

**MEMORANDUM**

Finance and Administrative Services Department

**DATE:** December 6, 2024

**TO:** Investment Review Committee

**FROM:** Elliot Young, Revenue Manager (Acting)  
Grace Zheng, Assistant Finance and Administrative Services Director  
Derek Rampone, Finance and Administrative Services Director

**SUBJECT:** **Report from Investment Review Committee and Proposed Changes to the Investment Policy**

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**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 (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 30, 2023 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, which limits what the City can invest in beyond the allowable State investment parameters. Staff has been directed to review the Investment Policy and bring back to the Committee any proposed recommended changes.

The draft minutes from the October 30, 2023 meeting have been presented at this meeting for approval as Item No. 3.

**ANALYSIS**

Section 10 of the current Policy outlines the types of investments the City is permitted to make. Based on deliberations from the October 30, 2023 meeting, staff reviewed Section 10.1.5 which details the investment parameters for Medium-term notes as illustrated below:

10.1.5 Medium-term (or corporate) notes with fixed coupons and fixed maturity issued by corporations organized and operating within the United States or by depository

institutions licensed by the United States or any state and operating within the United States, the long-term obligations of which are rated at least “AA/Aa” or equivalent by at least two of the three rating agencies (S&P, Moody’s, and Fitch). No more than 15% of the total portfolio may be invested in eligible medium-term or corporate notes. The maximum maturity of medium-term corporate notes is five years. Investments in medium-term notes issued by agencies of the federal government are governed by Section 10.1.1 of this Policy.

Upon review, staff noted that the requirement for a minimum rating of AA/Aa limits the City’s flexibility in investing in medium-term notes. While the investment policy allows for investing up to 15% in corporate notes, the limited availability of corporate notes with an AA rating has prevented staff from fully utilizing this asset class. Lowering the rating requirement to “A” would expand diversification opportunities by allowing access to a broader range of issuers across different sectors while still being subject to relatively low credit risk according to the Rating Agencies. Additionally, California Government Code Section 53600 permits investments with a rating of “A” or better from a nationally recognized rating agency, meaning the City’s current AA/Aa requirement is more stringent than state guidelines and has constrained the City’s investment options.

In addition, staff reviewed Section 10.1.2 which details the investment parameters for Mortgage-backed securities as illustrated below:

10.1.2 Mortgage-backed securities with a fixed coupon issued by an agency of the U.S. Government, provided that the stated final maturity of such securities does not exceed five years from the date of purchase. Investment in securities permitted under this section shall be limited to a maximum of 20% of the total portfolio.

Staff reviewed this section to determine whether the City’s investment policy should allow mortgage-backed and asset-backed securities issued by entities other than the U.S. Government. Securities issued by private industries, such as the automobile industry, carry higher risks. These securities are complex financial instruments, often involving the bundling of thousands of individual loans or assets, which makes it difficult to fully assess the associated risks. Additionally, these securities tend to have higher default risk during economic downturns.

## **RECOMMENDATIONS**

Based on the analysis above, staff recommends the following:

### **1. Medium-Term Notes**

Staff recommends lowering the City’s rating requirement for medium-term notes from AA to A to align with the broader options allowed under state law. Currently, medium-term

notes make up approximately 10% of the City's total investment portfolio, and the Policy allows up to 15%. Staff also recommend maintaining the 15% limit for now, with the expectation that lowering the rating requirement will increase investment opportunities. This limit can be reassessed once the City has successfully expanded its investments in corporate notes under the revised criteria.

## **2. Mortgage-Backed and Asset-Backed Securities**

Staff recommends no changes to the current Policy regarding mortgage-backed and asset-backed securities. The existing Policy, which limits such investments to those issued by the U.S. Government, should remain in place due to the higher risk associated with private-sector securities.

These recommendations align with the stated investment prioritization of Safety, Liquidity, Yield and the City's investment priorities to protect the value of its portfolio and manage risks prudently.

In addition, there are a few areas in the Policy that staff would like to clean up or clarify—specifically Section 14.1 of the Policy for the reporting requirements. This would require investment reports to be issued to the City Council and City Manager on a quarterly basis rather than monthly. This is consistent and common practice of other local municipalities.

### **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 January.

DR-EY-GZ/4/FIN

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- Attachments:
1. Draft Annual Report of the Investment Review Committee to the City Council
  2. Draft Updated Council Policy B-2 Investment Policy (red-line version)