



REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: DECEMBER 13, 2016

TITLE: TREASURER'S REPORT FOR THE QUARTER ENDED
SEPTEMBER 30, 2016

Director of Financial Services

City Manager

RECOMMENDED ACTION

Receive and file the Treasurer's Report for the quarter ended September 30, 2016.

EXECUTIVE SUMMARY

This report provides a synopsis of investment activity for the City's three investment portfolios for the quarter ended September 30, 2016. The portfolios are managed by United American Capital Corporation (UACC) under the direction of the Treasurer and 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 \$931.26 million as of September 30, 2016.

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

COMMISSION/BOARD/COMMITTEE RECOMMENDATION

On November 21, 2016, the Finance Commission reviewed the Treasurer's Report and voted 5-0, with all members present, to recommend the City Council receive and file the Treasurer's Report for the quarter ended September 30, 2016. At its November 16, 2016 Special Meeting, the Investment Advisory Committee voted 4-0-1 (Committee Members Carney, Gonzales, Greenberg, and Judd voting in favor, Chair Shanahan absent), to recommend the City Council receive and file the Treasurer's Report.

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, Bonds Proceeds Fund Portfolio and the Special Districts 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 principal, 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 rather than 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 Irvine Pooled Investment Portfolio is a combination of several operational funds, including the City's Asset Management Plan and funds earmarked for the development of the Orange County Great Park.

As of September 30, 2016, the book value (purchase price of securities as recorded on the City's books) of the Irvine Pooled Investment Portfolio was \$557.66 million and the average weighted yield to maturity was 1.06 percent. Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the Irvine Pooled Investment Portfolio as of September 30, 2016 was \$1.34 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**

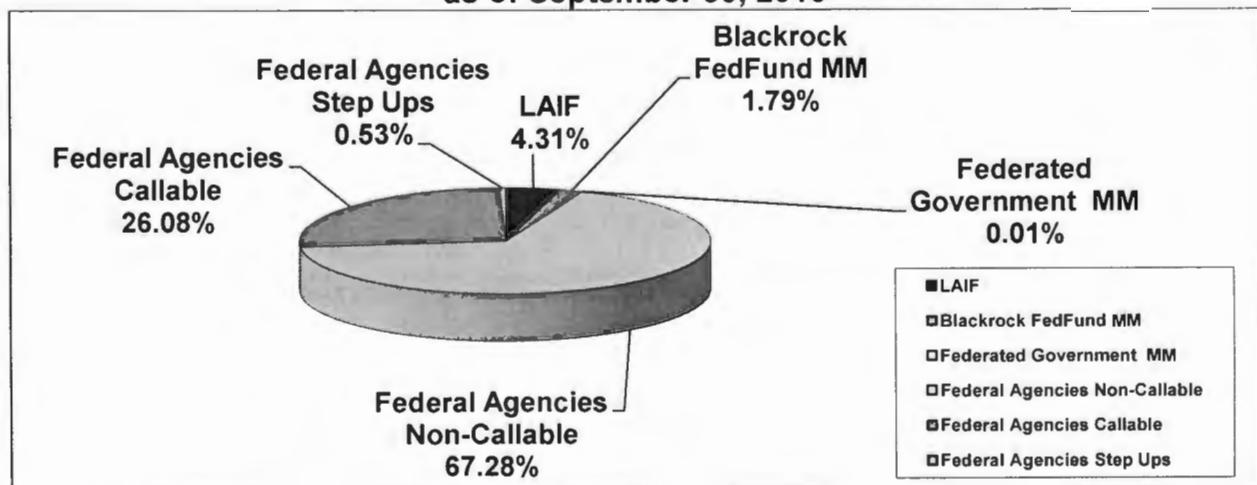
	Sept 30, 2016	June 30, 2016	March 31, 2016	Dec 31, 2015
Book Value	\$557,660,462	\$572,157,628	\$533,389,906	\$478,816,519
Market Value	\$559,208,937	\$574,913,200	\$535,191,367	\$477,843,844
Unrealized Gain/(Loss)	\$1,548,475	\$2,755,572	\$1,801,461	(\$972,675)
Unrealized Gain/(Loss) as % of Book Value	0.28%	0.48%	0.34%	(0.20%)
Average Yield To Maturity	1.06%	1.03%	1.05%	1.01%
Liquidity 0 –6 months	9.85%	13.19%	10.95%	10.95%
Average Years To Maturity	2.02	1.91	2.02	2.02
Modified Duration (Years)	1.98	1.84	1.98	1.97
Fiscal Year to Date Income	\$1,340,988	\$4,613,047	\$3,057,399	\$2,114,558

The Irvine Pooled Investment Portfolio's book value decreased by \$14.49 million from the previous quarter due to the planned seasonal cyclical nature of the City's revenue stream and cash flow that often fluctuates \$10 to \$50 million each quarter. Portfolio yield to maturity increased for the quarter ended September 30, 2016 by 3 basis points to 1.06 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 during the quarter ending September 30, 2016, the Irvine Pooled Investment Portfolio ended the quarter with an unrealized gain of \$1.55 million as compared to \$ 2.76 million on June 30, 2016. This is a normal result of the Irvine Pooled Investment Portfolio's modified duration of 1.98 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 Company (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.

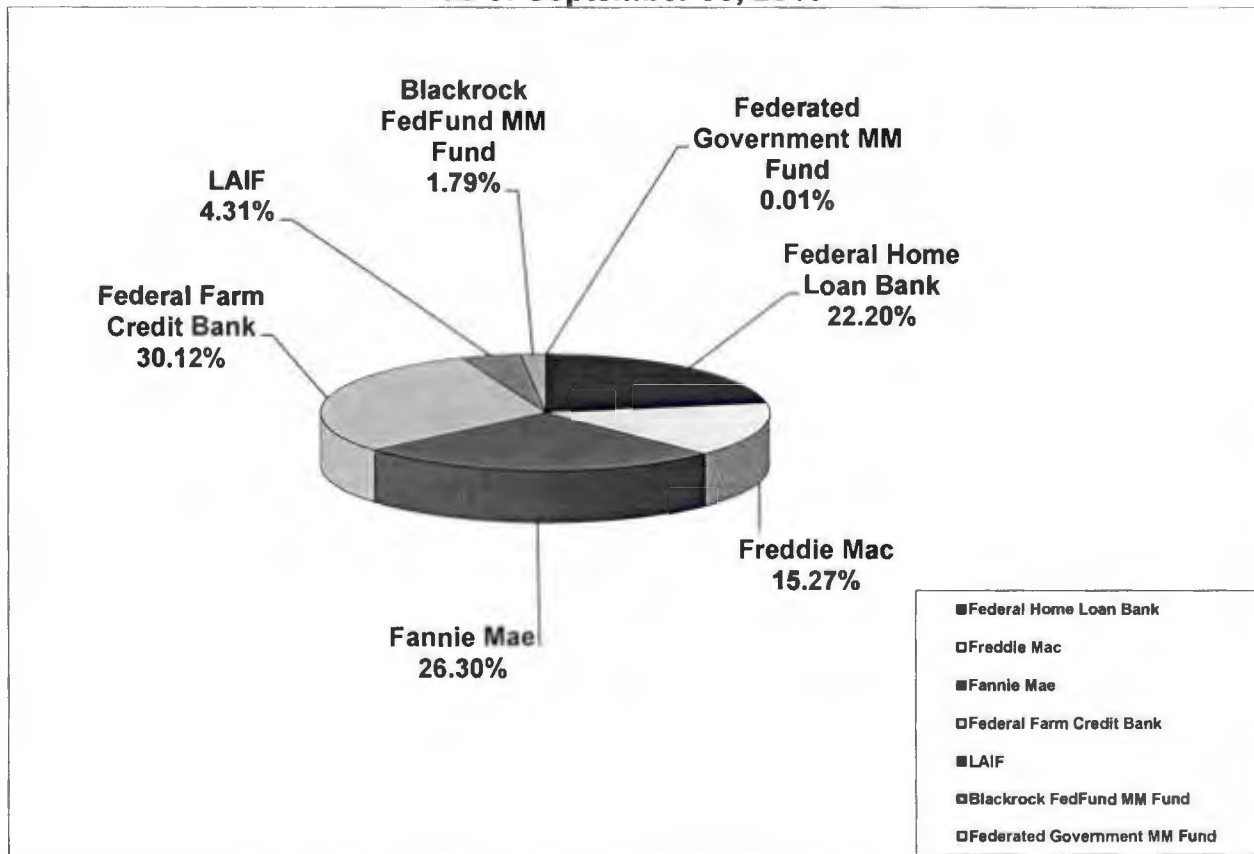
To manage liquidity, the Irvine Pooled Investment Portfolio is invested in Local Agency Investment Funds (LAIF), Federated Government Obligation money market fund, and the Blackrock FedFund money market fund. Chart 1 shows the asset allocation of the Irvine Pooled Investment Portfolio.

**Irvine Pooled Investment Portfolio
 Chart 1 - Asset Allocation
 as of September 30, 2016**



To diversify, the City purchases 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 - Allocation by Issuer Name
as of September 30, 2016**



Another key component in portfolio management is to ensure that the City has enough funds on hand to meet current expenses. As of September 30, 2016, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 9.85 percent versus 13.19 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 September 30, 2016

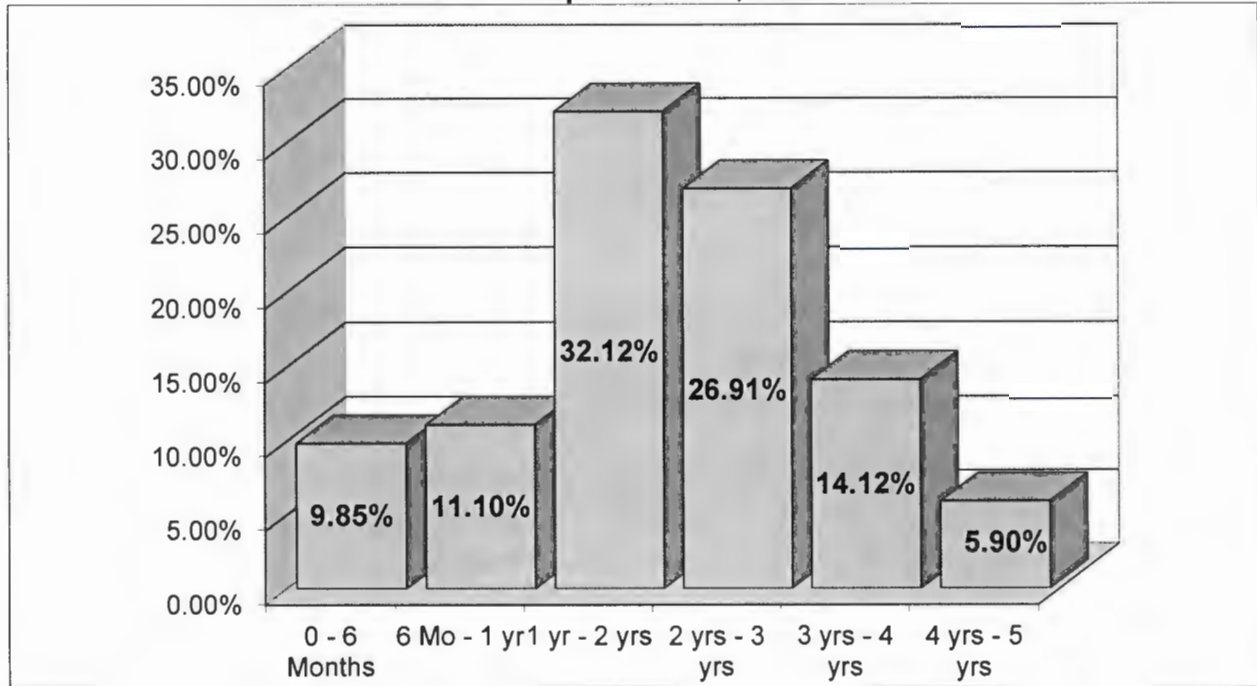
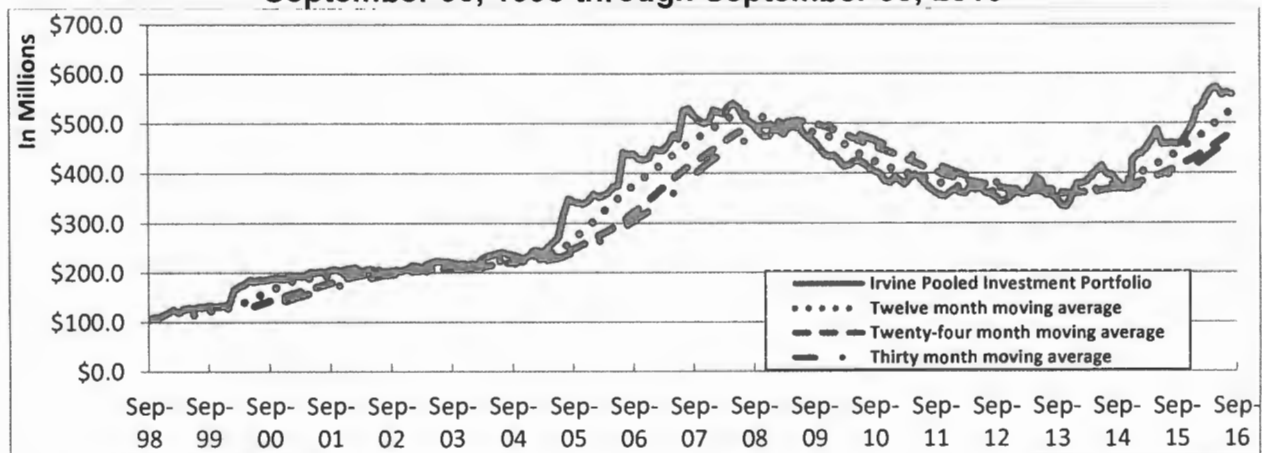
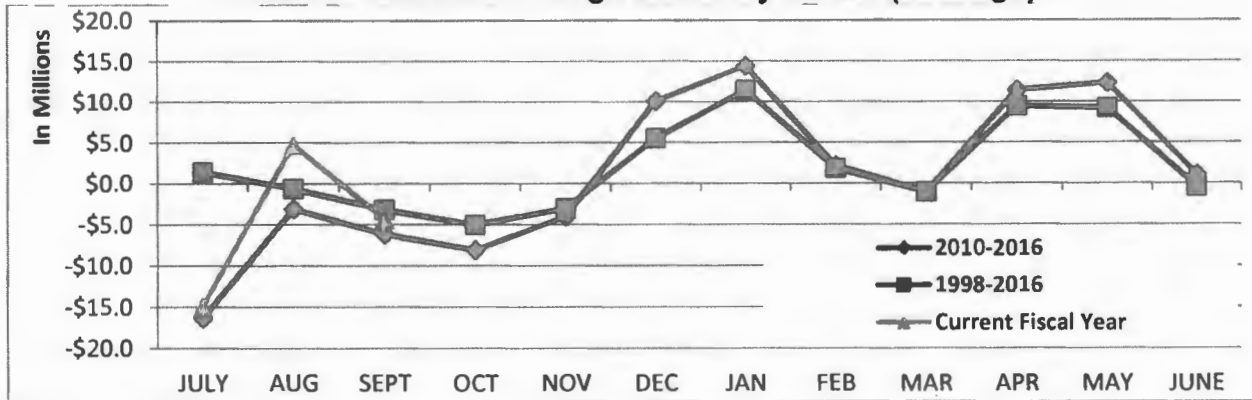


Chart 4 and Chart 5 show the volatility and cyclical nature of the Irvine Pooled Investment Portfolio fund balance and cash flows between September 1998 and September 2016.

Irvine Pooled Investment Portfolio
Chart 4 - Portfolio Balance
September 30, 1998 through September 30, 2016

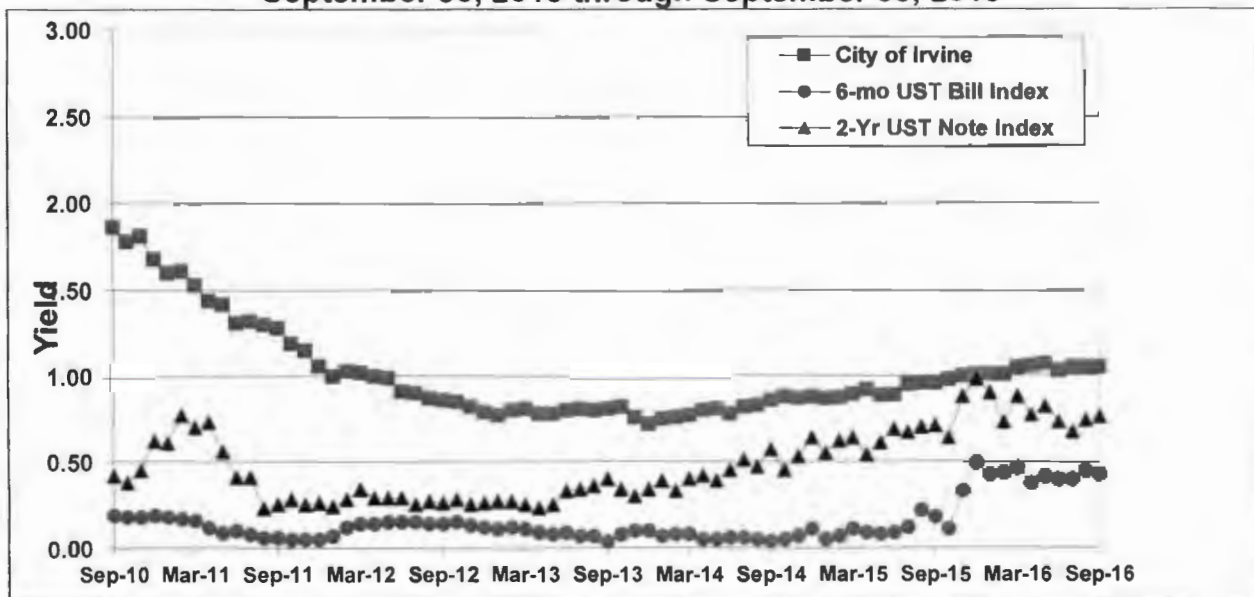


Irvine Pooled Investment Portfolio
Chart 5 – Balance Change Month by Month (Average)



To gauge performance, the City compares the Irvine Pooled Investment Portfolio's yield to maturity against two 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 Irvine Pooled Investment Portfolio against market movement. Chart 6 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 six years. The Portfolio's yield is higher than the 6-month UST by 0.63 percent and higher than the 2-year UST by 0.30 percent.

Irvine Pooled Investment Portfolio
Chart 6 - Yield to Maturity Compared to Assigned Benchmarks
September 30, 2010 through September 30, 2016



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 special districts 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 Irvine Pooled Investment Fund Portfolio due to the different cash needs between the two. The Bond Proceeds Fund Portfolio requires greater liquidity to meet debt service payments. The decrease in the portfolio balance from the prior fiscal year reflects a change in policy requiring the funds from special assessments received from the County of Orange to be transferred to the Trustee/Fiscal Agent accounts as soon as they are received. Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the Bond Proceeds Fund Portfolio as of September 30, 2016 was \$5,783.

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

	Sept 30, 2016	June 30, 2016	March 31, 2016	Dec 31, 2015
Book Value	\$760,436	\$755,436	\$4,986,436	\$12,852,436
Market Value	\$760,669	\$755,905	\$4,987,538	\$12,841,987
Unrealized Gain/(Loss)	\$233	\$469	\$1,102	(\$10,449)
Unrealized Gain/(Loss) as % of Book Value	0.03%	0.06%	0.02%	(0.08%)
Average Yield To Maturity	0.63%	0.58%	0.51%	0.40%
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	\$5,783	\$51,224	\$41,277	\$33,966

Special District Funds Portfolio

The Special District Funds Portfolio contains project and reserve funds for 26 assessment district bond issues and four community facilities district 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 September 30, 2016 was \$292,016.

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

	Sept 30, 2016	June 30, 2016	March 31, 2016	Dec 31, 2015
Book Value	\$371,479,758	\$285,890,825	\$290,492,013	\$335,498,764
Market Value	\$371,288,348	\$285,818,109	\$290,412,175	\$335,376,664
Unrealized Gain/(Loss)	(\$191,410)	(\$72,716)	(\$79,838)	(\$122,100)
Unrealized Gain/(Loss) as % of Book Value	(0.05%)	(0.03%)	(0.03%)	(0.04%)
Average Yield To Maturity	0.30%	0.37%	0.24%	0.15%
Average Days To Maturity	41	80	71	75
Fiscal Year to Date Income	\$292,016	\$695,259	\$463,659	\$188,223

Market Conditions

During the first quarter of FY 2016-17, interest rates increased with the yield curve flattening. The 6-month Treasury bill increased 8.10 basis points ending the period at 0.43 percent. Two-year Treasury notes increased 18.00 basis points to 0.76 percent, and the five-year Treasury note increased 15.00 basis points to 1.14 percent.

Financial markets continued to focus on economic data releases and their implications towards Federal Reserve Fund policy. The unemployment rate remained unchanged at 4.90 percent during the quarter as the under-employment rate increased slightly to 9.70 percent from 9.60 percent. Labor force participation increased to 62.80 percent from 62.70 percent and remains at levels not seen since 1978. The Federal Reserve Labor Market Conditions Index (LMCI) uses a weighted average of 19 monthly labor market indicators to gauge improvements in the labor market. The LMCI at -0.70, which has been a favored statistic of Federal Reserve chair Janet Yellen, has continued to show a declining trend since its January 2012 high of 12.00. The year over year comparison of average hourly earnings was reported at 2.40 percent by the Bureau of Labor Statistics. While steadily rising since the end of the financial crisis, average hourly earnings remain at the high end of the relatively narrow post-crisis range of 1.60 percent to 2.70 percent. The Federal Reserve is focused on full employment, price stability, and geo-economic stability. Federal Funds rate hike probabilities for December have risen from 9.20 percent as of June 30, 2016 to 59.3 percent as of September 30, 2016.

The economy advanced at a moderate pace in the third quarter, with a mild pickup in momentum coming predominantly from the household sector (especially retail, autos, food, and personal products), financial, housing, telecommunications and utilities. Frailty continues to linger in the restaurant, energy, manufacturing and export groups, while

transports have identified some mixed challenges, particularly in rails. "Election uncertainty" continued to delay business capital spending plans.

In conclusion, aging demographics, ballooning global debt, negative sovereign interest rates, and the presidential election will affect interest rates for the next fiscal quarter. While it is anticipated that the Federal Reserve will raise short term interest rates in December, future interest rate increases are expected to be gradual and data dependent.

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, and Special Districts portfolios totaled \$1.64 million with investments structured for security and liquidity.

REPORT PREPARED BY Don Collins, City Treasurer