City of Mountain View

MEMORANDUM

Finance and Administrative Services Department

DATE: October 30, 2023

TO: Investment Review Committee

FROM: Derek Rampone, Finance and Administrative Services Director

SUBJECT: **Investment Review Committee Annual Report**

PURPOSE

For the Investment Review Committee to hold its annual meeting to review the City's investment portfolio and policy pursuant to Section 14.3 of City Council Policy B-2, Investment Policy (Policy) (Exhibit 1 to Attachment 1).

BACKGROUND

Annually, the Investment Review Committee meets to review the City's investment portfolio and policy. An updated version of last fiscal year's Committee report is included as a refresher for the Committee (Attachment 1).

The Committee met on October 6, 2022 to review the City's investment portfolio and its overall performance. The Committee discussed the benefits the City has experienced due to its conservative approach to investing, and there was also some discussion about private-placement 144A securities that were added to the corporate portion of the portfolio. The Committee did not recommend making any changes to the Policy at that time.

Staff has been directed to review the Social Responsibility Section of the Policy to better address the core value of sustainability. In addition, staff is recommending adding an asset class as authorized investments and minor clean-up changes to the Policy (Attachment 2). Analysis and recommendations are discussed below.

The draft minutes from the October 6, 2022 meeting have been presented at this meeting for approval as Item No. 3.

BACKGROUND AND ANALYSIS

Social Responsibility:

Section 6 of the current Policy addresses Social Responsibility and includes subsections on Social and Environmental Concerns, Community Investments, and Prohibited Investments. The provisions of this section pertain to investments in Banker's Acceptances, Corporate Notes, and Certificates of Deposit. The most recent updates to this section occurred in 2018 with the addition of Sections 6.1.3 and 6.3.3, as follows:

6.1.3 Investments are encouraged in entities involved in the production of renewable energy and sustainable agriculture and that demonstrate a commitment to environmental sustainability and transparency and accountability in corporate governance.

6.3.3 No investment is to be made in entities that engage in the direct exploration, production, refining, or marketing of fossil fuels.

At that time, staff provided information on what was included in other Agencies' investment policies for social responsibility and information on Environmental, Social, and Governance (ESG) ratings that would identify socially responsible energy companies. An ESG rating is based on three criteria: Environmental (climate change, renewable energy, and sustainability), Social (diversity, labor relations, and conflict minerals), and Governance (management structure, board independence, and executive compensation).

Recently, staff reexamined investment policies of the same surrounding and comparable agencies (see Attachments 3 through 12 for excerpts of social responsibility sections from those policies). All of the policies reviewed, except the City of San Mateo, address social responsibility to varying degrees. Half of the policies include some form of a sustainability objective that is in addition to and subordinate to the three objectives required by California Government Code Section 53600.5, of safety, liquidity, and return on investment. (See attached excerpts of the Cities of Milpitas, Palo Alto, and San Jose, the County of San Mateo, and the Santa Clara Valley Water District for examples.) Staff believes Section 6.0 of the City's current Policy is more robust than most other agencies' policies with the exception of the Santa Clara Valley Water District's policy, which includes a scorecard for ESG investing.

Information on ESG and ESG ratings has not changed much since 2018. Most of the ESG services are indexes to which investment managers compare their own investments. The Calvert Index is an example. There are some services that can be looked at which provide a rating based on the provider's proprietary criteria. Bloomberg and Moody's are examples of these. The challenge with these types of services is that their criteria may not align with the City's priorities. For example, hypothetically, Calvert may include Chevron in its index (or Bloomberg may give them a "good" rating) because they may mitigate their negative business practices with positive activities, and the City's Policy specifically prohibits investments in entities that engage in the direct exploration, production, refining, or marketing of fossil fuels. The other challenge is that these indices are not all-inclusive. There may be issuers that do not have an ESG track record or score, which would eliminate them as a potential investment.

Chandler Asset Management, the City's investment advisor, researched and found that ESG services marketed for investors vary widely:

- Many provide a framework for judging issuers from an ESG standpoint, but the basis to judge these frameworks is conducted on a peer comparison, which may not filter out dirty fuels (Bloomberg, Sustainalytics, S&P, Moody's). Moreover, the ESG ratings that could be used to identify socially responsible energy companies are very subjective from one party to another and may allow for issuers the City's policy excludes.

- Some of the ESG services are theme-driven, such as those supporting clean energy or clean climate bonds. These certifications are done on an issue rather than issuer basis, and many of the issues are very small and less liquid. Many are also for bonds that are excluded from the City's portfolio by law (rated below the category of A, or foreign-issued bonds).

- Some ESG ratings provided by some ESG services (Morningstar) are provided as an average for investments held in a mutual fund setting, rather than by issuer. The City generally does not purchase mutual funds. Moreover, as an average, these scores may still allow for the investment in issuers actively involved in activities that may be contrary to the City's goals.

- Many of the ESG composite scores may promote values that may not be identified as values promoted by the City.

- Many ESG services simply provide data to allow the investor to establish their own criteria based on the data provided.

In light of the varying degrees of applicability for the ESG frameworks discussed and changes made to the Policy in 2018, the City may want to consider adding ESG concerns to the Policy, which should be considered only after safety, liquidity, and return have been met.

A stronger approach for the City, as mentioned in 2018, would be for the Committee and City staff to develop its own list of ESG priorities similar to what Santa Clara Valley Water District has done. After that, an index like the Calvert Index may be used for guidance only (not a hard list). Chandler recommends the language in the Policy should then describe investments in ESG issuers as "encouraged" to avoid some of the challenges described above. The City's current Policy and other agencies' investment policies provided currently take this approach.

Lastly, it is important to note that the City currently takes a conservative approach with regard to its investments in Medium-Term Corporate Notes. California Government Code Section 53601(k) requires that these types of Notes eligible for investment be rated in a rating category of "A" or its equivalent or better by a Nationally Recognized Statistical Rating Organization (NRSRO). The City's current investment policy requires that these types of notes be rated "AA-/Aa-" or its equivalent or better by two of the three NRSROs. Investment-grade companies in the "AA" credit tier are larger, established companies and historically take a positive approach in incorporating ESG standards into their corporate governance. Since the City's policy is more conservative and already incorporates a socially responsible investment restriction overlay, adding an ESG rating system is unlikely to alter the securities deemed suitable for the City's corporate portfolio. If the City decided to expand the investment policy to be more consistent with the California Government Code and allow "A" or better rated securities, it may be worth exploring adding in an ESG overlay given the broader universe of eligible investments.

JPA Investment Pool:

Adding Joint Powers Authority (JPA) Investment Pools as an authorized investment would complement the Local Agency Investment Fund (LAIF) pool as an "on demand" investment. The JPA investment pools are shorter in duration and correspondingly respond to changes in the market quicker. Having JPA Investment Pools as an authorized investment would allow staff the option to pivot between the LAIF and the JPA Investment Pool when market interest rates move quickly as they have over the past year. JPA Investment Pools are permitted under California Government Code Section 53601(p), which states:

> "Shares of beneficial interest issued by a joint powers authority organized pursuant to Section 6509.7 that invests in the securities and obligations authorized in subdivisions (a) to (q), inclusive. Each share shall represent an equal proportional interest in the underlying pool of securities owned by the joint powers authority. To be eligible under this section, the joint powers authority issuing the shares shall have retained an investment advisor that meets all of the following criteria:
>
> (1) The advisor is registered or exempt from registration with the Securities and Exchange Commission.
>
> (2) The advisor has not less than five years of experience investing in the securities and obligations authorized in subdivisions (1) to (q), inclusive.
>
> (3) The advisor has assets under management in excess of five hundred million dollars ($500,000,000)."

Staff has researched three JPA Investment Pools: the California Asset Management Program (CAMP), Investment Trust of California (CalTRUST), and California Cooperative Liquid Assets Securities System (CLASS) that meet the criteria above. The Cities of Redwood City, Santa Clara, and Sunnyvale, and the County of San Mateo include JPA Investment Pools as an authorized investment in their policies; the City of San Mateo includes only the CAMP JPA Investment Pool in its policy.

RECOMMENDATIONS

Social Responsibility:

Staff does not currently recommend making any changes to the policy regarding Social Responsibility.

JPA Investment Pool:

Staff recommends adding the JPA Investment Pool asset class as an authorized investment. Staff recommends keeping the 20% maximum currently in place for the LAIF as a combined maximum for the LAIF and the JPA Investment Pools, but limiting each JPA Investment Pool to a maximum of 10%.

Policy Language Clean-Up:

There are a few areas in the Policy that staff would like to clean up or clarify. Specifically, Section 14.2 of the Policy to add "or designee" for the City Manager to appoint a designee to attend the semiannual meetings.

NEXT STEPS

Staff will summarize the Committee's discussion, any observations, and recommendations in a revised draft report, to be reviewed by the Chair, before transmitting the annual report to the City Council in December.

DR/TC/4/FIN
546-10-30-23M

Attachments:
1. Draft Annual Report of the Investment Review Committee to the City Council
2. Draft Updated Council Policy B-2 Investment Policy
3. City of Milpitas Investment Policy Excerpt
4. City of Palo Alto Investment Policy Excerpt
5. City of Redwood City Investment Policy Excerpt
6. City of San Jose Investment Policy Excerpt
7. City of San Mateo Investment Policy Excerpt
8. City of Santa Clara Investment Policy Excerpt
9. City of Sunnyvale Investment Policy Excerpt
10. County of San Mateo Investment Policy Excerpt
11. County of Santa Clara Investment Policy Excerpt
12. Santa Clara Valley Water District Investment Policy Excerpt