



REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: SEPTEMBER 12, 2017

TITLE: TREASURER'S REPORT FOR THE FISCAL YEAR ENDED
JUNE 30, 2017

Director of Administrative Services

City Manager

RECOMMENDED ACTION

Receive and file the Treasurer's Report for the fiscal year ended June 30, 2017.

EXECUTIVE SUMMARY

This report provides a synopsis of investment activity for the City's three investment portfolios for the fiscal year ended June 30, 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 \$982.03 million as of June 30, 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 regular meeting of August 21, 2017, the Finance Commission unanimously voted to recommend that 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 District 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 various operational funds, including the City's Asset Management Plan and funds earmarked for the development of the Orange County Great Park. A summary of Pooled Investment Portfolio Book Value by Fund is presented at the end of this report (Attachment 1).

As of June 30, 2017, the book value (purchase price of securities as recorded on the City's books) of the portfolio was \$637.21 million and the average weighted yield to maturity was 1.24 percent. Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the portfolio as of June 30, 2017 was \$5.82 million. The following chart compares the portfolio's statistics over a rolling 12-month period.

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

	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016
Book Value	\$637,207,311	\$599,028,736	\$574,580,674	\$557,660,462
Market Value	\$634,768,340	\$596,334,045	\$571,366,011	\$559,208,937
Unrealized Gain/(Loss)	(\$2,438,971)	(\$2,694,691)	(\$3,214,663)	\$1,548,475
Unrealized Gain/(Loss) as % of Book Value	(0.38%)	(0.45%)	(0.56%)	0.28%
Average Yield To Maturity	1.24%	1.18%	1.12%	1.06%
Liquidity 0-6 months	14.32%	13.19%	13.56%	9.85%
Average Years To Maturity	1.91	1.98	2.03	2.02
Modified Duration (Years)	1.85	1.91	1.97	1.98
Fiscal Year to Date Income	\$5,819,215	\$4,137,190	\$2,720,039	\$1,340,988

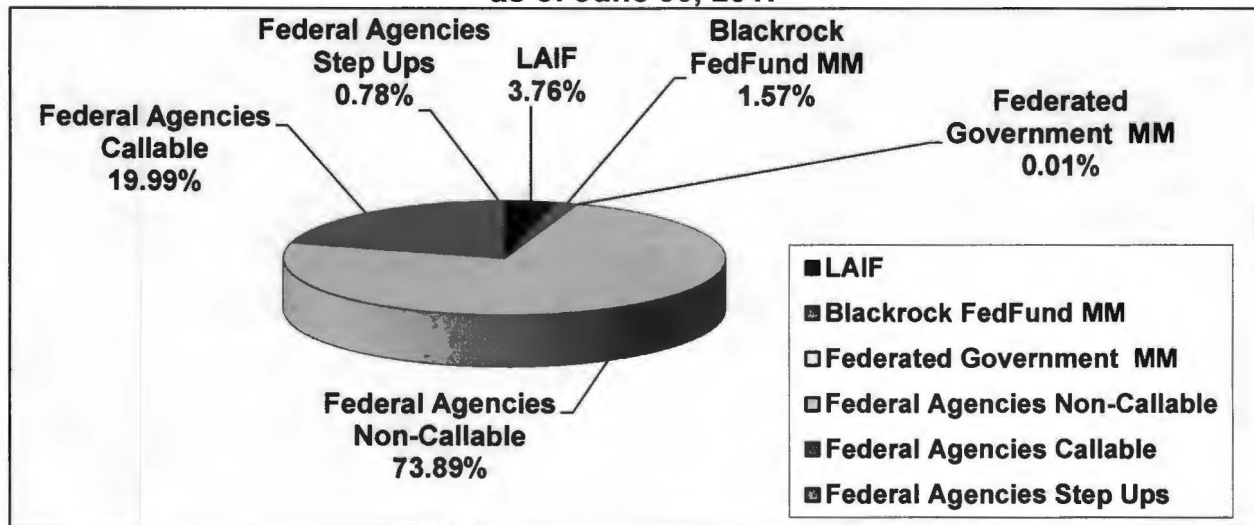
The Irvine Pooled Investment Portfolio's book value increased by \$38.18 million from the previous quarter, primarily attributable to the collections of property tax, local park fees, and

transportation mitigation fees. Portfolio yield to maturity increased for the quarter ended June 30, 2017 by 6 basis points to 1.24 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 June 30, 2017, the portfolio ended the quarter with an unrealized loss of \$2.44 million as compared to an unrealized loss of \$2.69 million on March 31, 2017. This is a normal result of the portfolio's modified duration of 1.85 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.

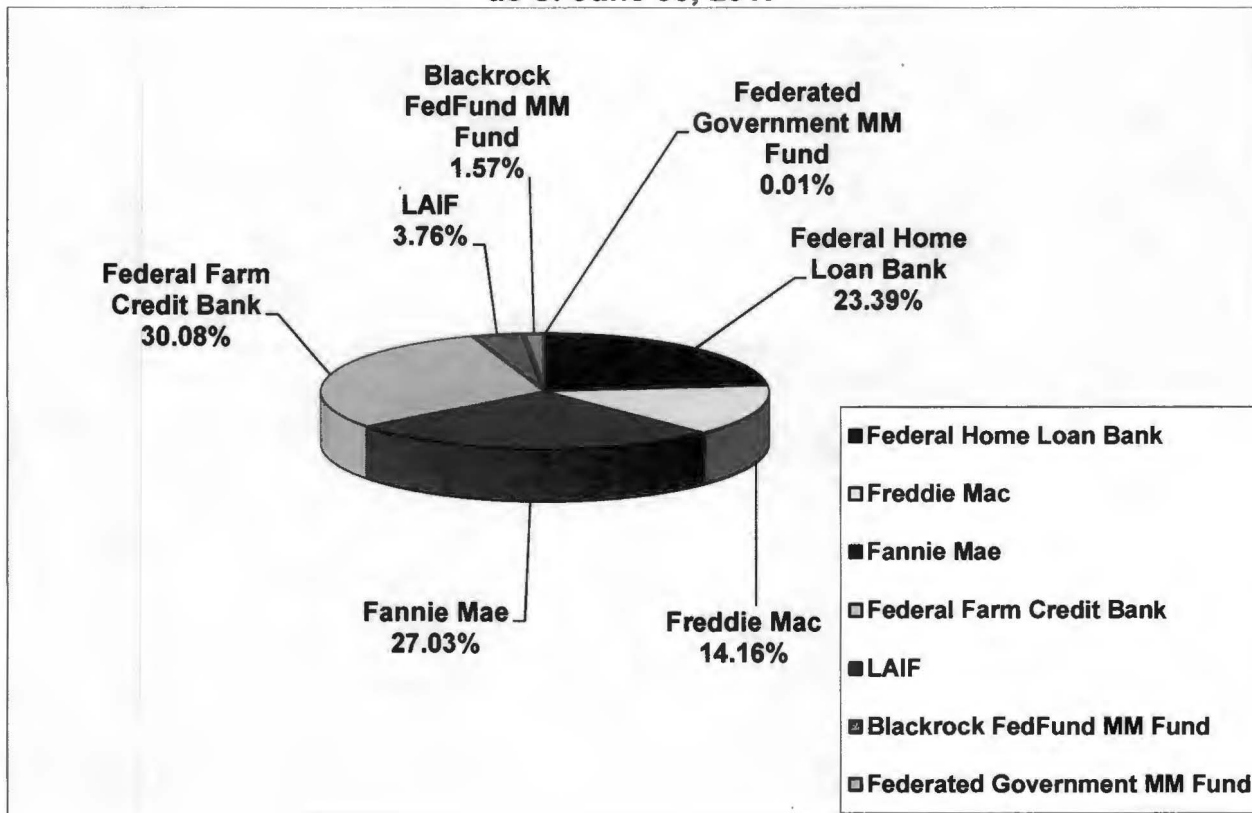
To manage liquidity, the Irvine Pooled Investment Portfolio is invested in Local Agency Investment Funds (LAIF), Federated Government Obligation money market fund, and the Blackrock FedFund money market fund. Chart 1 shows the asset allocation of the portfolio.

Irvine Pooled Investment Portfolio
Chart 1 - Asset Allocation
as of June 30, 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 June 30, 2017**



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, 2017, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 14.32 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 June 30, 2017**

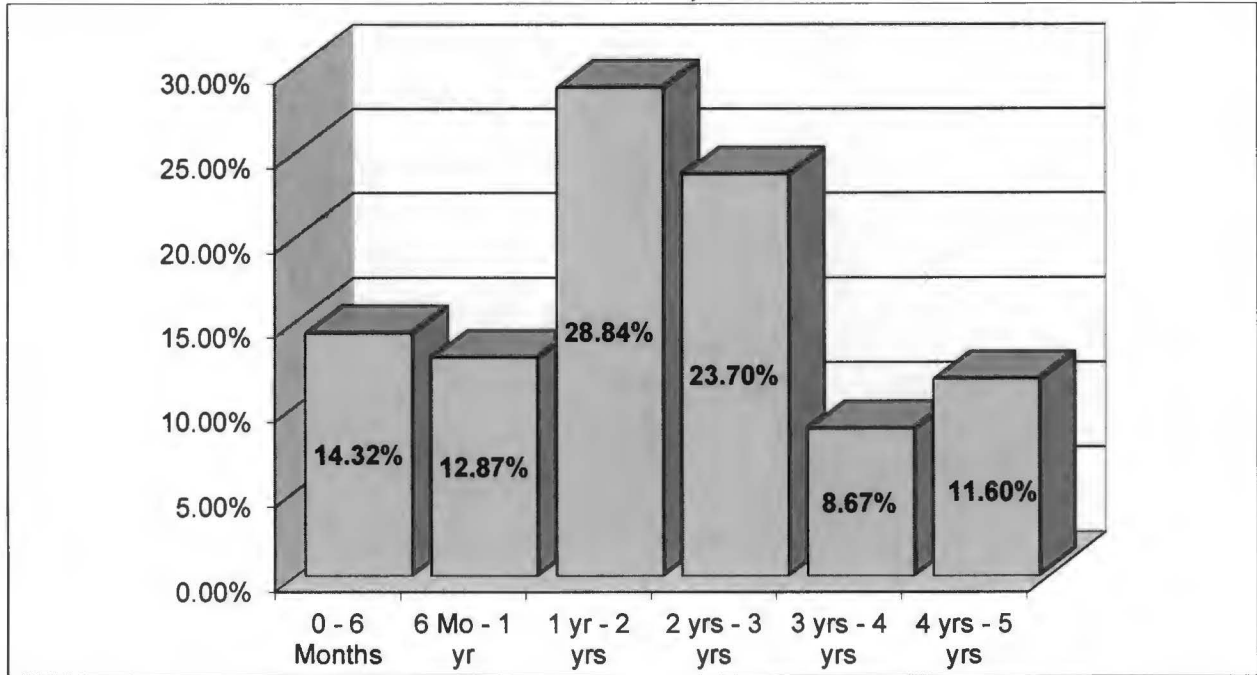
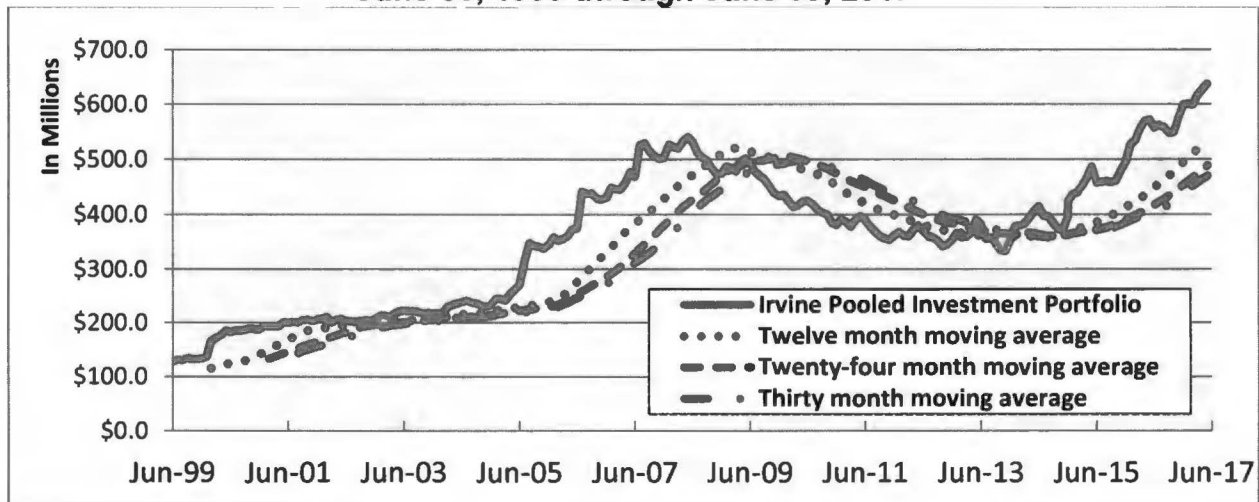
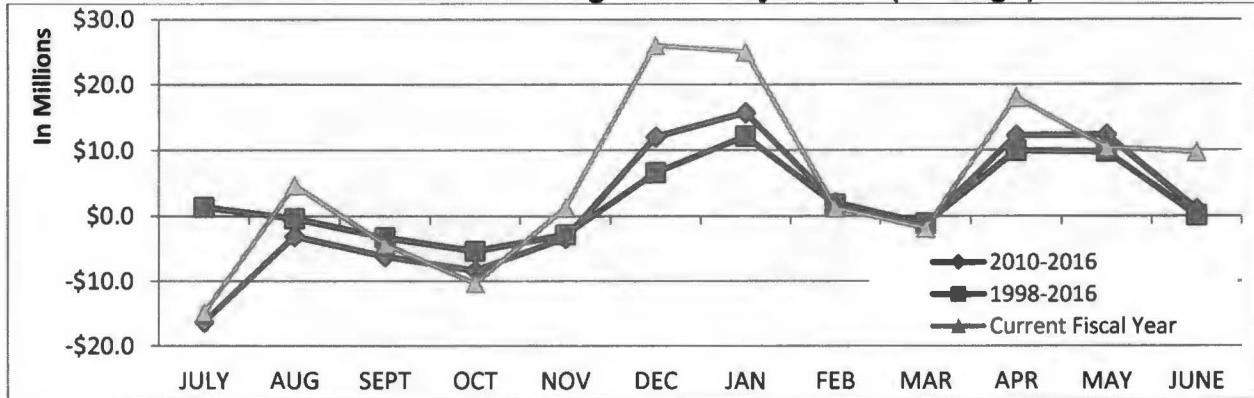


Chart 4 and Chart 5 show the volatility and cyclicalty of the Irvine Pooled Investment Portfolio fund balance and cash flows between June 30, 1999 and June 30, 2017.

**Irvine Pooled Investment Portfolio
 Chart 4 - Portfolio Balance
 June 30, 1999 through June 30, 2017**

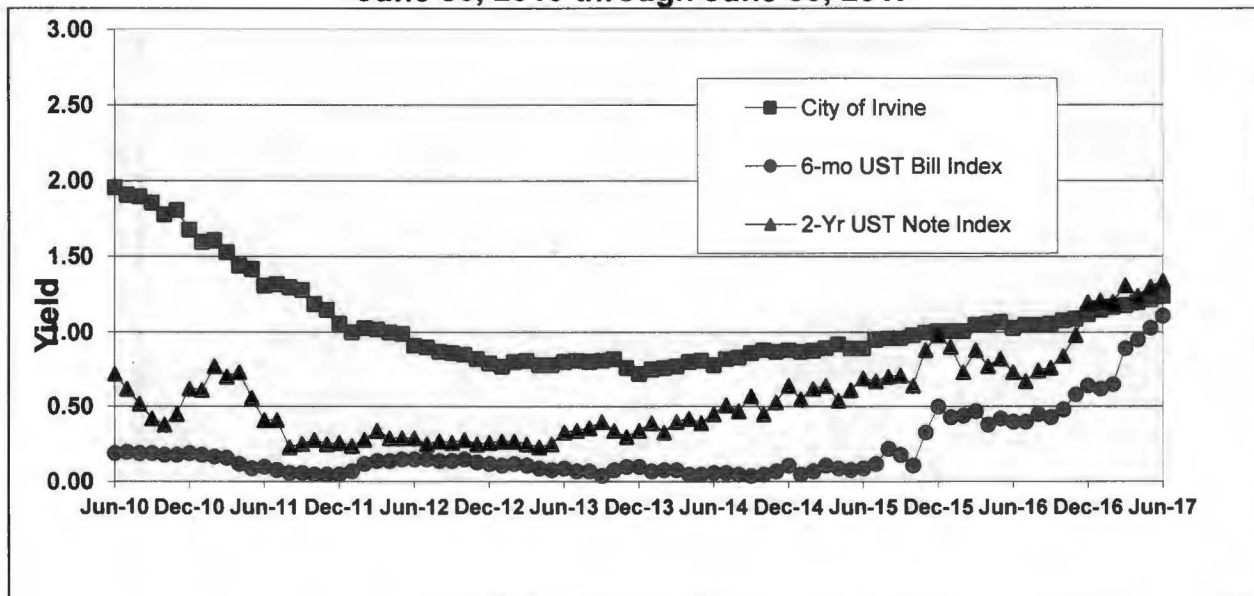


**Irvine Pooled Investment Portfolio
 Chart 5 – Balance Change Month by Month (Average)**



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 0.13 percent and lower than the 2-year UST by 0.10 percent.

**Irvine Pooled Investment Portfolio
 Chart 6 - Yield to Maturity Compared to Assigned Benchmarks
 June 30, 2010 through June 30, 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 district administration. Investment strategy differs in the Bond Proceeds Fund Portfolio from the Irvine Pooled Investment 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.
- (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 June 30, 2017 was \$28,832.

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

	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016
Book Value	\$4,605,000	\$4,609,437	\$7,608,436	\$760,436
Market Value	\$4,600,122	\$4,605,639	\$7,604,053	\$760,669
Unrealized Gain/(Loss)	(\$4,878)	(\$3,798)	(\$4,384)	\$233
Unrealized Gain/(Loss) as % of Book Value	(0.11%)	(0.08%)	(0.06%)	0.03%
Average Yield To Maturity	0.98%	0.82%	0.72%	0.63%
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	\$28,832	\$19,449	\$6,984	\$5,783

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 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 June 30, 2017 was \$2.24 million.

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

	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016
Book Value	\$343,067,156	\$348,802,144	\$387,387,309	\$371,479,758
Market Value	\$342,664,495	\$348,451,879	\$387,100,007	\$371,288,348
Unrealized Gain/(Loss)	(\$402,661)	(\$350,265)	(\$287,302)	(\$191,410)
Unrealized Gain/(Loss) as % of Book Value	(0.12%)	(0.10%)	(0.07%)	(0.05%)
Average Yield To Maturity	0.85%	0.70%	0.32%	0.30%
Average Days To Maturity	55	49	41	41
Fiscal Year to Date Income	\$2,239,450	\$1,423,682	\$694,044	\$292,016

Market Conditions

During the fourth quarter of Fiscal Year 2016-17, the yield curve flattened dramatically with interest rates increasing in the short end of the yield curve and decreasing in the long end of the yield curve. The 6-month Treasury bill yield increased 22 basis points ending the quarter at 1.02 percent. The two-year Treasury note yield increased 9.90 basis points to 1.37 percent, and the five-year Treasury note yield decreased 7.60 basis points to 1.85 percent. The flattening of the yield curve was primarily due to the Federal Reserve increasing short term rates while inflation and economic growth data weakened. The net effect to the Pooled Investment Portfolio was a slight decrease in the unrealized market value loss. The Special District Funds Portfolio’s unrealized market value loss increased due to the short duration of the fund and the increase in short term market rates.

In comparison to interest rates at FY 2015-16, benchmark Treasury interest rates increased approximately 76 basis points. FY 2016-17 began with the United Kingdom’s vote to withdraw from the European Union, which resulted in interest rates moving dramatically lower. Interest rates surged in the second quarter FY 2016-17 as economic optimism rose in the belief that the new administration would reform taxes, reduce burdensome regulations, increase fiscal spending, and overhaul the healthcare system. Additionally the Federal Reserve raised the Fed Funds rate by 25 basis points on December 14, 2016, citing that “the labor market has continued to strengthen and that economic activity has been expanding at a moderate pace since mid-year.” The Federal

Reserve increased short term borrowing rates again on March 15, 2017 and June 14, 2017 citing that “information received since the Federal Open Market Committee (FOMC) met in June indicates that the labor market strengthened and that economic activity has been expanding at a moderate rate.” Federal Reserve President Janet Yellen has indicated that the FOMC will raise rates again in calendar year 2017 and discussed plans to begin reducing the Federal Reserve’s balance sheet.

During the third and fourth quarter of FY 2016-17, economic data, while positive, remained tepid. Inflation data also increased, but are still below the FOMC’s 2.0 percent target rate. The U.S. Personal Consumption Expenditures (PCE) index, which has consistently averaged less than 2.0 percent, and the core consumer price index (CPI) have averaged 1.80 percent for the past twelve months.

Gross Domestic Product (GDP) averaged 1.90 percent for the past four quarters and continues to improve modestly. The U.S. unemployment rate improved to 4.3 percent from 4.70 percent year-over-year (YoY) and the underemployment rate improved to 8.40 percent from 9.70 percent YoY. The increase in average hourly earnings ended the fiscal year at 2.50 percent, down from the December 31, 2016 increase of 2.90 percent.

In conclusion, FY 2017-18 will begin with the fundamentals for subdued growth and low inflation remaining intact. These include a complex combination of aging demographics, onerous dependency ratios (nonworking versus working population), policy paralysis in Washington, excess capacity in many sectors, the rapid change in technology and mechanization, and excessive debt burdens which will continue to constrain global growth. Additionally, it is anticipated that the Federal Reserve will continue tightening despite a slower economic growth rate, declining inflation and credit/money supply growth data, and a flattening yield curve. Quantitative easing and monetary stimulus have inflated various asset classes that may rebalance as the Federal Reserve increases short term rates.

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 Fund Portfolio, and Special District Funds Portfolio totaled \$8.09 million with investments structured for security and liquidity.

REPORT PREPARED BY Don Collins, City Treasurer

Attachment: Summary of Pooled Investment Portfolio Book Value by Fund

City of Irvine
 Summary of Pooled Investment Portfolio Book Value by Fund
 As of June 30, 2017

General Reserve Funds	\$ 138,829,172
Capital Projects Funds:	
Capital Improvement Projects	26,414,622
Irvine Business Complex	83,630,373
North Irvine Transportation Mitigation	78,052,680
Orange County Great Park Development	882,036
Park Development	16,532,571
Total	<u>205,512,282</u>
Special Revenue Funds:	
Air Quality Improvement	544,856
County Sales Tax Measure M	3,775,971
Fees and Exactions	12,589,841
Gas Tax	11,820,708
Grants	3,805,066
I Shuttle	785,713
Local Park Fees	109,939,465
Maintenance District	2,964,088
Major Special Events	113,557
Orange County Great Park	86,964,881
Slurry Seal Fees	614,128
System Development	23,788,121
Total	<u>257,706,395</u>
Internal Service Funds:	
Equipment & Services	15,486,261
Inventory	130,354
Self-Insurance	18,868,346
Total	<u>34,484,961</u>
Permanent Fund:	
Senior Services	179,095
Senior Services Endowments	495,406
Total	<u>674,501</u>
Total Pooled Investments at June 30, 2017	<u><u>\$ 637,207,311</u></u>

Note: Funds are as presented in the City's Comprehensive Annual Financial Report (CAFR)