REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: DECEMBER 13, 2011

TITLE: TREASURER'S REPORT FOR THE QUARTER ENDED SEPTEMBER 30, 2011

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 September 30, 2011. 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 $614 million as of September 30, 2011.

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 a regular meeting of the Finance Commission on November 21, 2011, the Finance Commissioners recommended the City Council receive and file the Treasurer's Report for the Quarter Ended September 30, 2011 by a vote of 5-0. At a regular meeting of the Investment Advisory Committee on November 9, 2011, the committee members recommended the City Council receive and file the Treasurer's report for the Quarter Ended September 30, 2011 by a unanimous vote of 3-0 (Committee Members Nicolas and Shanahan absent).

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 evaluated at least annually and updated, if needed, in conformance 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 an agent for the City rather than held by a securities dealer. To further protect the City's cash and investments, 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 September 30, 2011, the book value (purchase price of securities as recorded on the City's books) of the Irvine Pooled Investment Portfolio was \$361.2 million and the average weighted yield to maturity was 1.27%. The decrease in book value of approximately \$30 million between June and September is the result of capital spending and the normal revenue stream, which typically occurs in the first quarter of the fiscal year prior to the receipt of property taxes. Fiscal year-to-date investment income (interest payments and capital gains) generated by the Irvine Pooled Investment Portfolio, as of the quarter ended September 30, 2011, was \$1.0 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

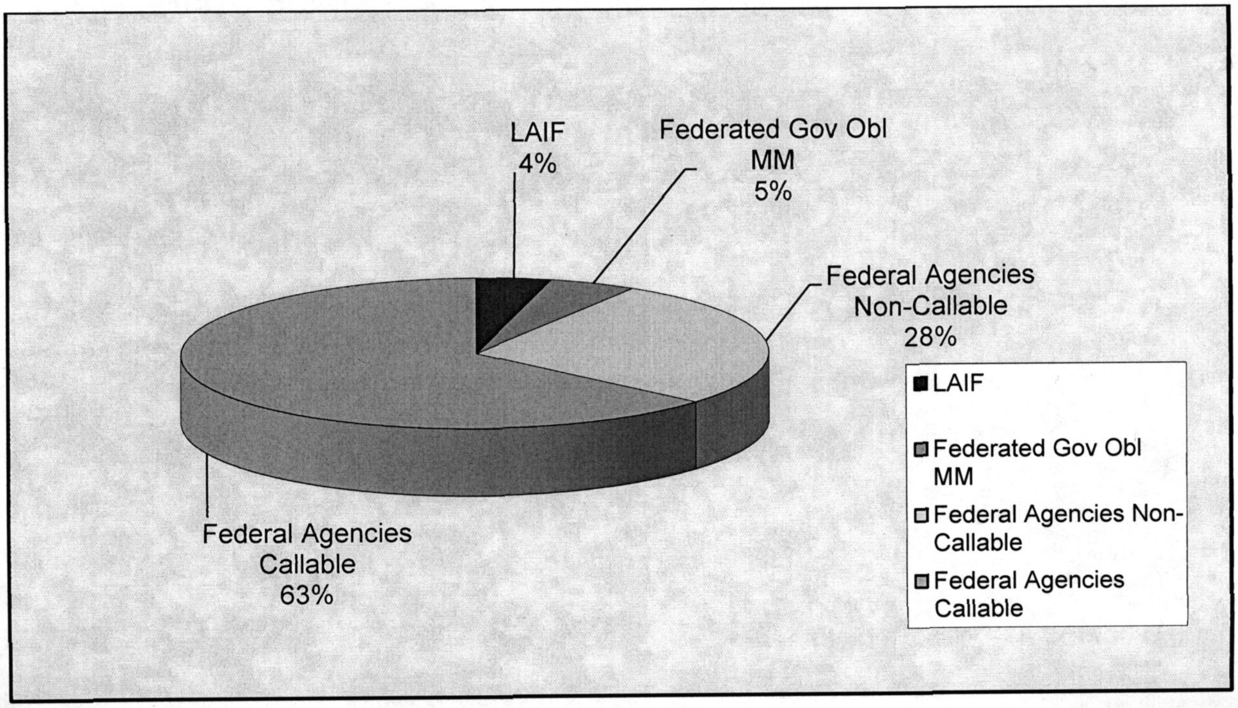
	Sept 30, 2011	**June 30, 2011**	**Mar 31, 2011**	**Dec 31, 2010**
Book Value	\$361,207,864	\$390,796,869	\$378,178,635	\$381,398,248
Market Value	\$363,079,325	\$392,583,506	\$378,532,425	\$383,270,170
Unrealized Gain/(Loss)	\$1,871,461	\$1,786,637	\$353,790	\$1,871,922
Unrealized Gain/(Loss) as % of Book Value	0.52%	0.46%	0.09%	0.49%
Average Yield To Maturity	1.27%	1.31%	1.53%	1.66%
Liquidity 0 – 6 months	13.10%	10.87%	16.56%	24.63%
Average Years To Maturity	2.31 years	2.25 years	2.12 years	2.03 years
Effective Duration	2.22 years	2.10 years	2.03 years	1.89 years

Despite a significant decline in interest rates during the quarter, the average yield to maturity only declined .04% (4 basis points). This is a result of the ongoing portfolio strategy to invest in longer term maturities to capture incremental yield, as seen by the increased average years to maturity and effective duration. In the event interest rates were to increase, there is sufficient liquidity in the Portfolio to take advantage of the shift in interest rates.

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, they are still 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.

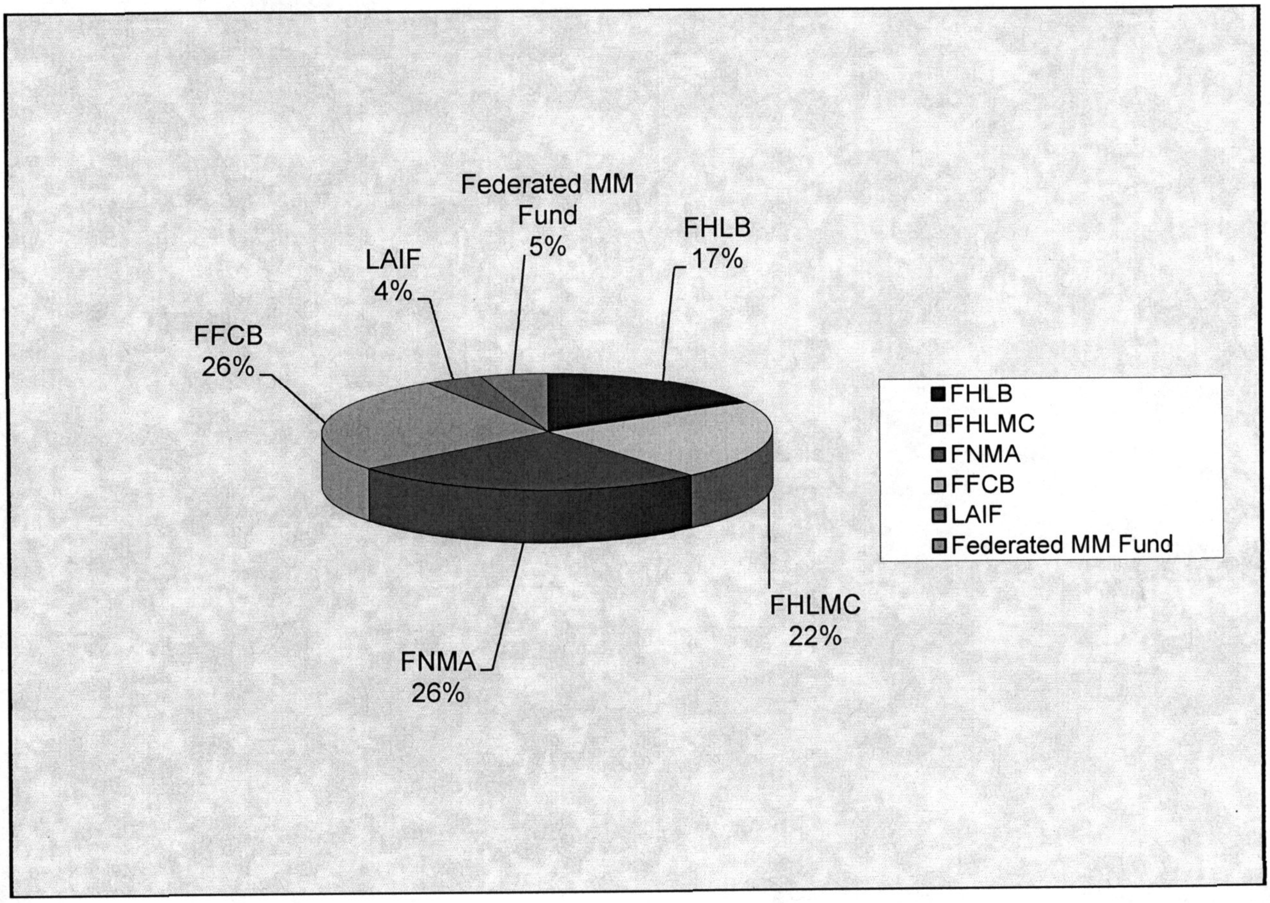
To manage liquidity, the Portfolio is invested in the State of California's Local Agency Investment Fund (LAIF), and the Federated Government Obligation Money Market Fund. The following chart shows the asset allocation of the Irvine Pooled Investment Portfolio.

Irvine Pooled Investment Portfolio
Asset Allocation
as of September 30, 2011



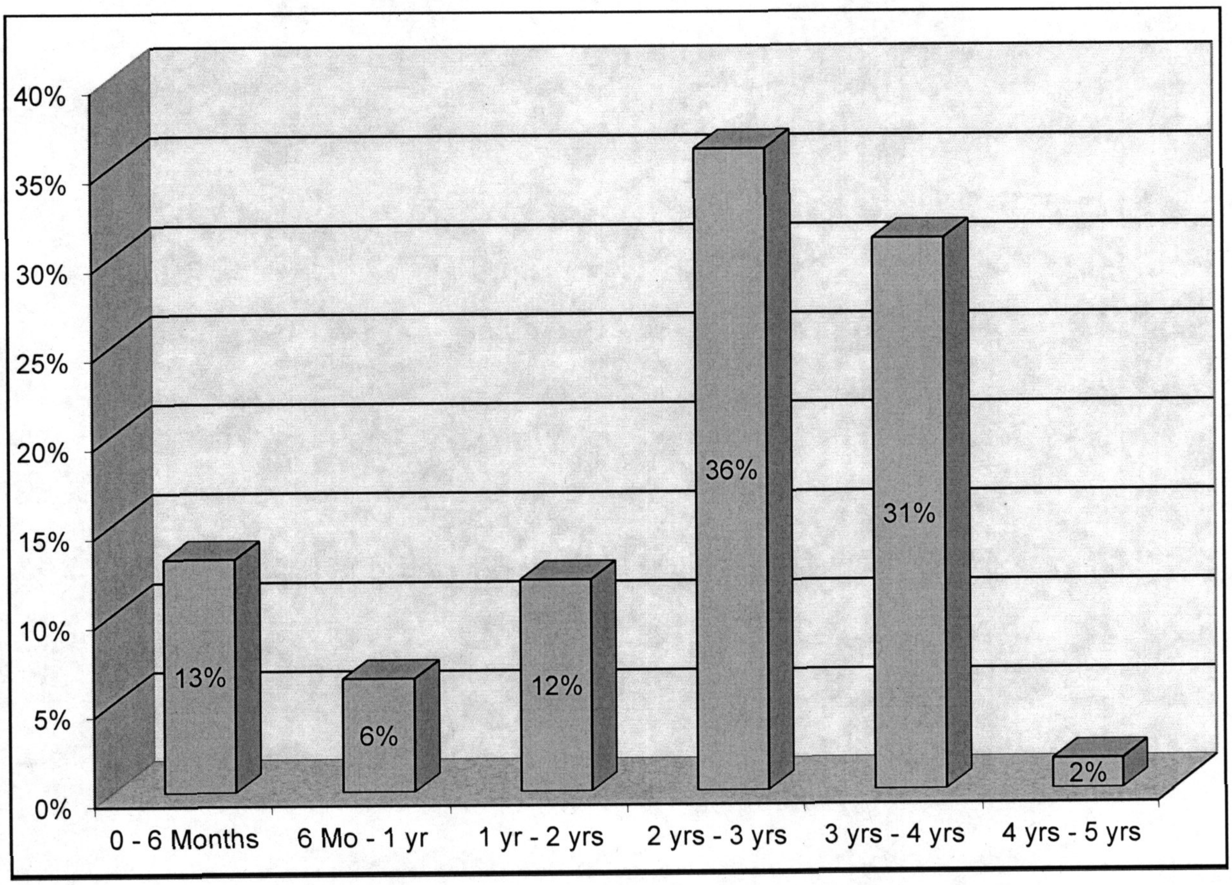
Since over 90% of the Portfolio is invested in Federal Agency securities, the safety of the Portfolio is further protected by purchasing securities from several different Federal Agencies. The four Federal Government sponsored entities that the City purchases securities from are Federal Home Loan Bank (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. The breakdown of the Portfolio holdings by issuer name is demonstrated on the following chart.

Irvine Pooled Investment Portfolio
Breakdown by Issuer Name
as of September 30, 2011



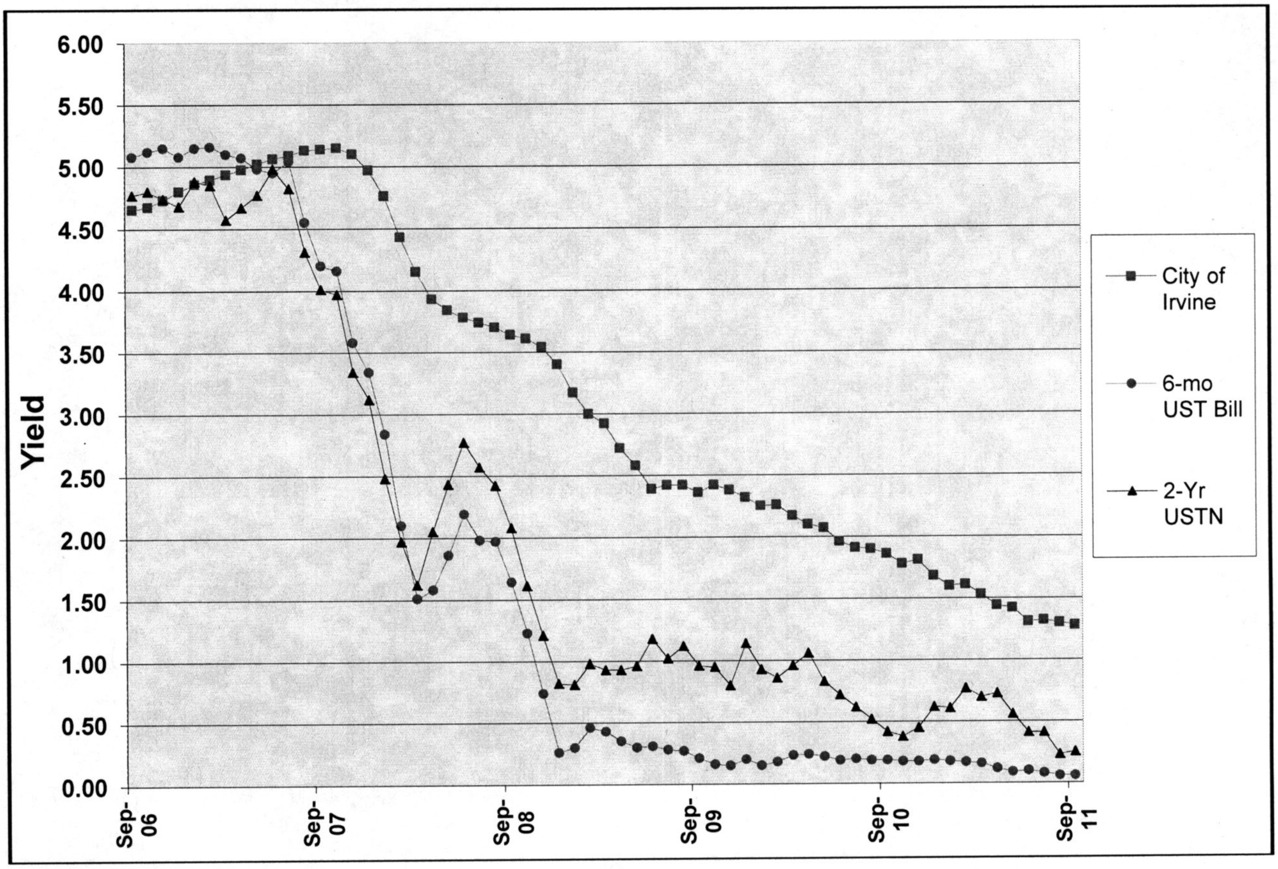
Another key component in portfolio management is to ensure that the City has enough liquidity available to meet current expenses. By using cash flow forecasts, the portfolio manager is able to project short and long-term cash needs to help make informed and appropriate investment decisions. As of September 30, 2011, the 0 to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 13%, which provides adequate liquidity to meet anticipated expenses. The chart below is an aging out to 5 years (the maximum maturity allowable by policy and state code) of the Irvine Pooled Investment Portfolio.

Irvine Pooled Investment Portfolio
Aging of Maturing Investments
as of September 30, 2011



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 benchmarks are used as a measure of the Portfolio against market movement. The graph on the following page compares the average yield to maturity of the Irvine Pooled Investment Portfolio to the 6-month United States Treasury (UST) Bill Index and 2-year UST Note Index, the two benchmarks stated in the Annual Investment Policy. The graph shows the spread (difference between the index and the yield to maturity) over the past five years. The City is experiencing a positive spread against both the 6-month UST and the 2-year UST. The Portfolio's yield is higher than the 6-month UST by 1.22% and higher than the 2-year UST by 1.03%.

Irvine Pooled Investment Portfolio
Yield to Maturity Compared to Assigned Benchmarks
September 2006 through September 2011



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 $67,674 for the quarter ending September 30, 2011 based on an average cash balance of $61.8 million. Additionally, the AMP has accrued interest through September 30, 2011 of approximately $2.9 million. This accrual is the result of $6.6 million in loans made in 2005 and 2006 by the AMP to the Irvine Redevelopment Agency to fund Agency activities prior to the receipt of tax increment funds. Principal and interest payments are scheduled to be repaid to the AMP from tax increment revenue starting in fiscal year 2015-16; however, interest is accruing at the City's earnings rate plus 3%.

Great Park Corporation Funds
The Great Park funds earned interest of $79,465 for the quarter ended September 30, 2011. The Great Park funds had a combined average daily cash balance of $74.5 million for the quarter ended September 30, 2011.

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 September 30, 2011.

• Book Value	$10,573,569
• Market Value	$10,612,607
• Unrealized Gains/(Losses)	$39,038
• Average Weighted Yield to Maturity	0.50%
• Fiscal Year to Date Investment Income	$30,163

Special District Funds Portfolio
The Special District Funds Portfolio contains project and reserve funds for 50 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 September 30, 2011.

• Book Value	$240,229,512
• Market Value	$240,247,565
• Unrealized Gains/(Losses)	$18,053
• Average Weighted Yield to Maturity	0.016%
• Fiscal Year to Date Investment Income	$612

Market Conditions

Bond interest rates moved lower during the first quarter of the fiscal year, especially in the 5-year to 30-year sector of the yield curve. Many factors have been contributing to the overall decline in rates including concerns about a slowing global economy, turmoil in the equity markets and the sovereign debt issues in Europe. While there have been several factors affecting interest rate movement, the most pronounced has been the events unfolding overseas, and investors are waiting expectantly for a resolution by the euro zone policy makers.

Further affecting the long end of the curve is the Fed announcement of "Operation Twist" at the September Federal Open Market Committee (FOMC) meeting. "Operation Twist" extends the average maturity of the securities purchased by the FOMC. By the end of June 2012, the FOMC intends to purchase $400 billion of Treasury securities with remaining maturities of 6 to 30 years and to sell $400 billion of three years or less. The intent of the program is to put downward pressure on long term interest rates to stimulate the economy. The Fed also kept the target rate for Fed Funds at 0% to .25%, and confirmed that it expects to keep the low rates until mid-2013.

ALTERNATIVES CONSIDERED

None.

FINANCIAL IMPACT

Fiscal year-to-date investment income for the Irvine Pooled Investment Portfolio, Bond Proceeds, and Special Districts portfolios totaled $1.05 million with investments structured for security and liquidity.

REPORT PREPARED BY: Michele C. Lund, City Treasurer