



# MEMORANDUM

Agenda Item #: \_\_\_\_\_  
Meeting Date: \_\_\_\_\_

**TO: HONORABLE MAYOR AND CITY COUNCIL MEMBERS**

**FROM: ELIZABETH YING, CITY TREASURER**

**SUBJECT: FIRST QUARTER REPORT OF CASH AND INVESTMENTS –  
September 30, 2020**

**DATE: October 27, 2020**

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**ACTION REQUIRED**  **CONSENT**  **RECEIVE & FILE**

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*Given the October 27 City Council meeting cancellation, and given the California Government Code 53646 and the City's Investment Policy Section 17 requirements to provide the Quarterly Report within 30 days of quarter-end, this report is provided to the City Council members and City Manager via email, and will be posted on the City's website.*

## **Recommendation**

It is recommended that the City Council review, receive and accept the First Quarter Report of Cash and Investments, shown as Attachment A.

**Summary** (See Background and Analysis, below)

## **Background and Analysis**

Pursuant to the City of Palos Verdes Estates FY 2020-21 Investment Policy, the Quarterly Report of Cash and Investments shall be provided within 30 days of quarter end.

## **Fiscal Impact**

There is no fiscal impact associated with this report.

## **Notification**

This matter has been agendized and posted in the routine manner.

## **ATTACHMENTS:**

A – First Quarter Report of Cash and Investments



# City of Palos Verdes Estates

## First Quarter Cash and Investment Report September 30, 2020

### ATTACHMENT A

| PORTFOLIO AT A GLANCE                          | QE 6/30/20              | QE 9/30/20               |
|--|-------------------------|--------------------------|
| Total Cash & Invest Bal (Adj BV)               | 30,215,526              | 25,933,911               |
| Weighted Avg Purchase Yield (Invested Assets)* | 1.87%                   | 1.80%                    |
| Weighted Avg Maturity (Invested Assets)*       | **3.03 yrs              | **2.82 yrs               |
| * Excludes pooled & money market accounts      | **1.51 yr to first call | **1.63 yrs to first call |
| Est. Interest Income <i>Collected</i>          | 129,207                 | 117,056                  |

## BACKGROUND

This Treasurer's report is presented to the City Council in accordance with California Government Code (CGC) 53646. Additionally, as required by City's Investment Policy, Sections 8 and 17, the investment portfolio and this Quarterly Report have been reviewed by the City Treasurer and the Investment Policy Advisory Committee (IPAC). The IPAC consists of the following members:

- Brad Boyd, Citizen member
- Jeff DeLarme, Citizen member
- Bob Murdock, Citizen member
- Stephen Hannah: City Finance Director (ex officio)
- Victoria Lozzi, City Council member, former Treasurer (ex officio)
- Elizabeth (Liz) Ying, City Treasurer, Chairperson

## CERTIFICATION

At September 30, 2020, the City's cash and investment portfolio totaled \$25.9 million, lower than Q4 balances of \$30.2 million and in line with prior year Q3 balances of \$25.1 million. This reflects the seasonality of the City's cash flows in which April property taxes inflows are depleted by operating expenses until December property taxes are received. The City benefited from a partial payment of CARES Act funds.

The portfolio is in compliance with the City's FY 2020-21 Investment Policy and with California Government Code (CGC) Section 53601.

We note that Negotiable CDs comprise 31% of the portfolio, slightly higher than the 30% Policy limit. However, CGC and Section 9 of the City's Investment Policy requires compliance *at the purchase time*, but does not dictate "rebalancing" when subsequent non-purchase activities result in

## CHALLENGES:

- Uncertainty re: COVID's impact on cash flows,
- Recession and low rate environment, and unlikely, but possible negative interest rates,
- Possible medium term inflationary risk,
- PVE Portfolio: 1) Concentration in daily liquidity and maturities under one year, 2) credit risk, including risk inherent in pooled funds.

## STRATEGY:

- Continue to work with Staff to refine cash flow projections and liquidity needs.
- Maintain higher liquidity to preserve investment flexibility, and given higher yields currently generated by pool funds,
- Continue to search for relative yield opportunistically to hedge against rate decline, while balancing safety, liquidity needs and yield objectives,
- Consider additional asset classes, including corporate medium term notes, if spreads justify risk, as determined by credit ratings, default risk probabilities and analyst buy-hold ratings. While spreads are significantly lower than March dislocation, the sector may offer value relative to 2019 OAS spreads.
- Added a second new broker-dealer, with expertise in areas of current investment focus,
- If conditions warrant, target higher non-interest bearing bank deposits to offset bank fees.

a rise above the percentage restrictions. Here, the portfolio was in compliance at the time of purchase, and as shown in the FY 6/30/20 review: However, normal seasonal cash outflows reduced the total portfolio size, resulting in CDs comprising a larger percentage. We expect this to self-correct when December property taxes are received.

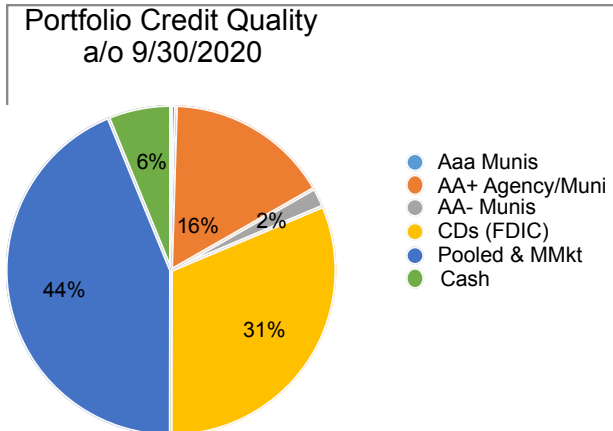
Although the COVID impact is not fully quantified, we believe that there is sufficient cash flow from liquid and maturing securities, bank deposits, and anticipated revenues to meet the City's forecasted expenditures for the next six months.



## EXECUTIVE SUMMARY

The portfolio is managed with the priorities of 1) safety, 2) liquidity and 3) yield.

**Safety:** The City seeks to mitigate credit risk by limiting purchases to the safest types of investments. The City's \$25.9 million portfolio is comprised of:



- \$1.6 million of cash in the Union Bank Demand Deposit Accounts and Money Market Account.
- \$11.4 million in pool accounts, including \$9.7 million in the California State's Local Agency Investment Fund (LAIF) and \$1.6 million in the Los Angeles County Investment Pool (LACIP). While neither are SEC-regulated money market funds, nor rated by credit rating agencies, they are subject to the California Government Code sections 16429, 16430, 53601 and 53635.
- \$8.1 million in FDIC- or NCUA-insured CDs,
- \$4.0 million in Agency securities which carry an implicit government guarantee and are held in the City's Union Bank Custody account, and
- \$0.8 million in six municipal securities, rated AA- or higher, and which are also held in the Custody account.

**Liquidity:** Liquidity is managed utilizing pooled funds with same or next day liquidity, in combination with maturing securities and forecasted revenues. At 9/30/20, the City held \$12.9 million in cash and same/next day liquidity, in two pool funds. As a matter of internal policy, our preference is to diversify among at least two funds to ensure our access to liquidity, rather than to concentrate liquidity in one fund, even at the expense of higher yield. Liquidity is further

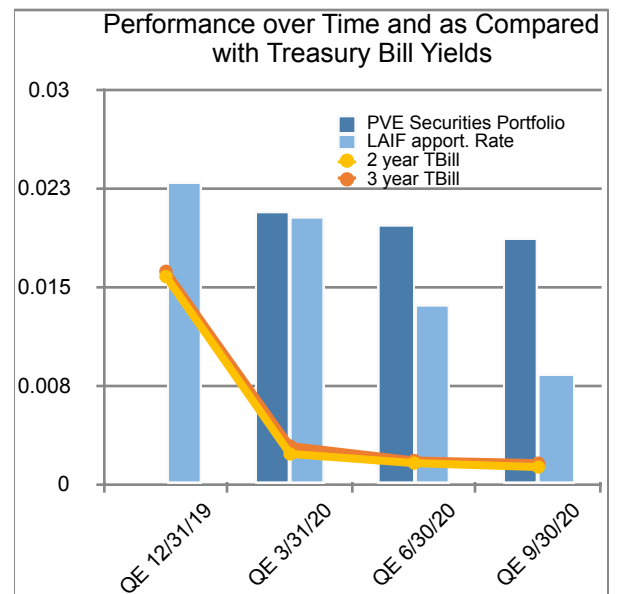
enhanced by \$0.25 million in securities maturing within six months. In addition, we anticipate that \$4 million in securities, subject to early call options, will be called.

Financial projections are in the process of being updated and have not yet been finalized. However, we believe that our current liquidity will be sufficient to meet our City Finance Director's estimates of \$12 million in anticipated revenue and \$10 million in projected cash outflows through March 31, 2021.

The pandemic has impacted the City's concessions revenue, and to a lesser extent, licensing and development fees. Longer term expectations include lower property tax receipts and higher pension obligations due to anticipated shortfall in CALPERs' returns.

**Yield:** As of 9/30/20, the weighted average purchase yield of the City's investment portfolio, excluding pooled and money market accounts, was 1.80%, down from 1.87% in the prior quarter. LAIF reported an 0.84% apportionment rate, significantly lower than the previous quarter 1.47% apportionment, reflecting falling market interest rates. For comparison the 2 and 3 year Treasury Bill rates at 9/30/20 were 0.13-0.16%.

Overall, we expect the overall portfolio yield to fall further due to early call redemptions and maturities of higher yielding investments, due to the lower yields of new investments, and as a result of declining yields generated by pooled funds.





## PORTFOLIO OVERVIEW

(as of 9/30/20, unless otherwise stated)

At 9/30/20, market value of the portfolio totaled \$26.2 million, showing an unrealized gain of \$270,066 against adjusted book value, as market rates continued to be depressed. Since the City's investment philosophy is to hold investments to maturity whenever possible to reduce market risk, full-face (par) value is expected and no realized gain or loss of funds is anticipated.

| Asset Class | Amortized Book Value* | Market Value* | Book Value % | Policy Max |
|-------------|-----------------------|---------------|--------------|------------|
| Cash        | 1,325,950             | 1,325,950     | 5.1%         | 100%       |
| M Mkt       | 279,306               | 279,306       | 1.1%         | 100%       |
| Pool        | 11,355,222            | 11,355,222    | 43.8%        | 100%       |
| Govt Oblig  | 4,000,000             | 4,008,780     | 15.4%        | 100%       |
| Muni Oblig  | 837,800               | 837,309       | 3.2%         | 100%       |
| CDs         | 8,135,633             | 8,405,699     | 31.4%        | 30%        |
| Total       | 25,933,911            | 26,212,265    | 100.0%       |            |

\* Market Value for government securities and CDs are provided by Union Bank a/o 9/30/20 and assumed accurate. At present, market values of Pooled Funds are assumed at a NAV of \$1. Cost Basis is reported by Union Bank, and is adjusted for amortization.

## INCOME

| Interest COLLECTED | FY 19-20 | QE 9/30/20 |
|--------------------|----------|------------|
| Govt Obl. + CDs    | 355,961  | 69,554     |
| LAIF               | 194,469  | 46,946     |
| JPA Camp           | 5,249    | 0          |
| LACIP (est.)       | 3,205    | 520        |
| MMkt               | 142      | 36         |
| TOTAL \$           | 559,026  | 117,056    |

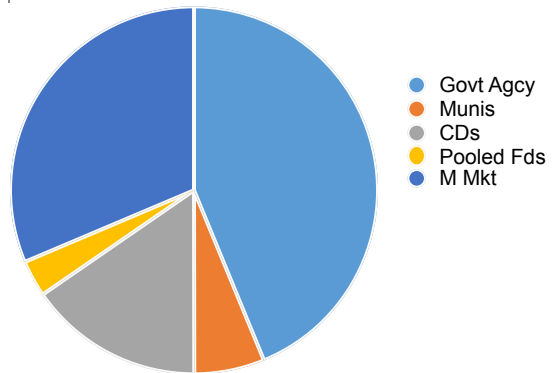
## PORTFOLIO COMPOSITION

City's investment portfolio is governed by CGC 53601, and by the City's Investment Policy.

At 9/30/20, pooled funds, primarily LAIF, constituted 44% of the portfolio. Liquidity is higher than our optimal target due to:

- 1) Seasonality, and the need to maintain liquidity to ensure expenses can be met prior to property tax receipts in mid-December,

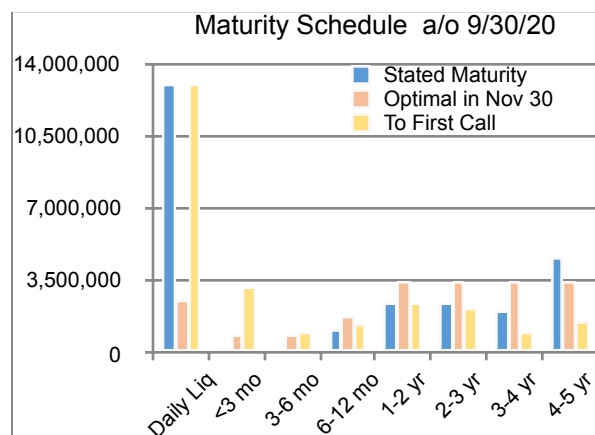
Portfolio Mix by Asset Class  
a/o 9/30/20



- 2) Unquantified COVID impact, which dictates higher liquidity target, and
- 3) Outsized LAIF yields relative to securities investment opportunities, due in part to the lag effect from higher yielding investments in the pool, and due in part to additional interest earned by LAIF on its CalPERS Supplemental Pension Payment and on the Wildfire Fund loans.
- 4) Finally, until a longer term strategy incorporating elements such as pension obligations, law enforcement and safety, and capital improvement, is constructed, and a cash flow projection is finalized, we believe it to be prudent to maintain excess liquidity.

Although we have not invested in any additional FDIC-insured CDs since the end of May, CDs continue to constitute the majority of the investment securities portfolio, as US Agency securities have been called.

## MATURITY SCHEDULE





The maximum maturity allowable by both the CGC and the City's Investment Policy is five years.

Securities maturing in the 4-5 year range are higher than target, however, assuming that the current rates persist, approximately \$4 million in this category will likely be called in the next six months. The weighted average maturity (WAM) of the securities portfolio utilizing the first call dates is 1.63 years, vs 2.82 years, using the stated maturity: As such, WAM is much lower than our historical 2.5 year target.

## ACTIVITY

| Date    | Trans  | Asset                                      | Par         | Price   | Pur. Yield |
|---------|--------|--|-------------|---------|------------|
| 7/1/20  | Purch. | CALIF ST TAX REV 2.25% 10/1/23, AA-/Aa2/AA | 200,000     | 105.47% | 0.55%      |
| 7/15/20 | Purch. | MENLO PK CALIF CITY 1.928% 7/01/24, Aaa    | 60,000      | 105.07% | 0.63%      |
| 8/3/20  | Purch. | SAN DIEGO CALIF CMNT 2.046% 8/01/24, Aaa   | 60,000      | 105.90% | 0.55%      |
| 8/12/20 | Mat.   | CAPITAL ONE NA C/D 2.300% 8/12/20          | (245,000)   | 100.00% |            |
| 8/28/20 | Call   | FEDERAL HOME LN MTG 1.750% 2/28/25         | (1,000,000) | 100.00% |            |
| 9/10/20 | Purch. | CUPERTINO CALIF UN 2.100% 8/01/25, AA+/Aa1 | 200,000     | 107.22% | 0.60%      |
| 9/16/20 | Mat.   | BARCLAYS BK C/D 2.200% 9/16/20             | (245,000)   | 100.00% |            |
| 9/18/20 | Call   | FREDDIE MAC 2.000% 12/18/23                | (1,000,000) | 100.00% |            |
| 9/28/20 | Mat.   | GOLDMAN SACHS C/D 1.900% 9/28/20           | (250,000)   | 100.00% |            |

Securities purchases were fewer than normal in the quarterly, given our higher liquidity target, and generally higher yields provided by pool funds. Nevertheless, term securities provide a diversification against the pool funds, and offer a way to lock in rates, should market rates decline further.

We look opportunistically for securities which offer yield, but only with acceptable risk. As such, we began investing in taxable municipal securities which offer higher spreads (specifically in the 4-5

year range) vs. historical spreads prior to the March 2020 market dislocation. We note that municipal securities have a generally lower cumulative default rate compared with global corporates, with the cumulative 5 year default rate of "A" rated Munis of 0.05% vs. 0.55% for "A" category global corporates. (2009-18, Moody's).

As of 9/30/2020, the portfolio included five California state general obligation or California local agency general obligation securities totaling \$800,000 of par value, all rated AA- or higher. These were purchased with yields ranging between 0.55%-0.63%.

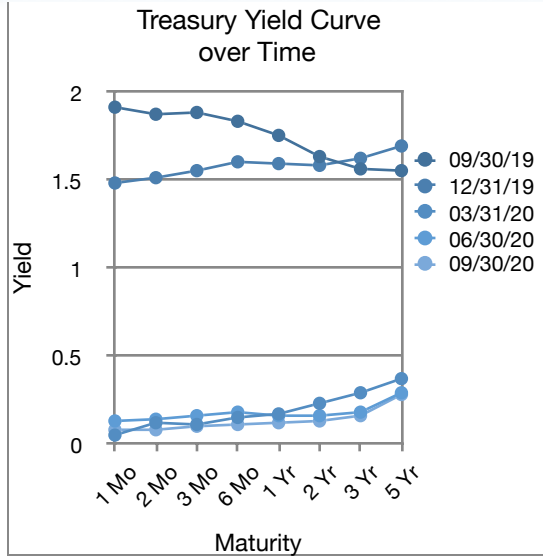
## OUTLOOK

### Economy:

- The Fed upgraded its near-term growth in 2020 from -6.5% to a lesser decline of -3.7%, reflecting stronger economic data and a faster pace of recovery. Going forward, the expectation is for a more anemic growth of 4% in 2021 and 3% in 2022. The WSJ Economic Survey (Oct., 2020) indicates the majority of respondents believe that GDP will recover to Q4, 2019 levels in Q4, 2021.
- The Fed also lowered its projections for the unemployment rate from 9.3% to 7.6% in 2020 and remaining below 6% thereafter. More than 11 million Americans remain out of work, disproportionately impact based on geography, demographics and infrastructure.
- Inflation is not expected to return to its 2% target till 2023.

### September 16<sup>th</sup> FOMC Economic Projections

| Variable                                | Median <sup>1</sup> |      |      |      |            |
|---|---------------------|------|------|------|------------|
|   | 2020                | 2021 | 2022 | 2023 | Longer run |
| Change in real GDP                      | -3.7                | 4.0  | 3.0  | 2.5  | 1.9        |
| June projection                         | -6.5                | 5.0  | 3.5  |      | 1.8        |
| Unemployment rate                       | 7.6                 | 5.5  | 4.6  | 4.0  | 4.1        |
| June projection                         | 9.3                 | 6.5  | 5.5  |      | 4.1        |
| PCE inflation                           | 1.2                 | 1.7  | 1.8  | 2.0  | 2.0        |
| June projection                         | 0.8                 | 1.6  | 1.7  |      | 2.0        |
| Core PCE inflation <sup>4</sup>         | 1.5                 | 1.7  | 1.8  | 2.0  |            |
| June projection                         | 1.0                 | 1.5  | 1.7  |      |            |
| Memo: Projected appropriate policy path |                     |      |      |      |            |
| Federal funds rate                      | 0.1                 | 0.1  | 0.1  | 0.1  | 2.5        |
| June projection                         | 0.1                 | 0.1  | 0.1  |      | 2.5        |



With the fiscal aid packages, US government debt is rapidly rising, with Debt/GDP expected to exceed 100% in 2021, and 107% in 2023.

PORTFOLIO DETAIL  
(See Chart)

**Monetary Policy: Lower rates, longer.** At its Sept 15-16 meeting, the Federal Reserve further indicated it would maintain rates near zero until it sees evidence of a tight labor market and inflation reaches 2% and is on track to moderately exceed 2% for some time. The statement reverses its historical strategy of preemptively lifting rates to head off higher inflation. In reality, inflation has fallen short of the Fed's 2% target for nearly a decade, averaging 1.3% over the past five years. This allows inflation to potentially run nearly 3% for the next five years, without exceeding a longer-term 2% average.

*"We're not thinking about raising rates, we're not even thinking about thinking about raising rates."*  
June 10, Fed Chair Powell

**Fiscal Policy:** The US has spent ~\$3.0 trillion to combat the economic fallout. The market anticipates another fiscal package, particularly if one party can dominate the upcoming elections.

U.S. Fiscal Response

