



REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: DECEMBER 10, 2013

TITLE: TREASURER'S REPORT FOR THE QUARTER ENDED
SEPTEMBER 30, 2013

Acting 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, 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 \$536 million as of September 30, 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 November 18, 2013, 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 13, 2013, recommended the City Council receive and file the Treasurer's Report by a unanimous vote of 3-0 (Chair Gonzales and Vice Chair Shanahan absent).

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, in accordance with the adopted Investment Policy, 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.

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 September 30, 2013, the book value (purchase price of securities as recorded on the City's books) of the Irvine Pooled Investment Portfolio was \$348.84 million and the average weighted yield to maturity was 0.81 percent. Fiscal-year-to-date investment income (interest payments and capital gains) generated by the Irvine Pooled Investment Portfolio as of September 30, 2013 was \$809 thousand. 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, 2013	June 30, 2013	March 31, 2013	Dec 31, 2012
Book Value	\$348,836,003	\$382,983,315	\$359,368,846	\$354,378,826
Market Value	347,866,493	\$381,136,798	\$360,707,990	\$356,003,429
Unrealized Gain/(Loss)	(\$969,510)	(\$1,846,517)	\$1,339,144	\$1,624,602
Unrealized Gain/(Loss) as % of Book Value	(0.28%)	(0.48%)	0.37%	0.46%
Average Yield To Maturity	0.81%	0.79%	0.81%	0.79%
Liquidity 0 – 6 months	15.79%	19.90%	15.92%	14.31%
Average Years To Maturity	2.47 years	2.47 years	2.49 Years	2.48 years
Effective Duration	2.40 years	2.40 years	2.42 Years	2.44 years

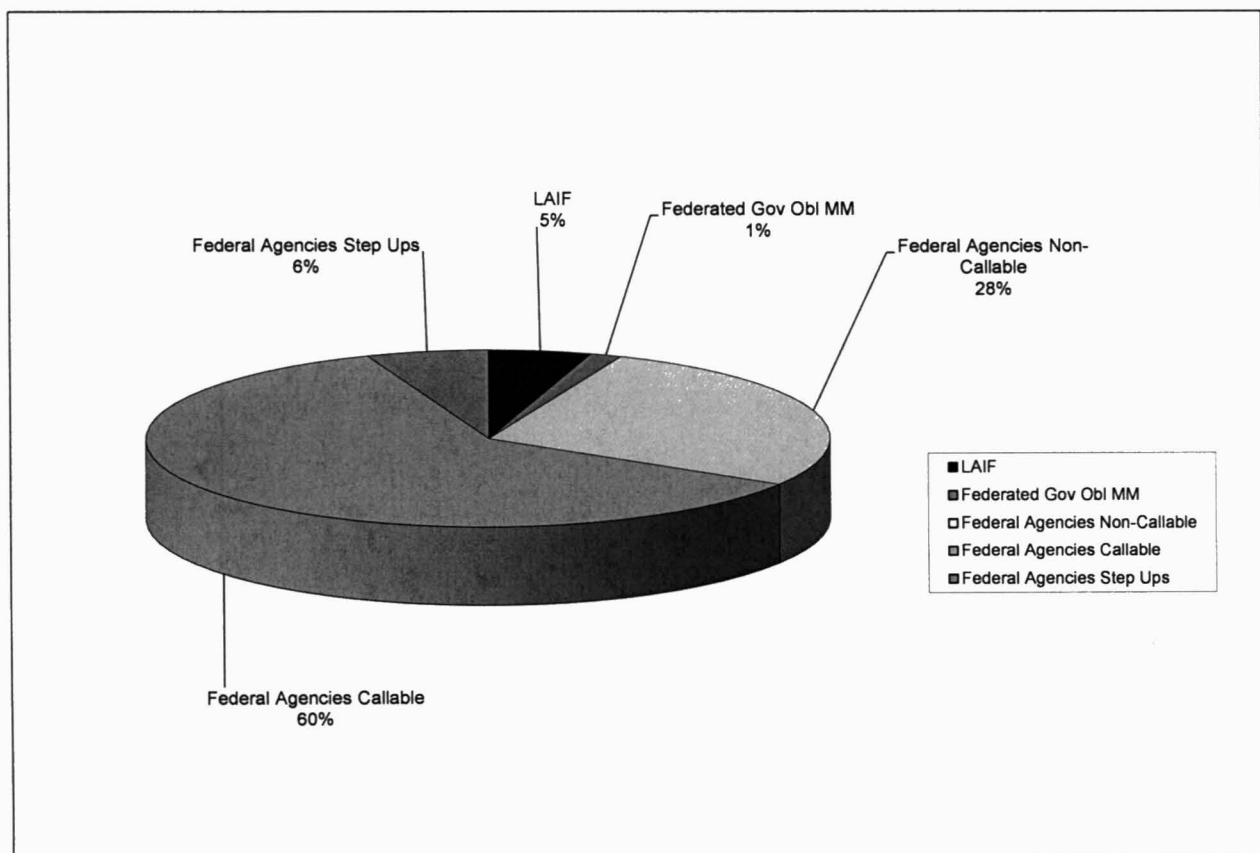
Book value was reduced by \$34.15 million as compared to the prior quarter that ended on June 30, 2013. A portion of the reduction was attributable to a July \$18 million prepayment of the Fiscal Year 2013-14 CalPERS retirement contribution. The remaining \$16 million book value decrease was due to normal cash flow fluctuations that are typically experienced during the first quarter of a fiscal year. During the first half of the fiscal year,

the City typically has greater cash disbursements than cash receipts until the December property tax distribution is received.

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 (FNMA) and Federal Home Loan Mortgage Company (FHLMC) remain under conservatorship 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.

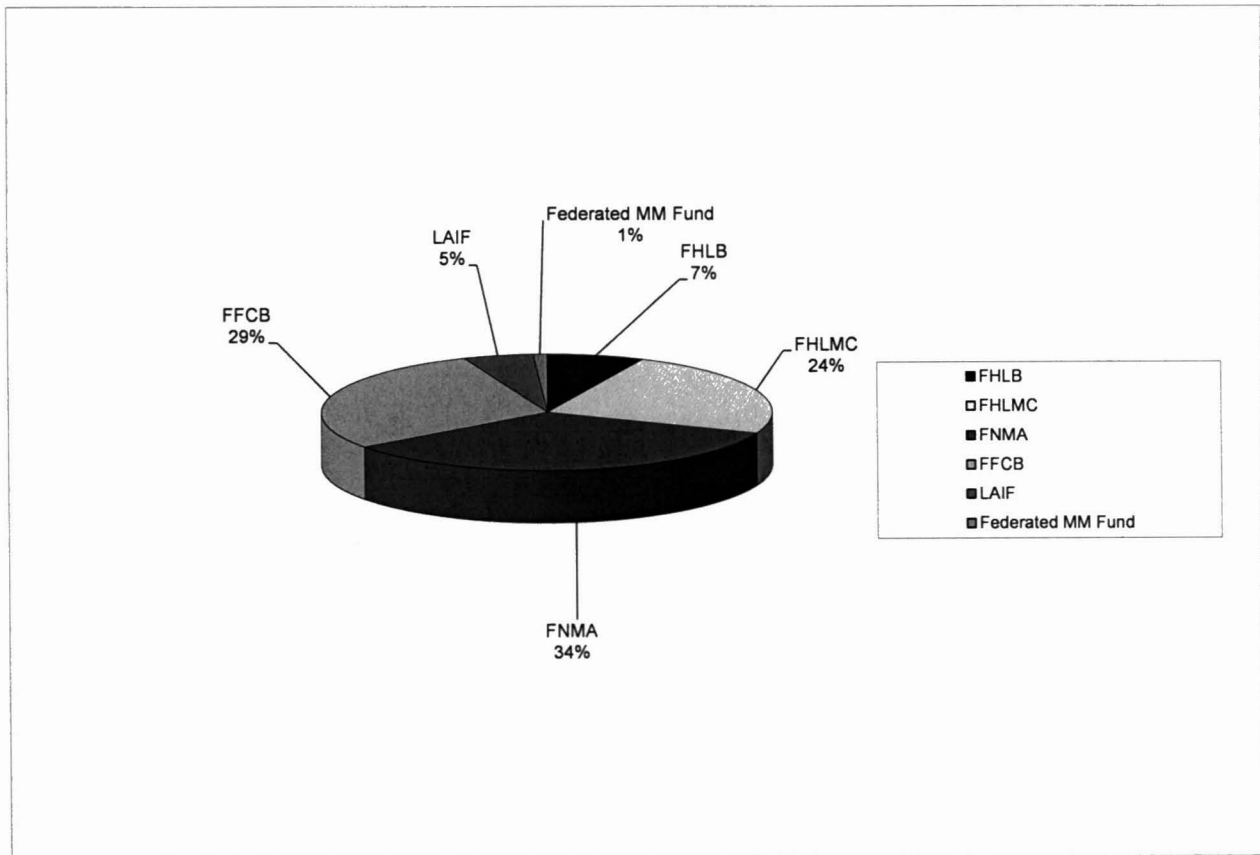
To manage liquidity, the Irvine Pooled Investment Portfolio is invested in LAIF (Local Agency Investment Funds) and the Federated Government Obligation money market fund. Chart 1 shows the asset allocation of the Irvine Pooled Investment Portfolio.

**Irvine Pooled Investment Portfolio
Chart 1 - Asset Allocation
as of September 30, 2013**



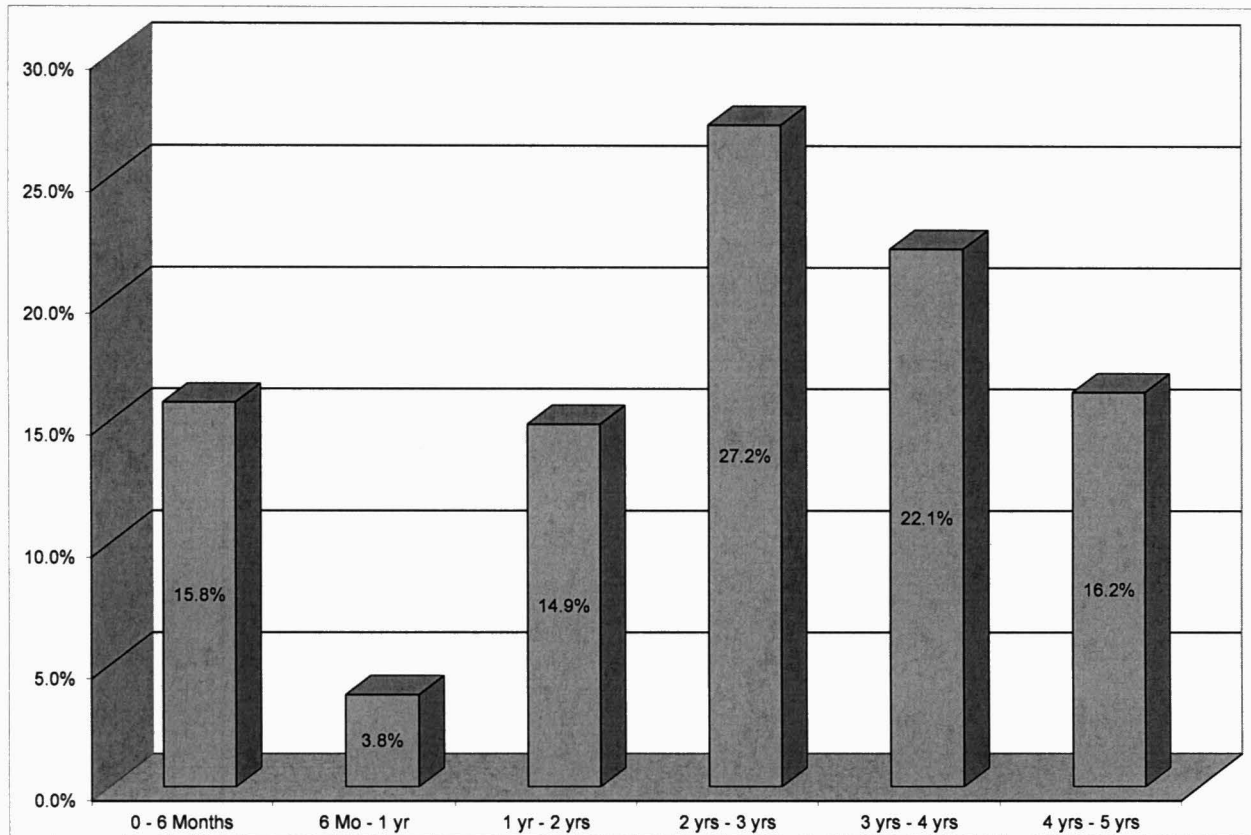
Since 94 percent of the portfolio is invested in Federal Agency securities, the safety of the Irvine Pooled Investment Portfolio is further protected by purchasing securities from several different Federal Agencies. The four Federal Government sponsored entities that the City purchases securities from are Federal Home Loan Bank (FHLB or Home Loan), Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac), Federal National Mortgage Association (FNMA or Fannie Mae), and Federal Farm Credit Bank (FFCB or Farm Credit). Because Fannie Mae and Freddie Mac are under conservatorship by the U.S. government, securities issued by these government sponsored entities carry an explicit guarantee by the Federal Government. Home Loan and Farm Credit carry an implied guarantee of the Federal Government. Chart 2 identifies portfolio holdings by issuer name.

**Irvine Pooled Investment Portfolio
Chart 2 - Allocation by Issuer Name
as of September 30, 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 September 30, 2013, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 15.79 percent, which provides adequate liquidity to meet anticipated expenses. Chart 3 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.

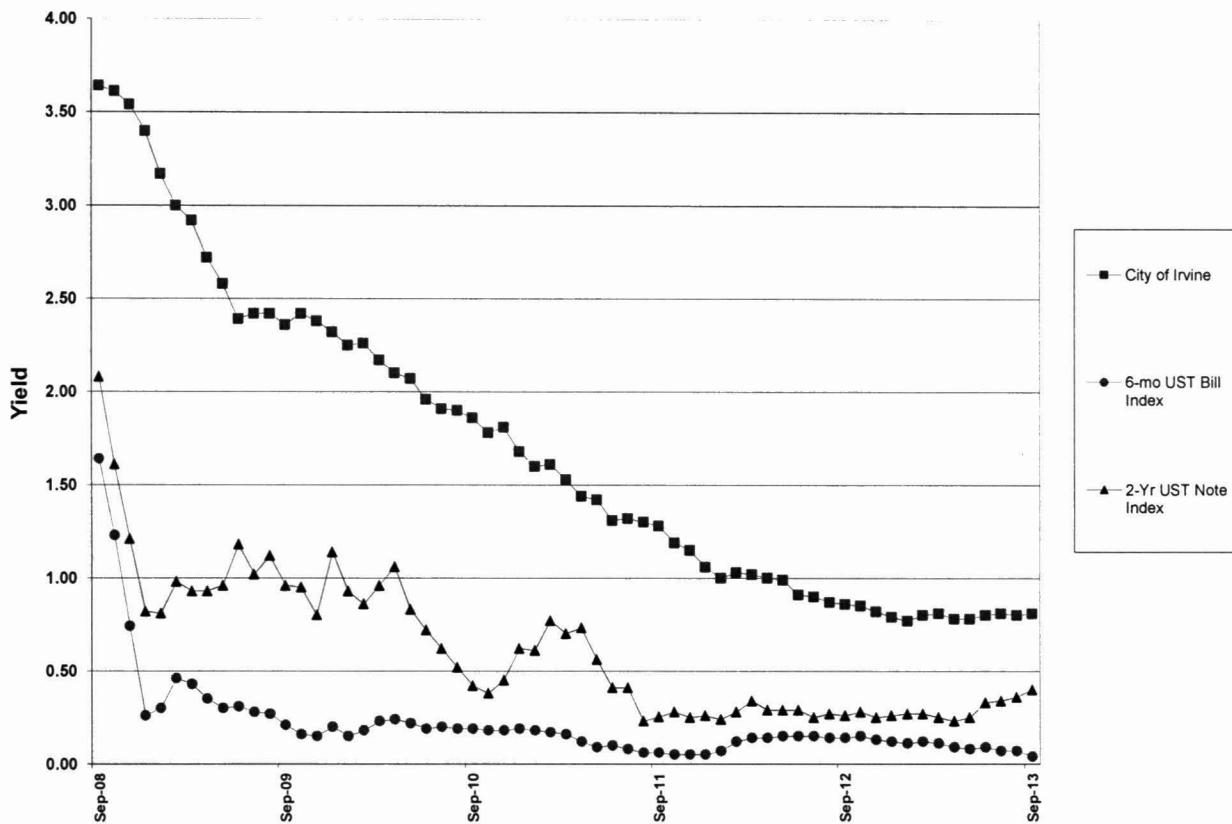
**Irvine Pooled Investment Portfolio
Chart 3 - Aging of Maturing Investments
as of September 30, 2013**



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 0.77 percent and higher than the 2-year UST by 0.41 percent.

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



The Irvine Pooled Investment Portfolio invests funds attributable to the Asset Management Plan (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 (AMP) Funds

Interest earnings for the AMP funds are allocated based on the AMP fund average daily cash balance. The AMP earned interest of \$32,820 for the quarter ended September 30, 2013 based on an average cash balance of \$55.78 million.

Great Park Corporation Funds

The Great Park funds earned interest of \$19,142 for the quarter ended September 30, 2013. The Great Park funds had a combined average daily cash balance of \$35.27 million for the quarter ended September 30, 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 September 30, 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 September 30, 2013.

Market Conditions

Bond market volatility continued into the first quarter of FY 2013–14, as market participants speculated over when the Federal Reserve would begin to taper asset purchases. Another factor contributing to the volatility in the market was the uncertainty

of the Congressional ability to resolve the budget and debt ceiling issues by their respective deadlines in October. As a result of the volatility, bond interest rates ended mixed along the curve. Interest rates were lower in the 3-month to 3-year sectors of the curve (0.5 to 6.0 basis points), and higher in the 1-month and 7 to 30-year sectors of the curve (1.5 to 20.0 basis points).

The minutes released from the July Federal Open Market Committee (FOMC) meeting revealed that the majority of the FOMC members agreed that a change in the asset purchase program was not appropriate at that time. The FOMC also reiterated that any changes to monetary policy would be driven by economic data, specifically, evidence of an unemployment rate of 6.50 percent and the gross domestic product (GDP) at 2.50 percent. The market was taken by surprise at the outcome of the September FOMC meeting. The market expected the FOMC to announce a schedule for the commencement of tapering asset purchases. Instead, the FOMC maintained its stance of economic data dependency to support any lifting of its current accommodative monetary policy.

ALTERNATIVES CONSIDERED

None.

FINANCIAL IMPACT

Fiscal year-to-date investment income for the Irvine Pooled Investment Portfolio, Bond Proceeds, and Special Districts portfolios totaled \$851 thousand with investments structured for security and liquidity.

REPORT PREPARED BY Michele C. Lund, City Treasurer