



REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: NOVEMBER 27, 2012

TITLE: TREASURER'S REPORT FOR THE QUARTER ENDED
SEPTEMBER 30, 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 of Irvine's (City's) three investment portfolios for the quarter ended September 30, 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 \$534.4 million as of September 30, 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 a regular meeting of the Finance Commission on November 19, 2012, the Finance Commissioners recommended the City Council receive and file the Treasurer's Report for the Quarter Ended September 30, 2012 by a vote of 3-0 (Commissioners Bollard and Chai absent). At a regular meeting of the Investment Advisory Committee (IAC) on November 14, 2012, the Committee Members recommended the City Council receive and file the Treasurer's Report by a vote of 4-0 (Committee Member Chung absent). Additionally, the IAC asked that the Treasurer, UACC, and the staff be acknowledged for their outstanding service in managing the City's funds.

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 safekeeper 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, 2012, the book value (purchase price of securities as recorded on the City's books) of the Irvine Pooled Investment Portfolio was \$352.1 million and the average weighted yield to maturity was 0.87 percent. Investment income (interest payments and capital gains) generated by the Irvine Pooled Investment Portfolio for the quarter ended September 30, 2012 was \$782 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, 2012	June 30, 2012	Mar 31, 2012	Dec 31, 2011
Book Value	\$352,053,216	\$369,761,787	\$360,681,836	\$362,257,751
Market Value	\$353,941,345	\$371,336,805	\$362,118,825	\$363,928,644
Unrealized Gain/(Loss)	\$1,888,129	\$1,575,018	\$1,436,989	1,670,903
Unrealized Gain/(Loss) as % of Book Value	0.54%	0.43%	0.40%	0.46%
Average Yield To Maturity	0.86%	0.91%	1.01%	1.06%
Liquidity 0 – 6 months	13.93%	12.91%	18.64%	19.73%
Average Years To Maturity	2.56 years	2.65 years	2.45 years	2.34 years
Effective Duration	2.39 years	2.54 years	2.38 years	2.29 years

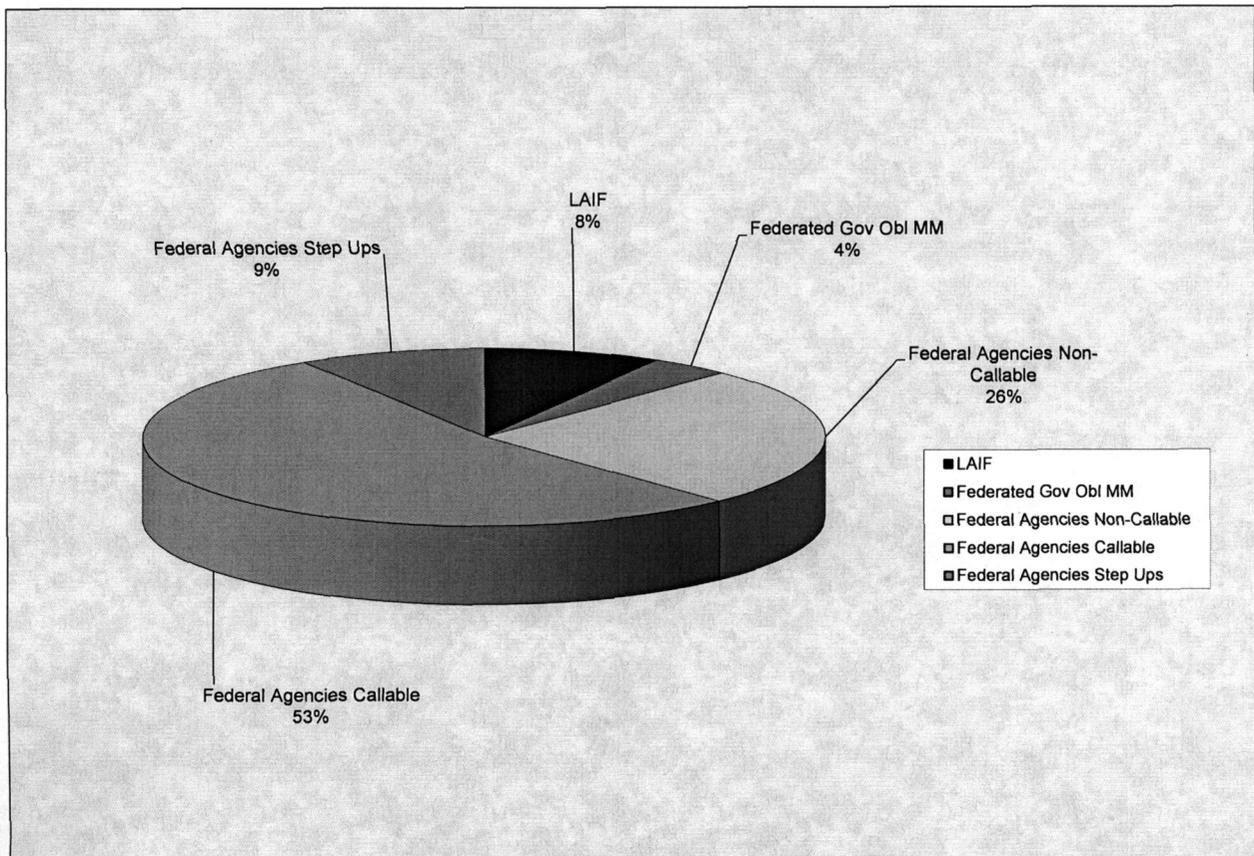
Portfolio average yield to maturity declined 5 basis points (0.05 percent) as compared to the prior quarter that ended on June 30, 2012. The portfolio strategy to invest in longer term maturities to capture incremental yield has helped minimize the decline in average yield to maturity as the interest rate environment remains at historically low levels. The overnight to 6-months of liquidity level of 13.93 percent will meet anticipated cash needs

and provide the ability to investment 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.

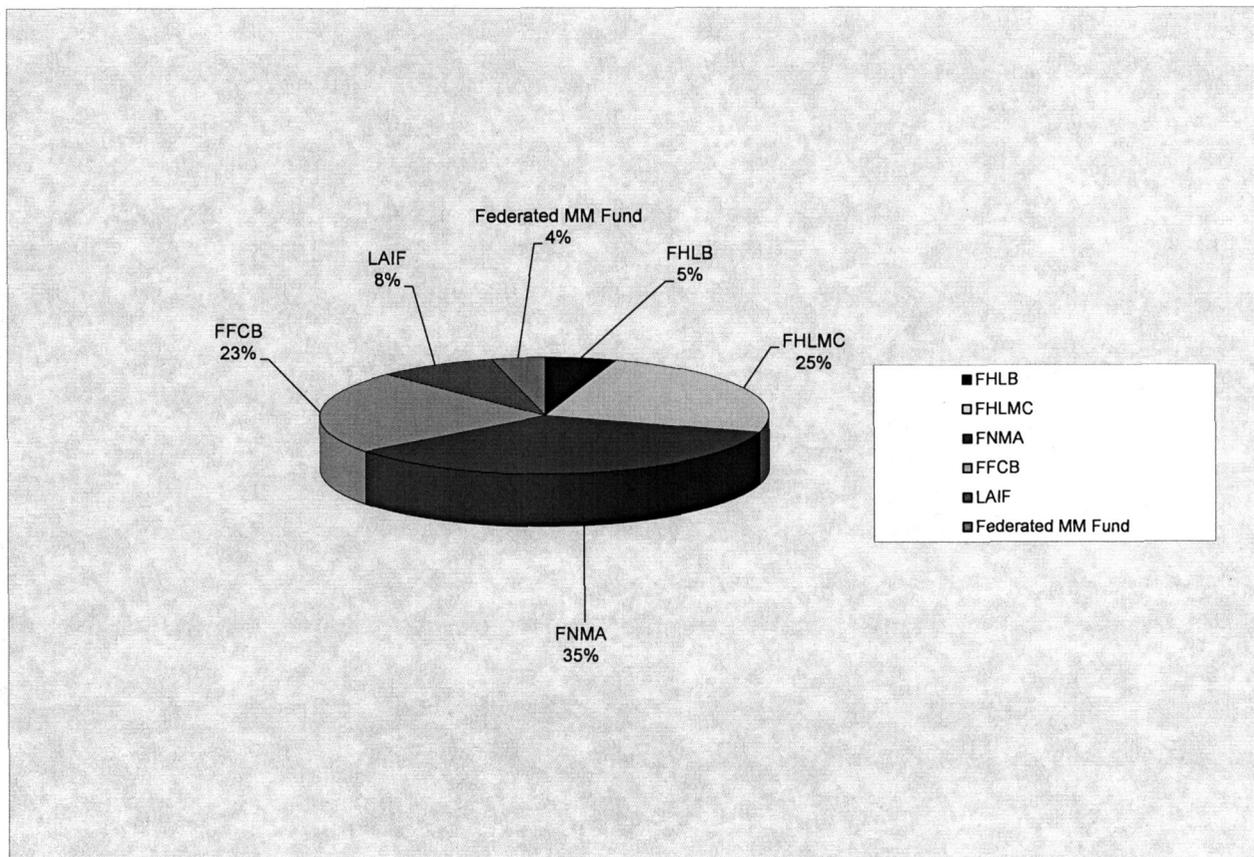
To manage liquidity, the Portfolio is invested in the State of California's Local Agency Investment Fund (LAIF), and the Federated Government Obligation money market fund. Chart 1 below shows the asset allocation of the Irvine Pooled Investment Portfolio.

**Irvine Pooled Investment Portfolio
Chart 1 - Asset Allocation
as of September 30, 2012**



Since 87.48 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.

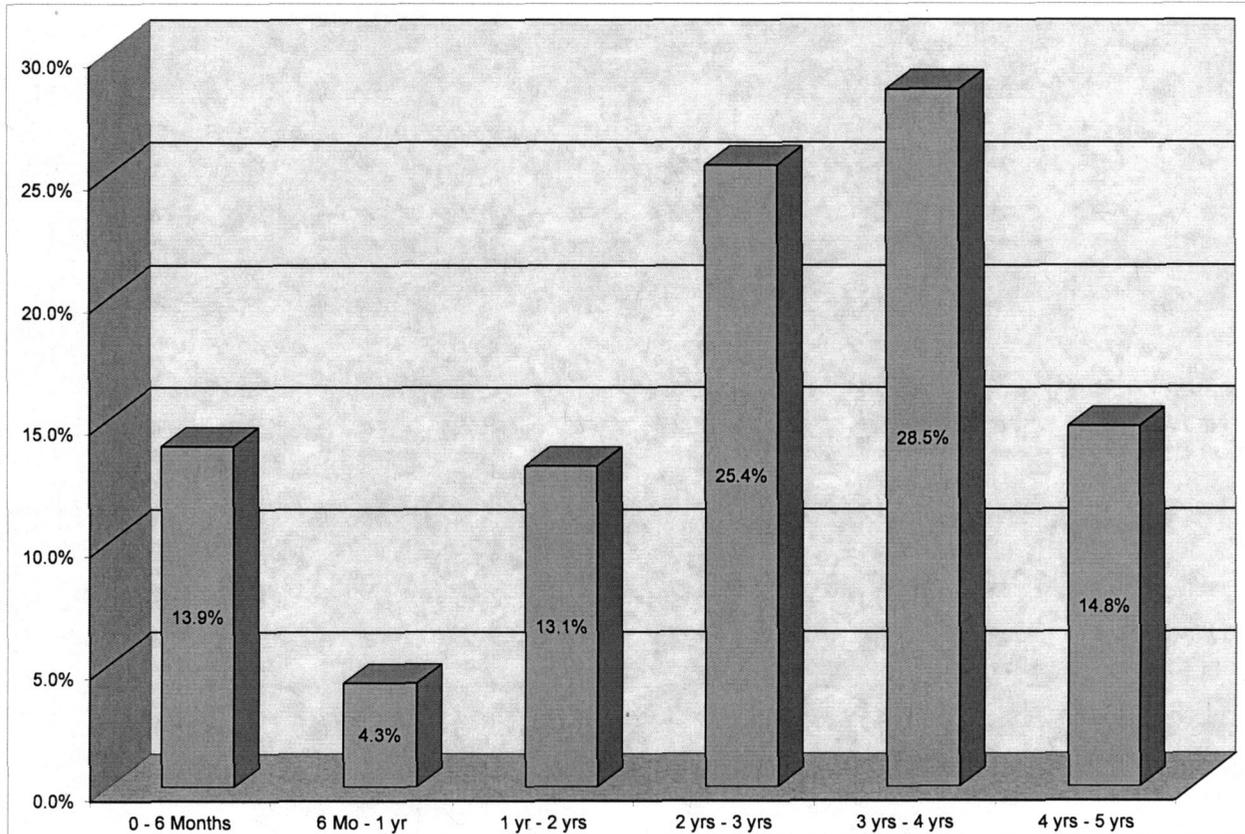
**Irvine Pooled Investment Portfolio
Chart 2 - Allocation by Issuer Name
as of September 30, 2012**



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 September 30, 2012, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 13.93 percent, which

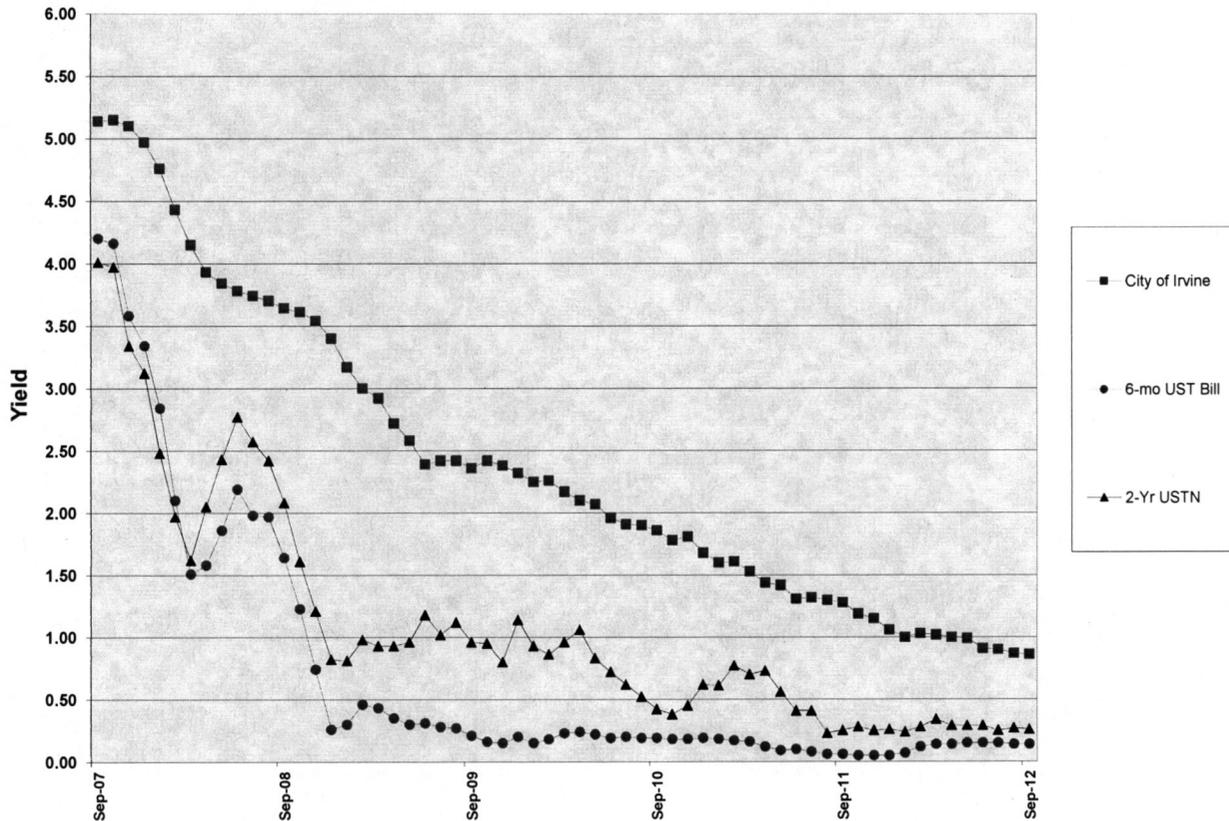
provides adequate liquidity to meet anticipated expenses. Chart 3 below is an aging of investment maturities up to 5 years (the maximum maturity allowable by policy and state code) of the Irvine Pooled Investment Portfolio.

**Irvine Pooled Investment Portfolio
Chart 3 - Aging of Maturing Investments
as of September 30, 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 by 0.72 percent and higher than the 2-year UST by 0.60 percent.

Irvine Pooled Investment Portfolio
Graph 1 - Yield to Maturity Compared to Assigned Benchmarks
September 2007 through September 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 \$35,959 for the quarter ended September 30, 2012 based on an average cash balance of \$61.3 million. Two loans, made by AMP in 2005 and 2006 to the Irvine Redevelopment Agency (Agency) have an outstanding balance of approximately \$9.9 million, including \$3.3 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 \$31,050 for the quarter ended September 30, 2012. The Great Park funds had a combined average daily cash balance of \$55.7 million for the quarter ended September 30, 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 September 30, 2012.

- Book Value \$4,925,220
- Market Value \$4,931,684
- Unrealized Gains/(Losses) \$6,464
- Average Weighted Yield to Maturity 0.35%
- Fiscal Year to Date Investment Income \$19,711

Special District Funds Portfolio

The Special District Funds Portfolio contains project and reserve funds for 46 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, 2012.

- Book Value \$175,167,785
- Market Value \$175,215,040
- Unrealized Gains/(Losses) \$47,255
- Average Weighted Yield to Maturity 0.05%
- Fiscal Year to Date Investment Income \$13,249

Market Conditions

Bond prices ended in the first quarter of the fiscal year slightly higher across the yield curve comparative to the final quarter of fiscal year ended 2012. Focus on the U.S. economy and Federal Reserve monetary policy contributed to market volatility mid-quarter. Economic data released supported sluggish economic growth, which in turn sparked market expectations of the Fed providing economic stimulus in the form a third round of quantitative easing (QEIII). The Fed did announce QEIII, but not at the August Federal Open Market Committee (FOMC) as expected, causing decline in bond prices. Bond prices increased to relatively the same levels as seen in July following the September FOMC meeting, when QEIII was finally announced.

At both of the FOMC meetings held during the quarter, the Fed kept the federal fund rate at 0 percent to .25 percent. As previously stated, the FOMC announced additional stimulus measures by the Fed at the September FOMC meeting. The Fed initiated a plan to purchase \$40 billion in agency mortgage-backed securities each month to put downward pressure on long-term bond interest rates. Additionally, the Fed stated that it plans to maintain exceptionally low levels for the federal fund rate, which are likely to be warranted at least through mid-2015.

ALTERNATIVES CONSIDERED

None.

FINANCIAL IMPACT

Fiscal year-to-date investment income for the Irvine Pooled Investment Portfolio, Bond Proceeds, and Special Districts portfolios totaled \$815 thousand with investments structured for security and liquidity.

REPORT PREPARED BY Michele C. Lund, City Treasurer