



May 13, 2021

Memorandum

To: Bret Prebula, Finance Director
Jessie Gooch, Finance Analyst
City of Napa

From: Monique Spyke, Managing Director
Allison Kaune, Sr. Client Representative
PFM Asset Management LLC

Re: Investment Policy Review 2021

We completed our review of the City of Napa's (the "City") Investment Policy (the "Policy"). As written, the Policy is in compliance with the sections of the California Government Code (the "Code") that govern the investment of public funds. This year, our proposed changes to the Policy reflect recent Code changes resulting from the passage of Senate Bill 998.

Information on Senate Bill 998, the resulting Code changes, and our Policy recommendations are described below. We have also included a marked-up version of the Policy with our proposed modifications.

Senate Bill 998 - Overview

Senate Bill 998 ("SB 998"), which took effect on January 1, 2021, and shall be in effect until January 1, 2026, made a number of amendments to certain sections of the Code which govern the investment of public funds. The bill was written in response to the potential impact COVID-19 may have on the California economy and the investment opportunities of California local agencies. Changes resulting from SB 998 include the following,

1. Allowing investment in securities issued or backed by the U.S. government that could result in zero or negative interest accrual if held to maturity, in the event of, and for the duration of, a period of negative market interest rates;
2. Allowing local agencies that have more than \$100 million of investment assets under management to invest up to 40% in commercial paper (existing limit is 25% for all agencies, other than a county or a city and county);
3. Deleting the commercial paper language regarding the issuing corporation's outstanding paper;
4. Establishing a 10% issuer limit on commercial paper and corporate notes for all agencies, other than a county or a city and county;
5. Adding permission for federally recognized Indian tribes to invest and participate in investment JPAs.



Senate Bill 998 – Analysis & Recommendation

Our analysis and recommendations for the City's Policy with respect to each numbered bullet are described below:

1. Where Code Section 53601.6 previously prohibited investment in any security that could result in zero-interest accrual if held to maturity, public agencies are now permitted to invest in zero- or negative-interest accrual securities, under certain circumstances, and provided that the securities are issued by, or backed by, the United States government. When short-term interest rates are yielding near 0%, as they currently are, banks sometimes refuse deposits, or charge customers to hold cash. Having the option to invest at zero or negative yields could be beneficial to the City during periods of extremely low or negative yields. We view this as an unlikely, but possible, event.

The City's Policy does not explicitly prohibit investment in zero- or negative-interest accrual securities and so no changes are required to allow this investment type.

2. With regard to bullet 2, we are recommending the City increase the maximum allocation allowed in commercial paper to the new limit of 40%. While the utilization of commercial paper does not play a significant role in the portfolio's current strategy, we think it is appropriate to increase the limit in order to have the maximum flexibility to utilize commercial paper. Per SB 998, the maximum allocation will return to 25% on January 1, 2026.
3. With regard to bullet 3, we recommend that the City strike the Policy language related to the City's holdings of the outstanding commercial paper of a single issuer to be consistent with Code.
4. With regard to bullet 4, we note that the Policy already establishes a more stringent 5% issuer limit on commercial paper and corporate notes, regardless of sector, and we recommend the City maintain the 5% limit. However, we recommend the new Code language be added to the Policy's summary of Code requirements in the commercial paper and corporate note paragraphs.
5. The change described in bullet 5 does not impact the City's Policy.

Please feel free to contact us at your convenience should you have any questions or if you'd like to discuss the review further.