




Office of the City Manager

INFORMATION CALENDAR

June 4, 2013

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 March 31, 2013

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 March 31, 2013 was 1.624% or 1.334% more than the .29% 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 1.624% for the quarter ended March 31, 2013 was .416% less than the rate of 2.04% earned in the December 31, 2012 quarter.
- The City's interest income in the General Fund in FY 2013 is projected to be about \$1.5 million less than last fiscal year's amount of \$4.7 million, because of the Federal Reserve Board's (the Fed) decision to keep its short-term interest rate in a range between zero and .25% throughout the entire fiscal year and beyond, and the Fed's decision to continue to 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 5.651% for the quarter ended March 31, 2013. That return was 1.349% 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. However, the cumulative average return for the plan since inception is 7.47% (including the FY 2013 rate earned YTD). This rate will continue to drop slightly in the next few quarters as staff reinvests the proceeds of maturing 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 1 page A-2. An evaluation of portfolio performance this accounting period compared to the previous two accounting periods is also included on Attachment 1 page A-1.

**A. Portfolio Results**1. Liquidity of Portfolio:

The average investment in the pooled portfolio matured in 426 days as of March 31, 2013. That represented a decrease of 45 days from the 471 days as of December 31, 2012.

2. Comparison of Results to Performance Measures—Pooled investments:  
Quarter Ended March 31, 2013

The City's yield on investments for the quarter ended March 31, 2013 was 1.624%, a decrease of 41.6 basis points (0.416%) from the 2.04% earned during the quarter ended December 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 March 31, 2013 was .09%, up from the .07% at the end of the previous quarter.

As summarized in Table 1, staff's results exceeded the performance measure for the quarter by 133.4 basis points (1.334%). Staff exceeded the performance measure in January by 134 basis points (1.34%); in February by 150.4 basis points (1.504%); and, in March by 115.5 basis points (1.155%). 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 March 31, 2013</b>			
<b>Period</b>	<b>City</b>	<b>State LAIF</b>	<b>Difference</b>
January 2013	1.64%	.300%	1.34%
February 2013	1.79%	.286%	1.504%
March 2013	1.44%	.285%	1.155%
January 1 through March 31, 2013	1.624%	.290%	1.334%

3. Investment Results-Retiree Health Insurance Funds:

Average interest rates earned on the retiree health insurance trust funds for the quarter ended March 31, 2013 compared to the quarter ended December 31, 2013 were as follows:

**Table 2**

<b>EARNED INTEREST RATES</b>		
<b>For Quarter Ended 3/31/2013 Compared To 12/31/12</b>		
<b>Fund</b>	<b>3/31/13</b>	<b>12/31/12</b>
Retiree Medical Trust Fund (Miscellaneous Employees)	5.651%	5.903%
Fire Retiree Medical Trust Fund	5.863%	5.856%
Police Retiree Medical Trust Fund	6.020%	5.988%

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

Details related to retiree health trust fund investments are in Attachment 1, Exhibits B, C and D of this report.

**B. Discussion of Interest Rate Environment and Outlook (The Fed's Statement)**

Information received since the Federal Reserve Board's Federal Open Market Committee held a meeting in January suggests a return to moderate economic growth following a pause late last year. Labor market conditions have shown signs of improvement in recent months but the unemployment rate remains elevated. Household spending and business fixed investment advanced, and the sector has strengthened further, but fiscal policy has become somewhat more restrictive. Inflation has been running somewhat below the Committee's longer-run objective, apart from temporary variations that largely reflect fluctuations in energy prices. 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 that, with appropriate policy accommodation, economic growth will proceed at a moderate pace and the unemployment rate will gradually decline towards levels the Committee judges consistent with its dual mandate. The Committee continues to see downside risks to the economic outlook. The Committee anticipates that inflation over the medium term likely will run at or below its 2 percent objective.

To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Committee decided to continue purchasing additional agency mortgage-backed securities at a pace of \$40 billion per month and longer-term Treasury securities at a pace of \$45 billion per month. 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 and of rolling over maturing Treasury securities at auction. Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative.

To support continued progress toward maximum employment and price stability, the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided on January 2013 to keep the target range for the Federal Funds rate at zero% to .25% and currently anticipates that this exceptionally low rate for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments.

In the current interest rate environment, staff expects returns in FY 2013 and FY 2014 to be lower than the returns earned in FY 2012, as some long-term securities will mature and be invested at much lower rates. However, the lower rate earned is expected to be higher than the City's benchmark (State LAIF) and the rate earned by other cities in California, a sample of which is reflected in table 3 below:

**Table 3**

<b>Sample of Other California Cities – Earned Interest Rates For the Quarter Ending December 31, 2012</b>	
<b>City</b>	<b>Rates Earned</b>
San Jose	0.577%
Oakland	0.32%
Hayward	0.357%
San Francisco	0.987%
Sacramento	1.66%
Sunnyvale	.61%
Santa Monica	.69%
Los Angeles	.67%
<b>Berkeley</b>	<b>2.04%</b>
Palo Alto *	2.44%

*\* Investment policies allow maturities out to 10 years.*

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, an average 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

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## ATTACHMENTS

1: Portfolio Evaluation Quarter Ended March 31, 2013

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