

## **TREASURY OVERSIGHT COMMITTEE MINUTES**

**July 27th, 2012 - 10 a.m.**

**Room 316, City Hall**

### **1. Call to Order and Roll Call**

Leo Levenson called the meeting to order at 10:05 a.m. The following Committee members were present: Joe Grazioli, Todd Rydstrom, Jose Cisneros (Treasurer) and Peter Goldstein. Ben Rosenfield, Controller, and Richard Sullivan (Citizen at Large) were excused.

### **2. Discussion and Action to Approve Minutes**

The minutes from the meeting on April 20, 2012 were unanimously approved. There was no public comment.

### **3. Review of the Treasurer's Recent Investment Performance**

Michelle Durgy, Chief Investment Officer, reviewed the following topics: 1) an economic overview; 2) market overview; 3) pooled fund review; 4) portfolio strategy 5) portfolio strategy; and 6) June 2012 monthly report.

Economic Overview: Although the U.S. economy has improved slightly, we are still a part of the global community. The European area is not doing well and is a bit unstable. Positive growth from this area is not expected until the second quarter of next year. This hampers U.S. growth as reflected in the monthly change in non-farm payrolls. Although these payrolls have been and remain positive, the picture is a little bleaker than it has been more recently.

The good news is reflected in the gas price per gallon, which has dropped. Hopefully, this will increase consumer spending in other areas. The 10-year U.S. Treasury Note has been dropping for several years now. Ms. Durgy compared the changes in U.S. Treasury Notes for the period of July 25, 2011 and July 24, 2012.

At the same time, there has been an increase in the short-term interest rates. There is the potential for the yield curve to become inverted. This could be the result of some of the actions by the Fed or could occur naturally in the market when people perceive recession. Ms. Durgy said it just so happens that the City's cash flow needs required the City to be shorter, as well as the expectation that the short end is going to provide more value in the coming year.

The 5-year U.S. Treasury yields have dropped almost 100 basis points in the past year. The good news is that it's gone up ten basis points since July 24<sup>th</sup>. These highlights: 1) good news story – the City has not dropped 100 basis points in terms of yield - but: 2) it is coming. The City cannot continue to reinvest in this low interest rate environment and not have it take a toll on the investments.

At the April meeting, it was stated that 85 basis points should be used in the projections. Since the market has dropped 30 basis points from there, we could go significantly lower. The area of volatility is unprecedented. At this time, the market is hitting all-time record lows on the 5-year. It is difficult to predict where the market will go. The current levels cannot be sustained. The good news is that the City is not in a position where it needs to buy in this environment. The financial position looks good for the next few months. However, Ms. Durgy expressed her opinion that if the City needs to buy in November or December, the purchases will have to be made at these levels which will have an effect of the yields, which will be lower.

Information about gross interest rate history was discussed. The Committee requested additional information about net interest rates allocated to pool members. Mr. Levenson agreed to provide additional information about any adjustments that may have occurred in FY 2011-12, any information about month-by-month values for net rates now as well as a full year average and whether or not there are any adjustments to FY2011-12 pending.

The 5-Year U.S. Treasury yield volatility decline continues. In April 2012, the yield volatility was at a high end. Ms. Durgy discussed the investments that are being purchased and the indicative short-term interest rates. LIBOR (London Interbank Offered Rate) is 3.6% of the portfolio, as of July 20, 2012. To date, LIBOR short-term interest rates have been good for the portfolio.

County Pooled Fund Statistics: Profit was taken in May 2012. It bumped the yield up a bit. Ms. Durgy reviewed CCSF's earned income yield as it compared to other counties. The disparity between what was earned and yielded was discussed. Pooled Fund participants were reviewed. At this time, both San Francisco International Airport and the San Francisco Unified School District are pool participants with about 8% of their total funds in the equity balance.

The 5-year pooled fund asset allocation history, as of June 30, 2012, was reviewed. In June 2011, 70% of the pooled fund was in federal agencies with CCSF at 73% (the limit is 70%). Pre-trade compliance was done prior to the purchase. The percentage bumped up from 70% to 73% because of market fluctuations. The amount was reduced as of September 2011. At this time, there aren't many changes in the pooled funds.

The credit allocation, as of June 30, 2012, was discussed. Ms. Durgy noted the negotiable CDs, commercial paper and medium term notes are all of high quality.

Federal agencies make up 73% of the allocation, followed by U.S. Treasuries at 13.9%, credit (negotiable CDs, commercial paper and medium term notes) at 9.7%.

The portfolio strategy was revisited. In order to manage/mitigate/prepare for the risk in the market, the portfolio structure has been moved from the bar bell to a more lateral approach. In the event the Fed raises rates, the City will have money and will be less affected by short term rates rising. Risk is also mitigated by having a percentage of the portfolio in floating rate securities (17%). A third way to mitigate interest rate risk is minimize the number of callables in the portfolio. It is currently below 20%.

Credit risk is being managed by tightening the credit approval process. The two main parts of this process are the use of the Credit Committee and credit templates. The use of internal credit guidelines have been discussed at Committee meetings in the past and have been created and are used. Finally, the effect of and preparation for the wind-down of federal agencies is in progress.

Ms. Durgy pointed out that risks to liquidity include the effect of the December 2012 FDIC coverage expiration and discussed some of the alternative liquid investments.

Treasurer Cisneros pointed out that portfolio performance has been good for the past year but said that expectations should be that yields will go down.

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 July 27, 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. There are no dramatic shifts. The year-end cash reflects the good financial position of the City.

There was no public comment.

#### **5. Public Comment**

There was no public comment.

The meeting adjourned at 10:40 a.m.