (CP) issuers. JPM, along with Bank of America and Wells Fargo Bank (both have been on the City's approved list) represent the top three mortgage servicers in the San Jose area. As of February 2010, the most recently released HAMP program statistics reported that JPMorgan had 39% active modifications as a share of their estimated eligible 60+ day delinquencies, Wells Fargo Bank 37% active modifications, and Bank of America 24% active modifications. In accordance with the City's new "Social Responsibility – Foreclosure Mitigation" criteria, the outcome of the new policy direction has been the primary use of financial service firm investment products indicative of their respective HAMP participation.

The City's Investment staff continues to keep the objective of Social Responsibility in relation to foreclosure mitigation in mind when investing City funds while following all guidelines provided in the Investment Policy as well as the California State Government Code.

**SUMMARY**

As Council addresses the challenges facing our community policy actions, a continued focus predicated on a "positive reinforcement" incentive for our financial partners will help ensure that the City can continue to deliver a valuable service to the community while maintaining the City's strong credit quality. It is very important to acknowledge the continued significance of the City's relationships with financial institutions as we maintain a complex financial structure. It is through these relationships that staff will continue to reach out to our lending partners to express the City's concerns about foreclosures impacting San Jose's residents and attempt to explore options with them on how they may strengthen their efforts to work with the community to mitigate potential foreclosures.



SCOTT P. JOHNSON  
Director, Finance

For questions please contact Scott P. Johnson, Director of Finance, at (408) 535-7001

## ATTACHMENT A

**Capital Market Services** - Below are key components of the capital market financial services the City accesses on a regular basis.

*Underwriting* – Underwriting is provided by an investment banking firm which, singly or as a member of an underwriting group or syndicate, agrees to purchase a new issue of bonds from the City for resale and distribution to investors. The City sells bonds either through competitive or negotiated sale. In the case of a negotiated bond sale, underwriters are selected through a competitive RFP process. In the case of multifamily housing bond issues the City currently utilizes a pool of 10 underwriters which were selected through a competitive RFP process. It's important to note that the City requires the specialized services of underwriters for virtually every bond issuance. In the City's most recent financing transaction for the 2010AB housing set-aside issuance, the underwriting team of Stone & Youngberg and Bank of America successfully marketed the housing bonds at extremely competitive markets rates with beneficial interest savings to the City that indirectly facilitated funding to enable the housing department to partially fund the Redevelopment Agency's payment to the State for SERAF.

*Letters of Credit (LOCs)* – An arrangement between the City and a bank which provides additional security to investors that money will be available to pay debt service on a bond issuance of the City. In addition, LOCs can act as a liquidity facility in connection with City obligations such as commercial paper and variable-rate bonds. The City currently has \$967 million worth of LOC arrangements with 8 LOC providers.

*Trustee* – The trustee is responsible for carrying out the administrative functions that are required under the bond documents associated with the City's bond issuances. The City currently maintains \$556 million of unspent bond proceeds with 5 trustees.

*Funding (Private Placement)* - A private placement is when a bank is the exclusive purchaser of a debt issuance of the City. The City currently has one debt issuance privately placed and anticipates adding an additional placement in FY2010-11. The City also extensively uses private placement for financing construction loans for affordable housing projects.

**Investment Services** - Below are key components of investment services the City accesses on a regular basis.

*Custodian* – A custodian is an independent third-party bank that safeguards the custody of the City's investment assets. All assets invested on behalf of the City's operating fund portfolio are transferred to the City's custodian bank for safekeeping and to ensure internal controls. In addition, to safeguarding the City's financial assets the custodian also provides independent record keeping and investment maturity notification. The City currently maintains a portfolio averaging \$1 billion dollars with its custodian bank.

*Broker Dealer*- Broker/Dealers provide the City with investment execution services and investment and financial advice. Broker dealers often act as an additional set of "eyes and ears" for the investment program providing valuable market insights as well as extensive published investment research. The City currently has 10 approved broker/dealer relationships.