



Office of the City Manager

INFORMATION CALENDAR

October 16, 2012

To: Honorable Mayor and Members of the City Council

From:  Christine Daniel, City Manager

Submitted by: Robert Hicks, Director, Finance Department

Subject: Investment Report: Quarter Ended June 30, 2012

SUMMARY

The City's investment policies require a quarterly report be submitted to the City Council on the status of the investment portfolio. The report includes all investments managed by the City of Berkeley and provides information on the values (par, book, and market), term, and yield of each security.

- The return on pooled investments for the quarter ended June 30, 2012 was 2.315% or 1.955% more than the .36% earned by the State Local Agency Investment Fund (State LAIF), which is the benchmark for investment performance used by the City. The return on pooled investments of 2.315% for the quarter ended June 30, 2012 was .235% more than the rate of 2.08% earned in the March 31, 2012 quarter. The large difference between the rate earned by the City of Berkeley and State LAIF (and other cities which fully or partially manage their own investments) exists primarily because staff locked in rates on several medium-term (3-5 years) securities in 2008 and 2009 that are much higher than the rates currently existing in the market.
- The City's interest income in the General Fund in FY 2013 is projected to be about \$800,000 less than last fiscal year's actual amount of \$4.7, because of the Federal Reserve Board's decision to keep its short-term interest rate in a range between zero and .25% and the Fed's decision to continue sell short-term Treasury securities and buy medium-term Treasury securities, to keep mortgage rates low.
- The return on Retiree Medical Trust Fund (Miscellaneous Plan) investments was 6.685% for the quarter ended June 30, 2012. That return was .315% lower than the average 7% return the City's actuary determined the City needed to earn on investments to fund the plan at the 70% level. This rate will continue to drop in the next few quarters as staff begins to reinvest the proceeds of matured securities at lower interest rates.

**CURRENT SITUATION AND ITS EFFECTS**

Attached is a quarterly report on the status of the City’s investment portfolio. The report includes all investments managed by the City of Berkeley and provides information on the values (par, book, and market), term, and yield of each security.

Summary information by type of security and detailed information on each security is provided on Attachment I page A-2. An evaluation of portfolio performance this accounting period compared to the previous two accounting periods is also included on Attachment I page A-1.

**A. Portfolio Results**

1. Liquidity of Portfolio:

The average investment in the pooled portfolio matured in 446 as of June 30, 2012. That represented a decrease of 361 days from the 807 days as of March 31, 2012.

2. Comparison of Results to Performance Measures – Pooled investments: Quarter Ended June 30, 2012

The City’s yield on investments for the quarter ended June 30, 2012 was 2.315%, an increase of 23.5 basis points (0.235%) from the 2.08% earned during the quarter ended March 31, 2012. The long-term rate earned during the quarter was 3.24%, and the short-term rate was .3%. The average yield on a 90-day Treasury bill at the end of the quarter ended June 30, 2012 was .09%, up from the .08% at the end of the previous quarter.

As summarized in Table 1, staff’s results exceeded the performance measure for the quarter by 195.5 basis points (1.955%). Staff exceeded the performance measure in April by 200 basis points (2.00%); in May by 150 basis points (1.50%); and, in June by 235 basis points (2.35%). The performance measure for the return on investments is that the rate of return of the portfolio is above the rate earned by State LAIF.

**Table 1**

<b>Quarter Ended June 30, 2012</b>			
<b>Period</b>	<b>City</b>	<b>State LAIF</b>	<b>Difference</b>
April 2012	2.371%	.367%	2.004%
May 2012	1.866%	.363%	1.503%
June 2012	2.708%	.358%	2.35%
April 1 through June 30, 2012	2.315%	.36%	1.955%

3. Investment Results-Retiree Health Insurance Funds:

Average interest rates earned on the retiree health insurance trust funds for the quarter ended June 30, 2012 compared to the quarter ended March 31, 2012 were as follows:

**Table 2**

<b>EARNED INTEREST RATES</b>		
<b>For Quarter Ended 6/30/2012 Compared To 3/31/12</b>		
<b>Fund</b>	<b>6/30/12</b>	<b>3/31/12</b>
Retiree Medical Trust Fund (Miscellaneous Employees)	6.685%	6.684%
Fire Retiree Medical Trust Fund	5.920%	5.915%
Police Retiree Medical Trust Fund	6.048%	6.044%

The rates earned on these plans will continue to drop over the next few quarters as staff reinvests the proceeds of matured securities at lower rates.

Details related to retiree health trust fund investments are in Attachment I, Exhibits B, C and D of this report.

**B. Discussion of Interest Rate Environment and Outlook**

The Federal Reserve Board's Federal Open Market Committee held a meeting on June 19-20, 2012. Information received since the Federal Open Market Committee met in April suggests that the economy has been expanding moderately this year. However, employment has slowed in recent months, and the unemployment rate remains elevated. Business fixed investment has continued to advance. Household spending appears to be rising at a somewhat slower pace than earlier in the year. Despite some signs of improvement, the housing sector remains depressed. Inflation has declined, mainly reflecting lower prices of crude and gasoline, and longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects economic growth over coming quarters to remain moderate and then to pick up gradually. Consequently the Committee anticipates that the unemployment rate will decline only slowly toward levels that the Committee judges to be consistent with its dual mandate. Strains in global financial markets continue to pose significant downside risks to the economic outlook. The Committee anticipates that over the medium term, inflation will run at levels at or below those consistent with the Committee's dual mandate.

To support a stronger economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate, the Committee expects to maintain a highly accommodative stance for monetary policy. In particular, the Committee decided today to keep the target range for the Federal Funds rate at zero% to .25% and currently

anticipates economic conditions-including low rates of resource utilization and a subdued outlook for inflation over the medium-term are likely are likely to warrant exceptionally low levels of the Federal Funds rate at least through late 2014.

The Committee also decided to continue its program to extend the average maturity of its holdings of securities as announced in September. Specifically, the Committee intends to purchase Treasury securities with remaining maturities of 6 years to 30 years at the current pace and to sell or redeem an equal amount of Treasury securities with remaining maturities of approximately 3 years or less. This continuation of the maturity extension program should put downward pressure on longer-term interest rates and help to make broader financial conditions more accommodative. The Committee is maintaining its existing policy of reinvesting principal payments from its holding of agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The Committee is prepared to take further action as appropriate to promote a stronger economic recovery and sustained improvement in labor market conditions in a context of price stability.

In the current interest rate environment, staff expects a return that is lower than the overall rate earned in FY 2012, as some long-term securities will mature and be invested at much lower rates. However, this lower rate earned will be higher than the City's benchmark (State LAIF) and the rate earned by other cities in California. The City's investment strategy will continue to focus on (1) locking in reasonable rates on long-term investments, when opportunities present themselves and (2) matching of investment maturities to cash flow.

## BACKGROUND

- Pooled Investments

Short-term cash is invested primarily in government sponsored enterprises (referred to as Federal Agency) discount notes and commercial paper. Additional cash is invested in a money market fund or over night securities to meet the liquidity needs of the City. Pooled investments are also made in medium term corporate notes, treasury coupon securities, and federal agency coupon securities for periods of one to five years.

In some cases, the City may have investments with a current market value that is greater or less than the recorded cost. These changes in market value are due to fluctuations in the market and have no effect on yield, as the City does not intend to sell securities prior to maturity.

- Retiree Health Trust Fund Investments

The City agreed to provide retiree Health insurance coverage for fire, police and miscellaneous employees under certain terms and conditions. An actuarial study commissioned by the City determined that, in addition to City Contributions, a rate of return of 7% on miscellaneous employees trust fund assets invested must

be achieved to fund the retiree health benefit at the desired 70% level. City Finance Department staff manages these investment portfolios.

CONTACT PERSON

Robert Hicks, Director, Finance Department, 981-7301

Attachments:

- 1: Portfolio Evaluation Quarter Ended June 30, 2012
  - Exhibit A: Pooled Investments Selected Funds
  - Exhibit B: Miscellaneous Employees Retiree Medical Trust Fund
  - Exhibit C: Fire Medical Trust Fund
  - Exhibit D: Police Medical Trust Fund