



REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: DECEMBER 9, 2014

TITLE: TREASURER'S REPORT FOR THE QUARTER ENDED
SEPTEMBER 30, 2014

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, 2014. 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 \$651.33 million as of September 30, 2014.

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

The Finance Commission, at its regular meeting of November 17, 2014, recommended the City Council receive and file the Treasurer's Report by a unanimous vote. The Investment Advisory Committee, at its regular meeting of November 5, 2014, recommended the City Council receive and file the Treasurer's Report by a unanimous vote of 3-0 (Committee Members Judd and Walther 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 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 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 the 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.

Irvine 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, 2014, the book value (purchase price of securities as recorded on the City's books) of the Irvine Pooled Investment Portfolio was \$384.28 million and the average weighted yield to maturity was 0.86 percent. Fiscal year-to-date investment income (interest payments and capital gains) generated by the Irvine Pooled Investment Portfolio as of September 30, 2014 was \$791.70 thousand. 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, 2014	June 30, 2014	March 31, 2014	Dec 31, 2013
Book Value	\$384,276,980	\$414,760,236	\$382,978,062	\$353,424,287
Market Value	\$383,467,567	\$414,767,525	\$381,555,730	\$351,926,503
Unrealized Gain/(Loss)	\$(809,413)	\$7,289	\$(1,422,332)	\$(1,497,784)
Unrealized Gain/(Loss) as % of Book Value	(0.21%)	0.00%	(0.37%)	(0.42%)
Average Yield To Maturity	0.86%	0.78%	0.77%	0.72%
Liquidity 0 – 6 months	11.87%	20.25%	17.33%	16.47%
Average Years To Maturity	2.34 Years	2.20 Years	2.40 Years	2.27 Years
Effective Duration	2.29 Years	2.12 Years	2.28 Years	2.21 Years

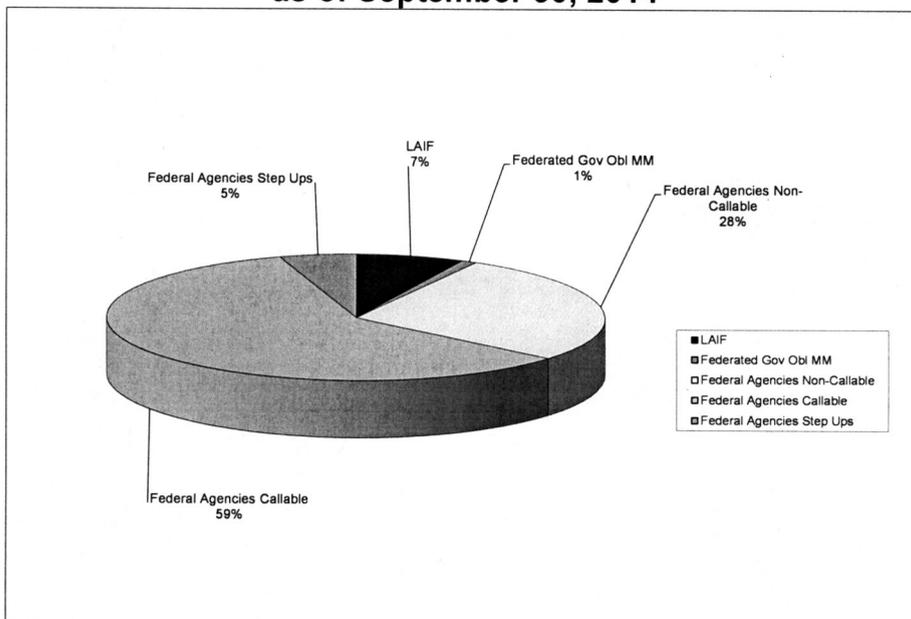
The Irvine Pooled Investment Portfolio's book value decreased by \$30.48 million from the last quarter. A portion of the decline was attributable to a July \$19.04 million prepayment

of the Fiscal Year 2014-15 CalPERS retirement contribution. The remaining \$11.44 million book value decline was due to the cyclical nature of the City's revenue stream that often fluctuates \$5 to \$10 million each quarter. Portfolio yield to maturity increased by 8 basis points (0.08 percent) as lower-yielding money market assets were utilized to meet current obligations and higher-yielding securities were purchased in the 3 to 4 year maturity sectors. Unrealized losses continue to fluctuate with the overall market. The increase in the unrealized losses is the result of raising interest rates. When interest rates rise, market values in a fixed income portfolio decline. As long as the securities are held to maturity, the City will not incur any actual losses.

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 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 by the Federal Government and carry an explicit guarantee 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.

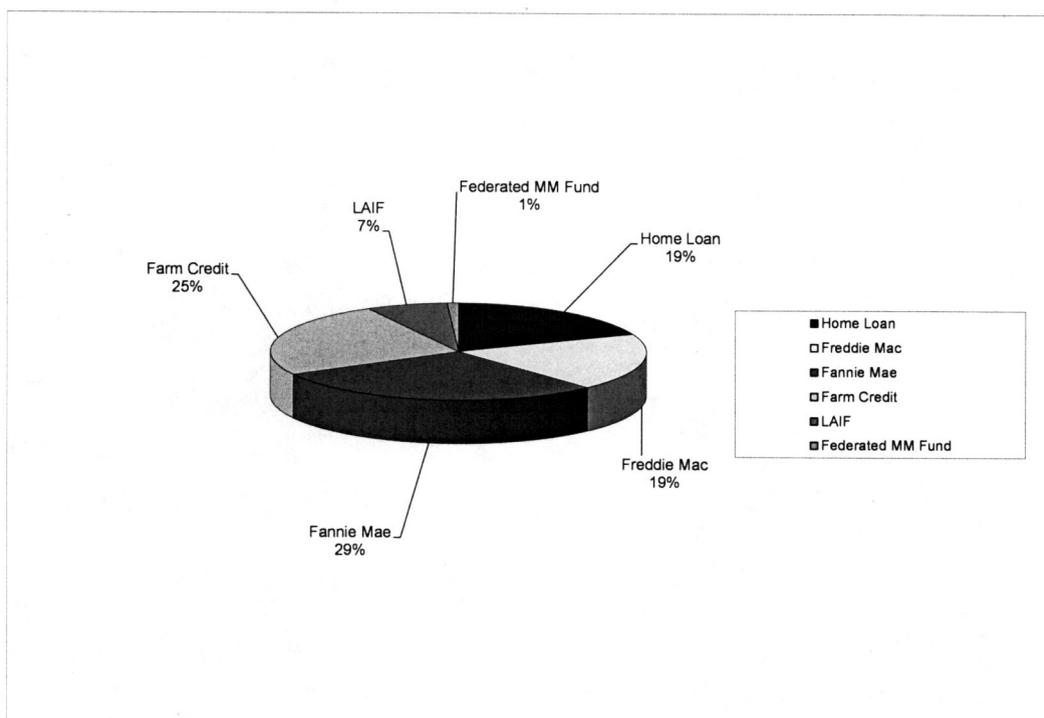
To manage liquidity, the Irvine Pooled Investment Portfolio is invested in LAIF (Local Agency Investment Funds) and the Federated Government Obligation money market fund. Chart 1 shows the asset allocation of the Irvine Pooled Investment Portfolio.

Irvine Pooled Investment Portfolio
Chart 1 - Asset Allocation
as of September 30, 2014



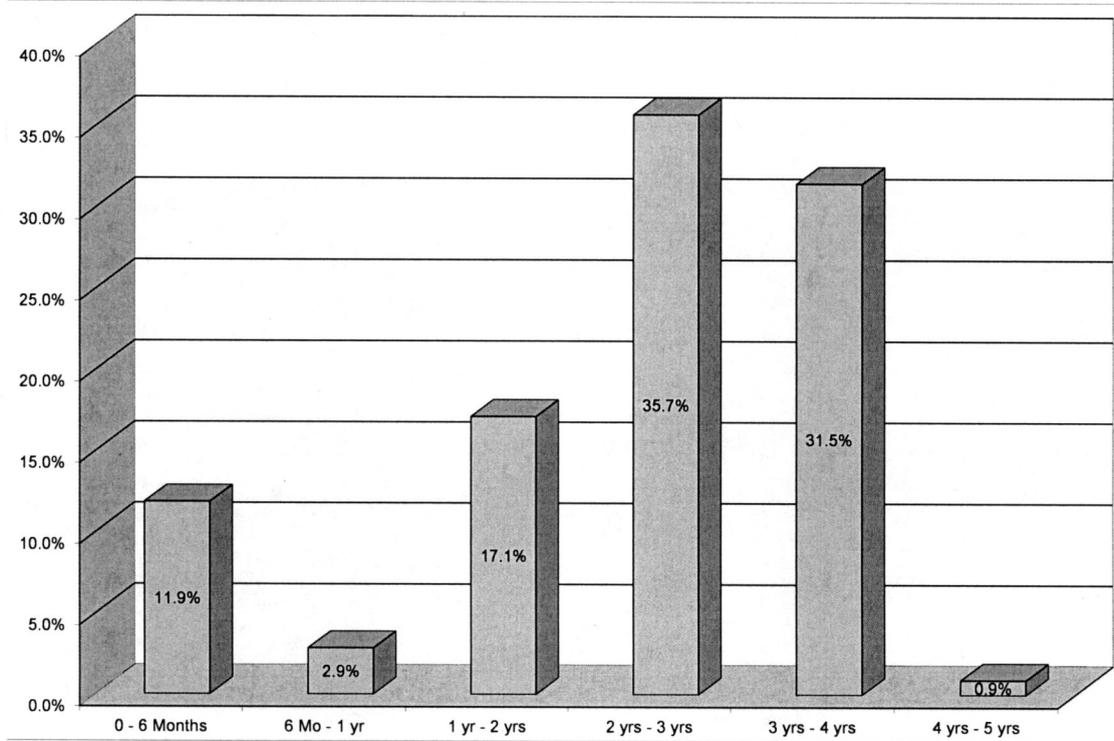
Since 92 percent of the portfolio is invested in Federal Agency securities, the safety of the Irvine Pooled Investment Portfolio is further protected by purchasing securities from several different Federal Agencies. The four Federal Government sponsored entities that the City purchases securities from are Fannie Mae, 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, 2014**



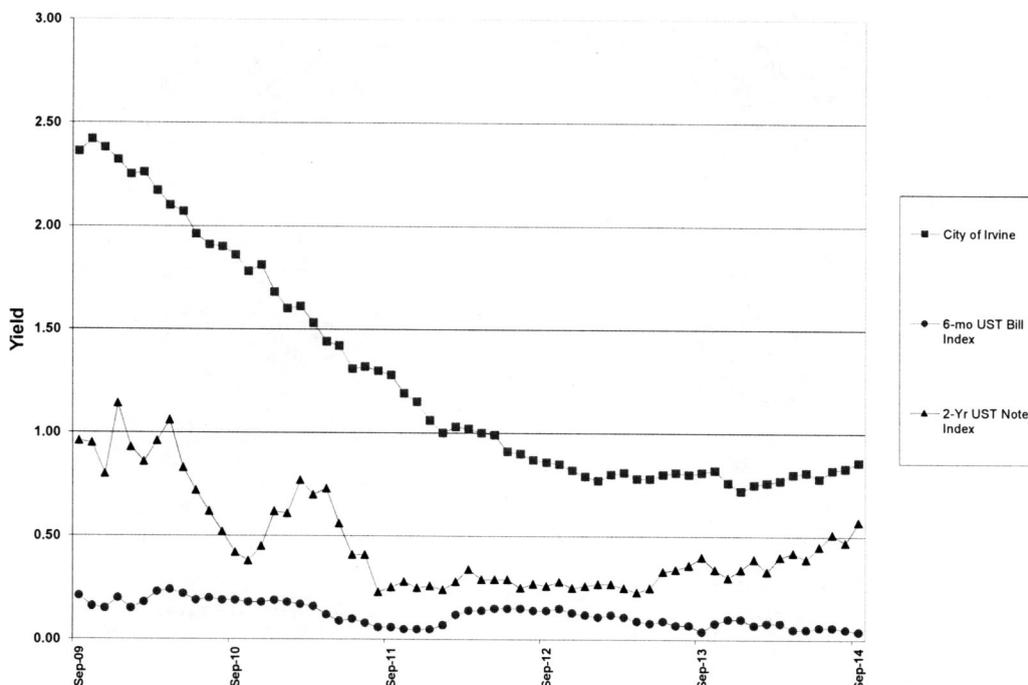
Another key component in portfolio management is to ensure that the City has enough funds on hand to meet current expenses. By using cash flow forecasts, the portfolio manager is able to project short and long-term cash needs to help make informed and appropriate investment decisions. As of September 30, 2014, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 11.87 percent, which provides adequate liquidity to meet anticipated expenses. 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
as of September 30, 2014**



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. 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 by 0.82 percent and higher than the 2-year UST by 0.29 percent.

Irvine Pooled Investment Portfolio
Graph 1 - Yield to Maturity Compared to Assigned Benchmarks
September 2009 through September 2014



The Irvine Pooled Investment Portfolio invests funds attributable to the 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 Funds

Interest earnings for the AMP funds are allocated based on the AMP fund average daily cash balance. The AMP earned interest of \$46,325 for the quarter ended September 30, 2014 based on an average cash balance of \$51.53 million.

Orange County Great Park Funds

The Great Park funds earned interest of \$30,532 for the quarter ended September 30, 2014. The Great Park funds had a combined average daily cash balance of \$34.09 million for the quarter ended September 30, 2014.

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, 2014.

Special District Funds Portfolio

The Special District Funds Portfolio contains project and reserve funds for 29 Special Assessment District bond issues and two Community Facilities Districts. 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, 2014.

Market Conditions

During the first quarter of FY 2014-15, the yield curve flattened in the long end, with the 30-year bond interest rate lower by 20 basis points (0.20 percent), and the belly of the curve (2, 3 and 5-year sectors) increased by as much as 15 basis points (0.15 percent). The domestic economy, labor market and inflation are key areas the Federal Open Market Committee (FOMC) is monitoring to provide guidance as to when to begin raising the federal funds rate. Since these two areas of the economy are moving closer to the FOMC's objectives of full employment and price stability, market analysts are predicting an increase in rates by the FOMC by the second calendar quarter of 2015. The upward pressure in interest rates has been tempered, however, by geopolitical tensions in the Ukraine and Iraq and by a sluggish European economy.

The FOMC met twice during the quarter and decided to continue the planned decrease in monthly asset purchases by \$10 billion at each of the meetings, bringing the monthly purchase levels to \$10 billion in Treasuries and \$5 billion in mortgage-backed securities. At the September meeting, the FOMC announced plans to end the asset purchase

program in October, concluding this part of its quantitative easing strategy which had been used to support economic growth.

ALTERNATIVES CONSIDERED

None.

FINANCIAL IMPACT

Fiscal year-to-date investment income for the Irvine Pooled Investment Portfolio, Bond Proceeds, and Special Districts portfolios totaled \$833.19 thousand with investments structured for security and liquidity.

REPORT PREPARED BY Michele C. Lund, City Treasurer