

Investment Strategy Update

City of Goleta
Council Meeting
July 16, 2019



Investment Policy Background

- ▶ **City initially adopted Investment Policy on June 20, 2005**
- ▶ **Last revised/reviewed on January 15, 2019**
 - ▶ Administrative updates that added clarity and additional definitions in glossary
 - ▶ Added the 1-Year and 2-Year U.S. Treasury Rates as additional useful benchmarks, in addition to Local Agency Investment Fund (LAIF) apportionment rate
- ▶ **Meets California Government Code statutes and best practices:**
 - ▶ California Debt and Investment Advisory Commission (CDIAC)
 - ▶ California Municipal Treasurer's Association (CMTA)
 - ▶ Government Finance Officers Association (GFOA)

Investment Policy Purpose

- ▶ **Establish guidelines, strategies, practices and procedures to be used in investing public funds**
- ▶ **Ensures conformance with California Gov. Code Sections (53600 and 53635 et seq.) and local statutes governing the investment of public funds**
- ▶ **Policy Objectives:**

Safety

- Likelihood that the City will get all its money back



Liquidity

- City's abilities to withdraw funds on short notice



Yield

- Interest or other return on the investment

Investment Practice (Current)

- ▶ **Held in overnight funds (same-day liquidity/access to cash)**
 - ▶ **Local Agency Investment Fund (LAIF)**
 - ▶ Pooled voluntary investment fund open to government entities (2,366 participating agencies)
 - ▶ Part of the Pooled Money Investment Account (PMIA), managed by the Investment Division of the State Treasurer's Office
 - ▶ Quarterly Apportionment Rate, current at 2.57%
 - ▶ **Collateralized money market account within Community West Bank**
 - ▶ Contract rate guaranteed at 0.7%, agreed to match LAIF and/or PMIA average monthly yield

Authorized Investments

- ▶ **Investments are pooled, except when required by law**
 - ▶ Maximizes investment earnings, efficiencies with administration and cash flow management to meet liquidity requirements
- ▶ **Summary of Authorized Investments (City Policy):**

Local Agency Investment Fund (LAIF)	JPA Pools (other investment pools) – CalTRUST
U.S. Treasury Obligations	Commercial Paper
U.S. Government-Sponsored Agency Securities	Money Market Mutual Funds
Sweep account	Passbook accounts
Certificates of Deposits	

Additional information of the City's authorized investments is found in the City's Investment Policy and staff report

Other Investment Policy Requirements

▶ **Maximum Maturities**

- ▶ Laddered portfolio shall be followed
- ▶ At least 35% of portfolio value within one-year maturity date from investment date
- ▶ No more than 25% of portfolio value within three to five year maturity date (can increase, if meet cash-flow requirements)
- ▶ No investments with maturities greater than 5 years

▶ **Diversification**

- ▶ No more than 10% of portfolio value with single issuer
 - ▶ Exceptions includes U.S., Treasury/Federal agency securities, authorized pools and collateralized investments.

▶ **Liquidity**

- ▶ Meet city cash flow needs
- ▶ Meet expenditure requirements for the next six months (Gov. Code Section 53646)

Investment Strategy

▶ **Buy and Hold**

- ▶ Passive, “buy and hold” process where financial instruments are held until maturity rather than actively bought and sold at various times
- ▶ Kept sufficiently liquid to preclude undesirable sale of investments prior to maturity
- ▶ Sale of investments prior to maturity, only on an exception basis and only when it is clearly favorable to do so

▶ **Benchmark**

- ▶ Used for comparison purposes (portfolio compositions, structure, and risk)
- ▶ LAIF apportionment rate, 1-year and 2-year U.S. Treasury Note

Investment Strategy – Liquidity/Cash Flow

▶ **Liquidity**

- ▶ Sufficiently liquid to enable the City to meet all operating requirements which might meet be reasonably anticipated.
- ▶ Confirming compliance with there are sufficient funds available to meet the City's expenditure requirements for the next six months or why sufficient money will not be available

▶ **Cash Flow Analysis and Forecasting**

- ▶ Daily cash flow tracking
- ▶ Cash flow projections confirms compliance
 - ▶ Historical data, known revenues and expenditures and assumptions
 - ▶ Budgetary data and timing of large capital improvement projects needing City to upfront funds
- ▶ Cash flow is primary factor in determining investment maturity terms

Investment Strategy – Liquidity/Cash Flow

► Summary of City Cash Flow Balance

City of Goleta - Historical MMA Balances

Month	FY 2016	FY 2017	FY 2018	FY 2019
July	\$ 35,676,974	\$ 44,639,790	\$ 57,709,070	\$ 50,701,965
August	\$ 38,039,143	\$ 45,899,330	\$ 58,927,481	\$ 50,872,245
September	\$ 34,054,437	\$ 50,908,334	\$ 57,627,245	\$ 50,232,784
October	\$ 36,875,141	\$ 48,326,953	\$ 57,312,516	\$ 50,920,550
November	\$ 36,416,904	\$ 48,833,220	\$ 53,389,415	\$ 50,666,458
December	\$ 37,819,015	\$ 48,664,880	\$ 52,978,440	\$ 50,800,304
January	\$ 40,386,147	\$ 50,894,155	\$ 54,291,103	\$ 54,605,025
February	\$ 41,625,386	\$ 50,566,543	\$ 52,959,505	\$ 52,564,106
March	\$ 41,720,220	\$ 50,325,765	\$ 52,507,931	\$ 54,167,895
April	\$ 42,633,857	\$ 51,238,184	\$ 53,164,553	\$ 53,912,981
May	\$ 43,348,512	\$ 54,855,019	\$ 49,587,738	\$ 54,292,515
June	\$ 45,454,341	\$ 57,712,012	\$ 51,746,155	\$ 54,771,017
Average	\$ 39,504,173	\$ 50,238,682	\$ 54,350,096	\$ 52,375,654

Programmed Expenditures for FY 19/20

(does not include FY 18/19 carryovers)

General Fund: \$27.4 M

Capital Projects: \$13.06M

Total: \$40.46M

Daily liquidity needed within 1 year, due to timing of revenues and expenditures, including funds that may need to be upfront in near term and timing of reimbursements, some include:

- City Hall Financing \$12m
- Federal Grants \$5.6m
- State Grants \$10.2m

Cash flow projections is primary factor in determining investment maturity terms. Staff to provide ongoing analysis to minimize liquidity risk. Portfolio maturities may be adjusted over time to address liquidity and cash flow needs.

Investment Strategy - Recommendation

- ▶ **5-Year Rolling CD Ladder Strategy starting with approximately \$5 million**
 - ▶ Conforms to Investment Policy (passive, buy and hold, laddered maturity and diversification requirements and liquidity needs and requirements)
 - ▶ Prioritizes safety, liquidity and yield
 - ▶ Preserves principal, FDIC insures CD's up to \$250,000
 - ▶ Portfolio remains sufficiently liquid to meet operating requirements (approx. 90% daily liquidity or \$45 million)
 - ▶ 1/5th of the money is available every year, if decided not to reinvest
 - ▶ Normal yield curve environment, long-dated CD's have higher yields than shorter-dated
 - ▶ Excess funds continued to be invested in overnight funds
 - ▶ Depending on cash flow projections and liquidity needs, can increase investment funding in maturity terms. Can also be used with other allowable investment vehicles such as agency bonds

CD Ladder Example

5-Year Rolling CD Ladder

- Staggered maturity dates, evenly distributed between 1 thru 5 years
 - Avoids timing the market, hedge (reduce risks) against unpredictable rates
- When 1-year CD matures, principal is then used (“rolled”) to purchase a new 5-year CD.
- After 4 years, all funds will have been invested in 5 year CDs

For presentation purposes only Year 1, Year 2, and Year 5 are shown, with total interest summary:

Year 1			
Maturity	Par Amount	Interest Rate	Annual interest
1 Year	1,000,000.00	2.5	25,000.00
2 Year	1,000,000.00	2.6	26,000.00
3 Year	1,000,000.00	2.8	28,000.00
4 Year	1,000,000.00	2.925	29,250.00
5 Year	1,000,000.00	3.15	31,500.00
Totals/Avg Rate	5,000,000.00	2.80	139,750.00

Year 2			
Maturity	Par Amount	Interest Rate	Annual interest
1 Year	1,000,000.00	2.6	26,000.00
2 Year	1,000,000.00	2.8	28,000.00
3 Year	1,000,000.00	2.925	29,250.00
4 Year	1,000,000.00	3.15	31,500.00
5 Year	1,000,000.00	3.15	31,500.00
Totals/Avg Rate	5,000,000.00	2.93	146,250.00

Year 5			
Maturity	Par Amount	Interest Rate	Annual interest
1 Year	1,000,000.00	3.15	31,500.00
2 Year	1,000,000.00	3.15	31,500.00
3 Year	1,000,000.00	3.15	31,500.00
4 Year	1,000,000.00	3.15	31,500.00
5 Year	1,000,000.00	3.15	31,500.00
Totals/Avg Rate	5,000,000.00	3.15	157,500.00

Interest Summary		
Year	Interest	Average Rate
Year 1	139,750.00	2.80
Year 2	146,250.00	2.93
Year 3	151,750.00	3.04
Year 4	155,250.00	3.11
Year 5	157,500.00	3.15
Total	750,500.00	

Example of \$5 million, five-year CD ladder over five years, utilizing rates as of 2/13/2019. Assumes as the 1-year CD matures, at end of each year, it is reinvested back out to current 5-year rate. Results in approximate \$750,500 interest earnings.

CD Ladder Example - Comparison

Investment Strategy Comparison (with LAIF Rate Increase Assumptions)

CD Ladder Interest Summary			LAIF Interest Summary		Difference	
Year	Interest	Effective Rate	Interest	Effective Rate	Interest Difference	Effective Rate Difference
Year 1	139,750.00	2.80	99,500.00	1.99	40,250.00	0.81
Year 2	146,250.00	2.93	105,470.00	2.11	40,780.00	0.82
Year 3	151,750.00	3.04	111,798.20	2.24	39,951.80	0.80
Year 4	155,250.00	3.11	118,506.09	2.37	36,743.91	0.73
Year 5	157,500.00	3.15	125,616.46	2.51	31,883.54	0.64
Total	750,500.00		560,890.75		189,609.25	

- ▶ **Each investment type is different and holds own purpose**
 - ▶ LAIF is liquid and considered an overnight fund, similar to money market account
 - ▶ Daily cash flow tool that preserves principal with ability to earn additional interest
 - ▶ CDs are fixed rate and have established maturity dates
 - ▶ Trading liquidity for higher yields (in normal yield curve environment)

Benchmarks and Next Steps

▶ Snapshot of Benchmarks (Treasury, LAIF and MMA Rates Over the Last 7 Months)

	12/31/2018	1/31/2019	2/28/2019	3/31/2019	4/30/2019	5/30/2019	6/30/2019	Cumulative Change
1 Year USTN	2.63%	2.55%	2.50%	2.40%	2.39%	2.21%	1.92%	-0.71%
2 Year USTN	2.48%	2.45%	2.54%	2.27%	2.27%	1.95%	1.75%	-0.73%
LAIF	2.40%	2.55%	2.55%	2.55%	2.57%	2.57%	2.57%	0.15%
MMA	2.19%	2.28%	2.40%	2.40%	2.55%	2.55%	2.55%	0.21%

- ▶ LAIF apportionment rate expected to decrease
 - ▶ (Now includes interest earned on CalPERS Supplemental Pension Payment ~\$6 billion)
- ▶ CD rates to be evaluated and ladder strategy to be built with initial \$5 million, per investment policy and recommended strategy
- ▶ Ongoing monitoring and review of cash flow projections
- ▶ Ongoing monthly investment transaction reports, and quarterly review of City's Treasurers Report (reviewed quarterly with Finance Committee)

Fiscal Impacts

- ▶ No fiscal impacts except staff time on additional reporting requirements on investment transactions
- ▶ Future investment income dependent upon, where rates are at time of investment
- ▶ Software to automate/assist with investment portfolio accounting, reporting, and analysis and managing cash flows
- ▶ **What if funds are needed?**
 - ▶ 1/5th of the money is available every year, as each CD term matures, can be decided whether to reinvest it all or part
 - ▶ Becomes a rolling ladder, when reinvest principal, as existing CDs mature and are replaced with higher-yielding CDs (normal yield curve environment)
 - ▶ Early withdrawal penalties varies, can be 6 months interest or 12 month's interest (example below):
 - ▶ Assume, \$240,000 5-year CD at 2.00% APY, with early withdrawal penalty of 12 months interest, decision to early withdrawal at 3 years with 2 years until maturity, can be subject to approximately \$14,500 in penalties

Recommendation

- ▶ **Finance Committee Review:**

- ▶ Met to review and discuss investment options and investment strategy on December 3, 2018, February 11, 2019, and February 27, 2019 and were in support of recommended strategy

- ▶ **City Council Recommendation:**

- ▶ Direct staff to implement recommended investment strategy