



DATE: December 11, 2018

CATEGORY: Consent

DEPT.: Investment Review Committee/
Finance and Administrative Services

TITLE: **Annual Report of the Investment
Review Committee for Fiscal Year
2017-18**

RECOMMENDATION

1. Accept the Annual Report of the Investment Review Committee for Fiscal Year 2017-18.
2. Adopt a Resolution of the City Council Modifying City Council Policy B-2, Investment Policy, to be read in title only, further reading waived (Attachment 1 to the Council report).
3. Approve the Investment Review Committee's recommendation to divest the City's holdings in Chevron and Exxon Mobil Corporate Notes as soon as possible.

BACKGROUND

This Council report transmits the Annual Report of the Investment Review Committee (IRC or Committee) (Attachment 2) as required by City Council Policy B-2, Investment Policy ([Policy](#)). The IRC is comprised of the members of the Council Finance Committee (CFC) and two public members appointed by the City Council with expertise in the area of fixed-income investments. One appointed public member is Steven Permut, Vice President, Senior Portfolio Manager, and Director of Municipal Investments for American Century Investment Management, Inc. The other public member, Janice Phan, Corporate Treasurer for Lumentum, has recently resigned from the position. The CFC is comprised of Councilmembers John McAlister and Ken S. Rosenberg, Chair of the IRC, and Vice Mayor Lisa Matichak. Appreciation is expressed to the IRC's public member for his advice, expertise, time, and assistance in fulfilling the responsibilities of the Committee.

The Policy requires that the IRC meet annually to review the performance, Policy compliance, and management of the City's investment portfolio. This meeting was held

on October 31, 2018 (Attachment 3) with a follow-up meeting on November 26, 2018 (Attachment 4). The Committee is also required to submit an annual report to the City Council containing the Committee's findings and any recommendations to amend the Investment Policy.

Acceptance of this report by the City Council also constitutes voluntary compliance with California Government Code Section 53646(a)(2), which states that "...the treasurer or chief fiscal officer of the local agency may annually render to the legislative body of that local agency and any oversight committee of that local agency a statement of investment policy, which the legislative body of the local agency shall consider at a public meeting."

ANALYSIS

Staff and the consultant reviewed the City's portfolio. The portfolio was in compliance with the Policy throughout the fiscal year. The total portfolio increased to \$632.1 million (cost value), compared to \$535.0 million at the end of the prior fiscal year. This is the first time the City's portfolio has reached over \$600 million.

At the October 31, 2018 meeting, the Committee discussed the following aspects of the portfolio:

- The Committee discussed environmental, social, and governance (ESG) ratings. Staff provided their assessment of the lack of an effective rating system and provided options to incorporate into the City's Policy. The Committee requested a more in-depth analysis of what is included in other agencies' investment policies and information on an ESG rating that would identify socially responsible energy companies. The City's external investment advisor, Chandler Asset Management, advised the Committee a limited number of corporations comply with the City's stricter AA rating for Corporate Notes, and prohibiting Chevron and Exxon Mobil or other energy companies will further reduce eligible Corporate Notes. In addition, the Committee approved recommending to the City Council that the City divest its holdings in Chevron and Exxon Mobil immediately and directed staff not to purchase Chevron or Exxon Mobil until the matter is decided.
- The Committee discussed segregating a portion of the portfolio, not needed for cash-flow purposes, to be invested in longer-term maturities pursuant to California Government Code Section 53601. Staff identified \$60.0 million, or about 10 percent of the portfolio, consisting of a variety of reserves. Although staff did not recommend investing in long-term maturities at this time due to the relatively flat yield curve, staff did recommend updating the Policy to allow the

purchase of up to 10 percent of the portfolio be invested in maturities of up to 10 years. The Committee took no action on this item.

- The Committee discussed additional recommendations made by staff to clean up a few areas in the Policy. These included changing “Supra National” to “Supranational,” correcting the minimum rating for Supranational Securities from “AA-/Aa-” to AA/Aa,” and having the rating for Supranational Securities be from one of the three rating agencies instead of two of the three rating agencies. The Committee approved recommending these changes to the Policy to the City Council.

At the November 26, 2018 meeting, the Committee discussed the following aspects of the portfolio:

- The Committee discussed other agencies’ investment policies and whether they included ESG ratings. In particular, staff provided information on Santa Clara Valley Water District’s and the City of Palo Alto’s investment policies. The City’s external investment advisor, Chandler Asset Management, provided more information on ESG ratings and services, and the Committee discussed further. Staff recommended adding two subsections to the Policy and provided an alternative. The Committee approved recommending the two subsections, with edits, to the City Council.

Recommendations from the October 31, 2018 and November 26, 2018 meetings include the following:

- Divest the City’s holdings in Chevron and Exxon Mobil as soon as possible.
- Update the areas of the Policy related to the Supranational Securities for clean-up and correction and other minor clean up language.
- Add Subsections 6.1.3 and 6.3.3 to the Policy related to environmental social responsibility 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 the 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.

The Committee's annual report is attached to this memo (Attachment 2). The Policy is attached to the resolution and shows markups and strikeouts.

FISCAL IMPACT

The Policy modifications do not have a direct fiscal impact. The inclusion of additional restrictions of companies engaged in the direct exploration, production, refining, or marketing of fossil fuels may reduce the number of eligible corporations the City may invest in. The Committee's recommendation to divest the City's holdings in Chevron and Exxon Mobil will have a financial impact to the City. The City currently holds approximately \$13.9 million of Corporate Notes in either Chevron or Exxon Mobil. The direct impact of selling these securities now will be an approximately \$125,000 realized loss to the City.

ALTERNATIVES

1. Do not accept some or all of the Committee's recommendations.
2. Modify some or all of the Committee's recommendations.
3. Provide other direction.

PUBLIC NOTICING – Agenda posting.

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- Attachments:
1. Resolution of the City Council Modifying City Council Policy B-2, Investment Policy
 2. Annual Report of the Investment Review Committee for Fiscal Year 2017-18
 3. Agenda and Reports from the Investment Review Committee Meeting, October 31, 2018
 4. Agenda and Report from the Investment Review Committee Meeting, November 26, 2018