



REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: MAY 22, 2018

TITLE: TREASURER'S REPORT FOR THE QUARTER ENDED
MARCH 31, 2018



Director of Administrative Services



City Manager

RECOMMENDED ACTION

Receive and file the Treasurer's Report for the quarter ended March 31, 2018.

EXECUTIVE SUMMARY

This report provides a synopsis of investment activity for the City's three investment portfolios for the quarter ended March 31, 2018. The portfolios, managed by United American Capital Corporation (UACC) under the direction of the Treasurer, include the Irvine Pooled Investment Portfolio, Bond Proceeds Fund Portfolio, and the Special District Funds Portfolio. The total market value for all three portfolios was \$932.95 million as of March 31, 2018.

This report provides information on assets, allocations, average maturities, yields, and valuations for each of the three portfolios. A discussion of market conditions is included to give additional perspective to these measurements.

COMMISSION/BOARD/COMMITTEE RECOMMENDATION

At its adjourned regular meeting of May 14, 2018, the Finance Commission unanimously voted to recommend the City Council receive and file the Treasurer's Report. The Investment Advisory Committee was scheduled to review the Treasurer's Report at its regular meeting of May 9, 2018; however, the meeting was canceled due to lack of a quorum.

ANALYSIS

The Treasurer's office is responsible for the investment of the City's three fixed income portfolios in conformance with the Investment Policy adopted annually by the City Council. In accordance with the Investment Policy, management of the Irvine Pooled Investment Portfolio, Bond Proceeds Fund Portfolio and the Special District Funds Portfolio are delegated to a contract management firm, UACC, with full authority to execute investment transactions on behalf of the City. The Investment Policy is updated annually in accordance with the California State Government Code. Treasurer's reports are provided

at quarter end and fiscal year end to the Investment Advisory Committee, Finance Commission, and City Council. The report includes investment activity and performance for each of the City's portfolios. The primary objectives of investing public funds, in order of importance, are safety of principle, liquidity of funds, and return on investment. All securities owned by the City are held in safekeeping by a third party custodial bank acting as the agent for the City instead of being held by a securities dealer or investment management firm. 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 after the funds have been sent in full as payment for the security.

Irvine Pooled Investment Portfolio

The Irvine Pooled Investment Portfolio contains funds invested for the daily operational requirements of the City and funds reserved for economic uncertainties, future rehabilitation and maintenance needs. The portfolio is a combination of various operational funds, including the City's Asset Management Plan and funds earmarked for the development of the Orange County Great Park. A summary of the Irvine Pooled Investment Portfolio by Fund is presented at the end of this report (Attachment 1).

As of March 31, 2018, the book value (purchase price of securities as recorded on the City's books) of the portfolio was \$661.61 million and the average weighted yield to maturity was 1.45 percent. Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the portfolio as of March 31, 2018 was \$5.90 million. The following chart compares the portfolio's statistics over a rolling 12-month period.

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

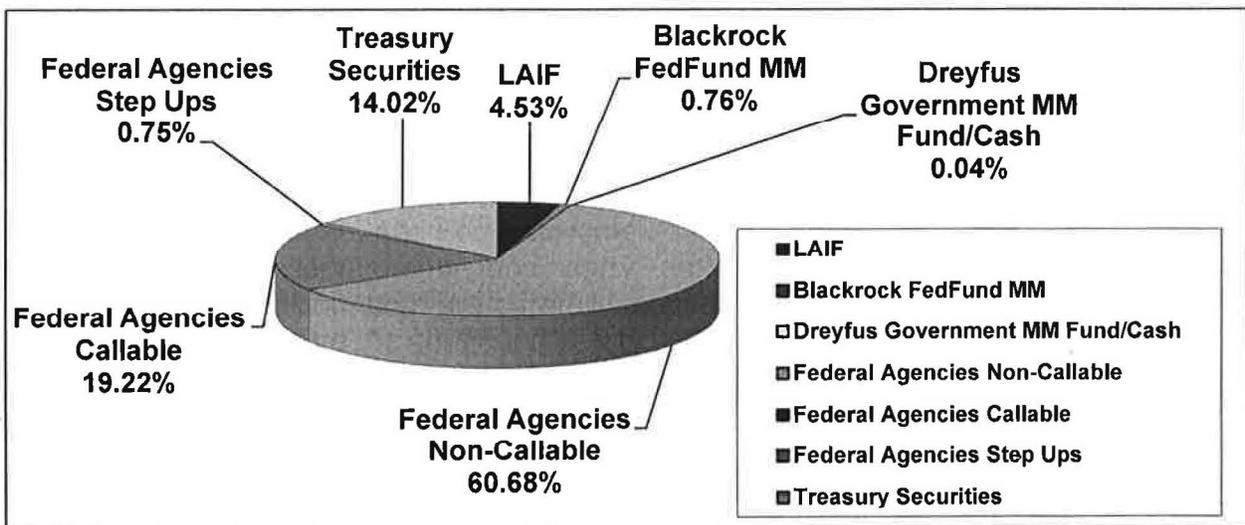
	March 31, 2018	December 31, 2017	September 30, 2017	June 30, 2017
Book Value	\$661,611,807	\$634,945,838	\$633,592,161	\$637,207,311
Market Value	\$653,215,825	\$629,344,603	\$631,069,975	\$634,768,340
Unrealized Gain/(Loss)	(\$8,395,982)	(\$5,601,235)	(\$2,522,186)	(\$2,438,971)
Unrealized Gain/(Loss) as % of Book Value	(1.27%)	(0.88%)	(0.40%)	(0.38%)
Average Yield To Maturity	1.45%	1.36%	1.30%	1.24%
Liquidity 0-6 Months	17.40%	12.97%	13.41%	14.32%
Average Years To Maturity	1.90	1.97	2.01	1.91
Modified Duration (Years)	1.83	1.91	1.95	1.85
Fiscal Year to Date Income	\$5,897,774	\$3,872,132	\$1,819,383	\$5,819,215

The Irvine Pooled Investment Portfolio's book value increased by \$26.67 million from the previous quarter due to the receipts of property taxes, Marine Way improvement funding and the Recognized Obligation Payment Schedule (ROPS) payment. Portfolio yield to maturity increased for the quarter ended March 31, 2018 by 9 basis points to 1.45 percent. This was directly attributed to the increasing rate environment as maturing investments were reinvested into longer dated higher rate securities. With market rates increasing, the portfolio ended the quarter with an unrealized loss of \$8.40 million as compared to an unrealized loss of \$5.60 million on December 31, 2017. This is a normal result of the portfolio's modified duration of 1.83 years, and its price-sensitivity to changes in market 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 agency securities. Although federal agency securities were downgraded by Standard & Poor's to AA+ in August 2011, they continue to be regarded as among the safest securities in the global market. Two of the government sponsored agencies, Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), remain under conservatorship and carry an implicit guarantee by the Federal Government. In addition, both are carefully monitored by the City's investment manager and Treasurer to ensure the continued safety of the City's funds.

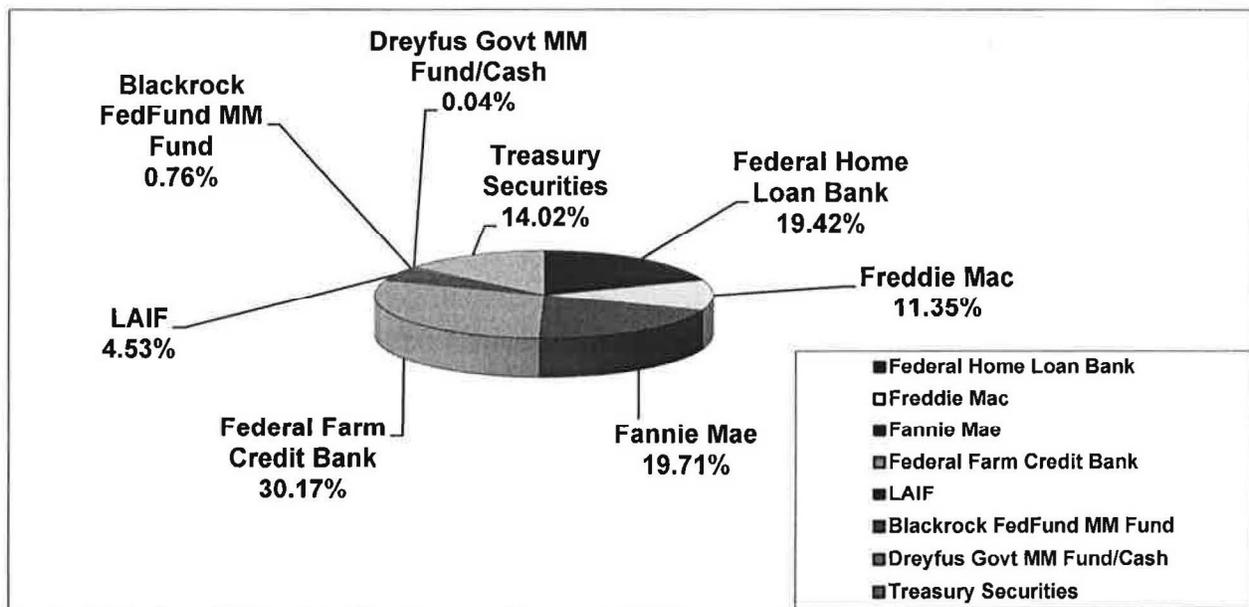
To manage liquidity, the Irvine Pooled Investment Portfolio is invested in Local Agency Investment Funds (LAIF), Dreyfus Government money market fund, and the Blackrock FedFund money market fund. Chart 1 shows the asset allocation of the portfolio.

**Irvine Pooled Investment Portfolio
 Chart 1 - Asset Allocation
 as of March 31, 2018**



To diversify, the City purchases United States Treasury notes and securities from several different federal agencies. The four Federal Government sponsored entities the City owns are: Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), Federal Home Loan Bank (Home Loan), and Federal Farm Credit Bank (Farm Credit). Chart 2 identifies portfolio holdings by issuer name.

**Irvine Pooled Investment Portfolio
Chart 2 - Holdings by Issuer Name
as of March 31, 2018**



Another key component in portfolio management is to ensure that the City has enough funds on hand to meet current expenses. As of March 31, 2018, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 17.40 percent versus 12.97 percent last quarter. Chart 3, on the following page, 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 (Maturity Value)
as of March 31, 2018

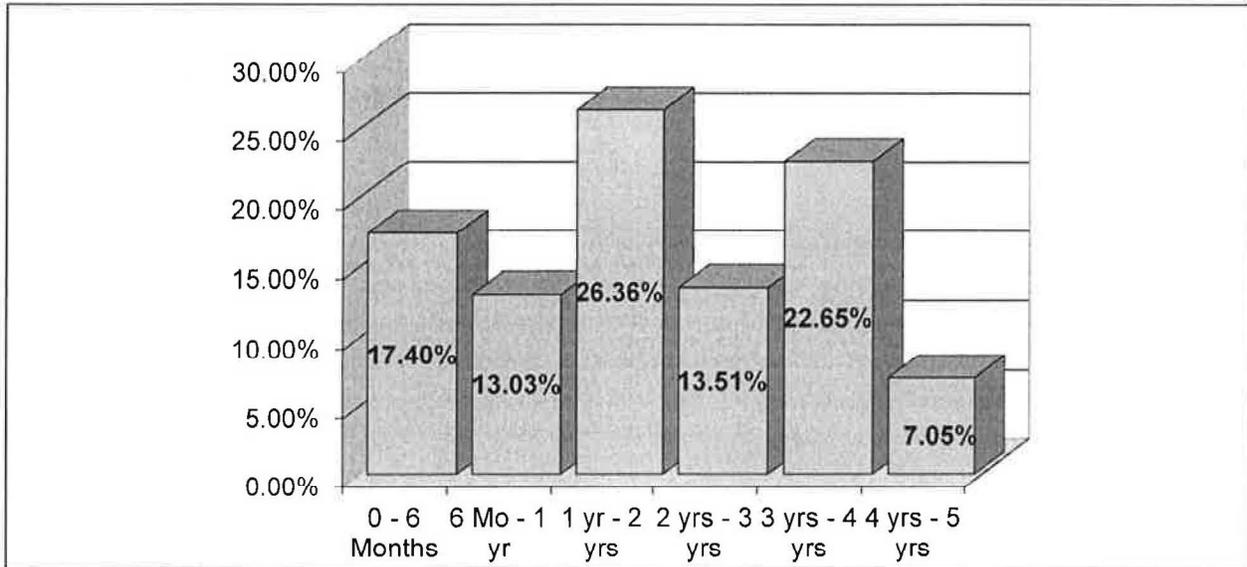
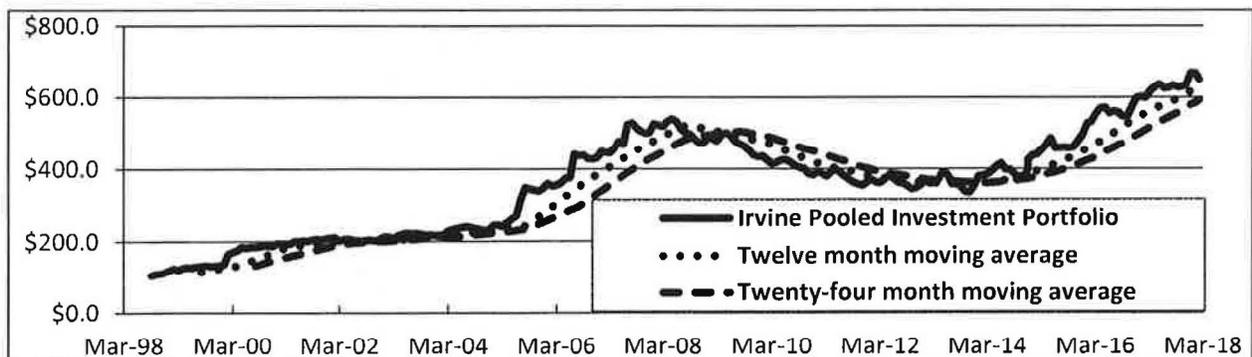
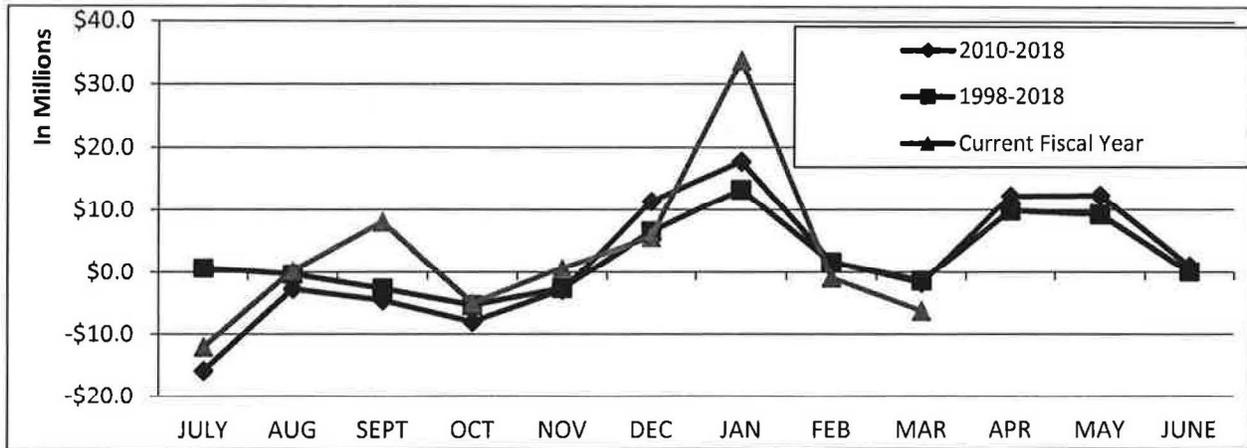


Chart 4 and Chart 5 show the volatility and cyclical nature of the Irvine Pooled Investment Portfolio fund balance and cash flows between 1998 and 2018. As noted in chart 5, the balance change in September 2017 reflects one-time receipts from development fees and the sale of the Fire Station 20 parcel. The above average increase in January 2018 reflects the one-time payment of Marine Way development funding for street improvements and higher receipts in property tax. Recent tax law changes prompted some property owners to pay both 2017-18 property tax installments in calendar year 2017.

Irvine Pooled Investment Portfolio
Chart 4 - Portfolio Balance
March 31, 1998 through March 31, 2018

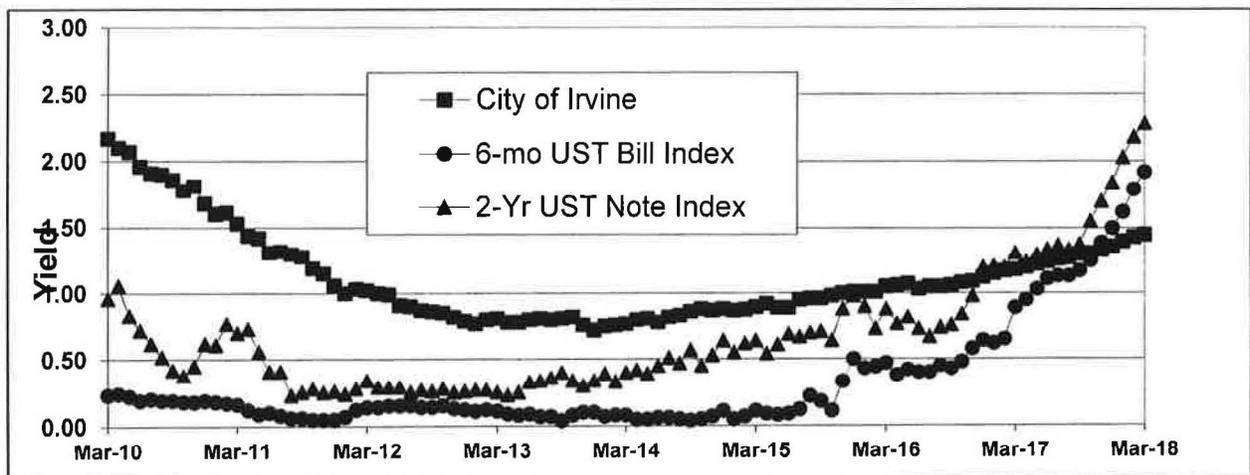


Irvine Pooled Investment Portfolio
Chart 5 – Balance Change Month by Month (Average)



To gauge performance, the City compares the Irvine Pooled Investment Portfolio's yield to maturity against two reference notes set in the City's Annual Investment Policy: the 6-month United States Treasury (UST) Bill Index and 2-year UST Note Index. The reference notes are used as a measure of the portfolio against market movement. Chart 6 compares the average yield to maturity of the portfolio to these reference notes, and shows the spread (difference between the index and the yield to maturity) for the past eight years. With the recent Federal Reserve rate hikes, the portfolio's book yield is less than the 6-month UST by 0.47 percent and the 2-year UST by 0.83 percent. The average yield on the 2-year treasury for the last 24 months is 1.28 percent, versus 1.45 percent for the Irvine Pooled Investment Portfolio.

Irvine Pooled Investment Portfolio
Chart 6 - Yield to Maturity Compared to Assigned Indices
March 31, 2010 through March 31, 2018



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, and funds on hand to finance the City's special district administration. Investment strategy in the Bond Proceeds Fund Portfolio differs from the Irvine Pooled Investment Portfolio due to the different cash needs between the two. The Bond Proceeds Fund Portfolio requires greater liquidity to meet debt related payments. The account balance in the Bond Proceeds Fund Portfolio fluctuates from quarter to quarter due to the timing of property assessment collections from the County of Orange and subsequent distributions. Several times a year, the portfolio receives special assessments and tax levies collected by the County. The special assessments and tax levies contain three major components:

- (1) The collections from the various Assessment Districts (AD), Reassessment Districts (RAD) and Community Facilities Districts (CFD). Upon receipt, the City transfers these funds to the Districts' bond trustees.
- (2) The collections for the guaranteed maintenance amount of the Great Park CFD. Upon receipt, the City transfers this amount to the Orange County Great Park Fund.
- (3) The collections for the Districts' construction and administration funds held and managed by the City. This portion remains in the Bond Proceeds Fund Portfolio.

Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the Bond Proceeds Fund Portfolio as of March 31, 2018 was \$43,787.

**Bond Proceeds Fund Portfolio
 Rolling 12-Month Quarterly Comparison**

	March 31, 2018	December 31, 2017	September 30, 2017	June 30, 2017
Book Value	\$6,056,000	\$5,381,000	\$4,294,000	\$4,605,000
Market Value	\$6,044,454	\$5,375,845	\$4,289,887	\$4,600,122
Unrealized Gain/(Loss)	(\$11,546)	(\$5,155)	(\$4,113)	(\$4,878)
Unrealized Gain/(Loss) as % of Book Value	(0.19%)	(0.10%)	(0.10%)	(0.11%)
Average Yield To Maturity	1.52%	1.24%	1.11%	0.98%
Liquidity 0-6 Months	100.00%	100.00%	100.00%	100.00%
Average Days To Maturity	1	1	1	1
Modified Duration in Days	1	1	1	1
Fiscal Year to Date Income	\$43,787	\$28,053	\$16,078	\$28,832

Special District Funds Portfolio

The Special District Funds Portfolio contains project and reserve funds for 28 AD and RAD bond issues and four CFD bond issues. Investments in this portfolio are made in accordance with each bond's indenture and the strategy is based on the cash flow needs of each district. The Special District Funds Portfolio must also remain very liquid to provide project funds, when needed, as well as meet debt service payment requirements. Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the Special District Funds Portfolio as of March 31, 2018 was \$1,969,221. The Special District Funds Portfolio unrealized market value loss decreased from \$402,661 to \$24,335 between June 30, 2017 and September 30, 2017. This was due to the maturity of two securities and their associated unamortized premium which in turn reduced the quarter to date earnings.

**Special District Funds Portfolio
 Rolling 12-Month Quarterly Comparison**

	March 31, 2018	December 31, 2017	September 30, 2017	June 30, 2017
Book Value	\$265,277,405	\$294,084,302	\$279,378,670	\$343,067,156
Market Value	\$265,185,789	\$294,001,956	\$279,354,335	\$342,664,495
Unrealized Gain/(Loss)	(\$91,616)	(\$82,346)	(\$24,335)	(\$402,661)
Unrealized Gain/(Loss) as % of Book Value	(0.03%)	(0.03%)	(0.01%)	(0.12%)
Average Yield To Maturity	1.74%	1.41%	1.06%	0.85%
Average Days To Maturity	70	73	60	55
Fiscal Year to Date Income	\$1,969,221	\$863,441	\$37,750	\$2,239,450

Market Conditions

During the third quarter of FY 2017-18, interest rates increased moderately across the yield curve. As expected, the Federal Reserve increased the federal funds rate by 25 basis points to 1.50 percent at the March 21, 2018 Federal Open Market Committee (FOMC) meeting for the third time in the past 12 months. During the past quarter, the 6-month Treasury bill increased 35.80 basis points to 1.92 percent. Two-year Treasury notes increased 34.47 basis points to 2.28 percent, and the five-year Treasury note increased 31.40 basis points to 2.56 percent. The Local Agency Investment Fund (LAIF) daily rate increased to 1.58 percent from 1.28 percent. The net effect to the Pooled Investment Portfolio was an increase in the unrealized market value loss, which was in direct proportion to the stated duration of the portfolio. As bonds mature, proceeds are reinvested into higher yielding Aaa/AA+ government bonds that increase the average rate of return and cash flows.

Financial markets continued to focus on economic releases, including labor and wage data, and Federal Reserve Fund policy. The unemployment rate remained at 4.10 percent as of March 31, 2018. The under-employment rate improved to 8.00 percent for March 31, 2018 from 8.1 percent last quarter. Labor force participation increased slightly to 62.9 percent from 62.7 percent but remains at levels not seen since 1978. The yearly percentage change of the average hourly earnings has steadily risen since the financial crisis ended, and remains at the high end of the relatively narrow range of 1.50 percent to 2.90 percent. The Federal Reserve remains focused on maximum employment, stable prices, and moderate long term interest rates. Federal Funds rate probabilities for a 25 basis point rate increase at the June 13, 2018 FOMC meeting is 79.40 percent as of March 31, 2018. Recent comments by Federal Reserve chair Jerome Powell regarding labor and inflation, "The labor market has been strong, and my colleagues and I expect it to remain strong, in fact, monthly inflation readings have been firmer over the past several months, and the 12 month change should move up notably." as well as the Federal Reserve's continued focus with regard to the historical inverse relationship between rates of unemployment and corresponding rates of inflation may suggest further rate tightening above the FOMC's current projected three 25 basis point rate hikes in calendar year 2018. The number one complaint regarding labor, as measured by the National Federation of Independent Business' small business quality index, is that hiring managers are having difficulty finding qualified employees.

The economy advanced at a moderate pace during the quarter, slightly less than the 2.90 percent pace in the prior quarter. Business spending remains healthy at 6.80 percent, having reacted to their tax cuts faster than consumers. The Atlanta Federal Reserve GDPNow forecast is currently 2.31 percent but looks poised to move higher during the year. Inflation remains below the Federal Reserve's 2.00 percent target with the Personal Consumption Expenditure Core Price index at 1.59 percent as of February 28, 2018.

In conclusion, the moderately expanding economy coupled with benign but slowly accelerating inflation data will keep the Federal Reserve policy of interest rate normalization on a cautious path. The Federal Reserve began quantitative tightening during the final months of the calendar year and will gradually accelerate the drawdown of its balance sheet from \$10 billion per month to \$50 billion per month. Fiscal policy with regard to federal government spending and taxation, trade issues, as well as the transition towards global central bank monetary tightening would suggest increased asset market volatility in the next quarter.

ALTERNATIVES CONSIDERED

None. The Treasurer's Report is intended to provide historical information about the City's investment portfolios. Pursuant to the City's Investment Policy, the Treasurer is required to submit quarterly Treasurer's reports to the City Council.

FINANCIAL IMPACT

Fiscal year-to-date investment income for the Irvine Pooled Investment Portfolio, Bond Proceeds Funds Portfolio, and Special Districts Funds Portfolio totaled \$7.91 million with investments structured for security and liquidity.

REPORT PREPARED BY Don Collins, City Treasurer

Attachment 1: Summary of Irvine Pooled Investment Portfolio by Fund

City of Irvine
Summary of Pooled Investment Portfolio Book Value by Fund
As of March 31, 2018

General Reserve Funds	\$ 118,343,818
Capital Projects Funds:	
Capital Improvement Projects	33,711,155
Irvine Business Complex	89,005,109
North Irvine Transportation Mitigation	78,570,463
Orange County Great Park Development	5,695,852
Park Development	18,109,404
Total	<u>225,091,983</u>
Special Revenue Funds:	
Air Quality Improvement	447,020
County Sales Tax Measure M	537,595
Fees and Exactions	16,383,033
Gas Tax	11,805,614
Grants	3,610,665
I Shuttle	841,108
Local Park Fees	115,103,890
Maintenance District	1,334,299
Major Special Events	91,442
Orange County Great Park	100,252,919
Road Maintenance and Rehab Account	348,990
Slurry Seal Fees	1,655,248
System Development	25,047,829
Total	<u>277,459,652</u>
Internal Service Funds:	
Equipment & Services	17,852,078
Inventory	83,459
Self-Insurance	17,958,816
Total	<u>35,894,353</u>
Permanent Fund:	
Senior Services	337,058
Senior Services Endowments	495,406
Total	<u>832,464</u>
Fiduciary Fund:	
Successor Agency	3,989,537
Total	<u>3,989,537</u>
Total Pooled Investments at March 31, 2018	<u>\$ 661,611,807</u>

Note: Funds are as presented in the City's Comprehensive Annual Financial Report (CAFR)