

FY 2008 Annual Investment Review

Summary



Prudent management, along with a sound Investment Policy have ensured a solid Investment Program.

The annual review provides an overview of the year's investment activities.

The annual report is provided to the City Council as a supplement to monthly investment reports.

The annual report is prepared in compliance with the City of Hayward Investment Policy and the State of California. The purpose of the report is to apprise the members of the City Council on the performance, composi-

tion, quality, diversity, and liquidity of the City investment portfolio during the preceding fiscal year.

The report provides an opportunity for the City Council to conduct its review, and annually adopt the Statement of Investment Policy in accordance with City and State requirements; and to amend the policy as required to meet local needs or comply with legal requirements.

FY 2008 Year In Review

The portfolio gross accrued interest declined a slight \$209,000 (from \$8.6 to \$8.4 million) or 2.4%, as the annual portfolio yield declined 47 basis points (from 5.06 to 4.59%), or 9%.

The decrease in total accrued interest was expected due to the combined effects of a reduction in the interest rates available for investment, offset by greater cash available for investment.

As available interest rates declined, we

shifted our short-term investments into LAIF, due to LAIF's competitive rate of return.

For FY 2008, average cash available for investment went up \$6.5 million (from \$177.6 to \$184 million), or 3.7%, which helped to minimize the effect of declining interest rates on investment earnings.

Staff continued to maintain our emphasis on safety, liquidity, and yield.

Special points of interest:

- FY 2008 accrued interest was \$8.4 million.
- The City earned a FY 2008 average of 4.59%.
- FY 2008 average cash available for investment was \$184 million.

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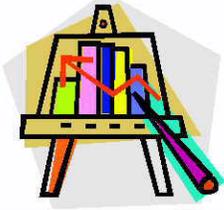
Annual Average Comparison

(\$ in 000's)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Annual Portfolio Yield	1.82%	2.38%	3.79%	5.06%	4.59%
Annual Accrued Interest	\$2,483	\$3,386	\$5,881	\$8,643	\$8,434
Annual Avg Portfolio Balance	\$136,411	\$147,642	\$162,458	\$177,590	\$184,095

Available Investment Rates

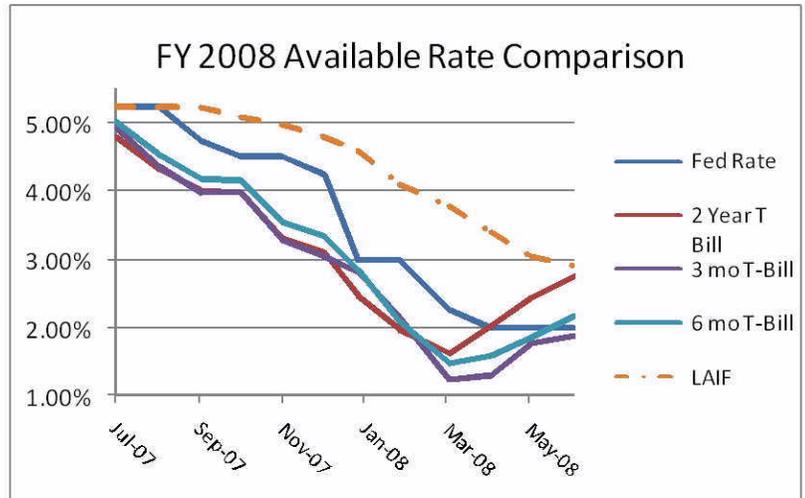
FY 2008 rates available for investment declined, as the economy softened.



Available investment rates are determined by national economic conditions.

The chart highlights the decline in short and medium term rates over the past year.

As the Federal Reserve maintained the 2% federal funds rate in March 2008, rates improved from their lows. Of particular note, the LAIF rate followed the decline of other rates, but declined at a lesser rate, due to its longer maturity period.



Portfolio Earnings



Yield is the percentage of annual return on investment.

The portfolio earned an average yield of 4.59% in FY 2008.

In FY 2008, rates available for investment declined. As rates available for investment declined, so did our investment portfolio yield. The average annual yield declined 47 basis points (from 5.06% to 4.59%); or 9%.

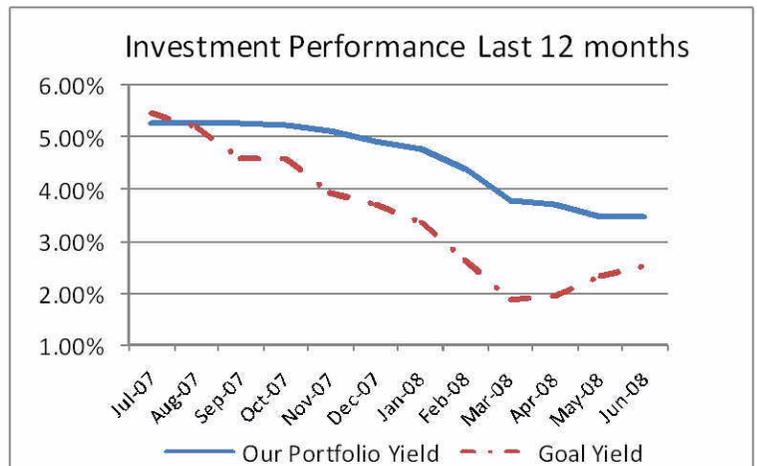
A \$6.5 million dollar increase in average cash available for investment helped to offset the decline in yield.

The yield decrease was a result of two factors. First, the maturation or call of higher yielding securities; followed by the purchase of lower yielding securities. Second, a 235 basis point decrease in the LAIF yield (from 5.25 to 2.90).

It should be emphasized that the Statement of Investment Policy states that the portfolio is to be managed with an emphasis first on safety, then on liquidity, and finally on yield.

Therefore, it should be emphasized that the need to maintain quality, diversity, and liquidity constrain the ability to maximize yield.

The chart highlights the FY 2008 portfolio and target yield. The chart shows a steady decline in both yields, however, the portfolio yield declined at a slower rate due to its longer maturity period.

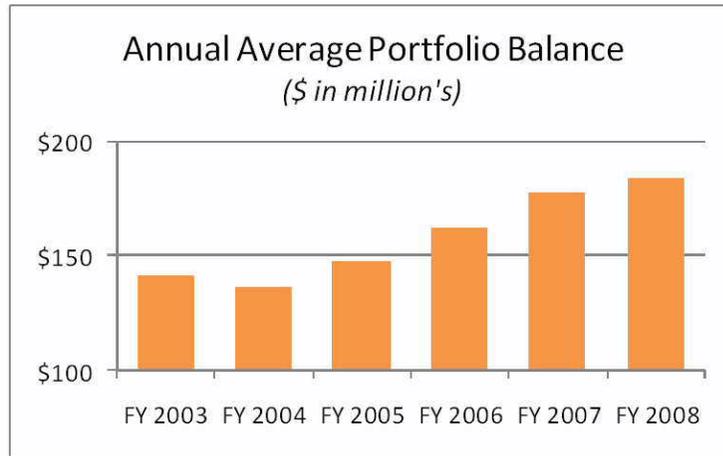


Cash and Interest Growth

Cash Available for Investment

For FY 2008, the annual portfolio cash balance averaged \$184 million, a \$6.5 million, or 3.6% increase over the previous year.

The chart shows that the City's cash available for investment has grown over the past five years. This is due to an overall increase in revenues.

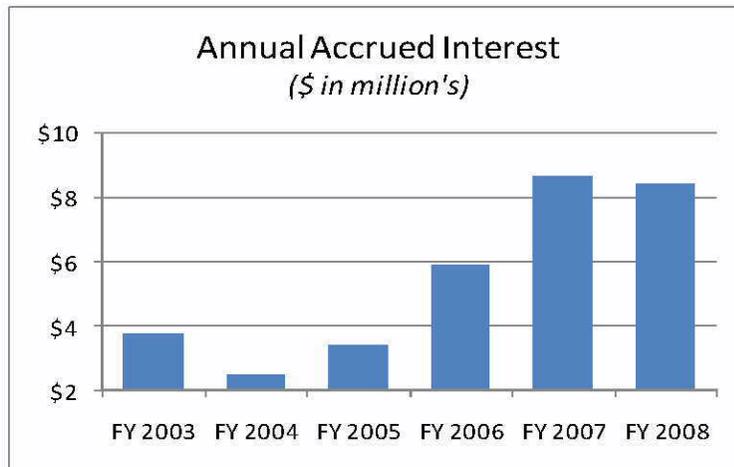


Over the past five years, cash available for investment has increased by \$48 million, while annual accrued interest has increase by \$6 million.

Interest Earnings

For FY 2008, the annual gross accrued interest totaled \$8.4 million (a \$209,000 decline from the previous year).

The chart shows the growth in annual accrued interest over the past five years. Interest earnings have increased from their FY 2004 lows.



Benchmarking Performance

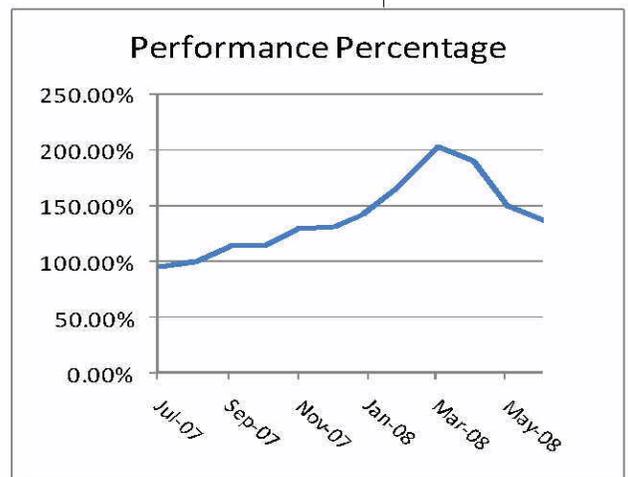
The Performance Percentage averaged 140% of target in FY 2008.

Investment Performance is measured by dividing the portfolio yield by the target yield. The resulting percentage lets us know how close the portfolio yield came to reaching the target.

One hundred percent would mean that the portfolio yield met the goal yield. For FY

2008, the performance percentage averaged 140%; a 54% improvement over last year's 91% average.

It is important to note that the movement of market interest rates largely determines the performance level. In periods of rapidly falling rates, portfolio performance will typically exceed the goal yield, until the relatively higher yielding holdings mature. Once rates stabilize, the portfolio yield will come closer to the goal yield.



Measuring Liquidity

Same day investments averaged 36% in FY 2008, and ended the year at 45%.

A portfolio has the appropriate level of liquidity if needed portions of it can be 1) converted into cash to meet obligations, and 2) take advantage of market conditions.

Of the two factors above, the need to meet obligations is the most critical.

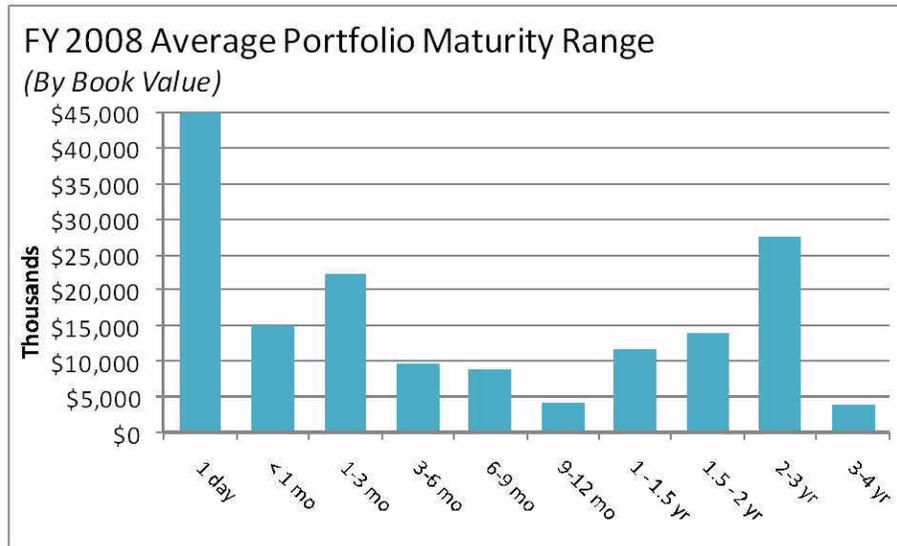
LAIF is the investment of choice for this purpose. LAIF offers the City overnight liquidity at rates that are equivalent to other short-term investment types, with the added benefit of daily withdrawal being available.

LAIF and other short-term investments provide sufficient liquidity to more than cover foreseeable shortfalls in cash resulting from the normal variability of our many revenue sources. If necessary, any investments in the portfolio can be sold immediately if the need arose, although it is generally our practice to hold investments until maturity.

The following chart represents the portfolio's June 30, 2008 book value, separated by maturity periods.



Securities are purchased in various maturity ranges in order to ensure liquidity.



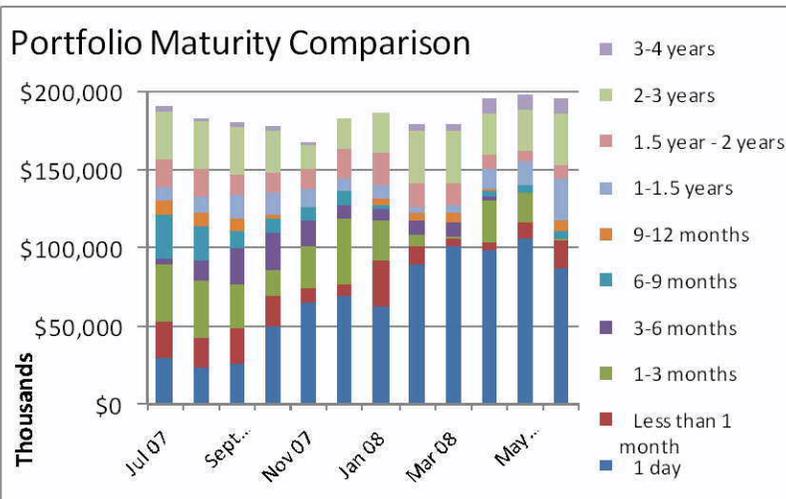
Average Liquidity

As rates declined, we concentrated our investments into LAIF.

Throughout the year, available investment rates declined. As the rates declined, we chose to invest larger percentages of the short-term portfolio into LAIF. During period of declining rates, the LAIF yield is slow to decline due to its longer maturity period. As rates improve, we will be evaluating our other short term investment opportunities.

The chart shows the average maturity periods for FY 2008. As can be seen in the chart, we chose to invest larger percent-

ages of the portfolio into LAIF; mainly due to the declining rates of other short-term investments. In the future, when rates improve, we will be laddering our maturity levels more evenly along the maturity range.



Market Value

If sold on June 30, 2008, \$336,802² would have been gained on the portfolio.

As stated in previous reports, the value at maturity of all securities in the portfolio is not affected by this calculation.

What is demonstrated is the movement in bond prices associated with changes in bond market yields. Since bond yields and bond prices move in opposite directions, any overall decrease in market interest rates serves to increase the prices of existing holdings.

The City reports the market value each month. The City is required to report its portfolio market value each June 30th. This information is reported in the Annual Comprehensive Annual Financial Report (CAFR).

²Market pricing is provided by Data Feed Market Pricing.



To ensure adequate cash is available, the City monitors its cash position daily, satisfying its obligations and investing the remaining cash.



Market value is the current price at which investors are willing to buy or sell a bond at a given time.



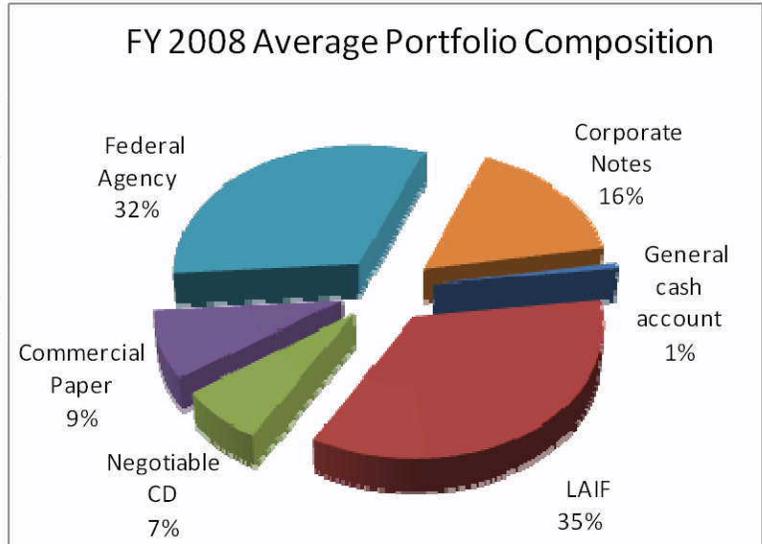
Portfolio composition describes the make-up of the portfolio by security type.

Portfolio Make-Up

Our diverse portfolio adds value and safety.

The investment program took advantage of its safety, liquidity, and yield requirements by investing in diverse security types. Diversifying security issuers and types, along with correlating investment maturities with cash flow needs dilutes risk.

The chart shows the average composition of a monthly FY 2008 portfolio. As can be seen from the graph, our portfolio is diversified among several security types.

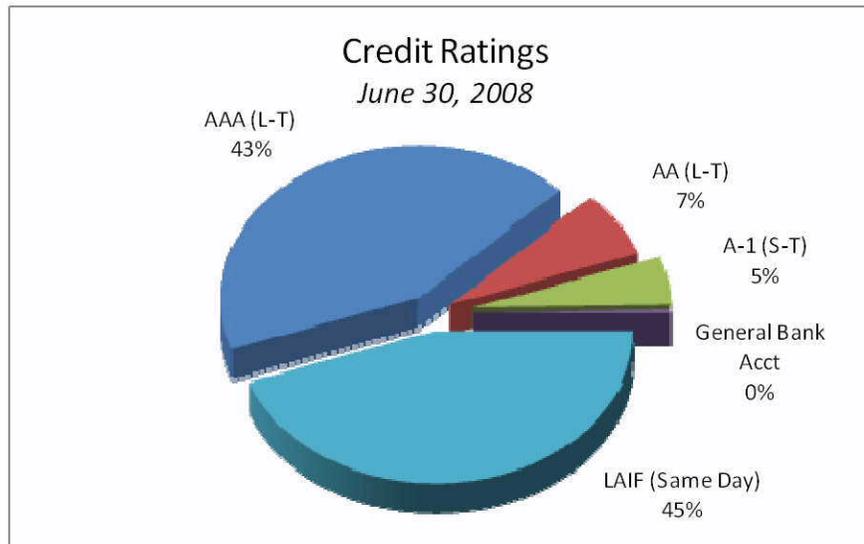


A credit rating assesses the credit worthiness of a corporation. Credit ratings are calculated from financial history and current assets and liabilities. Typically, a credit rating tells an investor the probability of the subject being able to pay back a bond.

Credit Worthiness

Security credit ratings are monitored monthly.

The graph presents the portfolio investments' by credit ratings as of June 30, 2008. AAA and AA are long-term ratings (maturity of greater than one year), while A-1 is a short-term rating (shorter than one year). LAIF has not been issued a credit rating by a national rating agency, and is listed separately.



Oversight

The Investment Advisory Committee has met with Finance staff every quarter for more than thirteen years.

The purpose of Investment Advisory Committee meetings is to review investment strategy, approval new investment sources, discuss economic developments, monitor investment activity and consider proposed changes to investment practices and to the Statement of Investment Policy.

The result has been a focus on safe investing, improved investment standards, and improved investment quality. The board has provided an invaluable sounding board for staff concerns

about the economy, the direction of interest rates, downgrading of well-rated issuers of securities, and a variety of other subjects related to the treasury operation.

Information is provided to the Committee monthly by the Finance Department. The Finance Director chairs quarterly meetings, which include a briefing from the Investment Officer on the status of the investment portfolio.

The Committee consists of the Assistant City Manager; the City Attorney (represented by the Assistant City Attorney); two department heads appointed by the City Manager (current

appointees include the City Clerk and Human Resources Director); a Professor from California State University, East Bay (CSUEB), representing the finance & economics educational community; and a representative from the banking community.

The contributions of Professor Zock of CSUEB and Andrew Stoddard, VP of Institutional Sales from Union Bank, warrant particular attention and deserve particular thanks. Their expertise in economic and financial matters within the private sector and the larger economy is invaluable to maintenance of prudent, effective investment.



The Investment Program is reviewed quarterly by the Investment Advisory Committee.

Accounting Requirements

Investment procedures and results are reviewed by independent auditors.

GASB No. 40, Deposit and Investment Risk Disclosure, requires annual disclosure of various types of investment risks as of the June 30 reporting period. The purpose of the accounting disclosure is to add information regarding certain risks associated

with cash and investments. The requirement serves to provide additional disclosure as related to credit rating risk, interest rate risk, and concentration risk. By disclosing these areas of risk in the City's Annual Financial Statements, a reader can become more informed of various risks associated with cash and investments.

The FY 2008 Comprehensive Annual Financial Report (CAFR) will be audited by the City's certified public accountant firm, and will be available in January 2009. The report will contain the GASB No. 40 reporting requirement.



Independent auditors review the Investment Program.



Internal Controls

As always, staff continued to monitor investment safety in FY 2008.

Internal control are defined as a process effected by an organization's structure, work and authority flows, people and management information systems, designed to help the organization accomplish specific goals or objectives. It is a means by which an organization's resources are directed, monitored, and measured. It plays an important role in preventing and detecting fraud and protecting the organization's resources. At the organizational level, internal control objectives relate to the reliability of financial reporting, timely feedback on the achievement of operational or strategic goals, and compliance with laws and regulations.

The Statement of Investment Policy's internal control requirements were observed, to include:

1. Transactions were only completed with investment institutions that were qualified and approved by the Investment Advisory Committee.
2. All transactions were executed on a delivery-versus-payment basis. This means that the City does not pay for securities until its title to them is confirmed.
3. Competitive bidding was the standard method of security procurement, and all bidders were pre-qualified by agreement to comply with the City policies. Furthermore, no addition to the bidders' list is made without the concurrence of the Investment Advisory Committee.
4. Investment practices followed written authorizations, controls and procedures in the Statement of Investment Policy; as previously approved by the City Council.
5. All investment instruments were secured through third-party custody and safe-keeping procedures by Bank of the West.
6. The City employed a computerized cash budgeting system, which plots expenditure requirements and income delivery for the entire year. Staff correlated investment maturities with cash flow needs as a matter of routine.

Policy Constraints

At June 30, 2008, the portfolio met all policy limitations.

The Investment Policy sets guidelines and constraints to guide the investment program. These standards ensure a safe and prudent investment program.

The Statement of Investment Policy sets three major maturity constraints to insure liquidity:

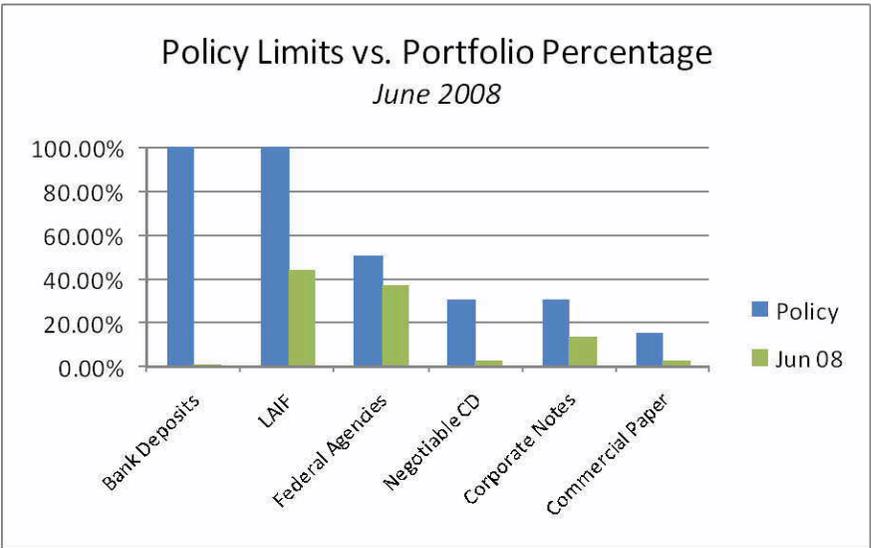
Policy	Program
1. The City shall not invest in instruments whose maturities exceed four years at the time of purchase. State law allows five-year maturities, but City policy is more restrictive than State law.	In FY 2008, no securities were purchased with a maturity beyond four years.
2. No more than 40% of the portfolio shall be invested beyond twelve months.	As of June 30, 40% of the portfolio was invested in maturities beyond one year.
3. The average maturity of portfolio investments shall not exceed 400 calendar days.	As of June 30, the portfolio's average weighted maturity was 317 days.



Actual results are measured against the policy to ensure compliance.

The Statement of Investment Policy sets security type constraints, such as maximums in each investment category, to insure diversity.

The chart provides a comparison between our policy and the investment category held as of June 30.



Future Investment Strategy

What does the future look like? Investment strategy requires assumptions about the future.



The investment strategy going into FY 2009 is to selectively extend maturities to take advantage of interest rates and to evaluate our investment in LAIF. As always, we will maintain our emphasis upon safety and liquidity.

The rate-setting Federal Reserve Open Market Committee maintained the 2.0% federal funds rate as of August 2008. For the upcoming year, we will continue to monitor national economic information and its affect on rates available for investment.

The table below was copied from Wachovia's weekly economic report. Wachovia is forecasting that the national economy will experience sluggish growth throughout this year and next. Based on this information, we anticipate rates for future investment to remain at their current, low levels.

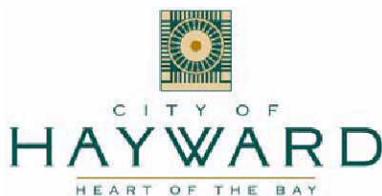
U.S. Forecast

	Actual				Forecast				Actual			Forecast			
	2007		2008		2005		2006		2007		2008		2009		2010
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2005	2006	2007	2008	2009	2010	
Real Gross Domestic Product ¹	0.0	4.8	4.8	-0.2	0.9	1.9	2.2	1.2	2.9	2.8	2.0	1.8	1.8	2.1	
Personal Consumption	3.9	2.0	2.0	1.0	0.9	1.5	-0.7	-0.7	3.0	3.0	2.8	0.9	0.7	2.2	
Inflation Indicators ²															
"Core" PCE Deflator	2.3	2.1	2.0	2.2	2.2	2.2	2.2	1.9	2.1	2.3	2.2	2.1	1.8	1.9	
Consumer Price Index	2.4	2.6	2.4	4.0	4.2	4.3	5.1	3.5	3.4	3.2	2.9	4.3	2.1	1.9	
Industrial Production ¹	1.5	3.2	3.6	0.3	0.5	-3.1	0.2	2.0	3.3	2.2	1.7	0.4	2.0	3.3	
Corporate Profits Before Taxes ²	-1.0	-0.5	-2.7	-2.0	-1.5	-8.0	-6.0	-10.5	17.6	15.2	-1.6	-6.5	4.9	9.2	
Trade Weighted Dollar Index ³	80.5	78.7	74.4	73.3	70.3	71.0	72.5	73.6	86.0	81.5	73.3	73.6	82.4	90.0	
Unemployment Rate	4.5	4.5	4.7	4.8	4.8	5.3	5.7	5.8	5.1	4.6	4.6	5.5	6.2	6.3	
Housing Starts ⁴	1.45	1.46	1.30	1.15	1.05	1.02	0.91	0.90	2.07	1.81	1.34	0.97	1.00	1.30	
Quarter-End Interest Rates															
Federal Funds Target Rate	5.25	5.25	4.75	4.25	2.25	2.00	2.00	2.00	4.25	5.25	4.25	2.00	2.00	3.00	
10 Year Note	4.65	5.03	4.59	4.04	3.45	3.99	4.00	3.90	4.39	4.71	4.04	3.90	4.00	5.20	

Data As of August 8, 2008

¹ Compound Annual Growth Rate Quarter-over-Quarter
² Year-over-Year Percentage Change

³ Federal Reserve Major Currency Index, 1973=100 -Quarter End
⁴ Millions of Units



Prepared by:
Investment Officer, Denise Blohm
Denise.blohm@hayward-ca.gov