

TREASURY OVERSIGHT COMMITTEE MINUTES

April 20, 2012 at 10 a.m.

Room 316, City Hall

1. Call to Order and Roll Call

Leo Levenson called the meeting to order at 10:10 a.m. The following Committee members were present: Joe Grazioli, Todd Rydstrom, Jose Cisneros (Treasurer) and Richard Sullivan. Ben Rosenfield, Controller, was excused.

2. Discussion and Action to Approve Minutes

The minutes from the meeting on October 21, 2011, October 27, 2011 and January 27, 2012 were unanimously approved. There was no public comment.

3. Review of the Treasurer's Recent Investment Performance

Treasurer Jose Cisneros expressed his pleasure to be at the meeting and to share news with the Committee about the economy and the City's portfolio.

Michelle Durgy, Chief Investment Officer, reviewed the following topics: 1) an economic overview; 2) market overview; 3) Pooled Fund review; 4) credit allocation and process; 5) portfolio strategy; and 6) March 2012 monthly report.

Economic Overview: The Gross Domestic Product (GDP) is showing signs of a slow economic recovery (which is very positive for the U.S.) while Europe lags. The forecast is through the period of the second quarter of 2013. One of the main constraints to growth is the unemployment picture which has not picked up the pace enough to sustain a strong recovery.

The U.S. Core PCE Deflator (the Fed's choice inflation indicator) will be watched until the Fed begins to raise rates. The 10-year U.S Treasury Note fell significantly in 2007 and hovers around the 2% level currently. The Fed has reduced rates significantly since 2007 in order to stimulate the economy. The 10-year Treasury Notes indicate interest rates will be low for a while longer.

The housing market continues to be a primary constraint on economic growth. There is still a huge backlog in the number of foreclosures. Banks are unwilling or unable to act on the massive volume of delinquencies.

Ms. Durgy reviewed the bank charge-offs and real estate owned (REOs) properties. The banks represented in the statistics are JP Morgan, Bank of America, Wells Fargo and Citigroup. The real estate owned by banks is expected to increase significantly.

The market overview focused on yields, volatility and short-term interest rates. The U.S. Treasury yields have now dropped, amidst massive moves in the market. The downward trend is expected to continue until there are improvements in the unemployment and housing areas. Ms. Durgy reviewed short-term interest rates (as of April 16th, 2012). There is value in credit and minimal risk in high quality names.

In terms of the Pooled Fund strategy, since late 2010, the duration of the Pool was able to be extended due to the significant percentage of bond proceeds invested, which has a longer investment horizon than operating funds. As a result of changing market conditions, the Pool's duration will continue to shorten over the course of the next year. In comparison to other Local Government Investment Pools, which are managed similarly to money market funds, San Francisco's duration is currently longer, resulting in higher yields.

Within San Francisco's pooled fund participants, the Public Utilities Commission has the largest percent of the fund and equity balances at 28.9% or \$1,504,636,949.00. Ms. Durgy reviewed the 5-year pooled fund asset allocation history and noted the small percentage of medium-term notes and decreasing allocation to Temporary Liquidity Guarantee Program (TLGP) paper as the program ends in December 2012.

The current investment allocation by security type is as follows: 1) 67.7% Federal Agencies; 2) 14.4% U.S. Treasuries; 3) 9.9% Credit; 4) 7.1% TLGP; 5) 1% State and Local Agency Government Obligations; and 6) 0.02% Public Time Deposits. The Negotiable CDs are from three high quality banks (Royal Bank of Canada NY, Toronto Dominion NY and Bank of Nova Scotia Houston) and represent 7.2% of the Pool's credit exposure. Medium Term Notes are issued by General Electric Capital Corp., Toyota Motor Credit Corp., New York Life Insurance Company and JP Morgan and amount to 2.7% of the Pool's assets.

Improvements to the credit process were discussed. In January 2011, the new credit review process was outlined to the Committee, which consisted of using PFM's Approved Issuer List as a starting point to develop the City's own list, complete with an ongoing monitoring system. Due to compliance restrictions, PFM cannot provide its Approved Issuer List. Therefore, staff has revised its credit process to include 1) the development of a proprietary, dynamic Approved Issuer List, which is vetted with PFM on biweekly strategy calls; and 2) the initiation of regular Credit Committee meetings, which review and approved new issuers.

In January 2011, Ms. Durgy also detailed the internal analysis portion of the credit review process. This process covers the monitoring of the latest rating changes, current news and announcements, CDS spreads, equity trend analysis, current financials and future forecasts, as well as socially responsible investing and predatory

lending practices. Current improvements include the phase-in of templates for credit analysis and monitoring. These improvements will incorporate: 1) all of past credit processes; 2) differentiation between banks, insurance companies and non-financial issuers; 3) the integration of generally accepted risk models such as FHLB Bank Risk Model, Bloomberg Default Risk Scale and Altman's Z-Score.

The current portfolio strategy is as follows:

- Short-term: Shorten duration while assessing current and future volatility in cash flows.
- Long-term: extend the duration by matching maturities with project fund draw schedules. This is dependent on the liquidity needs and market conditions.
- On-going: selectively add credit.

There was no public comment.

4. Review of Projected Pooled Cash Balance

Mr. Levenson reviewed the City's month-end pooled cash balance as of April 20, 2012. Key points included a review of the month-end pooled balances, month-to-month cash balance changes, and a review of General Fund sources and uses. There are no big negative surprises and no major costs affecting cash flow overall, which has improved since last year. The Committee talked about 7A – Unapportioned Taxes, on the spread sheet which total \$391 million dollars. There was also discussion about Pools 1, 2 and 3, which are unofficial polls.

There was no public comment.

5. Public Comment

There was no public comment.

The meeting adjourned at 10:40 a.m.