



REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: MARCH 28, 2017

TITLE: TREASURER'S REPORT FOR THE QUARTER ENDED
DECEMBER 31, 2016



Director of Financial Services



City Manager

RECOMMENDED ACTION

Receive and file the Treasurer's Report for the quarter ended December 31, 2016.

EXECUTIVE SUMMARY

This report provides a synopsis of investment activity for the City's three investment portfolios for the quarter ended December 31, 2016. The portfolios are managed by United American Capital Corporation (UACC) under the direction of the Treasurer and 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 \$966.09 million as of December 31, 2016.

This report includes portfolio assets, allocations, average maturities, yields, and portfolio valuations for each of the three portfolios. A discussion of market conditions is provided to give additional perspective to these measurements.

COMMISSION/BOARD/COMMITTEE RECOMMENDATION

At its regular meeting of February 21, 2017, the Finance Commission reviewed the Treasurer's Report and voted 5-0, with all members present, to recommend the City Council receive and file the Treasurer's Report. The Investment Advisory Committee unanimously voted, at its regular meeting of February 8, 2017, to recommend 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 Districts 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 Irvine Pooled Investment Portfolio is a combination of several operational funds, including the City's Asset Management Plan and funds earmarked for the development of the Orange County Great Park.

As of December 31, 2016, the book value (purchase price of securities as recorded on the City's books) of the Irvine Pooled Investment Portfolio was \$574.58 million and the average weighted yield to maturity was 1.12 percent. Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the Irvine Pooled Investment Portfolio as of December 31, 2016 was \$2.72 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, 2016	Sept 30, 2016	June 30, 2016	March 31, 2016
Book Value	\$574,580,674	\$557,660,462	\$572,157,628	\$533,389,906
Market Value	\$571,366,011	\$559,208,937	\$574,913,200	\$535,191,367
Unrealized Gain/(Loss)	(\$3,214,663)	\$1,548,475	\$2,755,572	\$1,801,461
Unrealized Gain/(Loss) as % of Book Value	(0.56%)	0.28%	0.48%	0.34%
Average Yield To Maturity	1.12%	1.06%	1.03%	1.05%
Liquidity 0 –6 months	13.56%	9.85%	13.19%	10.95%
Average Years To Maturity	2.03	2.02	1.91	2.02
Modified Duration (Years)	1.97	1.98	1.84	1.98
Fiscal Year to Date Income	\$2,720,039	\$1,340,988	\$4,613,047	\$3,057,399

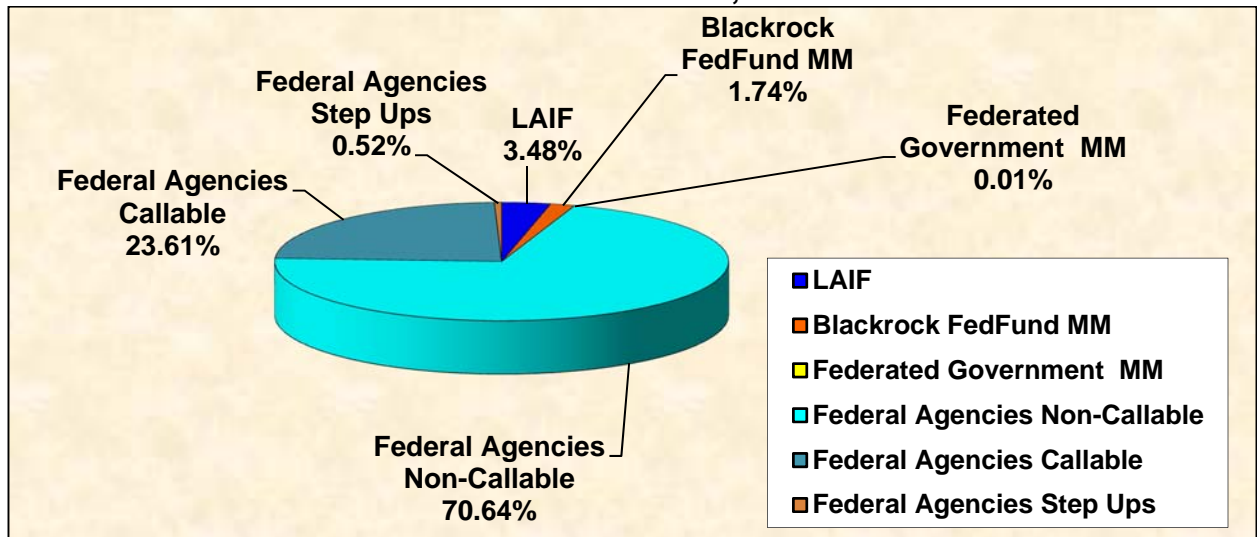
The Irvine Pooled Investment Portfolios book value increased by \$16.92 million from the previous quarter due to the planned seasonal cyclical nature of the City's revenue stream and cash flow that often fluctuates \$10 to \$50 million each quarter. Portfolio yield to maturity

increased for the quarter ended December 31, 2016 by 6 basis points to 1.12 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 December 31, 2016, the Irvine Pooled Investment Portfolio ended the quarter with an unrealized loss of \$3.21 million as compared to an unrealized gain of \$ 1.55 million on September 30, 2016. This is a normal result of the Irvine Pooled Investment Portfolio's modified duration of 1.97 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 Irvine Pooled Investment Portfolio.

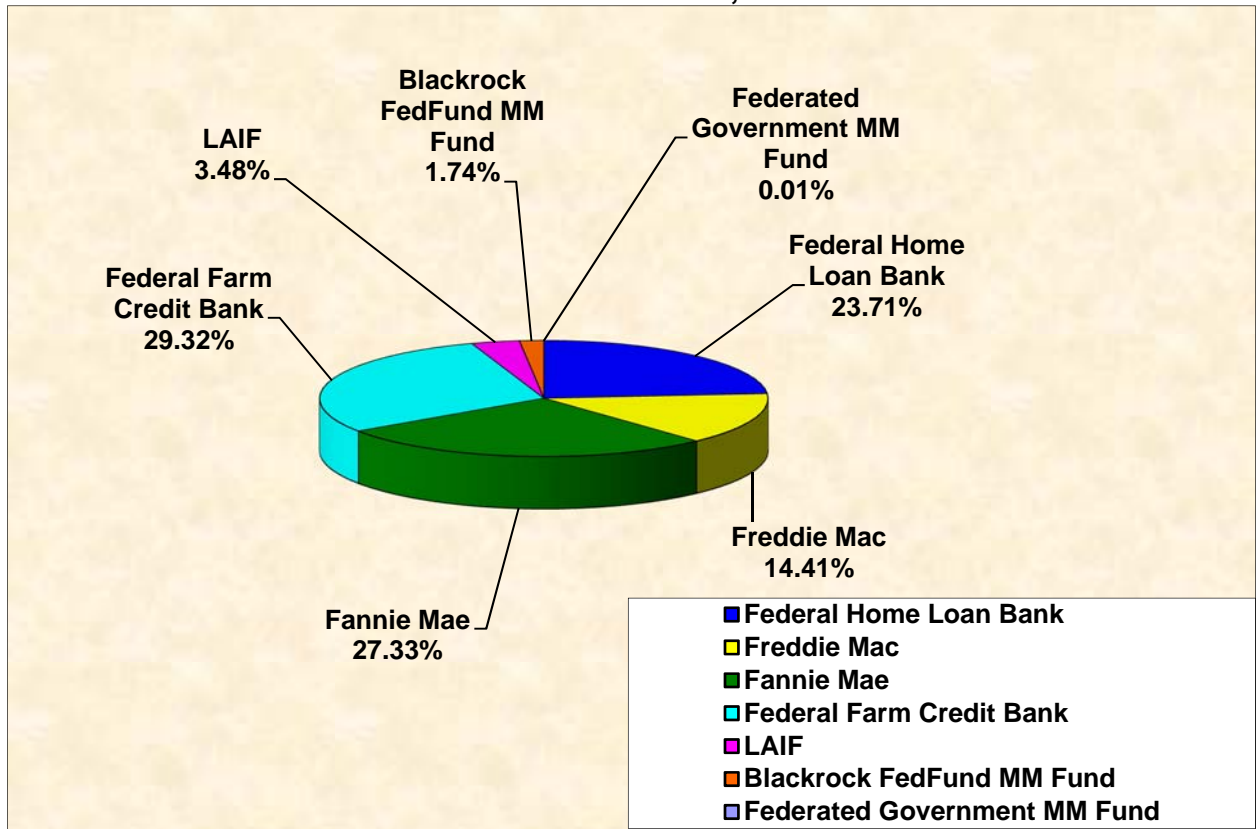
**Irvine Pooled Investment Portfolio
Chart 1 - Asset Allocation
as of December 31, 2016**



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 December 31, 2016**



Another key component in portfolio management is to ensure that the City has enough funds on hand to meet current expenses. As of December 31, 2016, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 13.56 percent versus 9.85 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 December 31, 2016

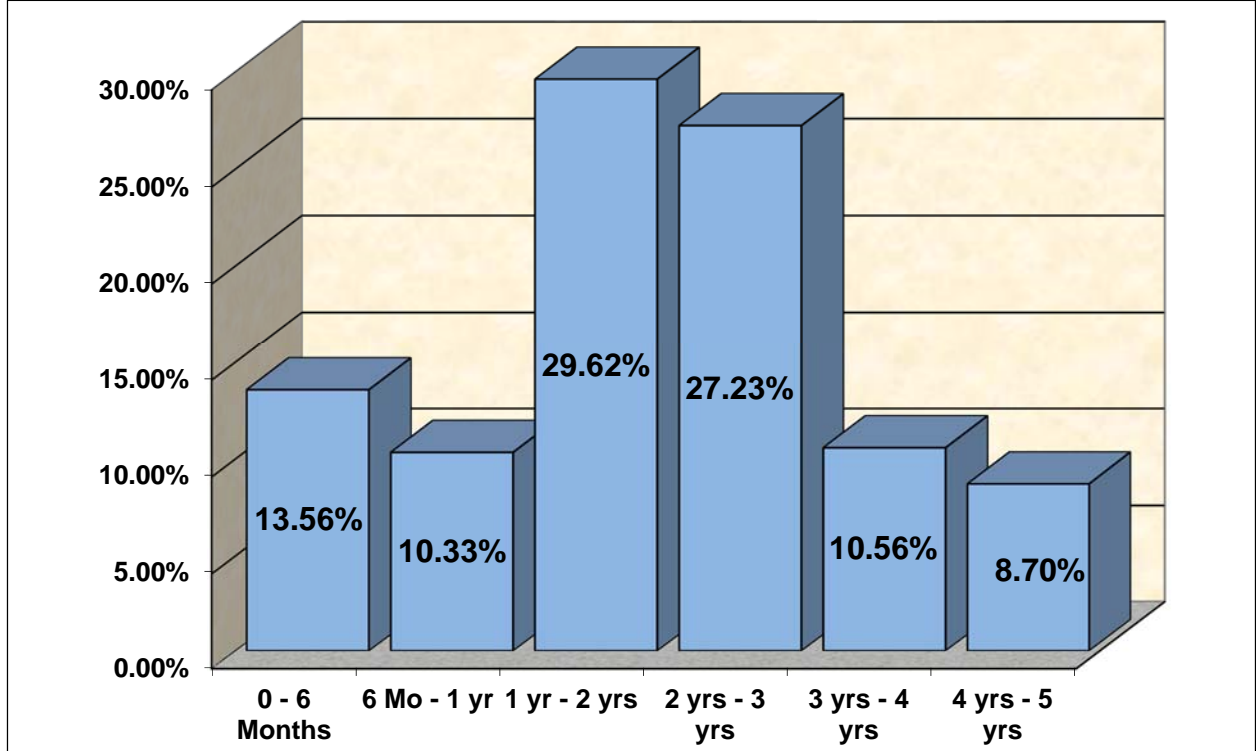
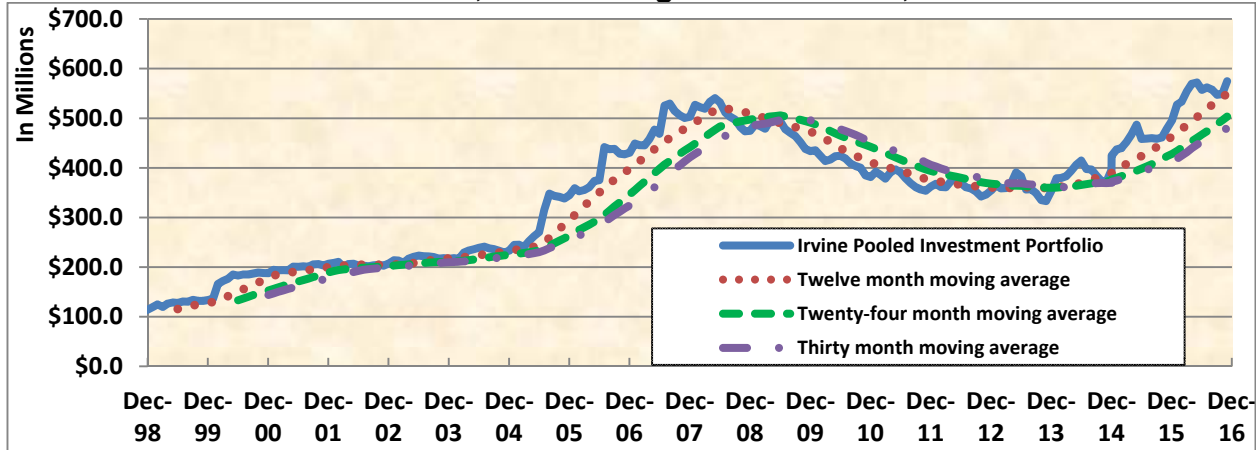
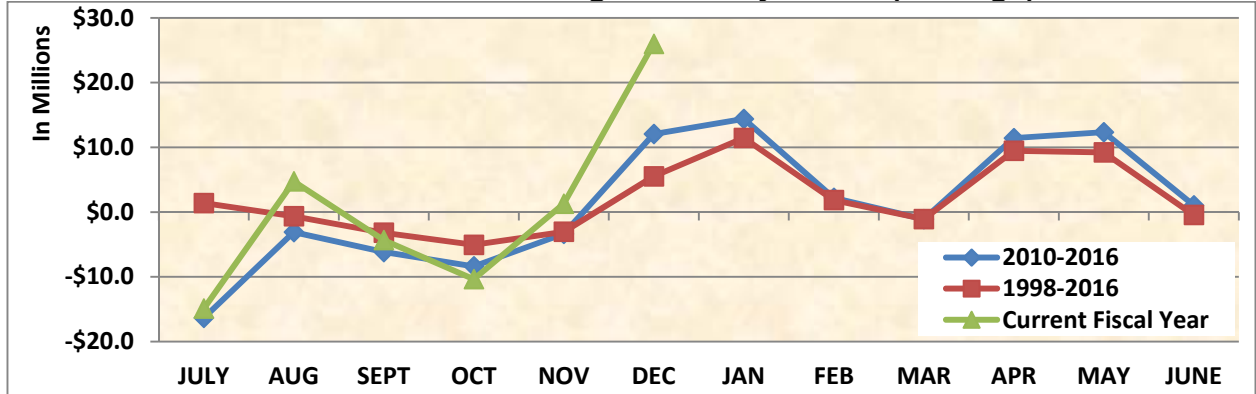


Chart 4 and Chart 5 show the volatility and cyclical nature of the Irvine Pooled Investment Portfolio fund balance and cash flows between December 31, 1998 and December 31, 2016.

Irvine Pooled Investment Portfolio
Chart 4 - Portfolio Balance
 December 31, 1998 through December 31, 2016

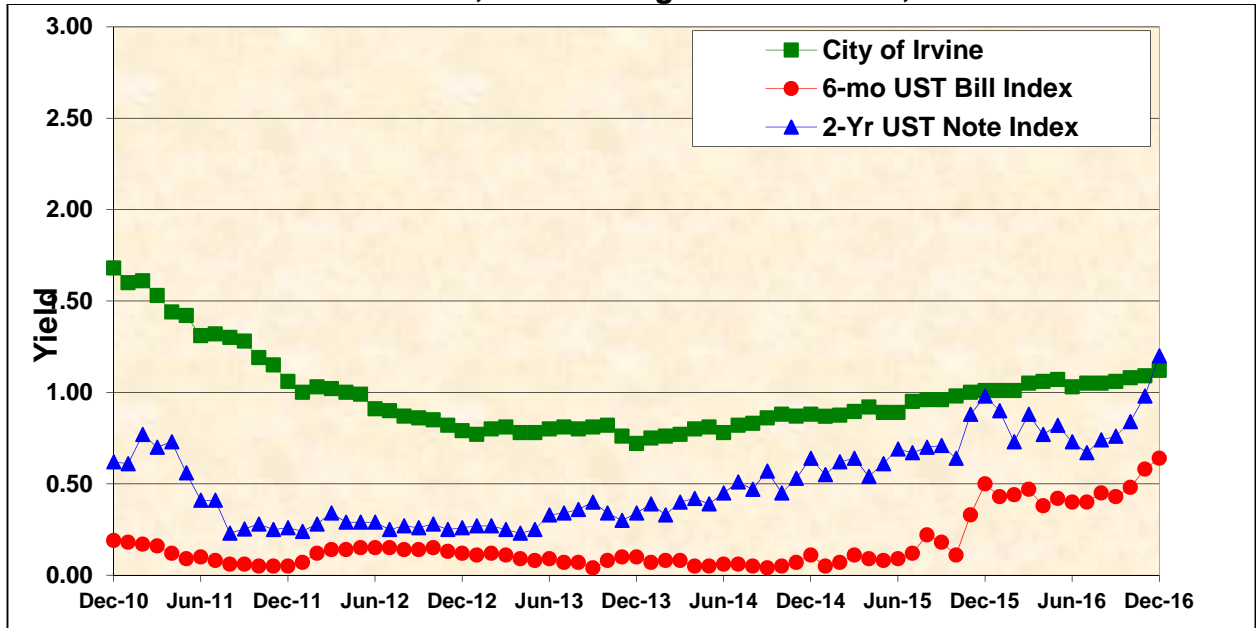


Irvine Pooled Investment Portfolio
Chart 5 – Balance Change Month by Month (Average)



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 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 six years. The Portfolio’s yield is higher than the 6-month UST by 0.48 percent and lower than the 2-year UST by 0.08 percent.

Irvine Pooled Investment Portfolio
Chart 6 - Yield to Maturity Compared to Assigned Benchmarks
December 31, 2010 through December 31, 2016



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 special districts inspection and administration. Investment strategy differs in the Bond Proceeds Fund Portfolio from the Irvine Pooled Investment Fund 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. The transfer of this amount for the quarter ended December 31, 2016 from the Bond Proceeds Fund Portfolio occurred in January 2017.
- (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 December 31, 2016 was \$6,984.

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

	Dec 31, 2016	Sept 30, 2016	June 30, 2016	March 31, 2016
Book Value	\$7,608,436	\$760,436	\$755,436	\$4,986,436
Market Value	\$7,604,053	\$760,669	\$755,905	\$4,987,538
Unrealized Gain/(Loss)	(\$4,383)	\$233	\$469	\$1,102
Unrealized Gain/(Loss) as % of Book Value	(0.06%)	0.03%	0.06%	0.02%
Average Yield To Maturity	0.72%	0.63%	0.58%	0.51%
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	\$6,984	\$5,783	\$51,224	\$41,277

Special District Funds Portfolio

The Special District Funds Portfolio contains project and reserve funds for 26 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 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 December 31, 2016 was \$694,044.

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

	Dec 31, 2016	Sept 30, 2016	June 30, 2016	March 31, 2016
Book Value	\$387,387,309	\$371,479,758	\$285,890,825	\$290,492,013
Market Value	\$387,100,007	\$371,288,348	\$285,818,109	\$290,412,175
Unrealized Gain/(Loss)	(\$287,302)	(\$191,410)	(\$72,716)	(\$79,838)
Unrealized Gain/(Loss) as % of Book Value	(0.07%)	(0.05%)	(0.03%)	(0.03%)
Average Yield To Maturity	0.32%	0.30%	0.37%	0.24%
Average Days To Maturity	41	41	80	71
Fiscal Year to Date Income	\$694,044	\$292,016	\$695,259	\$463,659

Market Conditions

During the second quarter of fiscal year 2016-17, interest rates increased with the yield curve steepening. The 6-month Treasury bill increased 17.80 basis points ending the period at 0.61 percent. Two-year Treasury notes increased 42.60 basis points to 1.18 percent, and the five-year Treasury notes increased 77.80 basis points to 1.93 percent.

Financial markets began the quarter focusing on economic data releases, the presidential election and their implications towards future Federal Reserve Fund policy. The election of Donald Trump and his proposed policies shifted both interest rates and equity indexes higher. Speculation that new policies would increase infrastructure and defense spending as well as reforms to healthcare, and tax codes has moved the Conference Board Consumer Confidence Index much higher to 113.70 from 103.50 last quarter.

On December 14, the Federal Open Market Committee (FOMC) raised interest rates for the first time in 12 months to .75 basis points stating that the labor market has continued to strengthen and economic activity has been expanding at a moderate pace since mid-year. Inflation has increased since earlier this year but is still below the FOMC's 2.00 percent longer-run objective. Consistent with its statutory mandate, the FOMC seeks to foster maximum employment and price stability. FOMC members, while still data

dependent, have stated that they anticipate three additional rate increases in calendar 2017.

Both the unemployment and underemployment rates continued to improve during the quarter, decreasing to 4.60 and 9.30 percent respectively. Average hourly earnings were 2.50 percent higher, in line with expectations. The Federal Reserve Labor Market Conditions Index (LMCI) uses a weighted average of 19 monthly labor market indicators to gauge improvements in the labor market. The value of average monthly change in the LMCI at -0.30, which has been a favored statistic of Federal Reserve chair Janet Yellen, has continued to show a declining trend since its January 2012 high of 12.00. The recent trends put the pace of improvement in the composite labor market just below their historical trend rates. While the labor market continues to improve, the rate of improvement is declining.

In conclusion, the dramatic political shift, as well as aging demographics and ballooning global debt, are expected to affect interest rates for the remainder of the fiscal year. While it is anticipated that the FOMC will increase rates this year, future interest rate increases are expected to be gradual and data dependent.

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 \$3.42 million with investments structured for security and liquidity.

REPORT PREPARED BY Don Collins, City Treasurer