



REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: June 13, 2017

TITLE: TREASURER'S REPORT FOR THE QUARTER ENDED
MARCH 31, 2017

Director of Financial Services

City Manager

RECOMMENDED ACTION

Receive and file the Treasurer's Report for the quarter ended March 31, 2017.

EXECUTIVE SUMMARY

This report provides a synopsis of investment activity for the City's three investment portfolios for the quarter ended March 31, 2017. 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 \$949.39 million as of March 31, 2017.

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 22, 2017, the Finance Commission reviewed the Treasurer's Report and voted 4-0 (Commissioner Reyno absent), 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 10, 2017; however, the meeting was cancelled 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, 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 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 several operational funds, including the City's Asset Management Plan and funds earmarked for the development of the Orange County Great Park.

As of March 31, 2017, the book value (purchase price of securities as recorded on the City's books) of the portfolio was \$599.03 million and the average weighted yield to maturity was 1.18 percent. Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the portfolio as of March 31, 2017 was \$4.14 million. The following chart compares the portfolio's statistics over a rolling 12-month period.

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

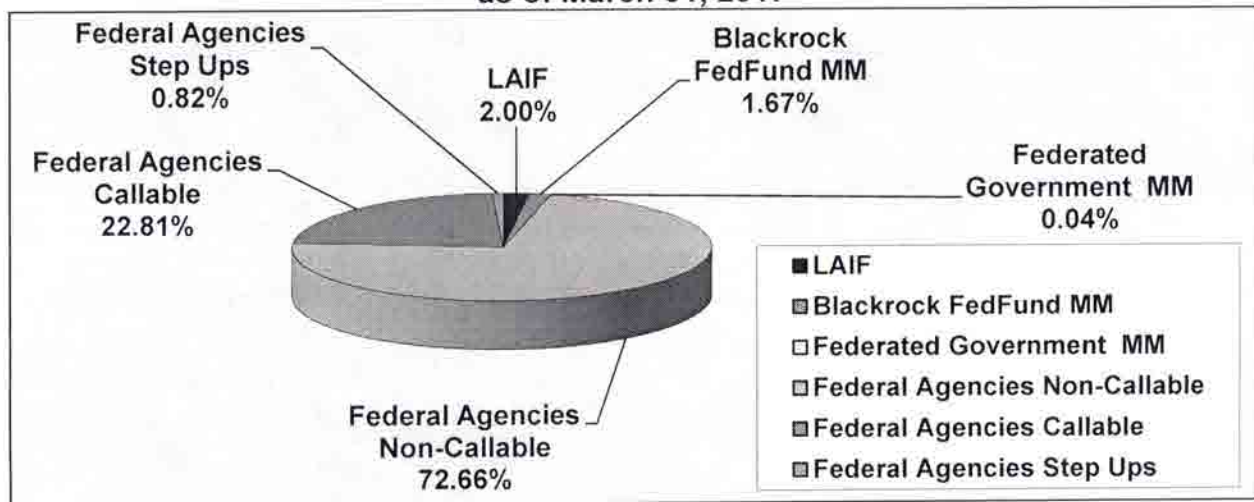
	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Book Value	\$599,028,736	\$574,580,674	\$557,660,462	\$572,157,628
Market Value	\$596,334,045	\$571,366,011	\$559,208,937	\$574,913,200
Unrealized Gain/(Loss)	(\$2,694,691)	(\$3,214,663)	\$1,548,475	\$2,755,572
Unrealized Gain/(Loss) as % of Book Value	(0.45%)	(0.56%)	0.28%	0.48%
Average Yield To Maturity	1.18%	1.12%	1.06%	1.03%
Liquidity 0 –6 months	13.19%	13.56%	9.85%	13.19%
Average Years To Maturity	1.98	2.03	2.02	1.91
Modified Duration (Years)	1.91	1.97	1.98	1.84
Fiscal Year to Date Income	\$4,137,190	\$2,720,039	\$1,340,988	\$4,613,047

The Irvine Pooled Investment Portfolio's book value increased by \$24.45 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 March 31, 2017 by 6 basis points to 1.18 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 March 31, 2017, the portfolio ended the quarter with an unrealized loss of \$2.69 million as compared to an unrealized loss of \$3.21 million on December 31, 2016. This is a normal result of the portfolio's modified duration of 1.91 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.

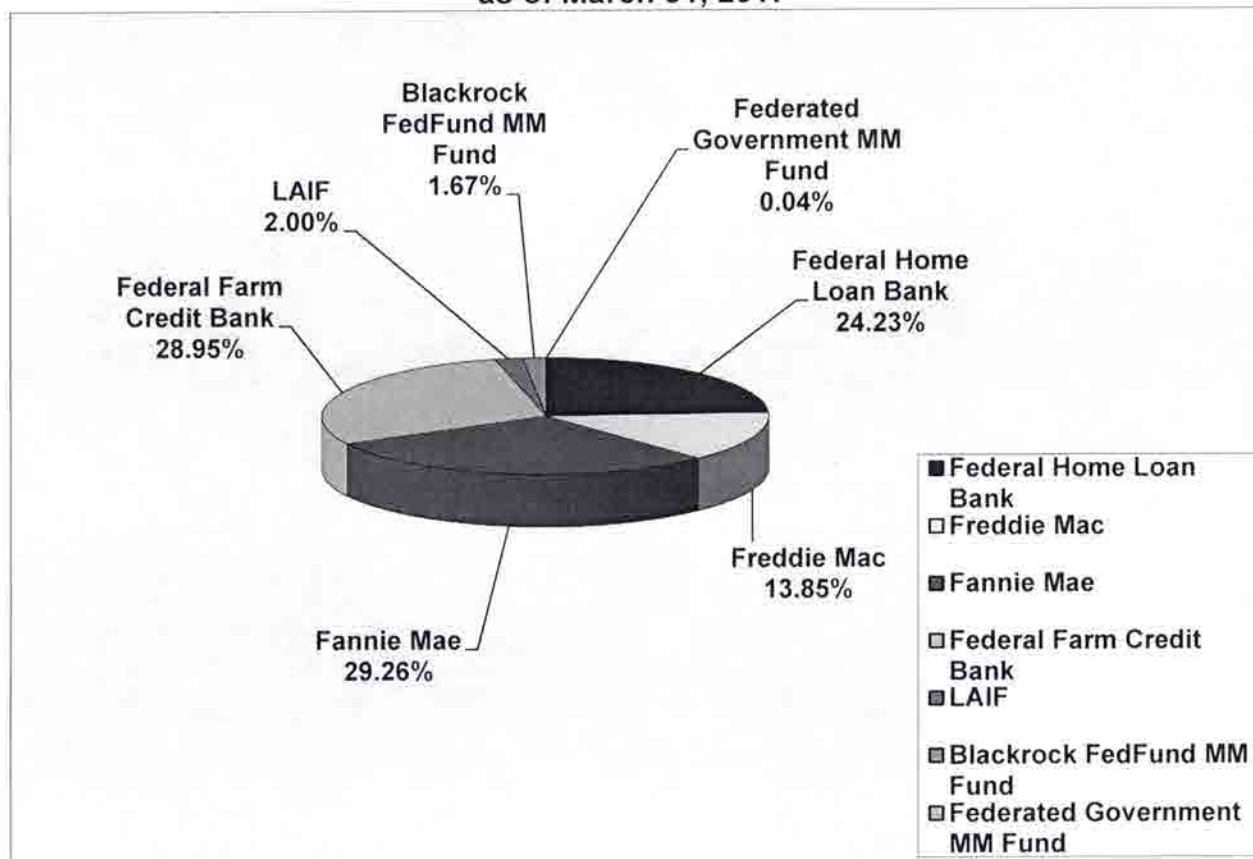
To manage liquidity, the Irvine Pooled Investment Portfolio is invested in Local Agency Investment Funds (LAIF), Federated Government Obligation money market fund, and the Blackrock FedFund money market fund. Chart 1 shows the asset allocation of the portfolio.

**Irvine Pooled Investment Portfolio
 Chart 1 - Asset Allocation
 as of March 31, 2017**



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 March 31, 2017**



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, 2017, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 13.19 percent versus 13.56 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, 2017

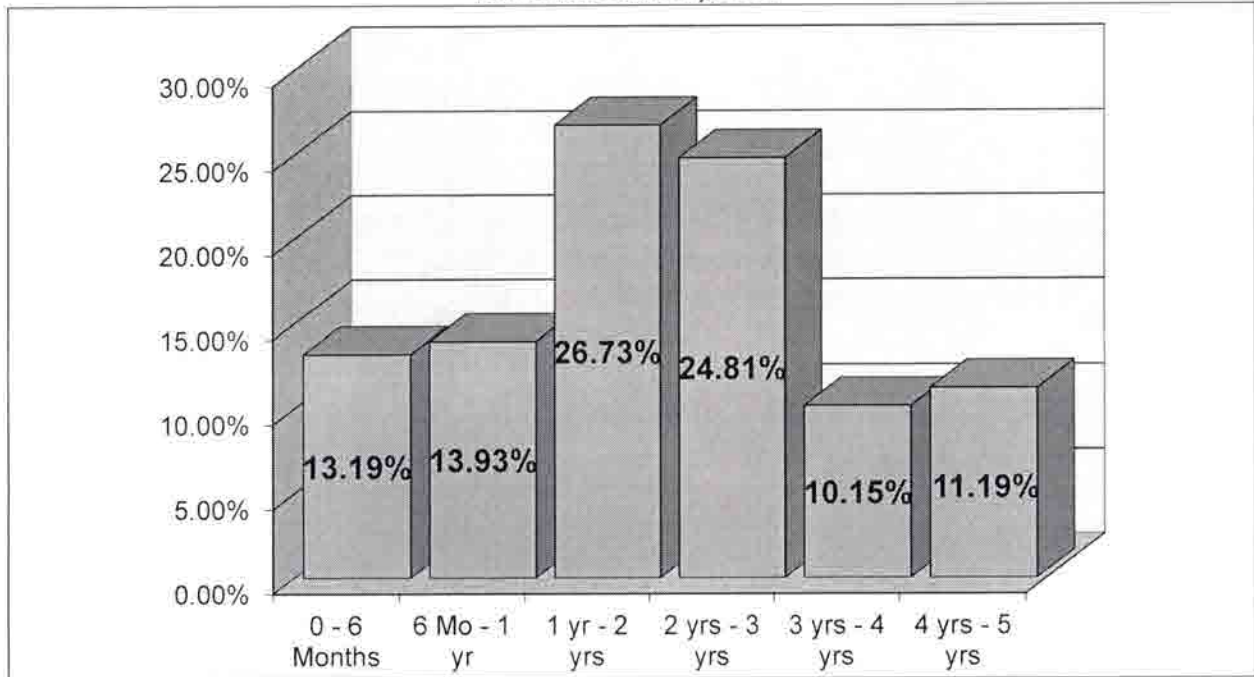
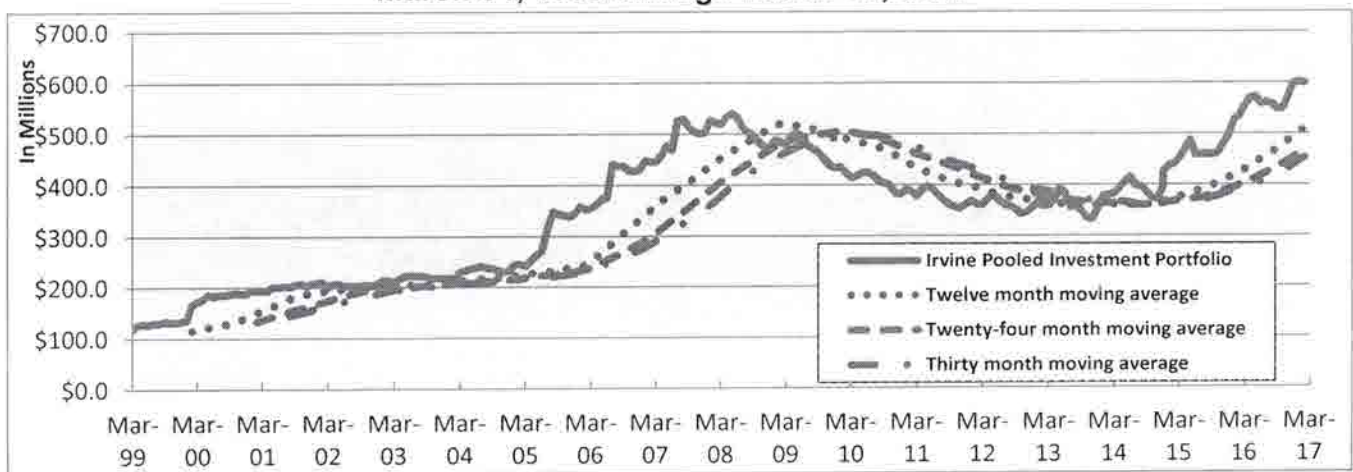
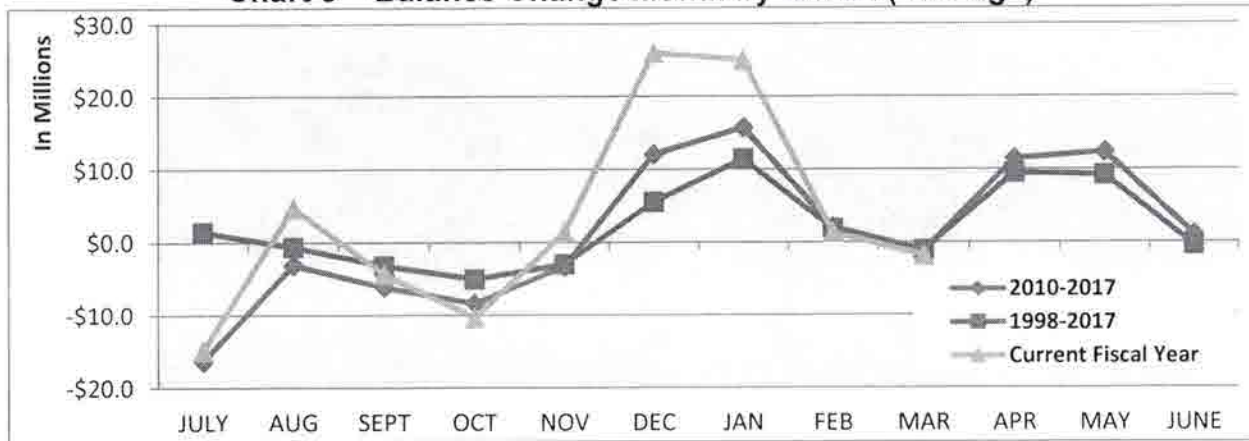


Chart 4 and Chart 5 show the volatility and cyclicalty of the Irvine Pooled Investment Portfolio fund balance and cash flows between March 31, 1999 and March 31, 2017.

Irvine Pooled Investment Portfolio
Chart 4 - Portfolio Balance
March 31, 1999 through March 31, 2017

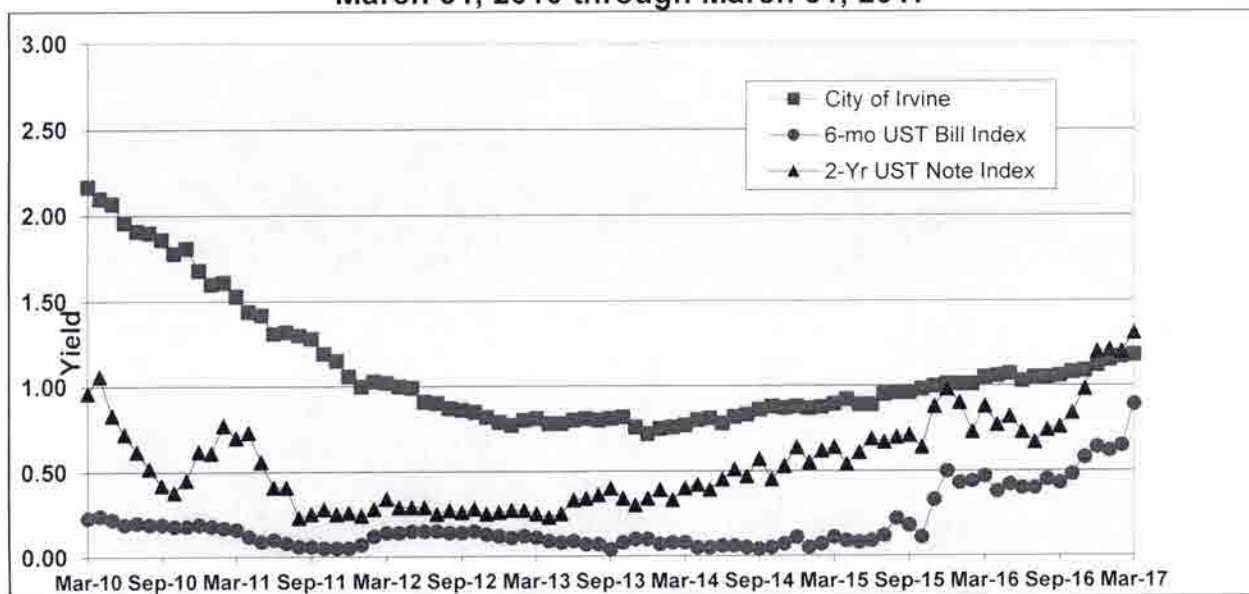


Irvine Pooled Investment Portfolio
Chart 5 – Balance Change Month by Month (Average)



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 portfolio against market movement. Chart 6 compares the average yield to maturity of the portfolio to these benchmarks, and shows the spread (difference between the index and the yield to maturity) for the past seven years. The portfolio's yield is higher than the 6-month UST by 0.29 percent and lower than the 2-year UST by 0.13 percent.

Irvine Pooled Investment Portfolio
Chart 6 - Yield to Maturity Compared to Assigned Benchmarks
March 31, 2010 through March 31, 2017



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 districts administration. 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-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 Facility 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. The transfer of this amount for the quarter ended December 31, 2016 from the Bond Proceeds Fund Portfolio occurred in January 2017.
- (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, 2017 was \$19,449.

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

	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Book Value	\$4,609,437	\$7,608,436	\$760,436	\$755,436
Market Value	\$4,605,639	\$7,604,053	\$760,669	\$755,905
Unrealized Gain/(Loss)	(\$3,798)	(\$4,384)	\$233	\$469
Unrealized Gain/(Loss) as % of Book Value	(0.08%)	(0.06%)	0.03%	0.06%
Average Yield To Maturity	0.82%	0.72%	0.63%	0.58%
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	\$19,449	\$6,984	\$5,783	\$51,224

Special District Funds Portfolio

The Special District Funds Portfolio contains project and reserve funds for 27 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 remain very liquid to provide project funds, when needed, as well as to 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, 2017 was \$1,423,682.

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

	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Book Value	\$348,802,144	\$387,387,309	\$371,479,758	\$285,890,825
Market Value	\$348,451,879	\$387,100,007	\$371,288,348	\$285,818,109
Unrealized Gain/(Loss)	(\$350,265)	(\$287,302)	(\$191,410)	(\$72,716)
Unrealized Gain/(Loss) as % of Book Value	(0.10%)	(0.07%)	(0.05%)	(0.03%)
Average Yield To Maturity	0.70%	0.32%	0.30%	0.37%
Average Days To Maturity	49	41	41	80
Fiscal Year to Date Income	\$1,423,682	\$694,044	\$292,016	\$695,259

Market Conditions

During the third quarter of FY 2016-17, interest rates increased in the short end of the yield curve with longer rates decreasing. The six-month Treasury bill increased 28.61 basis points ending the period at .89 percent. Two-year Treasury notes increased 6.60 basis points to 1.25 percent, and the five-year Treasury note decreased .60 basis points to 1.92 percent.

Financial markets began the quarter focusing on the incoming presidential administration and the potential U.S. policy changes to healthcare, taxation, foreign policy, and financial regulation. Consumer Confidence Index continued to rise, ending the quarter at 125.60 from 113.70 at the end of the prior quarter.

On March 15, 2017, the Federal Open Market Committee (FOMC) raised the target range for the Federal Funds rate from .75 percent to 1.00 percent due to realized and expected labor market conditions and inflation. Monetary policy remains accommodative, thereby supporting further strengthening in labor market conditions and a sustained return to 2.00 percent inflation. The FOMC stated that economic conditions will evolve in a manner that will warrant gradual increases in the Federal Funds rate, and that the Federal Funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run. The actual path of the Federal Funds rate will continue to depend on the economic outlook and incoming data. Existing policy of reinvesting proceeds from the Federal

Reserve's holdings will continue until the normalization of the Federal Funds rate is well under way. Consistent with its statutory mandate, the FOMC seeks to foster maximum employment and price stability. FOMC members, while still data dependent, have stated that they anticipate two additional rate increases in calendar year 2017.

Nationally, the Labor Force Participation Rate improved to 63.00 percent from last quarter's low of 62.60 percent. The unemployment rate remained at 4.70 percent and the underemployment rate decreased to 9.20 percent from 9.30 percent. Average hourly earnings increased by 2.80 percent from last quarter's 2.70 percent. In Orange County, the unemployment rate was 3.7 percent while Irvine closed the quarter at 2.7 percent.

In conclusion, the quarter began with a reflation trade supported by improving sentiment, and robust expectations for immediate pro-growth policy from the new administration. During the quarter, the divergence of sentiment indicators and actual economic data, along with renewed geopolitical tensions, has clouded market optimism. Aging demographics, as well as high debt to GDP ratios, will continue to hinder economic expansion.

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 \$5.58 million with investments structured for security and liquidity.

REPORT PREPARED BY Don Collins, City Treasurer