# REQUEST FOR CITY COUNCIL ACTION

**MEETING DATE:** MARCH 12, 2013

**TITLE:** TREASURER'S REPORT FOR THE QUARTER ENDED DECEMBER 31, 2012

Director of Administrative Services

City Manager

## RECOMMENDED ACTION

Receive and file.

## EXECUTIVE SUMMARY

This report provides a synopsis of investment activity for the City's three investment portfolios for the quarter ended December 31, 2012. These portfolios, which are managed by United American Capital Corporation (UACC) under the direction of the Treasurer, are categorized as the Irvine Pooled Investment Portfolio, Bond Proceeds Fund and Special District Funds. The market value of all investments under the Treasurer's management totaled $587.10 million as of December 31, 2012.

Total portfolio assets, asset allocations, average maturities, yields, and portfolio valuations are presented within this report. A discussion of market conditions is also provided to give perspective to these measurements.

## COMMISSION/BOARD/COMMITTEE RECOMMENDATION

At an adjourned regular meeting of the Finance Commission on February 19, 2013, the Finance Commissioners recommended the City Council receive and file the Treasurer's report by a unanimous vote of 5-0. At a regular meeting of the Investment Advisory Committee (IAC) on February 13, 2013, the committee members recommended the City Council receive and file the Treasurer's report by a unanimous vote of 5-0.

## ANALYSIS

The Treasurer's office is charged with investing the City's three fixed income portfolios in conformance with the Annual Investment Policy adopted by City Council. The Investment Policy is updated annually in accordance with the California State Government Code. Quarterly and annual treasury reports that provide investment activity and performance information for the City's portfolios, in accordance with the adopted Investment Policy, are submitted to the Investment Advisory Committee, Finance Commission, and City Council. The primary objectives of investing these public funds are the protection of principal (safety), provision of ample funds to meet cash requirements (liquidity), and to obtain a competitive market rate of return (yield), in that order. All securities owned by the City are held in safekeeping by a third party custodial bank acting as agent for the City rather than held by a securities dealer. Any trade executed with a broker/dealer is required to settle with the City's safekeeping agent on a delivery versus payment basis, where the delivery of a security to the appropriate party is made only in the event the funds have been sent as payment for the security.

**Pooled Investment Portfolio**

The Irvine Pooled Investment Portfolio contains funds invested for both the daily operational requirements of the City, as well as funds reserved for economic uncertainties, and future rehabilitation and maintenance needs. The Irvine Pooled Investment Portfolio is a combination of several operational funds, including the City's Asset Management Plan (AMP) and funds earmarked for the development of the Orange County Great Park.

As of December 31, 2012, the book value (purchase price of securities as recorded on the City's books) of the Irvine Pooled Investment Portfolio was $354.38 million and the average weighted yield to maturity was 0.79 percent. Fiscal year-to-date investment income (interest payments and capital gains) generated by the Irvine Pooled Investment Portfolio as of December 31, 2012 was $1.54 million. The following chart compares the Irvine Pooled Investment Portfolio statistics over a rolling 12-month period.

**Irvine Pooled Investment Portfolio**
**Rolling 12-Month Quarterly Comparison**

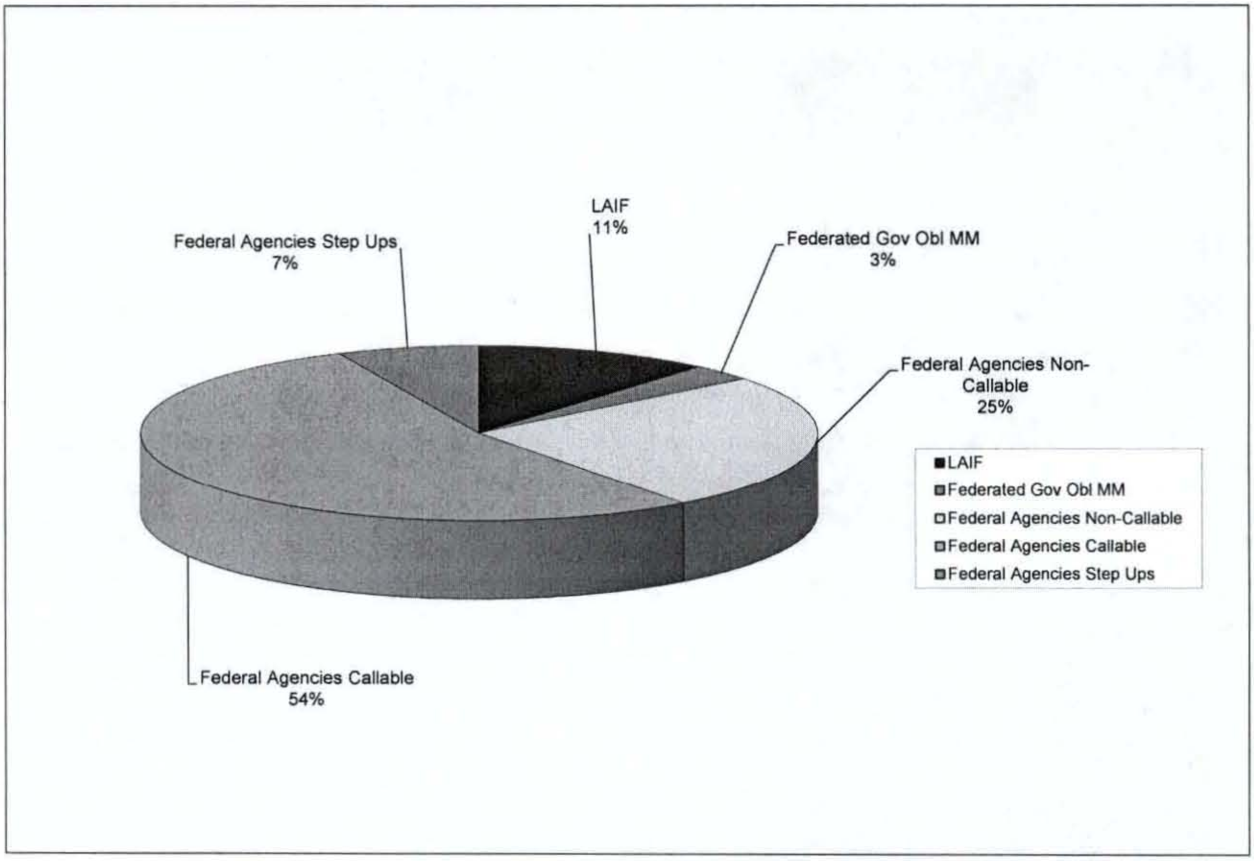
| | Dec 30, 2012 | Sept 30, 2012 | June 30, 2012 | Mar 31, 2012 |
|---|---|---|---|---|
| Book Value | $354,378,826 | $352,053,216 | $369,761,787 | $360,681,836 |
| Market Value | $356,003,429 | $353,941,345 | $371,336,805 | $362,118,825 |
| Unrealized Gain/(Loss) | $1,624,603 | $1,888,129 | $1,575,018 | $1,436,989 |
| Unrealized Gain/(Loss) as % of Book Value | 0.46% | 0.54% | 0.43% | 0.40% |
| Average Yield To Maturity | 0.79% | 0.86% | 0.91% | 1.01% |
| Liquidity 0 – 6 months | 14.31% | 13.93% | 12.91% | 18.64% |
| Average Years To Maturity | 2.48 years | 2.56 years | 2.65 years | 2.45 years |
| Effective Duration | 2.44 years | 2.39 years | 2.54 years | 2.38 years |

Portfolio average yield to maturity declined 7 basis points (0.07 percent) as compared to the prior quarter that ended on September 30, 2012. The portfolio strategy to invest in longer term maturities to capture incremental yield has helped minimize the decline in average yield to maturity as the interest rate environment remains at historically low levels. The overnight to 6-months of liquidity level of 14.31 percent will meet anticipated cash needs and provide the ability to invest in higher yielding securities should interest rates increase in the future.

To ensure the safety of the portfolio, investments that hold the highest credit quality are selected. The Irvine Pooled Investment Portfolio is comprised primarily of Federal Government sponsored entity debt, otherwise known as Federal Agencies. Although the Federal Agency securities were downgraded by Standard & Poor's to AA in August 2011, they are considered the safest securities in the global market next to Treasury securities. Two of the government sponsored agencies, Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Company (FHLMC) remain under conservatorship by the Federal Government. Both of these agencies are being carefully monitored by the City's investment manager to ensure the continued safety of the City's funds.

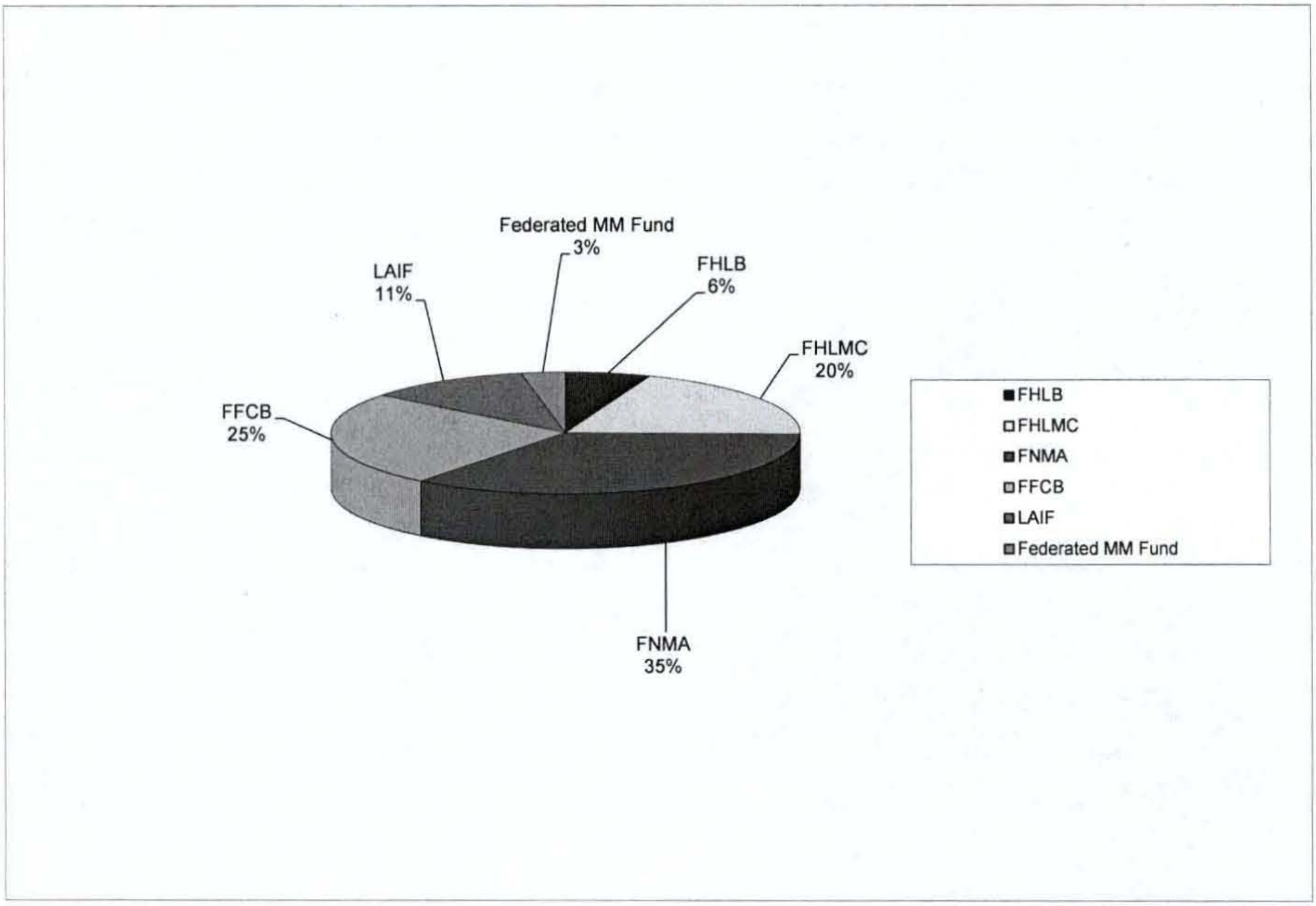
To manage liquidity, the Portfolio is invested in the State of California's Local Agency Investment Fund (LAIF), and the Federated Government Obligation money market fund. Chart 1 below shows the asset allocation of the Irvine Pooled Investment Portfolio.

**Irvine Pooled Investment Portfolio**
**Chart 1 - Asset Allocation**
**as of December 31, 2012**



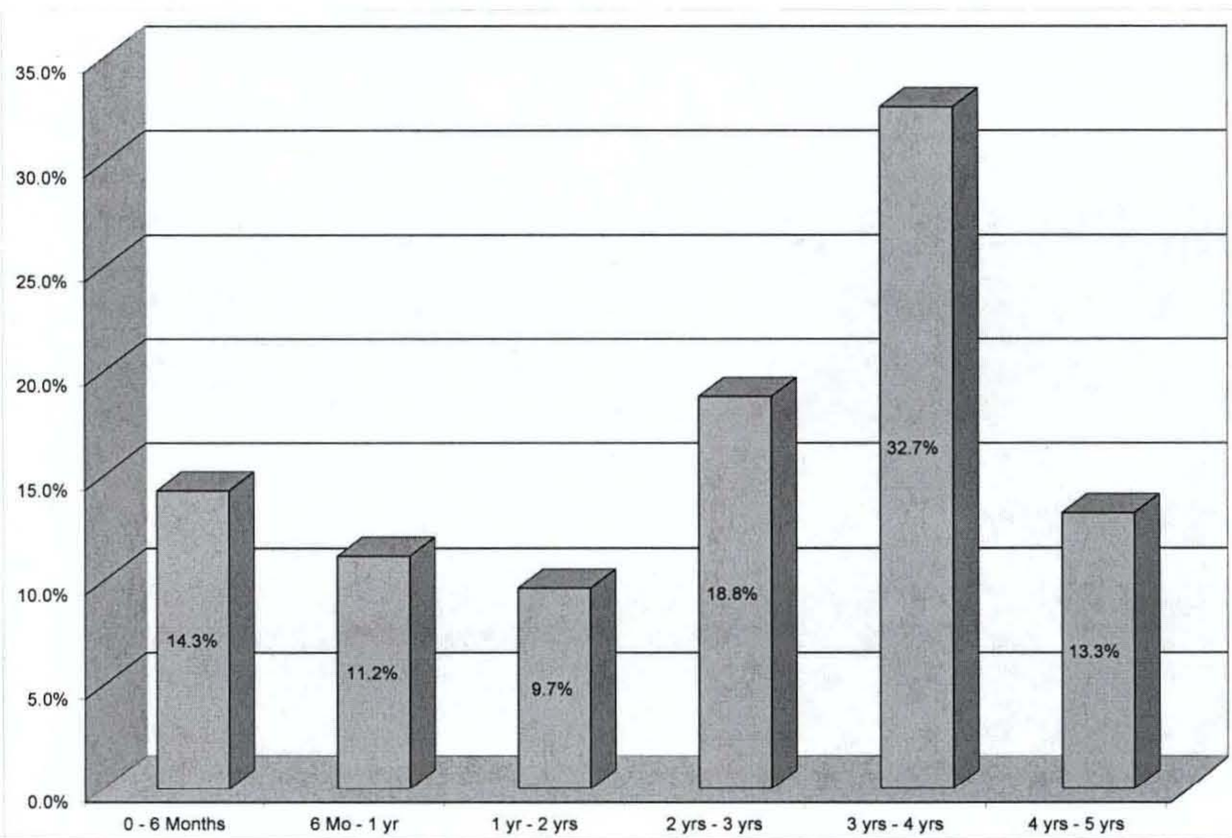
Since 86.00 percent of the portfolio is invested in Federal Agency securities, the safety of the Portfolio is further protected by purchasing securities from several different Federal Agencies. The four Federal Government sponsored entities that the City purchases securities from are Federal Home Loan Bank (FHLB or Home Loan), Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac), Federal National Mortgage Association (FNMA or Fannie Mae), and Federal Farm Credit Bank (FFCB or Farm Credit). Because Fannie Mae and Freddie Mac are under conservatorship by the U.S. government, securities issued by these government sponsored entities carry an explicit guarantee by the Federal Government. Home Loan and Farm Credit carry an implied guarantee of the Federal Government. Chart 2 below identifies portfolio holdings by issuer name.

**Irvine Pooled Investment Portfolio**
**Chart 2 - Allocation by Issuer Name**
**as of December 31, 2012**



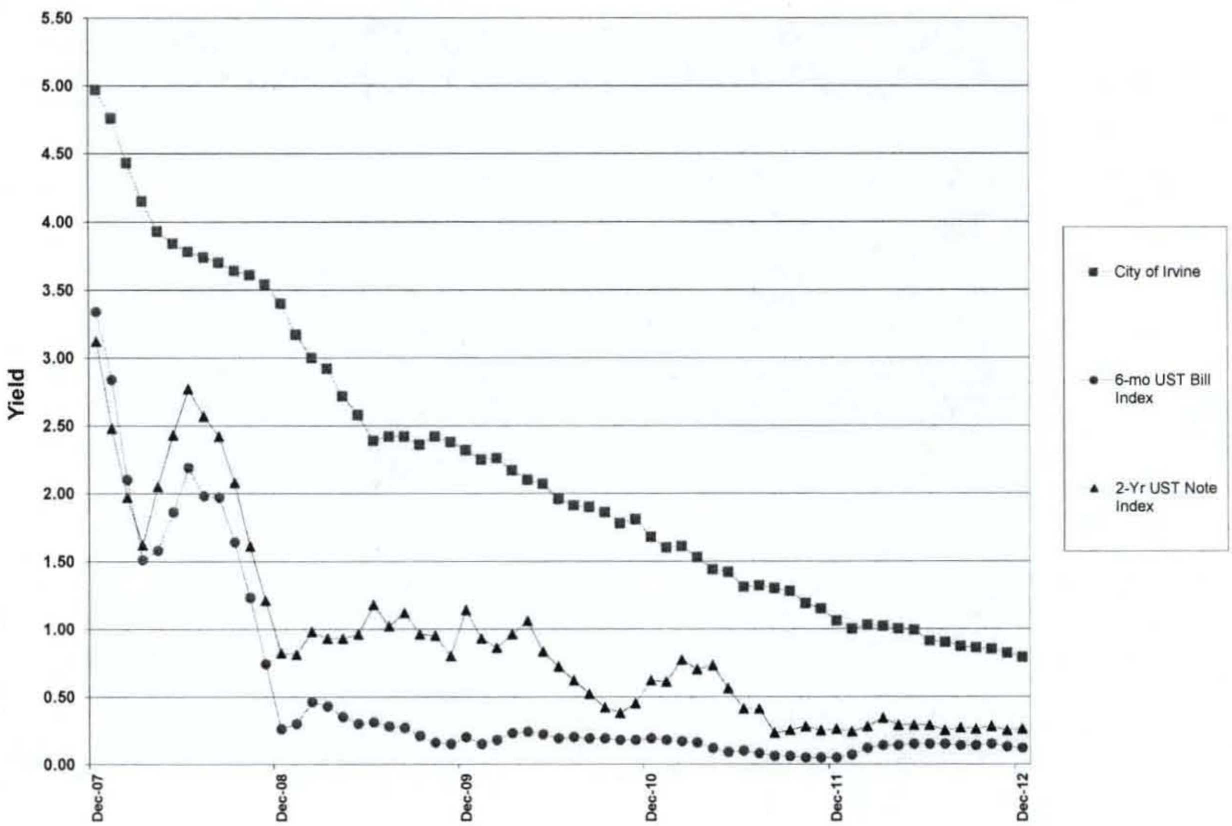
Another key component in portfolio management is to ensure that the City has enough funds on hand to meet current expenses. By using cash flow forecasts, the portfolio manager is able to project short and long-term cash needs to help make informed and appropriate investment decisions. As of December 31, 2012, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 14.31 percent, which provides adequate liquidity to meet anticipated expenses. Chart 3 below is an aging of investment maturities up to 5 years (the maximum maturity allowable by policy and state code) of the Irvine Pooled Investment Portfolio.

**Irvine Pooled Investment Portfolio**
**Chart 3 - Aging of Maturing Investments**
**as of December 31, 2012**




To gauge performance of the Portfolio, the City compares the Irvine Pooled Investment Portfolio's yield to maturity against two benchmarks set in the City's Annual Investment Policy; the 6-month United States Treasury (UST) Bill Index and 2-year UST Note Index. The benchmarks are used as a measure of the portfolio against market movement. Graph 1 on the following page compares the average yield to maturity of the Irvine Pooled Investment Portfolio to these benchmarks, and shows the spread (difference between the index and the yield to maturity) for the past five years. The City is experiencing a positive spread against both benchmarks. The Portfolio's yield is higher than the 6-month UST Bill Index by 0.67 percent and higher than the 2-year UST Note Index by 0.53 percent.

**Irvine Pooled Investment Portfolio**
**Graph 1 - Yield to Maturity Compared to Assigned Benchmarks**
**December 2007 through December 2012**




The Irvine Pooled Investment Portfolio invests funds attributable to the Asset Management Plan (AMP) and the Great Park Corporation. Pertinent information related to the AMP and Great Park Corporation funds are explained in the following paragraphs.

*Asset Management Plan (AMP) Funds*
Interest earnings for the AMP funds are allocated based on the AMP fund average daily cash balance. The AMP earned interest of $106,848 for the quarter ended December 31, 2012 based on an average cash balance of $61.35 million. Two loans, made by AMP in 2005 and 2006 to the Irvine Redevelopment Agency (Agency) have an outstanding balance of approximately $7.93 million, including $1.36 million of accrued interest. Repayment of these loans is scheduled to begin in Fiscal Year 2015-16.

Assembly Bill x1 26, enacted in 2011, dissolved all redevelopment agencies effective February 1, 2012. The Irvine City Council as the Successor Agency to the dissolved Agency is responsible for winding down the affairs of the dissolved Agency, with certain actions subject to the approval of an Oversight Board and review by the State Department of Finance. These loans are among the obligations of the dissolved Agency included on the Recognized Obligation Payment Schedule (Payment Schedule), which is the list of obligations to be paid from tax increment revenues formerly allocated to the Agency.

*Great Park Corporation Funds*
The Great Park funds earned interest of $85,746 for the quarter ended December 31, 2012. The Great Park funds had a combined average daily cash balance of $49.61 million for the quarter ended December 31, 2012.

**Bond Proceeds Fund Portfolio**
The Bond Proceeds Fund Portfolio contains special district construction and administration funds that are not held by a trustee. These include older bond issues, funds on hand to finance the City's assessment district inspection and administration, and property assessments received from the County prior to being sent to the trustee. Investment strategy differs in the Bond Proceeds Fund Portfolio from the Pooled Investment Fund Portfolio due to different cash needs between the two. The Bond Proceeds Fund Portfolio needs to be much more liquid to meet debt service payments.

The bullet points below provide a brief synopsis of the Bond Proceeds Portfolio for the quarter ended December 31, 2012.

- Book Value $21,871,220
- Market Value $21,895,867
- Unrealized Gains/(Losses) $24,647
- Average Weighted Yield to Maturity 0.326%
- Fiscal Year to Date Investment Income $33,374

**Special District Funds Portfolio**
The Special District Funds Portfolio contains project and reserve funds for 35 Special Assessment District bond issues and one Community Facilities District. Investments in this Portfolio are made in accordance with each bond's indenture and the strategy is set according to the cash flow needs of the individual district. The Special District Funds Portfolio must also remain very liquid to provide project funds, when requested, as well as meet debt service payment requirements.

The bullet points below provide a brief synopsis of the Special District Funds Portfolio for the quarter ended December 31, 2012.

| | |
|---|---|
| • Book Value | $209,157,028 |
| • Market Value | $209,199,815 |
| • Unrealized Gains/(Losses) | $42,787 |
| • Average Weighted Yield to Maturity | 0.048% |
| • Fiscal Year to Date Investment Income | $61,057 |

**Market Conditions**
The bond interest rates ended relatively the same as the prior quarter with the exception of the 5 to 30-year sector of the yield curve which has increased modestly by 10 basis points (0.10 percent). Overall, interest rates remained low as the Federal Reserve Board (Fed) continued to implement the same monetary policy of "Operation Twist" and quantitative easing (QEIII). Also contributing to the continued low interest rate were concerns over the impending "fiscal cliff" of tax increases and spending cuts by the year's end. However, speculation that U.S. lawmakers would avoid the "fiscal cliff" caused bond interest rates to rise during the final weeks of the quarter.

At both of the Federal Open Market Committee (FOMC) meetings held during the quarter, the Fed kept the target rate for Fed Funds at 0.00 percent to 0.25 percent, and reaffirmed their plan of maintaining the current target rate range at least through mid-2015. On December 12, 2012 the Fed revised their methodology for evaluating when the decision would be made to raise the Fed Funds rate. The Fed will now consider certain economic parameters as the basis for maintaining the Fed Funds rate near zero. According to the FOMC, "this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6.50 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2.00 percent longer-run goal, and longer-term inflation expectations continue to be well anchored". Additionally, the Fed announced plans to purchase $45.00 billion longer-term Treasury securities and $40.00 billion in mortgage-backed securities per month, with no set end-date for the purchases. The new plan will take the place of "Operation Twist," which expired on December 31, 2012.

## ALTERNATIVES CONSIDERED

None.

## FINANCIAL IMPACT

Fiscal year-to-date investment income for the Irvine Pooled Investment Portfolio, Bond Proceeds, and Special Districts portfolios totaled $1.57 million with investments structured for security and liquidity.

**REPORT PREPARED BY** Michele C. Lund, City Treasurer