



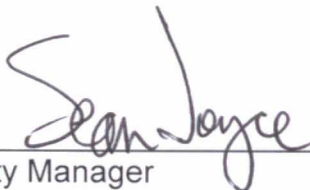
REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: MARCH 11, 2014

TITLE: TREASURER'S REPORT FOR THE QUARTER ENDED
DECEMBER 31, 2013



Acting Director of Administrative Services



City Manager

RECOMMENDED ACTION

Receive and file the Treasurer's Report for the quarter ended December 31, 2013.

EXECUTIVE SUMMARY

This report provides a synopsis of investment activity for the City's three investment portfolios for the quarter ended December 31, 2013. 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 \$559.24 million as of December 31, 2013.

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 March 3, 2013, recommended the City Council receive and file the Treasurer's Report by a unanimous vote. The Investment Advisory Committee was scheduled to review the Treasurer's Report at its regular meeting of February 12, 2014; however, the meeting was cancelled due to lack of a quorum.

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 December 31, 2013, the book value (purchase price of securities as recorded on the City's books) of the Irvine Pooled Investment Portfolio was \$353.42 million and the average weighted yield to maturity was 0.72 percent. Fiscal year-to-date investment income (interest payments and capital gains) generated by the Irvine Pooled Investment Portfolio as of December 31, 2013 was \$1.57 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

	Dec 31, 2013	Sept 30, 2013	June 30, 2013	March 31, 2013
Book Value	\$353,424,287	\$348,836,003	\$382,983,315	\$359,368,846
Market Value	\$351,926,503	347,866,493	\$381,136,798	\$360,707,990
Unrealized Gain/(Loss)	\$(1,497,784)	(\$969,510)	(\$1,846,517)	\$1,339,144
Unrealized Gain/(Loss) as % of Book Value	(0.42%)	(0.28%)	(0.48%)	0.37%
Average Yield To Maturity	0.72%	0.81%	0.79%	0.81%
Liquidity 0 – 6 months	16.47%	15.79%	19.90%	15.92%
Average Years To Maturity	2.27 years	2.47 years	2.47 years	2.49 Years
Effective Duration	2.21 years	2.40 years	2.40 years	2.42 Years

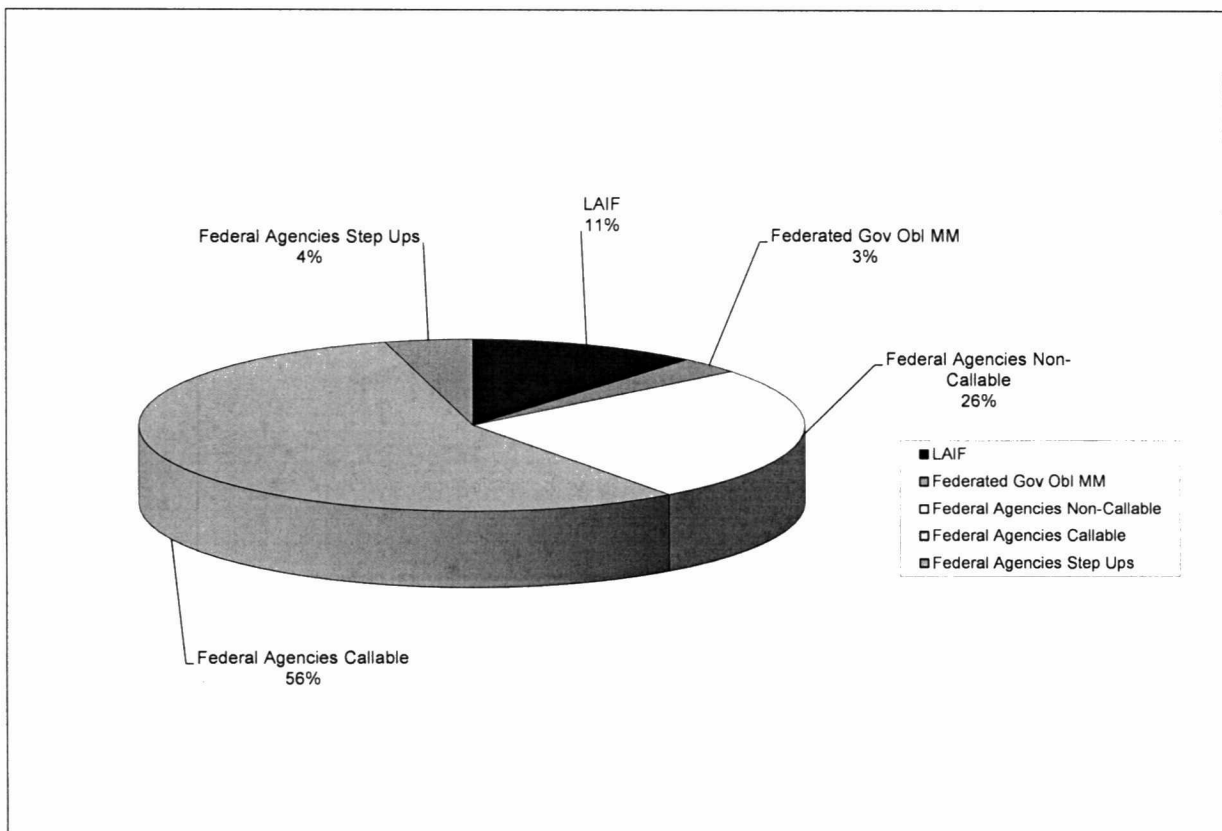
Yield to maturity of the Irvine Pooled Investment Portfolio declined by 9 basis points, or 0.09 percent. The decline is attributed to restoring the Portfolio's front-end liquidity position which was reduced during the first fiscal quarter to cover expenses. Low-yielding money market funds are used for portfolio liquidity; therefore increased investment in this asset class contributes to overall decline in yield to maturity. The increase in the unrealized losses is the result of rising 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 are considered the safest securities in the global market next to Treasury securities. 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.

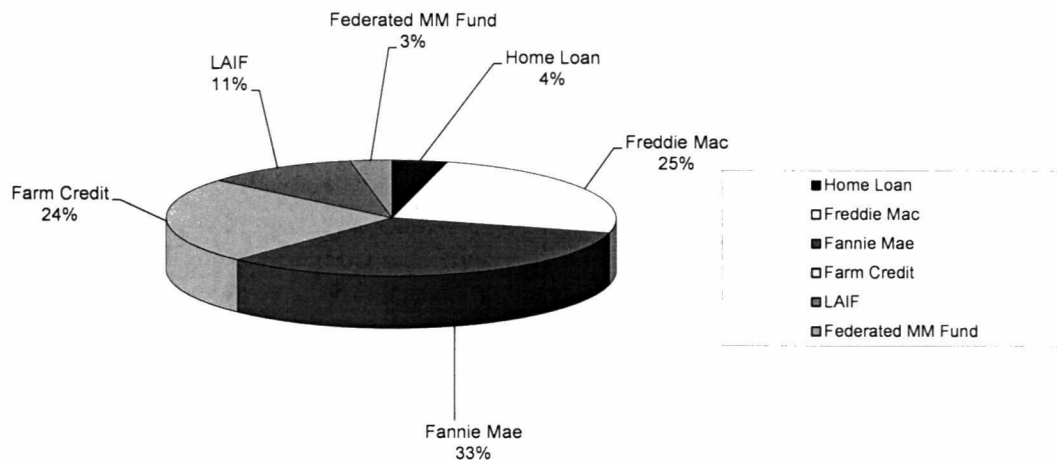
To manage liquidity, the Irvine Pooled Investment Portfolio is invested in LAIF (Local Agency Investment Funds) and the Federated Government Obligation money market fund. Chart 1 shows the asset allocation of the Irvine Pooled Investment Portfolio.

**Irvine Pooled Investment Portfolio
Chart 1 - Asset Allocation
as of December 31, 2013**



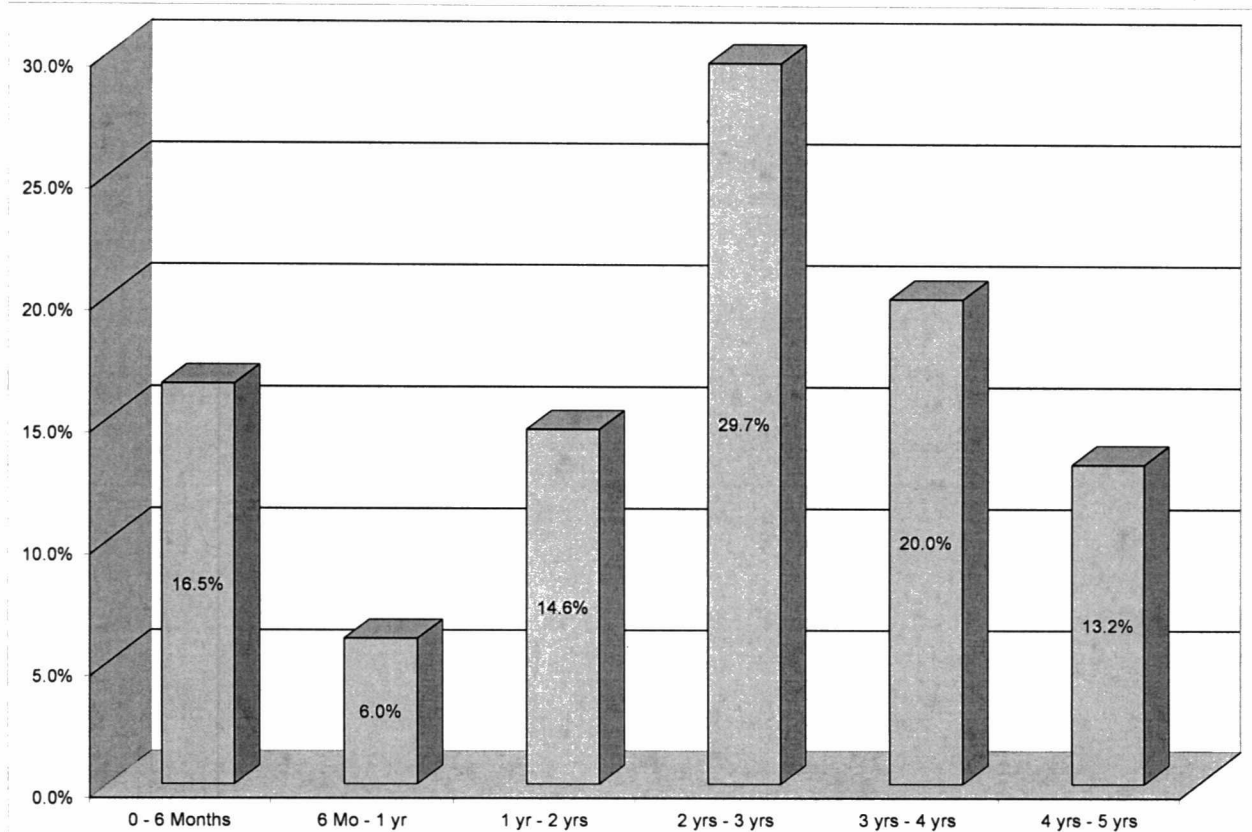
Since 86 percent of the portfolio is invested in Federal Agency securities, the safety of the Irvine Pooled Investment Portfolio is further protected by purchasing securities from several different Federal Agencies. The four Federal Government sponsored entities that the City purchases securities from 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 December 31, 2013**



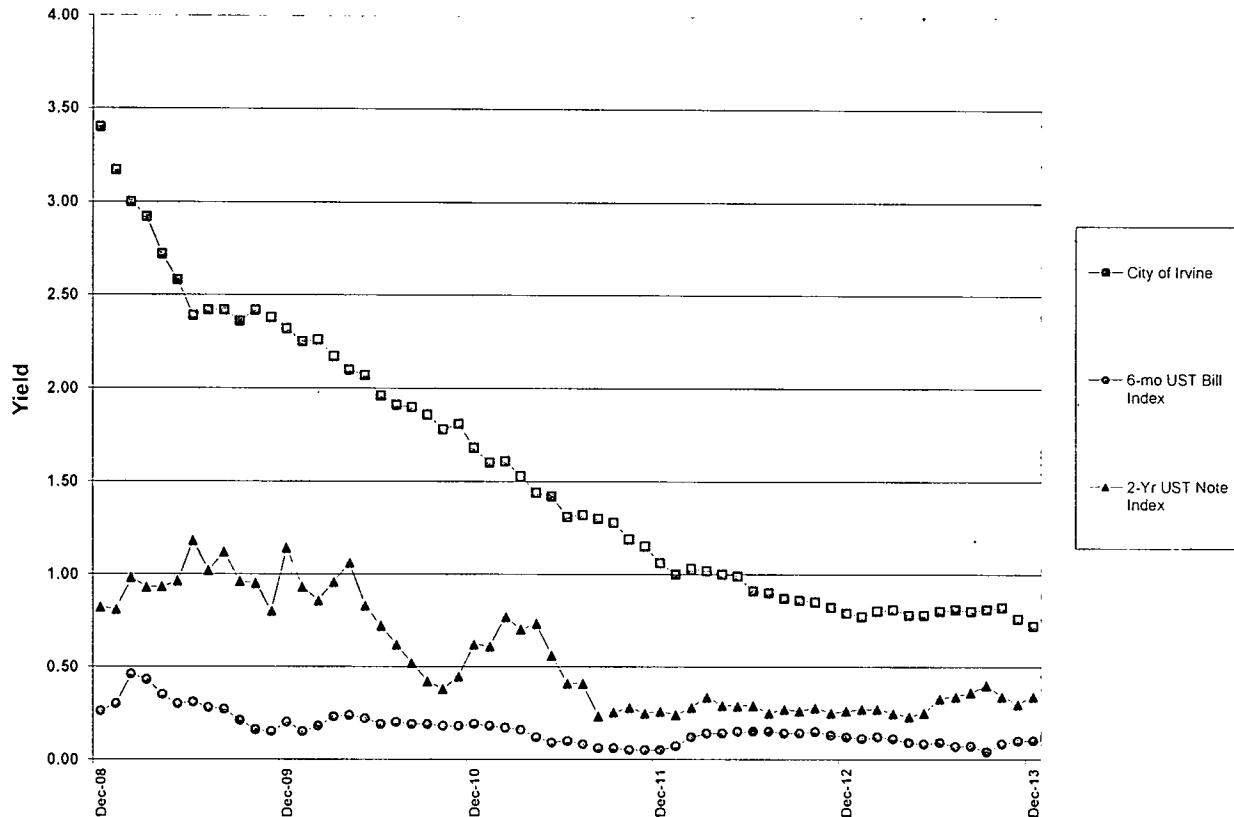
Another key component in portfolio management is to ensure that the City has enough funds on hand to meet current expenses. By using cash flow forecasts, the portfolio manager is able to project short and long-term cash needs to help make informed and appropriate investment decisions. As of December 31, 2013, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 16.47 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 December 31, 2013**



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 0.62 percent and higher than the 2-year UST by 0.38 percent.

Irvine Pooled Investment Portfolio
Graph 1 - Yield to Maturity Compared to Assigned Benchmarks
December 2008 through December 2013



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 \$98,624 for the quarter ended December 31, 2013 based on an average cash balance of \$55.84 million.

Orange County Great Park Funds

The Great Park funds earned interest of \$53,046 for the quarter ended December 31, 2013. The Great Park funds had a combined average daily cash balance of \$29.89 million for the quarter ended December 31, 2013.

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 December 31, 2013.

Special District Funds Portfolio

The Special District Funds Portfolio contains project and reserve funds for 28 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 December 31, 2013.

Market Conditions

Bond interest rates ended higher across the curve at the end of the December, 2013 quarter, especially in the 5 to 30-year sectors of the curve (up to 0.39% higher). Market volatility occurred throughout the quarter as investors contemplated whether the Federal Open Market Committee (FOMC) would announce tapering asset purchases since positive economic data was released in November and December. The FOMC announced plans to reduce asset purchases at its December 18, 2013 meeting, which led to the increase in bond interest rates toward the end of the quarter.

The tapering plan announced by the Federal Reserve Board (Fed) at the December FOMC meeting included the reduction of monthly bond purchases from \$85 billion to \$75 billion (\$5 billion less in both Treasury securities and Federal agency mortgage-backed securities) beginning in January, 2014. Positive growth seen in the labor market data released in November and December was a contributing factor to the decision by the FOMC to begin the reduction of asset purchases. The FOMC also indicated that further tapering may occur in measured steps depending on future labor market data. The Fed continues to maintain the current target fed funds rate of 0% to 0.25%.

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 \$1.63 million with investments structured for security and liquidity.

REPORT PREPARED BY Michele C. Lund, City Treasurer