 **TO:** HONORABLE MAYOR **FROM:** Drew Corbett
 AND CITY COUNCIL

**SUBJECT: INVESTMENT REPORT FOR DATE:** November 6, 2024

###  THE QUARTER ENDED

###  SEPTEMBER 30, 2024

###

|  |  |  |  |
| --- | --- | --- | --- |
| Approved |  |  Date:11/8/2024 |  |

Transmitted herewith is the City Investment Report for the quarter ended September 30, 2024. To meet the reporting requirements set forth in the City of San José Investment Policy, an electronic version of this report will be posted on the City’s website at

<https://www.sanjoseca.gov/your-government/departments-offices/finance/reports/-folder-450> and a hard copy will be on file at the City Clerk’s Office located at 200 East Santa Clara Street, San José.

This report will be distributed to the Public Safety, Finance and Strategic Support Committee (PSFSS) for discussion during its meeting on November 21, 2024, and will be agendized through the PSFSS Committee for review by the full City Council on December 17, 2024.

Summary of portfolio performance and compliance for quarter ended September 30, 2024:

* **Size of total portfolio**: $2,522,084,221
* **Earned income yield**: 3.605%
* **Weighted average days to maturity:** 646days
* **Fiscal year-to-date net interest earnings**: $24,022,421
* No exceptions to the City’s Investment Policy during this quarter

During the quarter, the City’s external auditor, Macias, Gini, & O’Connell LLP, evaluated the City’s investment program for the six-month period ended June 30, 2024. The Independent Accountant’s Report on Applying Agreed-Upon Procedure is included herewith. The report noted no exceptions to the Investment Policy.

If you have questions on this investment report, please do not hesitate to call me at (408) 535-7011, or via email at drew.corbett@sanjoseca.gov.

 /s/

DREW CORBETT

Acting Director of Finance

cc: Jennifer A. Maguire, City Manager
Joe Rois, City Auditor

Nora Frimann, City Attorney

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# City of San José

**California**

# INVESTMENT REPORT FOR THE QUARTER ENDED

# SEPTEMBER 30, 2024



## Prepared by Finance Department

*Debt and Treasury Management Division*

## Drew Corbett

*Acting Director of Finance*

**Investment Report for The Quarter Ended September 30, 2024**

**City of San José Department of Finance**

**Debt and Treasury Management Division**

## Drew Corbett

*Acting Director of Finance*

## Qianyu Sun

*Deputy Director of Finance,*

*Debt & Treasury Management Division*

**Investment Staff**

Brian Chi, *Principal Investment Officer*

Cesar Blengino, *Financial Analyst* Frances Tao, *Accounting Technician*

**Special Assistance by**

Katie Su, *Senior* *Accountant*

Katrina Feng*, Accountant*

Rebecca Todd, *Administrative Assistant*

**CITY OF SAN JOSE INVESTMENT REPORTS FOR**

**THE QUARTER ENDED SEPTEMBER 30, 2024**

 **TABLE OF CONTENTS**

|  |
| --- |
| LETTER OF TRANSMITTAL |
| SECTION A. | PORTFOLIO STATISTICS |
|  | Portfolio Statistics – Quarter-to-Date |
| SECTION B. | TOTAL EARNINGS REPORTS |
|  | Total Earnings – Quarter-to-Date |
| SECTION C.SECTION D. | PORTFOLIO HOLDINGS AT COSTInvestment Status ReportMARKET VALUE OF PORTFOLIO |
|  | Portfolio Details - Investments |
| SECTION E. | DETAIL OF INVESTMENT ACTIVITY |
|  | Transaction Activity Report |
|  | Reconciliation of Investment Activities |
|  | Purchase Report |
| SECTION F. | INDEPENDENT ACCOUNTANT’S REPORT |
|  | Independent Accountant’s Report on Applying Agreed-Upon Procedures as of June 30, 2024 |

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November 6, 2024

HONORABLE MAYOR and CITY COUNCIL

### INVESTMENT REPORT FOR THE QUARTER ENDED SEPTEMBER 30, 2024

I am pleased to present this report of investment activity for the quarter ended September 30, 2024, in compliance with the reporting requirements set forth in the City of San José Investment Policy. The report presents information in the following major categories: Portfolio Statistics, Portfolio Performance, Compliance Reporting Requirements, Investment Trading Activity, and Investment Strategy.

The information presented in the table below highlights the investment activity for the quarter ended September 30, 2024, and provides a comparison to the quarters ended June 30, 2024, and September 30, 2023.

|  |
| --- |
| **INVESTMENT SUMMARY** |
| **For the Quarter Ended** | **September 30, 2024** |  | **June 30, 2024** |  | **September 30, 2023** |
| ***Total Portfolio*** |  |  |  |  |  |
| Portfolio Value (1) (2) | $2,522,084,221 |  | $2,962,110,309 |  | $2,540,849,470 |
| Earned Interest Yield | 3.605% |  | 3.631% |  | 3.000% |
|  |  |  |  |  |  |
| Dollar-weighted average yield |  |  |  |  |  |
| Purchases | 4.405% |  | 5.181% |  | 5.229% |
| Maturities | 4.939% |  | 4.520% |  | 4.611% |
| Called Securities | 5.033% |  | 5.695% |  | 4.083% |
|  |  |  |  |  |  |
| Weighted avg. yield at end of period | 3.502% |  | 3.748% |  | 2.998% |
| Weighted avg. days to maturity | 646 |  | 581 |  | 631 |
|  |  |  |  |  |  |
| 1 Reflects book value (principal plus any purchased interest) of investments.2 Total excludes bond proceeds held by trustees for the City of San José ($346,679,668). |  |  |

### PORTFOLIO STATISTICS

Detailed information can be found in the attachments while summaries are provided below.

#### Portfolio Composition

Within this section are snapshots of the City’s total investment portfolio as of September 30, 2024.

The first graph shows the portfolio composition by investment type.

**Portfolio Composition**

**$2,522,084,221**

The graph below reflects the reconciliation of total balances reported by the investment program’s record-keeping system to the City’s Financial Management System (FMS).

**Balances by Fund Type1**

**$2,488,351,510**

|  |  |
| --- | --- |
| Portfolio Balance | $2,522,084,221 |
| General Banking Balance |  9,096,075 |
| Deposit-in-Transit, Outstanding Checks2 |  (42,828,786)  |
| Total Balances per FMS |  $2,488,351,510 |

1 General Fund includes $403,492,133 of General Fund (Fund 001) as well as $12,018,399 of other General Fund funds which are separately tracked including the Depositor Fund, Developer Fees, and other smaller funds and reserves.

2 Reflects timing difference between when deposits are made and accounted for in FMS or when checks are written and not yet cashed by the receiving party.

#### General Fund Balances

The General Fund balances decreased by $472 million during the quarter and ended with a balance of $416 million as of September 30, 2024. This decrease is attributed to prefunding of employer contributions towards the Police and Fire Retirement Plan in July 2024, and debt service payments in August 2024. General Fund cash balances usually peak during the months of January and June, when the bulk of property taxes are received, and decline in the summer months due to retirement prefunding, debt service payments and operational expenditures.

The following graph compares monthly balances of five largest City funds as reported by FMS.

**Monthly Comparison of Balances by Fund Type**

**September 2022 – September 2024**

#### Prefunding of Annual Retirement Contributions

The City opted to prefund Police and Fire Retirement Plan Tier 1 annual employer retirement contributions along with Other Post-Employment Benefit (OPEB) contributions for Fiscal Year 2024-25 with cash and matured investments on July 1, 2024. The total prefunding amount was $221 million.

#### Successor Agency to the Redevelopment Agency of the City of San José

Historically, the Redevelopment Agency participated in the City investment pool with both restricted bond proceeds and operating cash balances. As of February 1, 2012, redevelopment agencies in California were dissolved by legislative action and the City, as the Successor Agency to the Redevelopment Agency (SARA), transferred the Redevelopment Agency funds from the investment pool to SARA bank accounts. In July 2018, the City entered the final stage of dissolution and absorbed the remaining SARA operations into City operations. City staff will continue to manage SARA’s accounts until all assets are liquidated and bonds are redeemed.

As of September 30, 2024, SARA reported cash balances as outlined in the table below:

|  |
| --- |
| **SARA CASH SUMMARY** |
|  | **Pledged for Bond/Enforceable****Obligations** |  |
| LAIF |  $563,349 |  |
|  |  |  |
|  Wells Fargo General Account: |  $128,571 |  |
|  |  |  |
|  Wilmington Trust Funds |  $4,765,886 | (A) |
| **TOTAL** |  $5,457,806 |  |
| (A) Funds restricted for tax allocation bond debt service payments |  |

### PORTFOLIO PERFORMANCE

The following table illustrates the total portfolio income recognized for the last quarter as compared to the prior quarter and the same quarter one year ago.

|  |
| --- |
| **TOTAL PORTFOLIO INCOME RECOGNIZED** |
| **Accrual Basis** |
| **Total Portfolio** | **September 30, 2024** |  | **June 30, 2024** |  | **September 30, 2023** |
| ***Quarter-End*** |  |  |  |  |  |
| Total interest earnings | $23,906,900 |  | $24,977,005 |  | $19,674,293 |
| Realized gains (losses) | $115,521 |  | $56,006 |  | $99,346 |
| Total income recognized | $24,002,421 |  | $25,033,011 |  | $19,773,639 |
|  |  |  |  |  |  |
| ***Fiscal Year-to-Date*** |  |  |  |  |  |
| Total interest earnings | $23,906,900 |  | $86,343,152 |  | $19,674,293 |
| Realized gains (losses) | $115,521 |  | $308,822 |  | $99,346 |
| Total income recognized | $24,002,421 |  | $86,651,974 |  | $19,773,639 |
|   |   |   |   |   |   |

#### Yield and Maturity Trend

The following graph illustrates the monthly dollar-weighted average maturity (WAM) of the Portfolio (bar graph) along with the weighted average yield (line graph) for the past two years.

**Portfolio Yield and Maturity Trends**

**September 2022 – September 2024**

The Portfolio’s WAM increased from 581 days on June 30, 2024, to 646 days on September 30, 2024. The weighted average yield decreased from 3.748% on June 30, 2023, to 3.502% on September 30, 2024.

The Federal Reserve elected to cut short-term interest rates by 50 basis points (bps) at the September 2024 Federal Open Market Committee (FOMC) meeting. Policymakers want to support the labor market while it is still strong and will decide the committee’s action at each meeting, indicating that despite the first cut being 50 bps, further cuts are expected to be lower. Over the quarter, the 10-year benchmark Treasury dropped from 4.40% on June 28 to 3.78% on September 30. The yield curve remains inverted, with shorter-term investments offering more yield than longer-term investments. Staff is investing the portfolio to match anticipated cash needs, with some investments made in the near-term to match cash outflows, and excess funds being invested longer to lock-in prevailing rates. Across the yield curve, rates decreased during the quarter, and new investments were purchased at the prevailing yields. As a result, the aggregate portfolio WAM increased, and the yield decreased.

#### Comparison with Benchmarks

The City’s Portfolio is compared against benchmarks for performance purposes. The following graph demonstrates a yield comparison by month of the City’s Portfolio, the California LAIF, and the BAML Index for the period from September 2022 to September 2024.

**Portfolio vs. Benchmarks September 2022 – September 2024**

**Notes:**

1. **City** refers to the City's Portfolio, and the yield data are month-end weighted average yields.
2. **LAIF** refers to the State of California Local Agency Investment Fund and yield data are average monthly effective yields.
3. **BAML** refers to the Bank of America Merrill Lynch 1-3 Year AAA-A US Corporate & Government Index, and yield data are rolling 2-year effective yields.

LAIF is a short-term investment option available to local agencies in California. LAIF’s WAM was 231 days as of September 30, 2024, much shorter than the City’s portfolio WAM of 646 days. When the yield curve is inverted, a portfolio with a shorter WAM is likely to gain a higher yield. The variance in yields will decrease with the normalization of the yield curve.

The BAML Index is a broad market index that tracks dollar-denominated, investment-grade, bonds with a remaining maturity of up to three (3) years. To simulate an index portfolio for comparison purposes, Treasury staff calculates a 2-year rolling average of daily BAML Index effective yields. The City’s Investment Policy allows investments, in several sectors, up to a 5-year final maturity. As of September 30, 2024, approximately 22% of the City’s portfolio held securities were purchased prior to December 2021 when interest rates were much lower. As interest rates have increased since 2023, especially in the short-term maturities (under 2 years), the BAML Index has surpassed the City portfolio in performance and widened the spread.

#### Unrealized Losses and Gains

As shown in the Investment Summary Table on page one of this report, the total portfolio size as of September 30, 2024, was approximately $2.52 billion. The following table illustrates the net unrealized gains or losses on the portfolio when comparing the portfolio’s market value to both its original cost and amortized cost for the quarter ending September 30, 2024.

|  |
| --- |
| **UNREALIZED GAINS & LOSSES****Cash Basis****Original Cost Amortized Cost** |
| **Market Value** | $2,537,220,350 | **Market Value** |  $2,537,220,350 |
| **Original Cost** | (2,522,084,221) | **Amortized Cost** | (2,539,999,976) |
| **Net Unrealized Gain** | $ 15,136,129 | **Net Unrealized Loss** | $ (2,779,626) |

An inverse relationship exists between changes in interest rates (Yield) and the value (Price) of fixed income investment securities. As interest rates decrease, the value of fixed income investments increases. Conversely, as interest rates increase, the value of fixed income investments decrease. The City’s investment practice, per the Investment Policy, is generally to hold securities to maturity, with exceptions as noted in the Investment Policy. The net unrealized gains and losses noted above are “paper gains and losses” and would only be realized if securities were sold prior to maturity.

Given the inverse relationship between interest rates and value, this has led to an unrealized gain in FY Q1 2024 of $15 million (as compared with original cost) and an unrealized loss of $2.8 million (as compared with amortized cost) as of September 30, 2024, respectively, as shown in the table above. As interest rates are expected to decline in late 2024, this may lead to a reversal of unrealized losses.

#### Earned Interest Yield

The earned interest yield of the total investment portfolio for the quarter ended September 30, 2024, was 3.605%, 0.026% lower than the previous quarter and 0.605% higher than a year ago.

### COMPLIANCE REPORTING REQUIREMENTS

Pursuant to Section 21.0 of the City’s Investment Policy, “No less than semi-annually each year, a compliance audit shall be conducted of the City’s investment program to determine whether the City’s investments within the City’s pooled portfolio are in compliance with the City’s Investment Policy, internal controls and department procedures.” These compliance audits per the Investment Policy can be included in the City Auditor’s work plan or can be conducted by an external auditor at the request of the Director of Finance. During the quarter, the City Auditor’s Office engaged the services of Macias, Gini, & O’Connell LLP (MGO) to audit the City’s investments within the pooled portfolio.

MGO completed its evaluation for the six-month period ended June 30, 2024, and found the City’s investment program to be in compliance with the City’s Investment Policy, internal controls, and department procedures. The report noted no exceptions to the Investment Policy. A copy of the Independent Accountant’s Agreed-Upon Procedures Report is attached to this quarterly report (Section F).

#### Cash Management Projection

Based on the Finance Department’s pooled cash flow projection as of September 30, 2024, total revenues, investment maturities, and cash for the next six months are anticipated to be approximately $2.2 billion. This is sufficient to cover projected expenditures of approximately $2.0 billion.

#### Statement of Compliance with the Policy

There were no exceptions or violations outstanding for the quarter ended September 30, 2024. The investment portfolio meets the requirements of the City’s Investment Policy and California Government Code Section 53601.

#### Comparison of Portfolio Investment Earnings to FY 2023-24 Budget

The following is a comparison of actual General Fund investment earnings, on an accrual basis, to the Fiscal Year 2024-25 budget. The Fiscal Year 2024-25 Budget included $14 million for interest earnings for the General Fund, based on an assumed net interest yield of 3.26%. The schedule below compares the unaudited actual net investment earnings to the General Fund budget for the quarter ended September 30, 2024. The actual interest earning rates are greater than the forecast for the quarter and for the fiscal year.

|  |
| --- |
|  **BUDGET COMPARISON** |
| **Net Investment Earnings** | **Yield** |
| ***Quarter Ended*** |  |
| Budget(a) | 3.26% |
| Actual(b) | 3.46% |
| Variance | 0.20%  |
| ***Fiscal Year to Date*** |  |
| Budget(a) | 3.26% |
| Actual(b) | 3.46% |
| Variance |  0.20% |
| 1. Reflects the 2024-2029 General Fund Forecast Information submitted by Finance on January 31, 2024.
2. Reflects the earned interest yield less costs to administer the investment program, adjusted for funds with negative cash balances at month end.
 |

### INVESTMENT TRADING ACTIVITY

Section E provides details of the City’s investment activities, including purchases, maturities, amortization, interest received, and realized gains or losses from trading activities.

In general, the City holds all securities to maturity. On rare occasions, the City may liquidate holdings to raise cash or as allowed under the Investment Policy.

### INVESTMENT STRATEGY AND MARKET UPDATE

The Investment Program continues to focus on its core mandates of safety, liquidity, and yield. Staff continues its effort to match known cash flow outlays in the next 24-month horizon with investment maturities. Beyond the 24-month horizon, staff selectively invests in various asset classes and maturity buckets to diversify the portfolio structure and maximize the portfolio’s earnings potential, as allowed by the Investment Policy.

The U.S. economy is continuing its path towards a soft landing, with a healthy labor market and inflation decreasing towards 2.00%. Bond markets are pricing in continued growth, while equity indices are at or near all-time highs. Despite the positive outlook, volatility is very high as investors scrutinize each new data release to better understand the rate outlook. Current expectations are for the Federal Reserve to cut overnight rates by one notch at each meeting.

Investment staff will closely monitor market developments, continue to focus on the overall quality of the portfolio, and invest with care, prudence, and diligence.

***Future Commitments*** – As of September 30, 2024, the City had no obligations to sell securities and no commitments to participate in securities trading.

***Executed Reverse Repurchase Agreements*** – No reverse repurchase agreements were executed this quarter.

***Restructuring*** – No restructuring activities took place during this quarter.

### CONCLUSION

The total investment portfolio as of September 30, 2024, was $2,522,084,221, a decrease of approximately $440 million from the previous quarter. For the quarter ended September 30, 2024, the earned interest yield decreased from 3.631% to 3.605% as compared to the quarter ended June 30, 2024, and the weighted average days to maturity increased from 581 days to 646 days over the same period. As of September 30, 2024, approximately 42% of the total portfolio was invested in U.S. Treasuries and Agency securities.

 /s/

DREW CORBETT

Acting Director of Finance