



REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: DECEMBER 8, 2015

TITLE: TREASURER'S REPORT FOR THE QUARTER ENDED
SEPTEMBER 30, 2015

Interim Director of Administrative Services

City Manager

RECOMMENDED ACTION

Receive and file.

EXECUTIVE SUMMARY

This report provides a synopsis of investment activity for the City's three investment portfolios for the quarter ended September 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 \$701.71 million as of September 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 November 16, 2015, recommended the City Council receive and file the Treasurer's Report by a unanimous vote. The Investment Advisory Committee, at its regular meeting of November 4, 2015, recommended the City Council receive and file the Treasurer's Report by a unanimous vote of 4-0 (Chair Gonzales 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 September 30, 2015, the book value (purchase price of securities as recorded on the City's books) of the Irvine Pooled Investment Portfolio was \$461.14 million and the average weighted yield to maturity was 0.98 percent. Quarter-to-date investment revenue (interest payments and capital gains) generated by the Irvine Pooled Investment Portfolio as of September 30, 2015 was \$890,371. 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**

	Sept 30, 2015	June 30, 2015	March 31, 2015	Dec 31, 2014
Book Value	\$461,135,393	\$486,857,944	\$439,932,507	\$395,727,888
Market Value	\$462,618,007	\$487,453,132	\$440,906,767	\$395,007,261
Unrealized Gain/(Loss)	\$1,482,614	\$595,188	\$974,260	\$(720,627)
Unrealized Gain/(Loss) as % of Book Value	0.32%	0.12%	0.22%	(0.18%)
Average Yield To Maturity	0.98%	0.89%	0.90%	0.88%
Liquidity 0 –6 months	9.85%	14.20%	9.07%	10.91%
Average Years To Maturity	2.07	2.00	2.17	2.26
Modified Duration (Years)	1.99	1.85	2.09	2.22

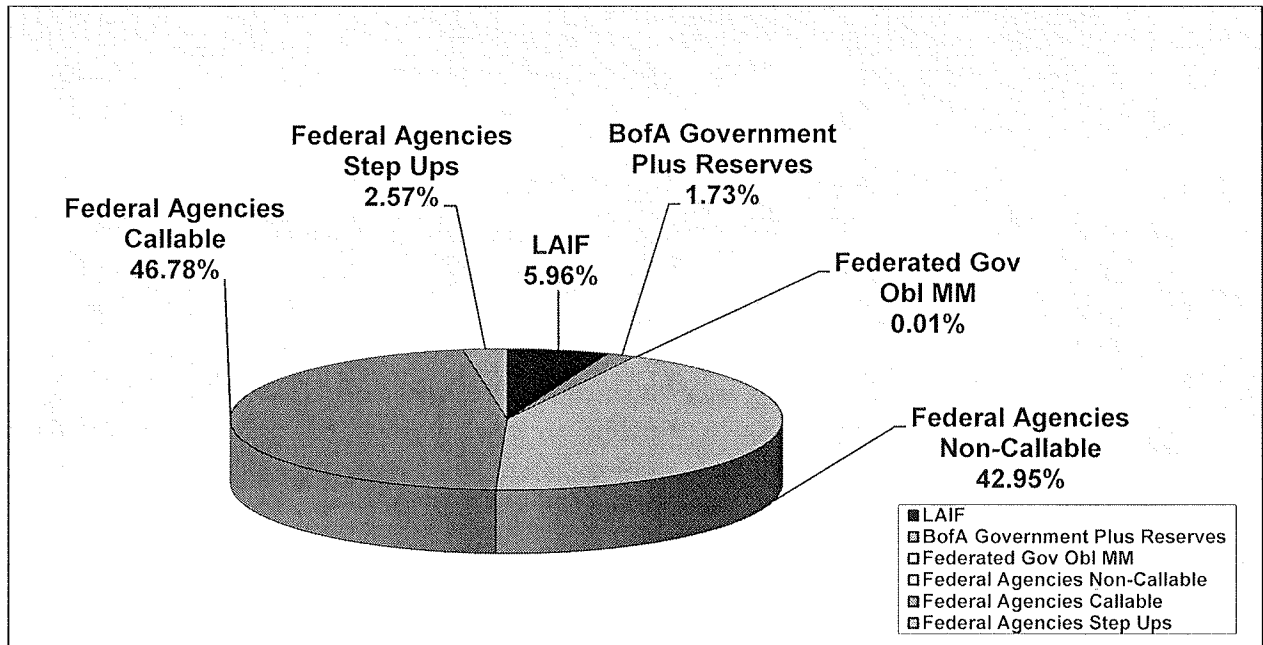
The Irvine Pooled Investment Portfolios book value decreased by \$25.72 million from the last quarter. The decrease in book value was due to the cyclical nature of the City's revenue stream that often fluctuates \$10 to \$40 million each quarter. Portfolio yield to maturity increased by 9 basis points to 0.98 percent as available liquidity was invested in higher yielding assets. With rates decreasing during the quarter ending September 30, 2015, the

unrealized gain increased to \$1,482,614 from \$595,188 as of June 30, 2015. This is a normal result of the Irvine Pooled Investment Portfolio's modified duration of 1.99 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.

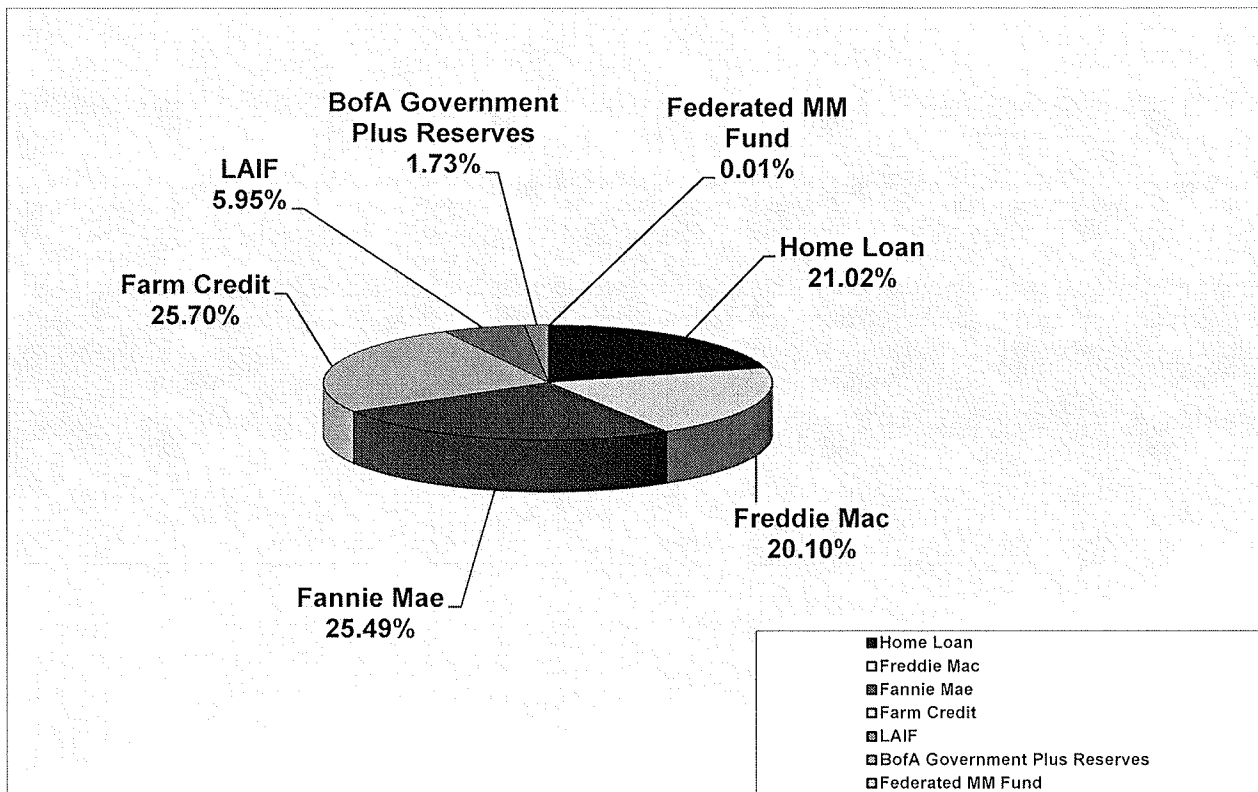
**Irvine Pooled Investment Portfolio
Chart 1 - Asset Allocation
as of September 30, 2015**



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 September 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 September 30, 2015, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 9.85 percent versus 14.20 percent last quarter. The planned decrease in liquidity was due to the 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 September 30, 2015

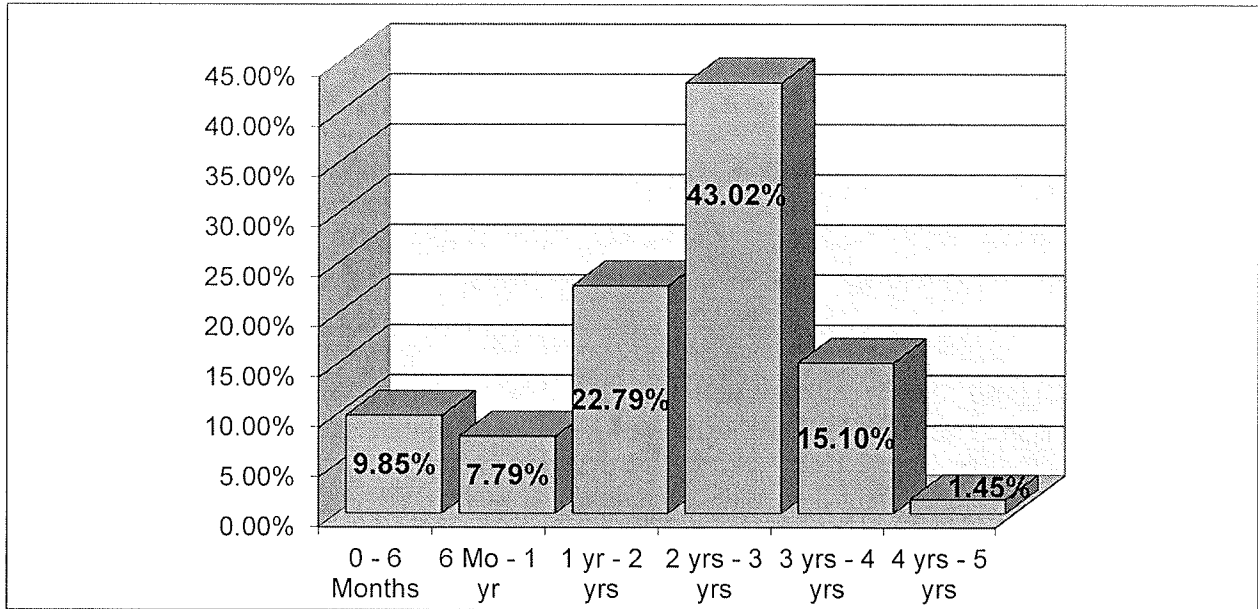
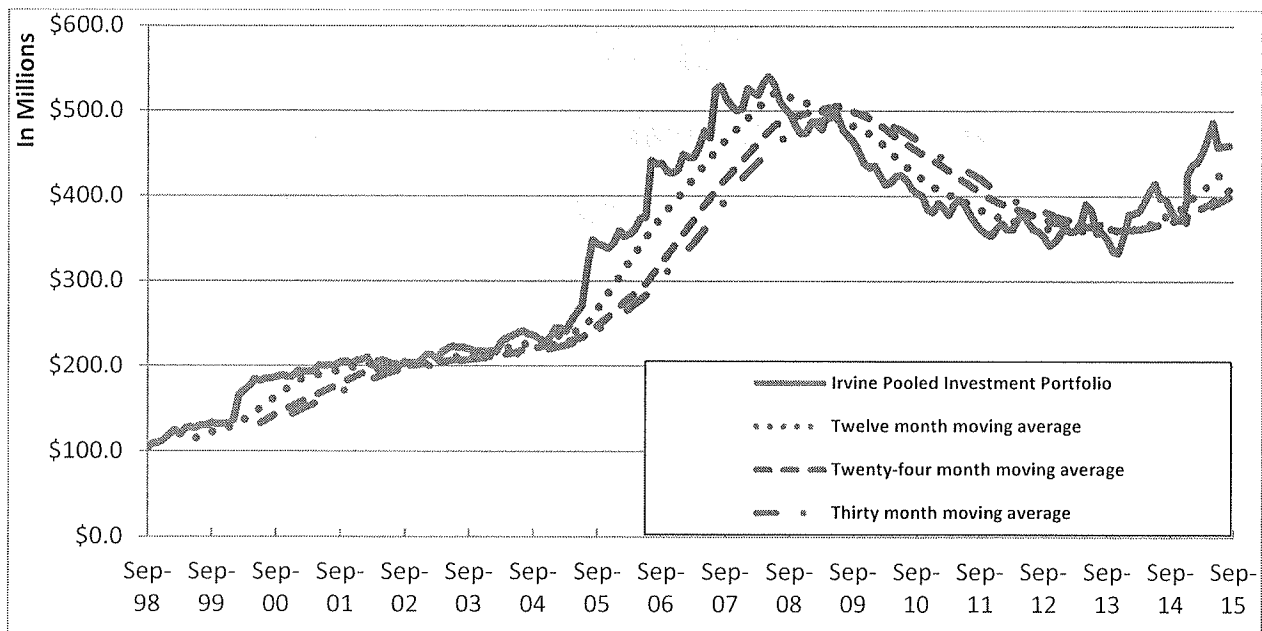
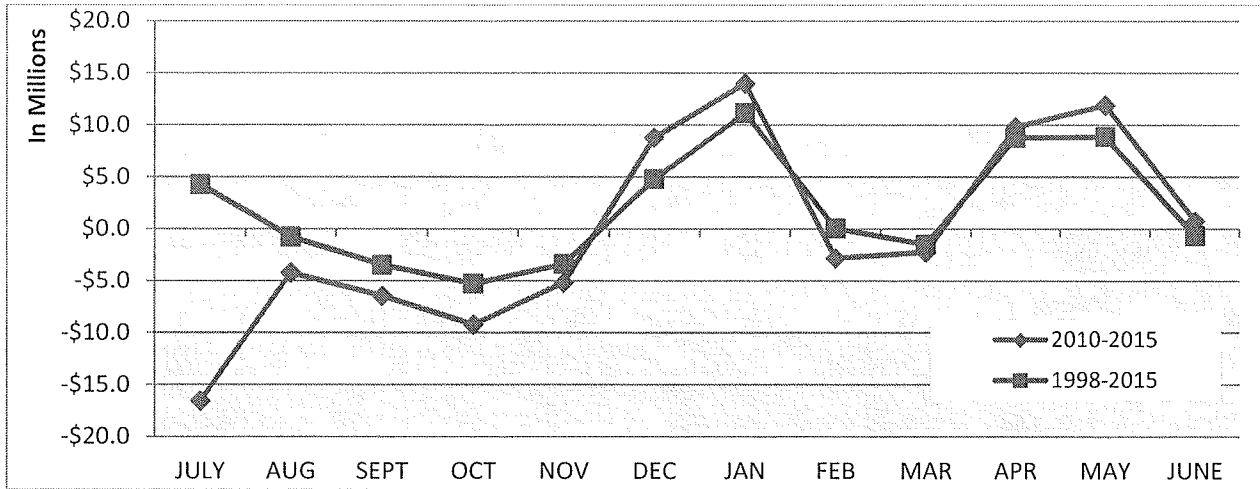


Chart 4 and chart 5 show the volatility and cyclicalty of the Irvine Pooled Investment Portfolio fund balance and cash flows between July 1998 and September 2015.

Irvine Pooled Investment Portfolio
Chart 4 - Portfolio Balance
 September 30, 1998 through September 30, 2015

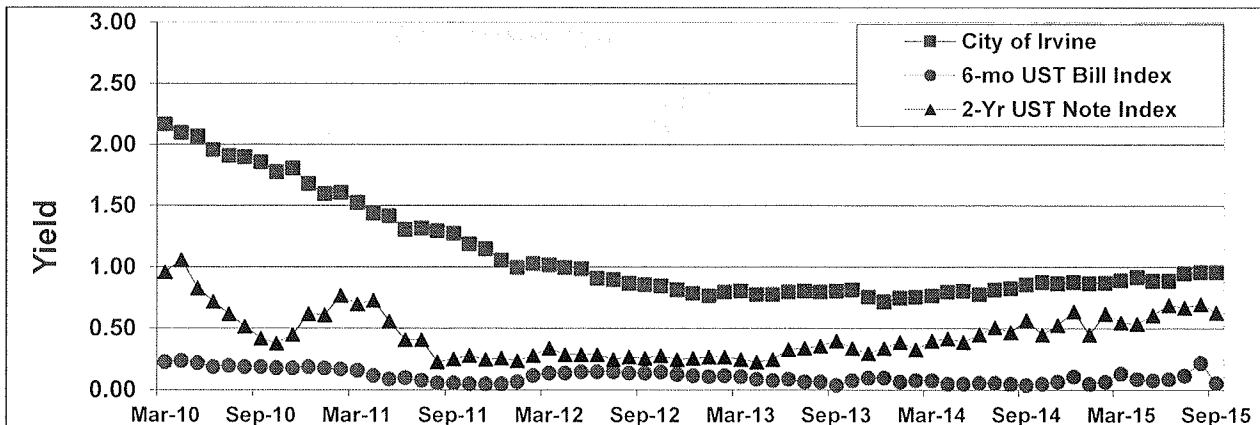


Irvine Pooled Investment Portfolio
Chart 5 – Balance Change Month by Month (Average)
 July 31, 1998 through September 30, 2015



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 0.80 percent and higher than the 2-year UST by 0.28 percent.

Irvine Pooled Investment Portfolio
Chart 6 - Yield to Maturity Compared to Assigned Benchmarks
 March 2010 through September 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. The AMP earned interest of \$21,892 for the quarter ended September 30, 2015 based on an average cash balance of \$48.16 million.

Orange County Great Park Funds

The Great Park funds earned interest of \$18,298 for the quarter ended September 30, 2015 the Great Park funds had a combined average daily cash balance of \$40.63 million for the quarter ended September 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 September 30, 2015 was \$27,359.

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

	Sept 30, 2015	June 30, 2015	March 31, 2015	Dec 31, 2014
Book Value	\$7,378,436	\$9,659,436	\$50,000,436	\$27,423,436
Market Value	\$7,382,823	\$9,663,068	\$50,019,622	\$27,422,898
Unrealized Gain/(Loss)	\$4,387	\$3,632	\$19,186	\$(538)
Unrealized Gain/(Loss) as % of Book Value	0.04%	0.04%	0.04%	0.00%
Average Yield To Maturity	0.33%	0.30%	0.28%	0.27%
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

Special District Funds Portfolio

The Special District Funds Portfolio contains project and reserve funds for 23 assessment district bond issues and four 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. Quarter-to-date investment revenue (interest payments and capital gains) generated by the Special District Funds Portfolio as of September 30, 2015 was \$90,718.

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

	Sept 30, 2015	June 30, 2015	March 31, 2015	Dec 31, 2014
Book Value	\$231,674,282	\$259,740,586	\$239,814,616	\$246,877,913
Market Value	\$231,713,444	\$259,757,661	\$239,814,344	\$246,774,905
Unrealized Gain/(Loss)	\$39,162	\$17,075	\$(272)	\$(103,008)
Unrealized Gain/(Loss) as % of Book Value	0.02%	0.01%	0.00%	(0.04)%
Average Yield To Maturity	0.17%	0.12%	0.13%	0.13%
Average Days To Maturity	132	131	149	124

Market Conditions

During the first quarter of FY 2015-16, interest rates decreased with the yield curve flattening 27.53 basis points. The 3-month Treasury bill decreased 2.30 basis points ending the period at (.015) percent. Two-year Treasury notes decreased by 1.40 basis points to .63 percent, and the 5-year Treasury note decreased by 29.10 basis points to 1.36 percent.

Trading was dominated by speculation that the Federal Open Market Committee (FOMC) would raise the Federal Funds rate by the September 17 meeting. Two-year Treasury note yields rose to .81 percent by September 16. On September 17, the FOMC held the Federal Funds rate between 0 to 0.25 percent stating that emerging market economies and financial market stability were of concern. The Federal Reserve is effectively in a Fed policy loop. As perception rises for the FOMC to move interest rates higher, the dollar appreciates, credit spreads widen and equities fall. The ensuing tighter financial conditions raise the downside risks to the US growth and inflation outlook, causing the FOMC to ease credit conditions. As the FOMC backs off raising interest rates, financial conditions ease with the dollar depreciating, credit spreads tightening and equities rising. Ensuing asset inflation causes the FOMC to move once again to its hawkish statements. Employment continued to expand with the unemployment rate decreased to 5.10 percent from 5.30 percent. Automobile annual sales reached an all-time high of 18.07 million

units. Retail sales and consumer confidence remained steady through the quarter. Data released at the end of the quarter show an economy with signs of weakening labor market growth, marginal wage growth, declining corporate profits and emerging market instability. The probability of a FOMC rate hike in 2015 has dropped below 37 percent. Treasury yields are unlikely to rise above current forward rates given the current depressed global economic backdrop and persistent strength in the US 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

Quarter year-to-date investment income for the Irvine Pooled Investment Portfolio, Bond Proceeds, and Special Districts portfolios totaled \$1.01 million with investments structured for security and liquidity.

REPORT PREPARED BY Don Collins, City Treasurer