



REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: DECEMBER 11, 2017

TITLE: TREASURER'S REPORT FOR THE QUARTER ENDED
SEPTEMBER 30, 2017



Director of Administrative Services



City Manager

RECOMMENDED ACTION

Receive and file the Treasurer's Report for the quarter ended September 30, 2017.

EXECUTIVE SUMMARY

This report provides a synopsis of investment activity for the City's three investment portfolios for the quarter ended September 30, 2017. The portfolios, managed by United American Capital Corporation (UACC) under the direction of the Treasurer, 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 \$914.71 million as of September 30, 2017.

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

COMMISSION/BOARD/COMMITTEE RECOMMENDATION

At its regular meeting of November 26, 2017, the Finance Commission unanimously voted to recommend that 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 District 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 portfolio is a combination of various operational funds, including the City's Asset Management Plan and funds earmarked for the development of the Orange County Great Park. A summary of Irvine Pooled Investment Portfolio by Fund is presented at the end of this report (Attachment 1).

As of September 30, 2017, the book value (purchase price of securities as recorded on the City's books) of the portfolio was \$633.59 million and the average weighted yield to maturity was 1.30 percent. Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the portfolio as of September 30, 2017 was \$1.82 million. The following chart compares the portfolio's statistics over a rolling 12-month period.

**Irvine Pooled Investment Portfolio
 Rolling 12-Month Quarterly Comparison**

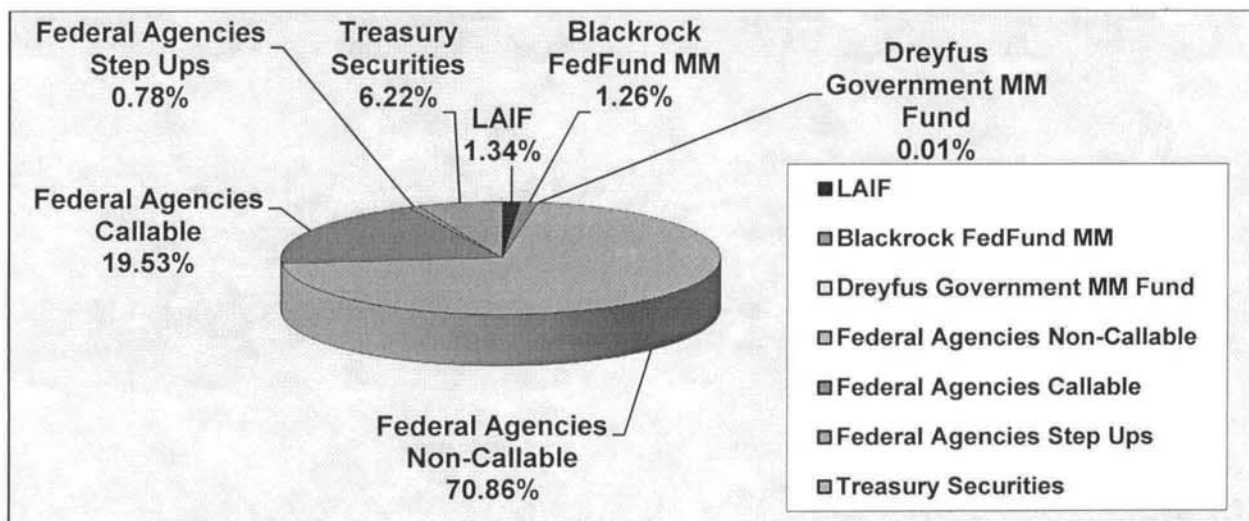
	September 30, 2017	June 30, 2017	March 31, 2017	December 31, 2016
Book Value	\$633,592,161	\$637,207,311	\$599,028,736	\$574,580,674
Market Value	\$631,069,975	\$634,768,340	\$596,334,045	\$571,366,011
Unrealized Gain/(Loss)	(\$2,522,186)	(\$2,438,971)	(\$2,694,691)	(\$3,214,663)
Unrealized Gain/(Loss) as % of Book Value	(0.40%)	(0.38%)	(0.45%)	(0.56%)
Average Yield To Maturity	1.30%	1.24%	1.18%	1.12%
Liquidity 0-6 Months	13.41%	14.32%	13.19%	13.56%
Average Years To Maturity	2.01	1.91	1.98	2.03
Modified Duration (Years)	1.95	1.85	1.91	1.97
Fiscal Year to Date Income	\$1,819,383	\$5,819,215	\$4,137,190	\$2,720,039

The Irvine Pooled Investment Portfolio's book value decreased by \$3.62 million from the previous quarter, primarily due to the prepayment of CalPERS pension liability for Fiscal Year 2017-18, offset by receipts of development fees and sale of Fire Station 20 parcel. Portfolio yield to maturity increased for the quarter ended September 30, 2017 by 6 basis points to 1.30 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, the portfolio ended the quarter with an unrealized loss of \$2.52 million as compared to an unrealized loss of \$2.44 million on June 30, 2017. This is a normal result of the portfolio's modified duration of 1.95 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 Corporation (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.

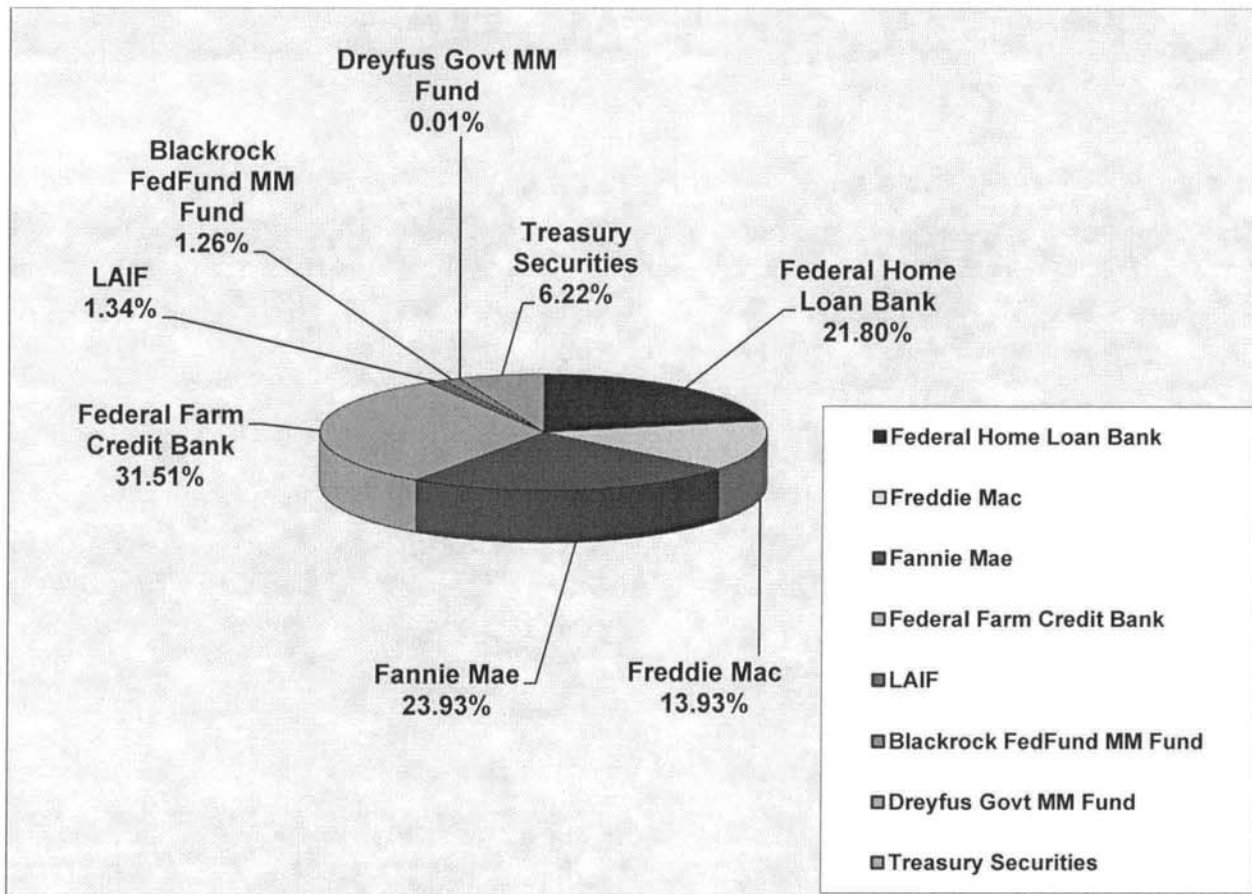
To manage liquidity, the Irvine Pooled Investment Portfolio is invested in Local Agency Investment Funds (LAIF), Dreyfus Government money market fund, and the Blackrock FedFund money market fund. Chart 1 shows the asset allocation of the portfolio.

**Irvine Pooled Investment Portfolio
Chart 1 - Asset Allocation
as of September 30, 2017**



To diversify, the City purchases United States Treasury notes and 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, 2017**



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, 2017, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 13.41 percent versus 14.32 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 September 30, 2017

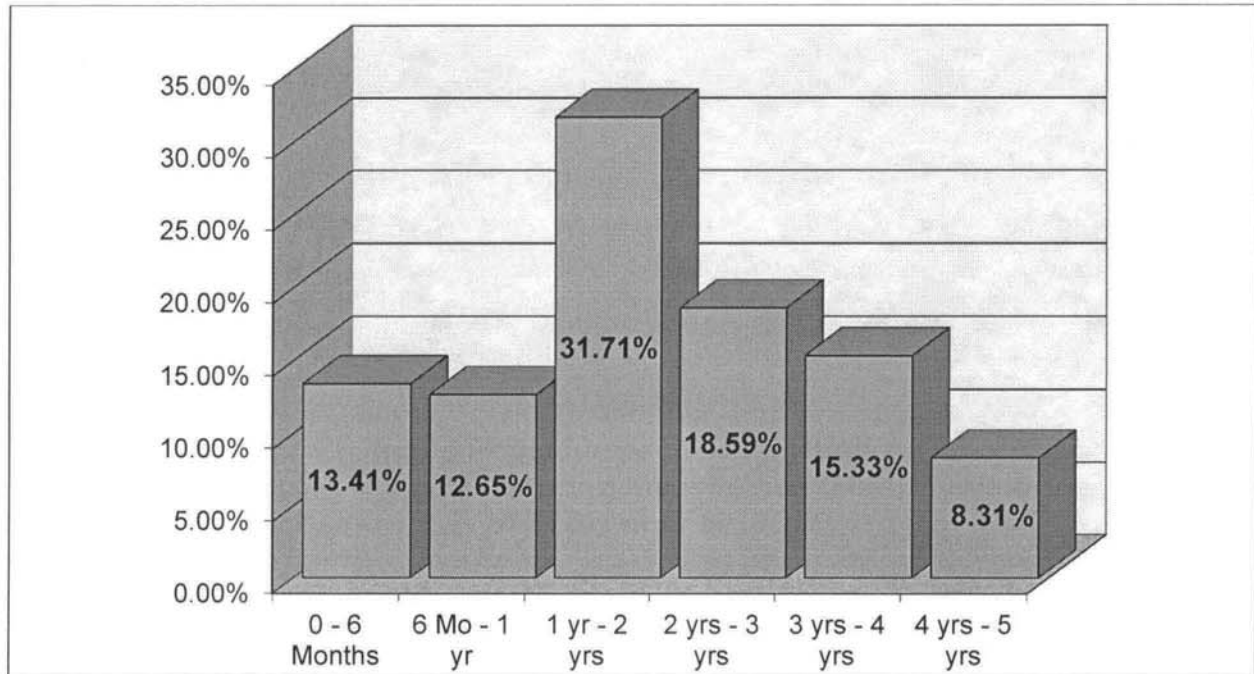
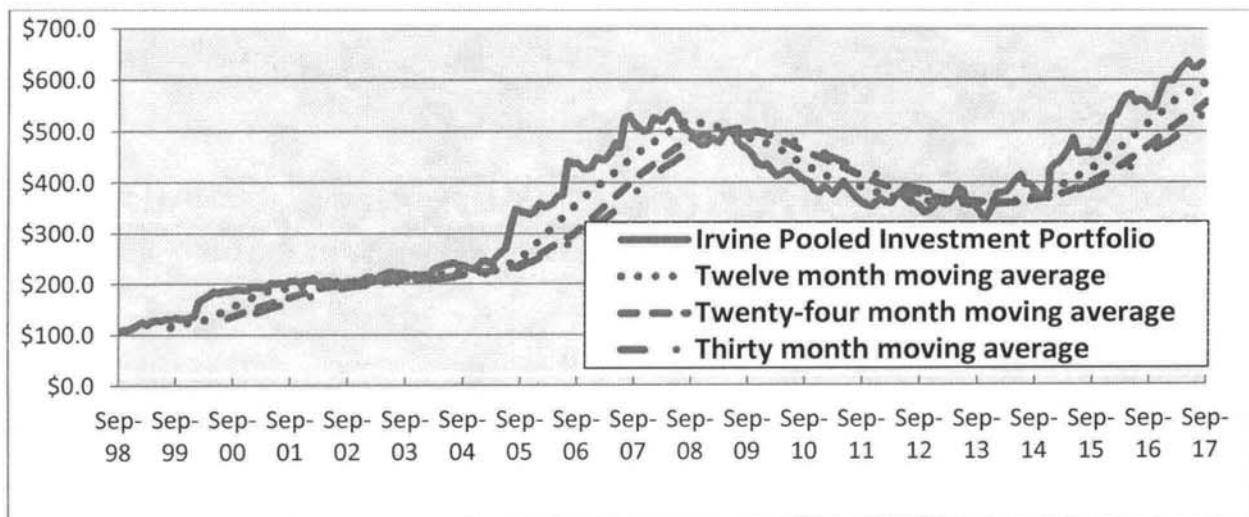
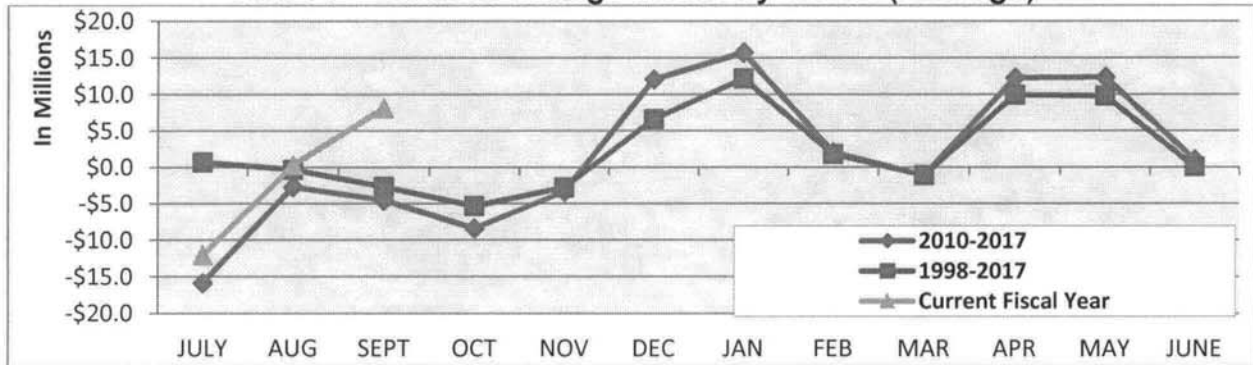


Chart 4 and Chart 5 show the volatility and cyclical nature of the Irvine Pooled Investment Portfolio fund balance and cash flows between September 30, 1998 and September 30, 2017.

Irvine Pooled Investment Portfolio
Chart 4 - Portfolio Balance
September 30, 1998 through September 30, 2017

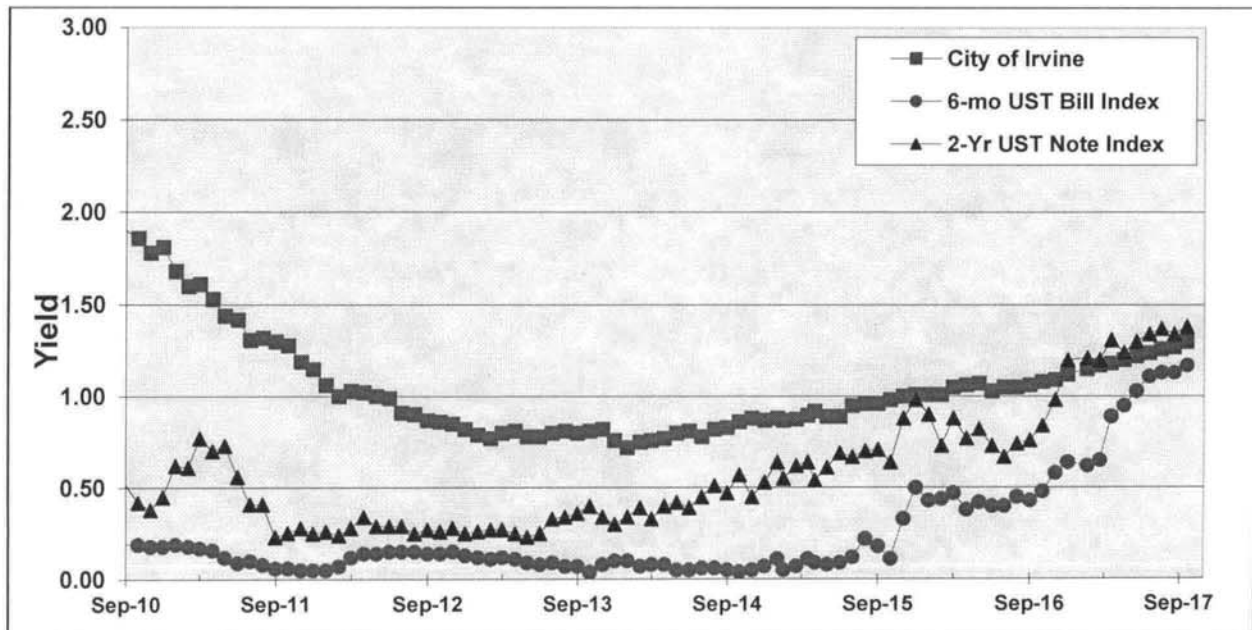


Irvine Pooled Investment Portfolio
Chart 5 – Balance Change Month by Month (Average)



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 portfolio against market movement. Chart 6 compares the average yield to maturity of the portfolio to these benchmarks, and shows the spread (difference between the index and the yield to maturity) for the past seven years. The portfolio's yield is higher than the 6-month UST by 0.13 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
September 30, 2010 through September 30, 2017



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, and funds on hand to finance the City's special district administration. Investment strategy in the Bond Proceeds Fund Portfolio differs from the Irvine Pooled Investment 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 Facilities 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.
- (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 September 30, 2017 was \$16,078.

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

	September 30, 2017	June 30, 2017	March 31, 2017	December 31, 2016
Book Value	\$4,294,000	\$4,605,000	\$4,609,437	\$7,608,436
Market Value	\$4,289,887	\$4,600,122	\$4,605,639	\$7,604,053
Unrealized Gain/(Loss)	(\$4,113)	(\$4,878)	(\$3,798)	(\$4,383)
Unrealized Gain/(Loss) as % of Book Value	(0.10%)	(0.11%)	(0.08%)	(0.06%)
Average Yield To Maturity	1.11%	0.98%	0.82%	0.72%
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	\$16,078	\$28,832	\$19,449	\$6,984

Special District Funds Portfolio

The Special District Funds Portfolio contains project and reserve funds for 28 AD and RAD bond issues and four CFD 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 September 30, 2017 was \$37,750. The Special District Funds Portfolio unrealized market value loss decreased from \$402,661 to \$24,335 from last quarter end. This was due to the maturity of two securities and their associated unamortized premium which in turn reduced the quarter to date earnings.

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

	September 30, 2017	June 30, 2017	March 31, 2017	December 31, 2016
Book Value	\$279,378,670	\$343,067,156	\$348,802,144	\$387,387,309
Market Value	\$279,354,335	\$342,664,495	\$348,451,879	\$387,100,007
Unrealized Gain/(Loss)	(\$24,335)	(\$402,661)	(\$350,265)	(\$287,302)
Unrealized Gain/(Loss) as % of Book Value	(0.01%)	(0.12%)	(0.10%)	(0.07%)
Average Yield To Maturity	1.06%	0.85%	0.70%	0.32%
Average Days To Maturity	60	55	49	41
Fiscal Year to Date Income	\$37,750	\$2,239,450	\$1,423,682	\$694,044

Market Conditions

During the first quarter of FY 2017-18, interest rates increased with the majority of the change concentrated in the two and three year sector. The 6-month Treasury bill increased 5.90 basis points ending the period at 1.18 percent. Two-year Treasury notes increased 11.40 basis points to 1.48 percent, and the five-year Treasury note increased 8.60 basis points to 1.93 percent. The Local Agency Investment Fund (LAIF) daily rate increased to 1.13 percent from 0.97 percent. The net effect to the Pooled Investment Portfolio was a slight increase in the unrealized market value loss which was in direct proportion to the stated duration of the portfolio.

Financial markets continued to focus on economic data releases and their implications towards Federal Reserve Fund policy. The unemployment rate continued to improve to 4.20 percent as of September 30, 2017 from a rate of 4.40 percent as of June 30, 2017. The under-employment rate improved to 8.30 percent from 8.60 percent during the same period. Labor force participation increased to 63.10 percent from 62.80 percent, remaining at levels not seen since 1978. The yearly percentage change of the average

hourly earnings has steadily risen since the financial crisis and remains at the high end of the relatively narrow range of 1.50 percent to 2.90 percent. The Federal Reserve is focused on full employment, price stability, and geo-economic stability. Federal Funds rate hike probabilities for December have risen from 42.20 percent as of June 30, 2017 to 70.30 percent as of September 30, 2017. Recent comments by Federal Reserve officials regarding "asset frothiness, current transitory effects on inflation," as well as their continued focus with regard to the historical inverse relationship between rates of unemployment and corresponding rates of inflation that result within the economy all suggest further rate tightening.

The economy advanced at a moderate pace during the quarter, slightly slower than the 3.10 percent pace in the prior quarter. Private consumption, business investment spending, and residential construction were the primary drivers of growth. Inflation remains below the Federal Reserve's 2.00 percent target with the Personal Consumption Expenditure Core Price index at 1.30 percent.

In conclusion, the moderately expanding economy coupled with weak inflation data will keep the Federal Reserve policy of interest rate normalization on a cautious path. Additionally, the Federal Reserve may initiate quantitative tightening during the final months of the calendar year, but also at a very cautious and methodical pace. Fiscal policy with regard to federal government spending and taxation will remain at the forefront of markets, but it would be premature and speculative to forecast in terms of its timing and composition.

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 Funds Portfolio, and Special Districts Funds Portfolio totaled \$1.87 million with investments structured for security and liquidity.

REPORT PREPARED BY Don Collins, City Treasurer

Attachment 1: Summary of Irvine Pooled Investment Portfolio by Fund

City of Irvine
Summary of Pooled Investment Portfolio Book Value by Fund
As of September 30, 2017

General Reserve Funds	\$	116,129,043
Capital Projects Funds:		
Capital Improvement Projects		33,067,615
Irvine Business Complex		86,354,995
North Irvine Transportation Mitigation		78,263,633
Orange County Great Park Development		1,359,355
Park Development		16,307,247
Total		<u>215,352,845</u>
Special Revenue Funds:		
Air Quality Improvement		531,553
County Sales Tax Measure M		2,749,977
Fees and Exactions		19,420,924
Gas Tax		12,052,471
Grants		3,609,009
I Shuttle		821,442
Local Park Fees		113,128,911
Maintenance District		(366,213)
Major Special Events		53,792
Orange County Great Park		88,469,953
Slurry Seal Fees		1,331,021
System Development		22,835,156
Total		<u>264,637,996</u>
Internal Service Funds:		
Equipment & Services		15,706,696
Inventory		93,360
Self-Insurance		16,989,089
Total		<u>32,789,145</u>
Permanent Fund:		
Senior Services		173,547
Senior Services Endowments		495,406
Total		<u>668,953</u>
Fiduciary Fund:		
Successor Agency		4,014,179
Total		<u>4,014,179</u>
Total Pooled Investments at September 30, 2017	\$	<u><u>633,592,161</u></u>

Note: Funds are as presented in the City's Comprehensive Annual Financial Report (CAFR)