



# REQUEST FOR CITY COUNCIL ACTION

**MEETING DATE:** SEPTEMBER 8, 2015

**TITLE:** TREASURER'S ANNUAL REPORT FOR THE FISCAL YEAR  
ENDED JUNE 30, 2015

Director of Administrative Services

City Manager

## RECOMMENDED ACTION

Receive and file the Treasurer's Annual Report for the fiscal year ended June 30, 2015.

## EXECUTIVE SUMMARY

This report provides a synopsis of investment activity for the City's three investment portfolios for the fiscal year ended June 30, 2015. 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 \$756.26 million as of June 30, 2015.

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 17, 2015, recommended City Council receive and file the Treasurer's Report for the fiscal year ended June 30, 2015 by a unanimous vote of 4-0 (Commissioner Reyno absent). The Investment Advisory Committee, at its regular meeting of August 12, 2015, recommended City Council receive and file the Treasurer's Report by a unanimous vote of 3-0 (Chair Gonzales and Committee Member 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, 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 June 30, 2015, the book value (purchase price of securities as recorded on the City’s books) of the Irvine Pooled Investment Portfolio was \$486.86 million and the average weighted yield to maturity was 0.89 percent. Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the Irvine Pooled Investment Portfolio as of June 30, 2015 was \$3.44 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**

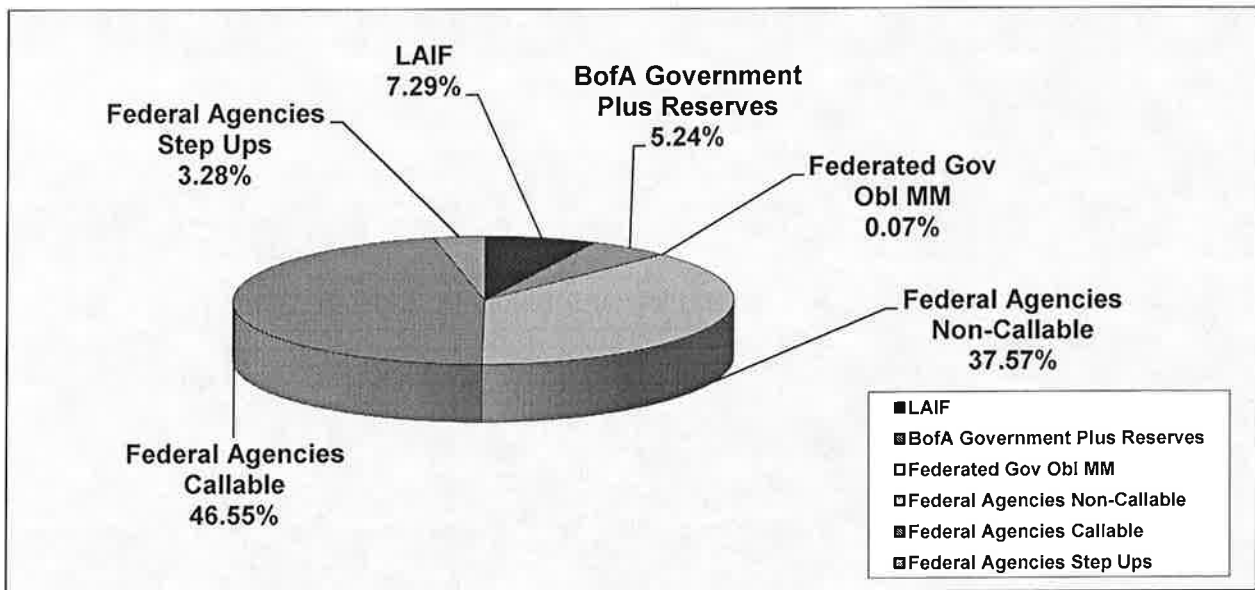
	<b>June 30, 2015</b>	<b>March 31, 2015</b>	<b>Dec 31, 2014</b>	<b>Sept 30, 2014</b>
Book Value	\$486,857,944	\$439,932,507	\$395,727,888	\$384,276,980
Market Value	\$487,453,132	\$440,906,767	\$395,007,261	\$383,467,567
Unrealized Gain/(Loss)	\$595,188	\$974,260	\$(720,627)	\$(809,413)
Unrealized Gain/(Loss) as % of Book Value	0.12%	0.22%	(0.18%)	(0.21%)
Average Yield To Maturity	0.89%	0.90%	0.88%	0.86%
Liquidity 0 –6 months	14.20%	9.07%	10.91%	11.87%
Average Maturity (Years)	2.00	2.17	2.26	2.34
Modified Duration (Years)	1.85	2.09	2.22	2.29

The Irvine Pooled Investment Portfolios book value increased by \$46.93 million from the last quarter. The increase in book value was due to the cyclical nature of the City's revenue stream that often fluctuates \$10 to \$40 million each quarter. Portfolio yield to maturity decreased by 0.01 percent as liquidity was increased to meet future short term liabilities. With rates increasing during the quarter ending June 30, 2015, the unrealized gain of \$974,260 as of March 31, 2015 decreased to \$595,188. This is a normal result of the Irvine Pooled Investment 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 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.

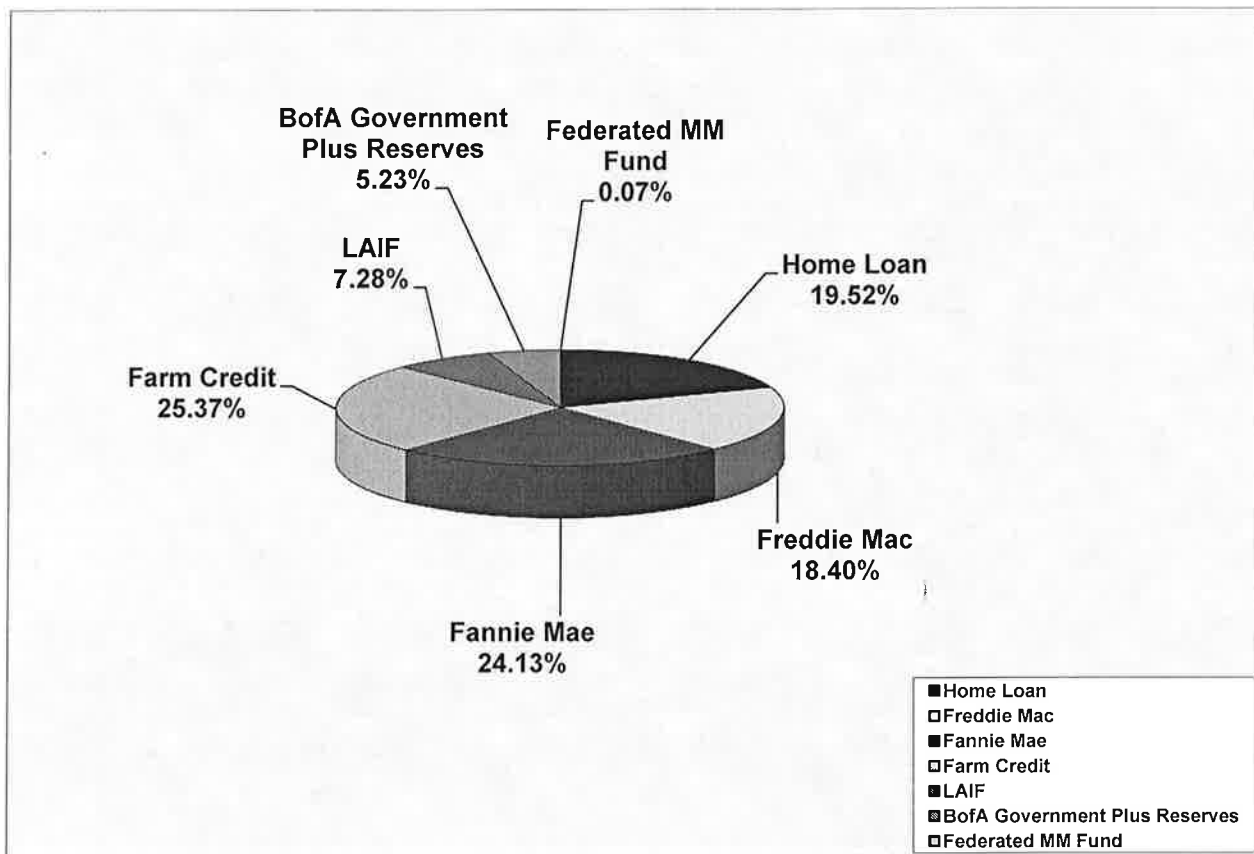
To manage liquidity, the Irvine Pooled Investment Portfolio is invested in Local Agency Investment Funds (LAIF) and the Federated Government Obligation money market fund. Chart 1 shows the asset allocation of the Irvine Pooled Investment Portfolio.

**Irvine Pooled Investment Portfolio**  
**Chart 1 - Asset Allocation**  
**as of June 30, 2015**



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, 2015**



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, 2015, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 14.20 percent versus 9.07 percent last quarter. The planned increase in liquidity was for pre-payment of the CalPERS obligation of \$19.70 million which occurred in July 2015. 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, 2015

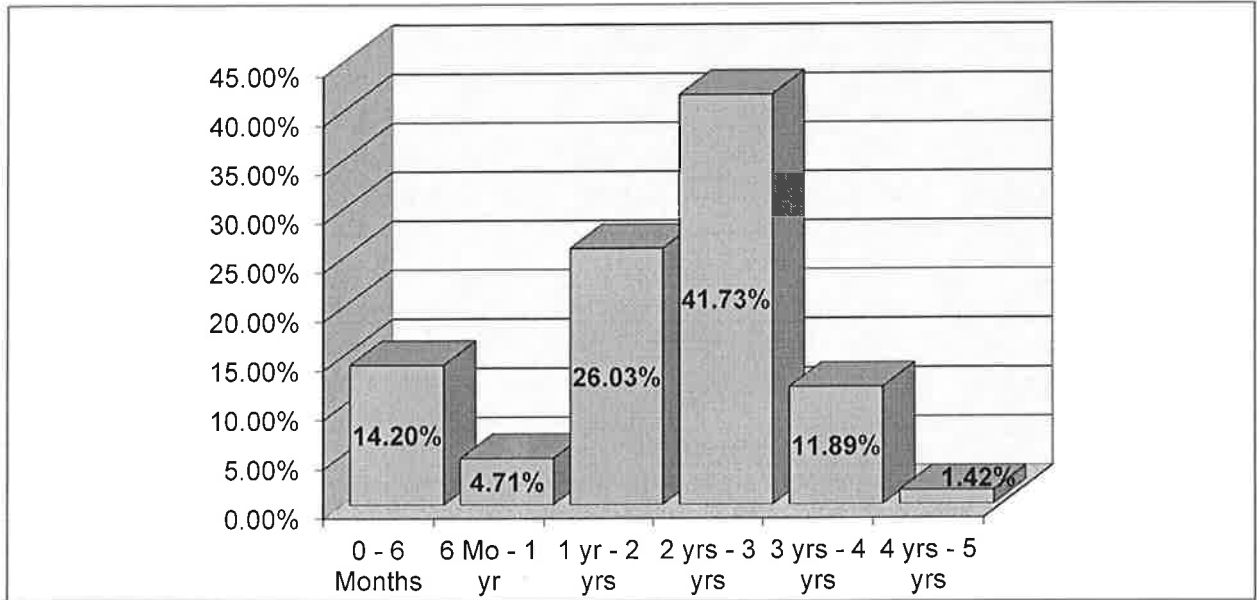
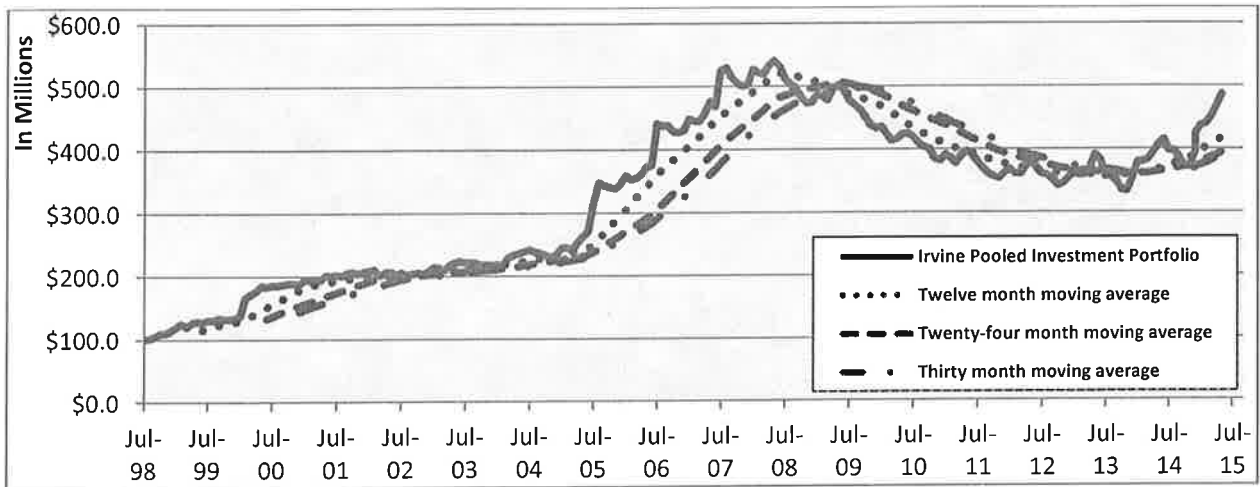
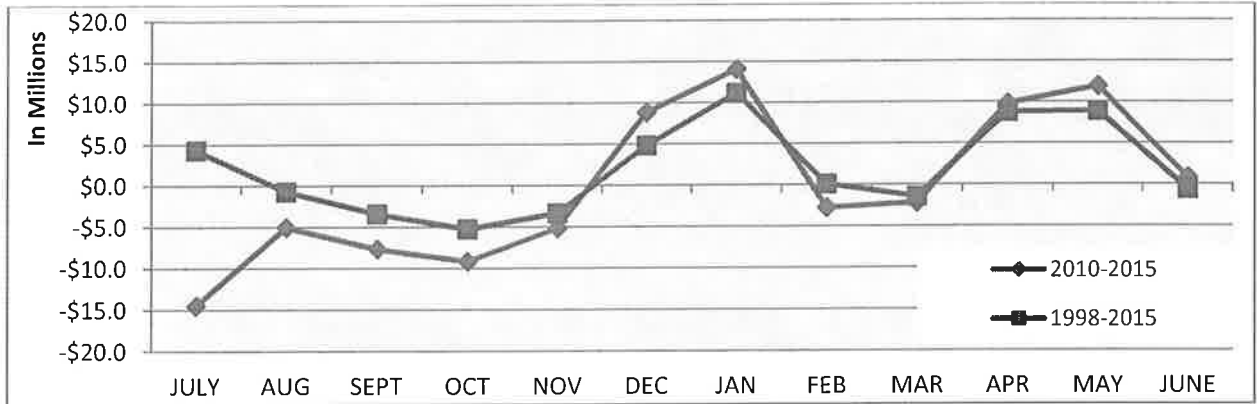


Chart 4 and chart 5 shows the volatility and cyclicalty of the Irvine Pooled Investment Portfolio fund balance and cash flows between July 1998 and June 2015.

**Irvine Pooled Investment Portfolio**  
**Chart 4 - Portfolio Balance**  
 July 31, 1998 through June 30, 2015

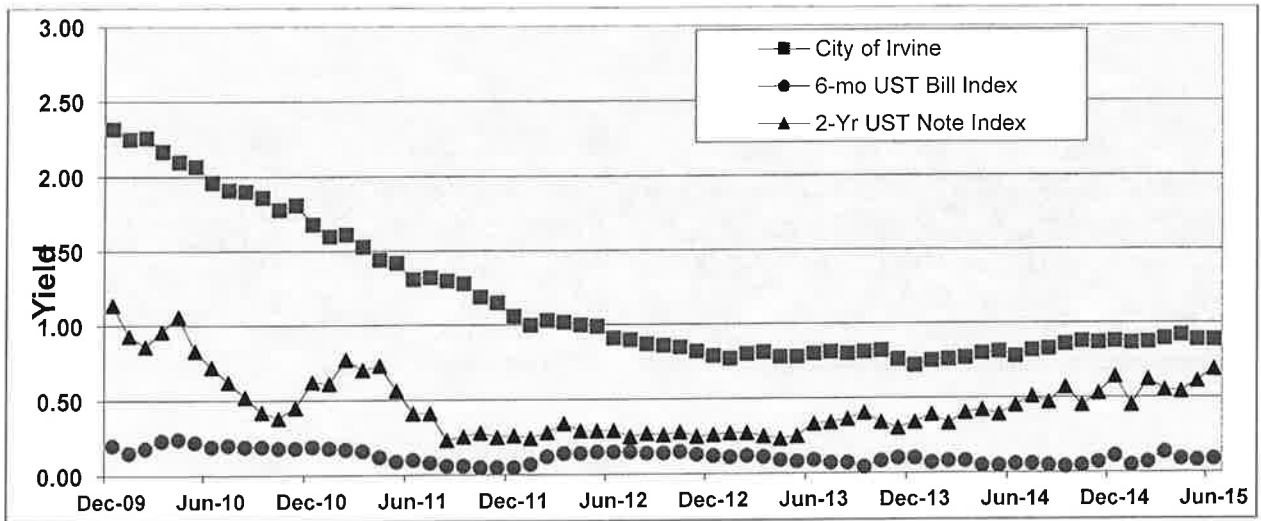


**Irvine Pooled Investment Portfolio**  
**Chart 5 – Balance Change Month by Month (Average)**  
**July 31, 1998 through June 30, 2015**



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 five years. The City is experiencing a positive spread against both benchmarks. The Portfolio's yield is higher than the 6-month UST by 0.78 percent and higher than the 2-year UST by 0.24 percent.

**Irvine Pooled Investment Portfolio**  
**Chart 6 - Yield to Maturity Compared to Assigned Benchmarks**  
**December 2009 through June 2015**



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. Through the first close of June’s books, the AMP earned interest of \$321,563 for the fiscal year ended June 30, 2015, based on an average cash balance of \$52.37 million.

*Orange County Great Park Funds*

Through the first close of June’s books, the Great Park funds earned interest of \$229,942 for the fiscal year ended June 30, 2015. The Great Park funds had a combined average daily cash balance of \$37.09 million for the year ended June 30, 2015.

**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, 2015 was \$57,099.

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

	<b>June 30, 2015</b>	<b>March 31, 2015</b>	<b>Dec 31, 2014</b>	<b>Sept 30, 2014</b>
Book Value	\$9,659,436	\$50,000,436	\$27,423,436	\$6,634,436
Market Value	\$9,663,068	\$50,019,622	\$27,422,898	\$6,635,639
Unrealized Gain/(Loss)	\$3,632	\$19,186	\$(538)	\$1,203
Unrealized Gain/(Loss) as % of Book Value	0.04%	0.04%	0.00%	0.02%
Average Yield To Maturity	0.30%	0.28%	0.27%	0.25%
Liquidity 0 –6 months	100.00%	100.00%	100.00%	100.00%
Average To Maturity (Days)	1	1	1	1
Modified Duration (Days)	1	1	1	1

**Special District Funds Portfolio**

The Special District Funds Portfolio contains project and reserve funds for 27 assessment district bond issues and two 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, 2015 was \$266,330.

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

	<b>June 30, 2015</b>	<b>March 31, 2015</b>	<b>Dec 31, 2014</b>	<b>Sept 30, 2014</b>
Book Value	\$259,740,586	\$239,814,616	\$246,877,913	\$261,301,484
Market Value	\$259,757,661	\$239,814,344	\$246,774,905	\$261,224,021
Unrealized Gain/(Loss)	\$17,075	\$(272)	\$(103,008)	\$(77,463)
Unrealized Gain/(Loss) as % of Book Value	0.01%	0.00%	(0.04%)	(0.03%)
Average Yield To Maturity	0.12%	0.13%	0.13%	0.12%
Liquidity 0 –6 months	100.00%	100.00%	100.00%	100.00%
Average To Maturity (Days)	131	149	124	118

**Market Conditions**

During the fourth quarter of FY 2014-15, interest rates increased with the yield curve steepening in the short end. The 3-month Treasury bill decreased 2.20 basis points ending the period at 0.00 percent. Two-year Treasury notes increased 9.00 basis points to 0.64 percent, and the five-year Treasury note increased 28.00 basis points to 1.65 percent.

In comparison to FY 2013-2014, interest rates increased from the 6-month Treasury bill to 5-year Treasury note maturities, with the greatest increase of 18.00 basis points in 2-year Treasury notes. This was a direct result of speculation that the Federal Funds rate would be increased by the Federal Open Market Committee (FOMC) above the current 0.00 percent to 0.25 percent range. In contrast, the 10-year Treasury note yields decreased by 17.00 basis points, and the 30 year bonds decreased by 24.00 basis points.

In the first quarter calendar year, Gross Domestic Product (GDP) was restated from (0.20) percent to 0.60 percent and rebounded to 2.30 percent in the second quarter, whereas GDP decreased from an annualized rate of 2.83 percent to 2.19 percent in FY



2013-2014. Employment improved as continuing jobless claims ended the quarter at 2.22 million versus 2.31 million in the prior quarter. Most economic indicators continue to show improvement which increased speculation of the Federal Funds rate increase at the September 2015 FOMC meeting. As the U.S. economy continues to expand, rate hike speculation is being tempered by ongoing geopolitical instability with Greece, China, and the Middle East. The dollar index dropped slightly to 95.48 at the end of the quarter but remains near its decade high.

In conclusion, most economists believe the Federal Reserve will not raise rates prior to the September 2015 meeting as it will remain focused on its dual mandate of full employment and price stability. While the odds of a monetary policy tightening have increased, any near-term negative phase will likely be short lived and shallow due to the disinflationary effects of a strengthening dollar.

#### **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 \$3.76 million with investments structured for security and liquidity.

**REPORT PREPARED BY**            Don Collins, City Treasurer