



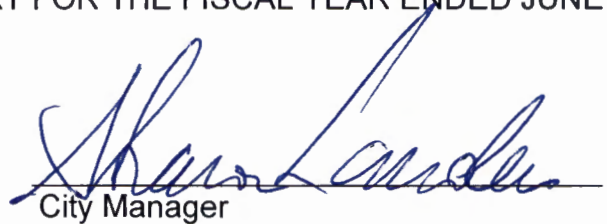
REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: SEPTEMBER 13, 2016

TITLE: TREASURER'S REPORT FOR THE FISCAL YEAR ENDED JUNE 30, 2016



Director of Administrative Services



City Manager

RECOMMENDED ACTION

Receive and file the Treasurer's Report for the fiscal year ended June 30, 2016.

EXECUTIVE SUMMARY

This report provides a synopsis of investment activity for the City's three investment portfolios for the fiscal year ended June 30, 2016. 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 \$861.49 million as of June 30, 2016.

Portfolio assets, 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 August 15, 2016, recommended the City Council receive and file the Treasurer's Report by a 3-0-2 vote (Chair Dressler, Vice Chair Bartlett, Commissioners Koh, approving; Commissioners Montgomery and Reyno absent). The Investment Advisory Committee, at its regular meeting of August 10, 2016, recommended City Council receive and file the Treasurer's Report by a 3-0-2 vote (Chair Shanahan, Vice Chair Judd, Committee Member Carney approving; Committee Members Gonzales and Greenberg absent).

ANALYSIS

The Treasurer's office is responsible for the investment of the City's three fixed income portfolios in conformance with the Annual Investment Policy adopted by City Council. In accordance with the Investment Policy, management of the Irvine Pooled Investment Portfolio, Bonds Proceeds Portfolio and the Special Districts Portfolio have been 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. Quarterly and annual Treasurer's reports are provided on investment activity and performance information for the City's portfolios and submitted to the Investment Advisory Committee, Finance Commission, and City Council. 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 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 in the event 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 June 30, 2016, the book value (purchase price of securities as recorded on the City's books) of the Irvine Pooled Investment Portfolio was \$572.16 million and the average weighted yield to maturity was 1.03 percent. Year-to-date investment revenue (interest payments and capital gains) generated by the Irvine Pooled Investment Portfolio as of June 30, 2016 was \$4.61 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**

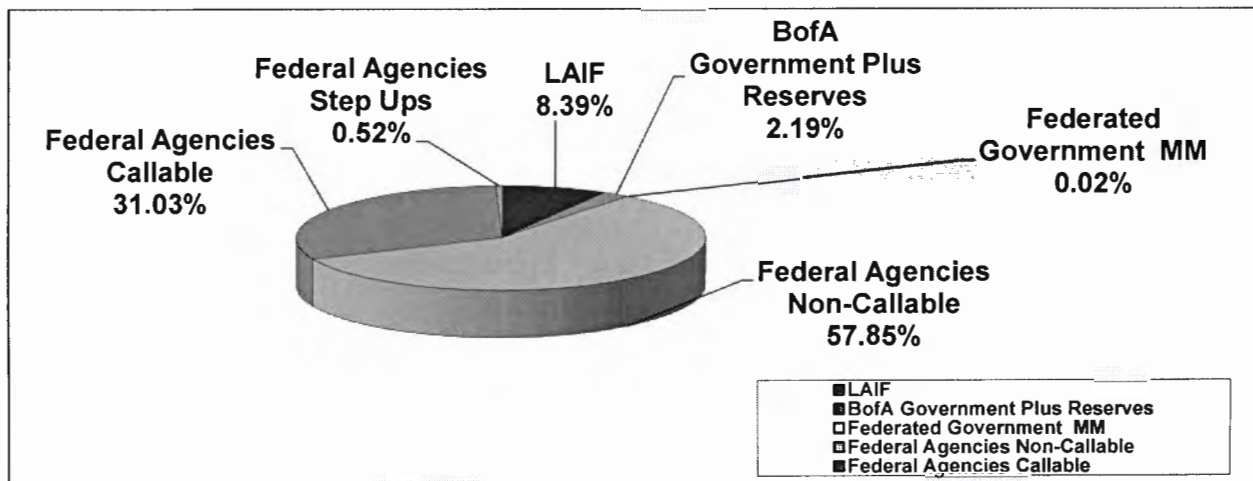
	June 30, 2016	March 31, 2016	Dec 31, 2015	Sept 30, 2015
Book Value	\$572,157,628	\$533,389,906	\$478,816,519	\$461,135,393
Market Value	\$574,913,200	\$535,191,367	\$477,843,844	\$462,618,007
Unrealized Gain/(Loss)	\$2,755,572	\$1,801,461	(\$972,675)	\$1,482,614
Unrealized Gain/(Loss) as % of Book Value	0.48%	0.34%	(0.20%)	0.32%
Average Yield To Maturity	1.03%	1.05%	1.01%	0.98%
Liquidity 0 –6 months	13.19%	10.95%	10.95%	9.85%
Average Years To Maturity	1.91	2.02	2.02	2.07
Modified Duration (Years)	1.84	1.98	1.96	1.99
Fiscal Year to Date Income	\$4,613,047	\$3,057,399	\$2,114,558	\$890,371

The Irvine Pooled Investment Portfolios book value increased by \$38.77 million from the last quarter. The increase in book value was due to a combination of property tax revenues, sales tax revenues, developer fees and the cyclical nature of the City's revenue stream that often fluctuates \$10 to \$50 million each quarter. Portfolio yield to maturity decreased for the quarter ended June 30, 2016 by 2 basis points to 1.03 percent. This was directly attributed to the decreasing rate environment and increased liquidity to meet planned fiscal year-end cash flows. With rates decreasing during the quarter ending June 30, 2016, the Irvine Pooled Investment Portfolio ended the quarter with an unrealized gain of \$2,755,572. This is a normal result of the Irvine Pooled Investment Portfolio's modified duration of 1.84 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 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 implicit guarantee by the Federal Government. Both of these agencies are carefully monitored by the City's investment manager to ensure the continued safety of the City's funds.

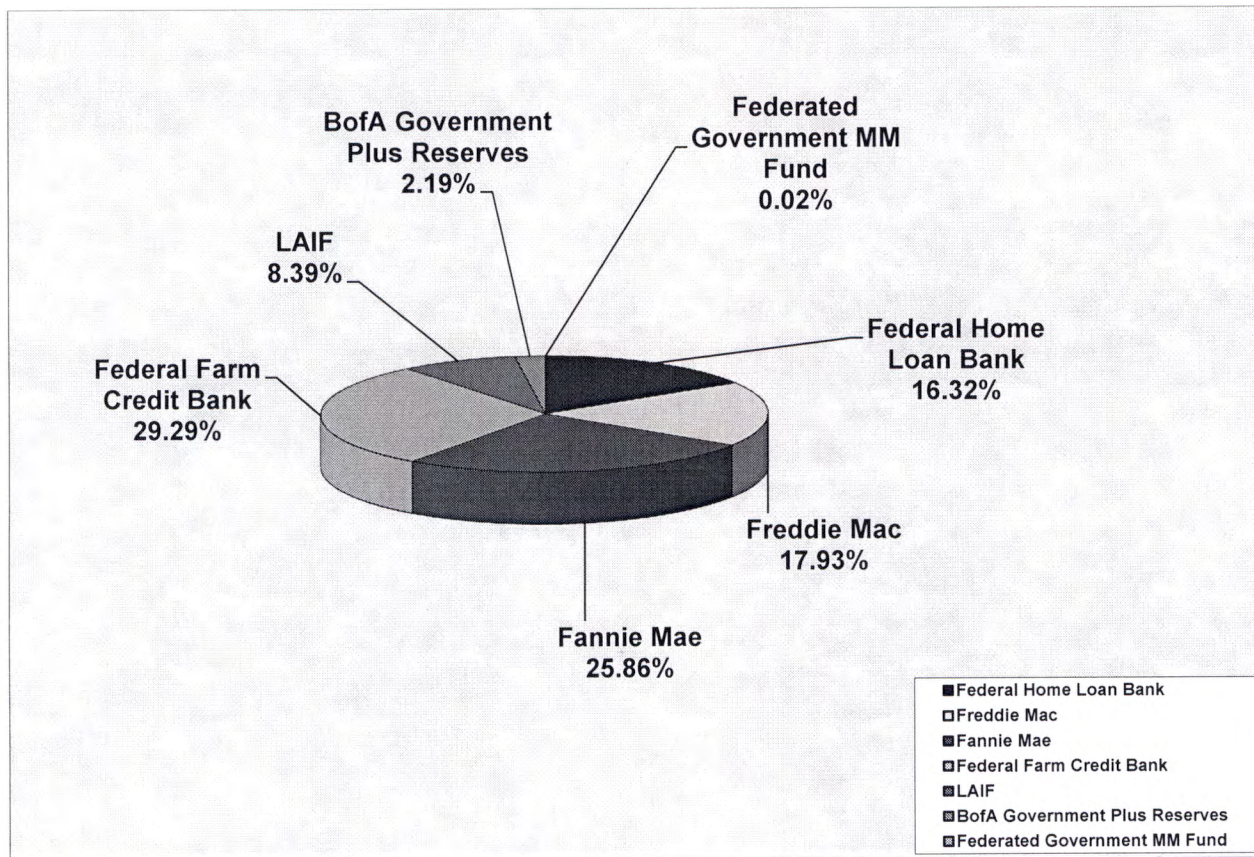
To manage liquidity, the Irvine Pooled Investment Portfolio is invested in Local Agency Investment Funds (LAIF), Federated Government Obligation money market fund, and the Bank of America Government Plus Reserves fund. Chart 1 shows the asset allocation of the Irvine Pooled Investment Portfolio.

**Irvine Pooled Investment Portfolio
 Chart 1 - Asset Allocation
 as of June 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 June 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 June 30, 2016, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 13.19 percent versus 9.78 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 June 30, 2016

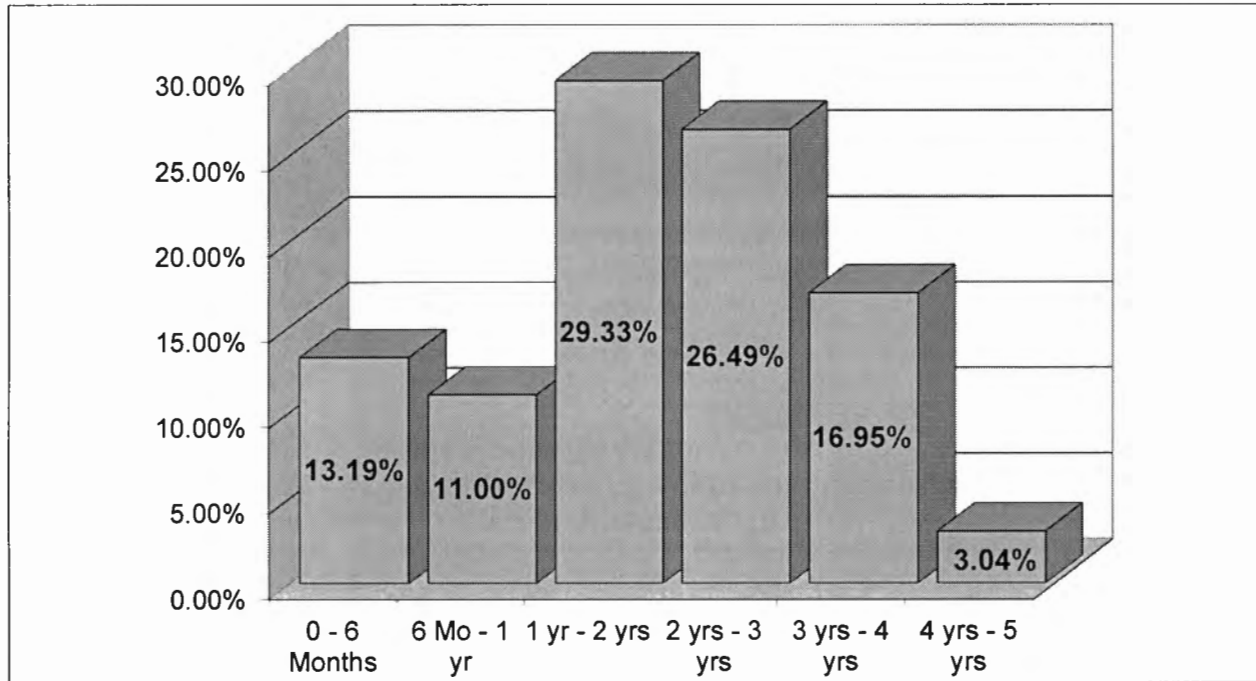
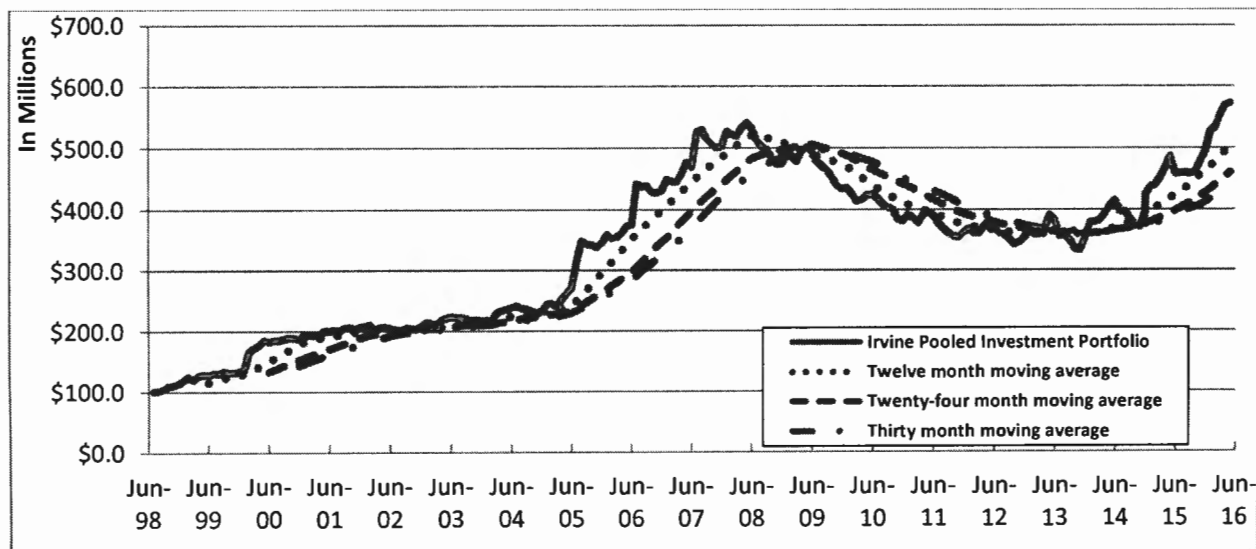
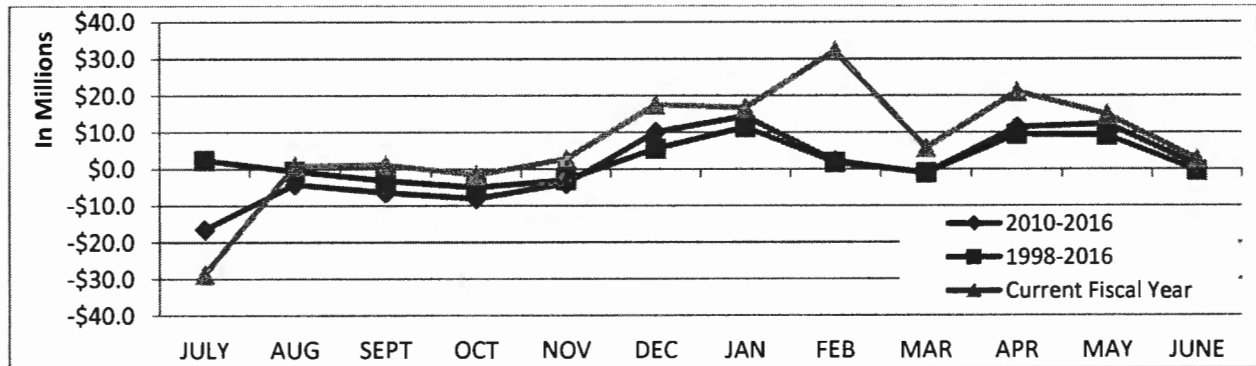


Chart 4 and chart 5 show the volatility and cyclical nature of the Irvine Pooled Investment Portfolio fund balance and cash flows between June 1998 and June 2016.

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

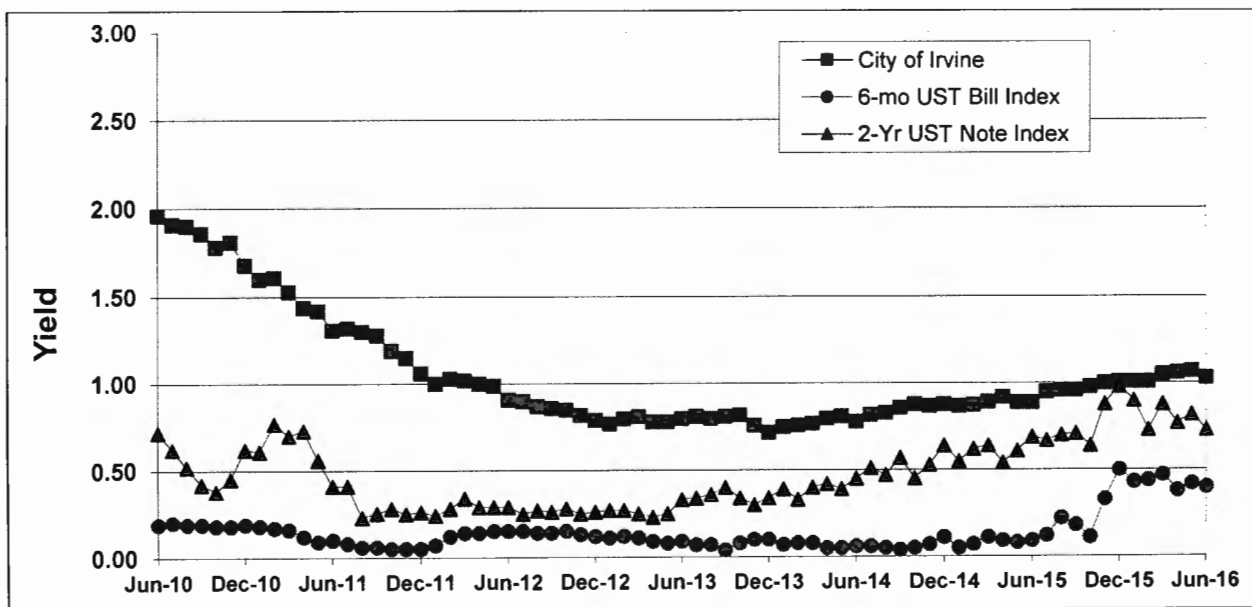


Irvine Pooled Investment Portfolio
Chart 5 – Balance Change Month by Month (Average)



The increase in the portfolio balance in 2016 reflects an increase in various taxes and fees. 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
 June 30, 2010 through June 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 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 Irvine Pooled Investment Fund Portfolio due to different cash needs between the two. The Bond Proceeds Fund Portfolio requires greater liquidity to meet debt service payments. Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the Bond Proceeds Fund Portfolio as of June 30, 2016 was \$51,224.

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

	June 30, 2016	March 31, 2016	Dec 31, 2015	Sept 30, 2015
Book Value	\$755,436	\$4,986,436	\$12,852,436	\$7,378,436
Market Value	\$755,905	\$4,987,538	\$12,841,987	\$7,382,823
Unrealized Gain/(Loss)	\$469	\$1,102	(\$10,449)	\$4,387
Unrealized Gain/(Loss) as % of Book Value	0.06%	0.02%	(0.08%)	0.06%
Average Yield To Maturity	0.58%	0.51%	0.40%	0.33%
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	\$51,224	\$41,276	\$33,967	\$27,359

Special District Funds Portfolio

The Special District Funds Portfolio contains project and reserve funds for 25 assessment district bond issues and three community facilities district bond issues. 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. Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the Special District Funds Portfolio as of June 30, 2016 was \$695,259.

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

	June 30, 2016	March 31, 2016	Dec 31, 2015	Sept 30, 2015
Book Value	\$285,890,824	\$290,492,013	\$335,498,764	\$231,674,282
Market Value	\$285,818,109	\$290,412,175	\$335,376,664	\$231,713,444
Unrealized Gain/(Loss)	(\$72,715)	(\$79,838)	(\$122,100)	\$39,162
Unrealized Gain/(Loss) as % of Book Value	(0.03%)	(0.03%)	(0.04%)	0.02%
Average Yield To Maturity	0.37%	0.24%	0.15%	0.17%
Average Days To Maturity	80	71	75	132
Fiscal Year to Date Income	\$695,259	\$463,659	\$188,223	\$90,717

Market Conditions

During the fourth quarter of FY 2015-16, interest rates decreased with the yield curve flattening. The 6-month Treasury bill decreased 2.50 basis points ending the period at 0.35 percent. Two-year Treasury notes decreased 13.90 basis points to 0.58 percent, and the five-year Treasury note decreased 20.50 basis points to 1.00 percent.

In comparison to FY 2014-2015, the yield curve flattened dramatically with interest rates increasing in the short end of the curve and decreasing in the long end of the curve. During FY 2015-2016, the 6-months Treasury bill yield increased 24 basis points year-over-year (YOY) and the 5-year Treasury note decreased 64 basis points. The increase in the short term rates was a direct result of speculation that the Federal Funds rate would be increased by the Federal Open Market Committee (FOMC) as the economy continued to improve. During the second quarter of FY 2015-16, interest rates continued to increase in anticipation of the December FOMC meeting which resulted in the first Federal Funds rate increase since June 28, 2006. Expectations of four rate increases in calendar year 2016 have since been priced out of the market to reflect geo-political issues, as well as weak global growth. The June 30, 2016 probability of a Federal Funds rate hike occurring by June 30, 2017 closed at 22.90 percent.

Gross Domestic Product (GDP) averaged 2.10 percent compared to the prior four quarters average of 2.9 percent. The U.S. unemployment rate improved to 4.70 percent from 5.50 percent YOY and the Underemployment rate improved to 9.70 percent from 10.70 percent YOY. Average hourly earnings improved to 2.50 percent from 2.30 percent YOY. Inflation increased YOY with surging prices in rents, insurance costs, and recently

energy. Slow top line growth in nominal GDP should ultimately force consumers to bid down prices on discretionary goods and services eventually subduing the recent rise in inflation.

In conclusion, FY 2016-2017 will begin with continued market volatility, a presidential election, and elevated geo-political risk. The Federal Reserve is not expected to raise interest rates prior to the December 2016 meeting due to FED Chair Janet Yellen's recent statement of, "headwinds – which include restraint on U.S. economic activity from economic and financial developments abroad, subdued household formation, and meager productivity growth – mean that the interest rate needed to keep the economy operating near its potential is low by historical standards." While the Federal Reserve will remain "data dependent", it will continue to be focused on its dual mandate of full employment and price stability. Market yields should begin to gradually rise as the 'flight to safety' trade of the Brexit vote fades and the second quarter economic performance is priced in.

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 \$5.36 million with investments structured for security and liquidity.

REPORT PREPARED BY Don Collins, City Treasurer