APPENDIX D
Finance Department Memorandum
June 5,2017

City of Santa Fe New Mexico

Finance Department

Memorandum

DATE: June 5, 2017

TO: Finance Committee

FROM: Adam Johnson, Finance Director
Christina Keyes, Treasury Officer
Bradley Fluetsch, CFA, Cash and Investment Officer

RE: Treasury Management and Investment Practices Update

Background:
The Public Bank Feasibility Study identified areas of the City's financial management policies and practices that were not performing optimally. The study characterized these opportunities as Phase I of creating a City Banking Function. For the purposes of this report, the creation of the Treasury Division is synonymous with Phase I of the City Banking Function. The Division was created by one simple re-classification and separating the asset custody from the record-keeping operations of the Finance Department. The cost of the re-organization was de minimis while the financial and non-financial gains have been demonstrative.

The actions taken by the Executive Financial Staff did not occur as a result of the feasibility study. Rather, this group identified the similar areas for improvement and took immediate actions to address. The areas identified by the Public Bank Feasibility Study include the following:

- Update the City's collateral policy
- Optimize investment returns while maintaining liquidity and safety
- Utilize available fund balances to pay off expensive debt obligations and/or finance capital projects.

The Finance Department has accomplished all of the aforementioned recommendations.

Finance Department Expansions:
In Fiscal Year 2017, the Finance Department adopted a new direction to pursue best practices for municipalities and implement efficiencies. To support this focus, the Treasury Division was established, staffed with two new hires. Christina Keyes was hired in September 2016 for the newly created position, Treasury Officer. Bradley Fluetsch, CFA was also hired in September 2016 as Cash and Investment Officer. Both new employees bring significant education, training and Treasury and investment management experience to the Finance Department. With their knowledge and experience, industry best policies, practices and procedures are being implemented in the management of the City's cash and investments. These two new hires bring expertise and experience that the City of Santa Fe has not had on staff previously.

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Investment Policy Update:
Since the creation of the Treasury Division, the Investment Policy has been significantly revised and subsequently adopted by the City Council in December 2016. The revisions to the policy brought it into greater alignment with New Mexico Statutes and regulations.
Two specific changes:

- Collateral for checking, savings and CDs was changed from an across the board 102 percent of funds on greater than the FDIC insured, to levels specified by New Mexico State Treasurer's Office, quarterly collateral requirements. By changing the collateralization requirements it will allow highly rated local banks to lend a portion of City of Santa Fe deposits into the local economy, where previously they were not able to.

- Inclusion of Statute 6-10-10 (G); which states communities in Class A counties and a population greater than 65,000 in the last decennial US census can invest in investment pools with more than $100 million in assets that include Corporate Bonds, Commercial Paper and other non-US Treasury or Agency securities. By incorporating this statute into the investment policy, staff was able to substantially increase the rate of return on the City's most liquid investments, money market funds. The increase in return can be attributed to increasing credit risk without changing the interest rate risk in the portfolio.

The new investment policy also calls for Treasury staff to analyze and select a total return benchmark against which to compare investment performance. In the past, investment performance was not measured against a total return benchmark. The portfolio yield was compared against the constant maturity of one and two year US Treasuries. Changing portfolio performance measurement from a yield comparison to a total return comparison insures that the City's investments are maximizing returns while still providing safety and liquidity. This is a new level of investment reporting and performance measurement that the City has never had.

Internal Investment Management:
Cash and investment management has been elevated to a more important role within the Finance Department, where previously only the Cash and Investment Officer was involved in the day to day activities of the portfolio. Now, the Finance Director, Treasury Officer and the Cash and Investment Officer are involved in the active management of the portfolio. As such, First Southwest Asset Management, investment advisor was terminated March 31, 2017. Subsequently, the management of the investment portfolio has been moved in-house for a savings of $48,000 per year.

The three Finance Officers meet regularly to discuss the economy and review the internally developed investment strategy for the portfolio, taking into account liquidity needs, market risks and opportunities. The Bank Feasibility study discussed liquidity management in detail. The new approach to managing the City's cash, liquidity should be considered in two contexts. First, how much does the City need to pay its bills on a monthly basis and second, how much is placed in short-term investments. Once the first question is answered, the second question is an investment strategy question. As an example, today the fixed income market is pricing in two rate hikes by the Federal Reserve over the next 18 months. The Federal Reserve has told the market to expect five rate hikes over the next 18 months. There are many reasons the market has not priced in the Federal Reserve's statements, namely they have different expectations of future economic and market performance. Currently, it is staff's belief that the market should have more rate hikes priced in, therefore, we are keeping the duration of the portfolio shorter than we would otherwise and a higher balance in liquid, overnight investments. When the markets price in what the Federal Reserve announces, staff will extend maturities and lower the portfolio's liquidity.

Investment Portfolio Improvements:
The Finance Staff implemented various investment updates and best practices to the investment portfolio during the first four months of assuming their new positions. Adjustments to the portfolio were made to improve investment performance while maintaining optimal liquidity for the City's needs. Changes included:

- Transferring funds from two large savings accounts, approximately $56 million in total from Wells Fargo and First National Bank of Santa Fe, into the Wells Fargo Trust Account.

- Transferring $5.7 million from the New Mexico LGIP account to the Wells Fargo Trust Account.

- Applied New Mexico Statute 6-10-36, which states the rate of interest paid by a local depository must be equal or greater than the equivalent US Treasury of the same maturity.

- The Treasury Division has upgraded the internal systems by installing a Bloomberg terminal for active, real-time monitoring of global economic conditions, fixed income markets and specific trading opportunities. Additionally, the SymPro software was upgraded to include the Debt Portfolio module, which is used to document, monitor, model and reconcile the City's debt portfolio.

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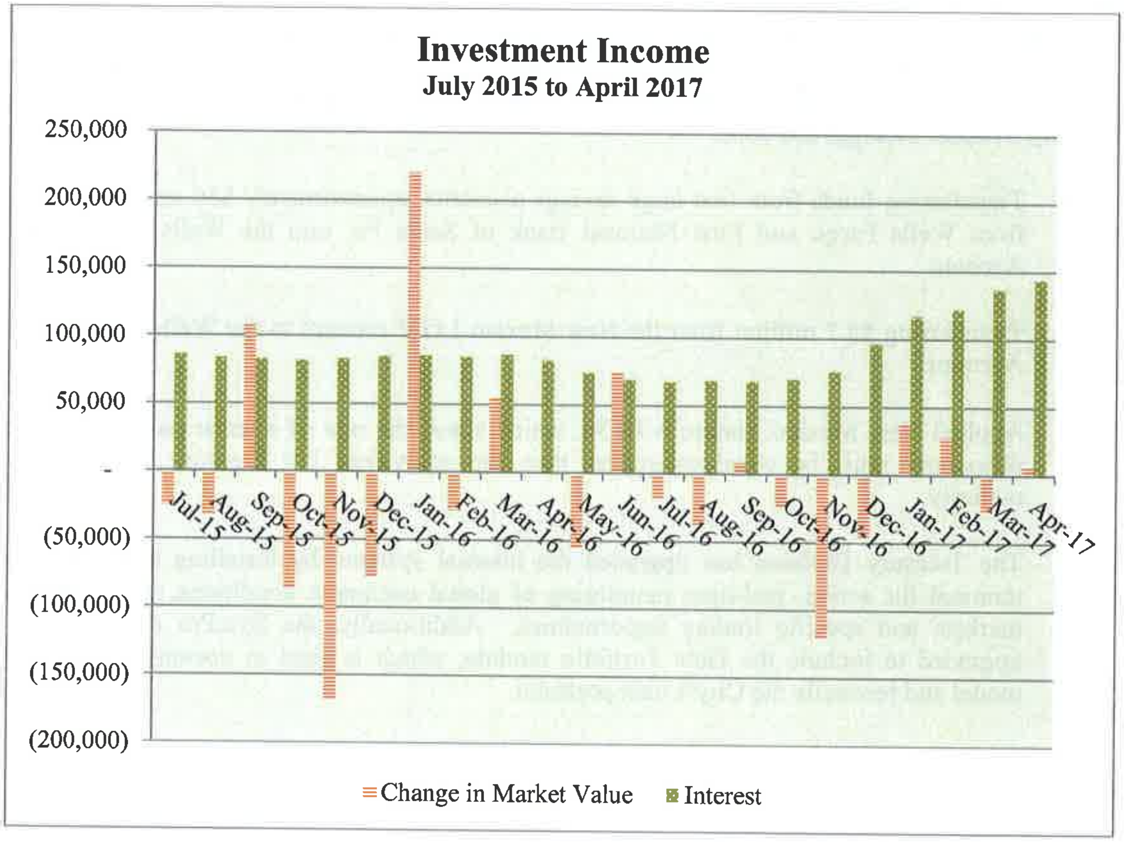
Investment Performance Growth:
The green dotted bars depict interest income of the total portfolio. There was a substantial increase in interest rates beginning in December 2016. This was the first month all of the funds in savings accounts were moved to a Government Money Market investment fund. In January 2017, another substantial increase occurred, attributed to moving funds from Government Money Market Funds to Prime Money Market funds. The sale of low yielding bonds in February and the reinvestment of the proceeds into the Prime Funds provided the increase in March's income. Staff actively monitors and manages the portfolio to insure maximum return within the safety guidelines.



The following chart presents the composition of the investment portfolio and how it has changed since the City's Treasury Department was created. The most significant change to the portfolio was the substantial reduction in the use of savings accounts and the increase in Money Market funds.

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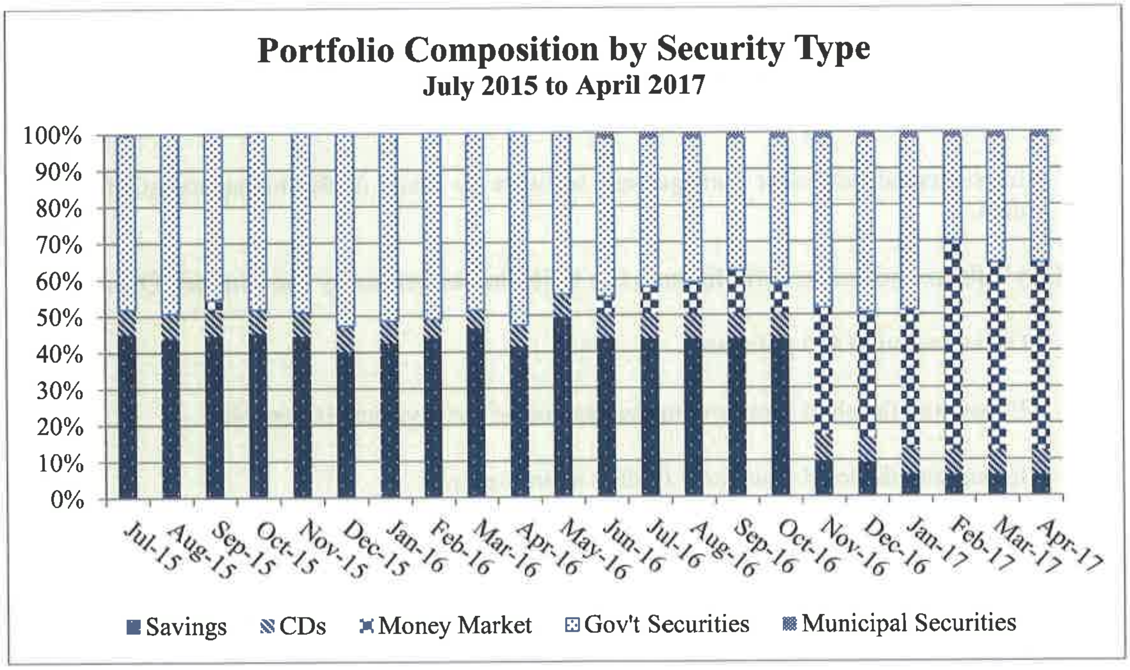

Debt Management Improvements:

In regards to debt management, the Bank Feasibility study pointed out that bond proceeds were not expended in a timely fashion. Prior to the Bank Feasibility study, the City adopted a new CIP budgeting process. The new CIP budget process is a five year plan for CIP, where projects are prioritized. This new process allows for better planning of bond issuance and provides the necessary lead times to plan, develop, and engineer projects allowing bond proceeds are expended in a timely manner.

The Finance Officers are taking a new look at debt management and issuance practices. The debt policy was found broadly lacking and a new one is being developed by staff, in consultation with the City's Municipal Advisor and Bond Counsel. The new debt policy will include a section for internal loans that are aligned with the investment policy as far as concentration percentage of the total portfolio and time to maturity.

Specific actions taken by staff to improve the City's Debt Management:

- Reformed the CIP budget process.
- Defeased the 2008 General Obligation and paid off two NMFA Railyard Loans with an internal loan.
- Refinanced the 2012C Tax Exempt Bond with a taxable bond, subsequently improving the marketability of the Market Station condominium.

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- Held a debt conference with Bond Counsel, Municipal Advisor and senior Finance Department staff to strategize utilization of bond proceeds and bonding capacity over the next five, 10 and 20 years.

- Implemented new debt management software to assist in the management of existing debt.

The City's future endeavors will include the following activities by the Finance Officers:

- Optimization of CD purchases.

- Expanding the short term investment section of the investment portfolio.

- Expanding the local placement of debt instruments.

- Continued implementation of investment and Treasury best practices for municipalities.

- Greater alignment of the City's use of debt to meet strategic goals and achieve quality of life ambitions.

- Implement a benchmarking and performance analytics process.

- Consideration of a reserve fund for softening economic swings.

- Optimization of the Fixed Income Asset Allocation.

- Pursue public outreach efforts for Continuing Financial Education within the community.

Conclusion:
This informational memo provides an overview of financial and investment activities over the last eight months. The Finance Officers at the City of Santa Fe assumed their positions bringing to the Department professional skills to achieve strong efficiencies and improved investment returns. The staff identified many opportunities for improvement, some of which were also noted in the Public Bank feasibility study. Over this brief period, staff has accomplished all of these items and more. The small business lending suggestion would be best served by various established local banking institutions. The City stands ready to provide funds to these institutions via a targeted CD program to help meet the loan demand of the local banking community.