



# REQUEST FOR CITY COUNCIL ACTION

**MEETING DATE:** OCTOBER 9, 2018

**TITLE:** TREASURER'S REPORT FOR THE FISCAL YEAR ENDED  
JUNE 30, 2018

  
\_\_\_\_\_  
Director of Administrative Services

  
\_\_\_\_\_  
City Manager

## RECOMMENDED ACTION

Receive and file the Treasurer's Report for the fiscal year ended June 30, 2018.

## EXECUTIVE SUMMARY

This report provides a synopsis of investment activity for the City's three investment portfolios for the fiscal year ended June 30, 2018. The portfolios, managed by United American Capital Corporation (UACC) under the direction of the City Treasurer, include the Irvine Pooled Investment Portfolio, Bond Proceeds Fund Portfolio, and Special District Funds Portfolio. The total market value for all three portfolios was \$963.78 million as of June 30, 2018.

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 September 17, 2018, the Finance Commission recommended that the City Council receive and file the Treasurer's Report for fiscal year ended June 30, 2018 by a 4-0-1 vote (Chair Stein, Vice Chair Dressler, Commissioners Reyno and Sievers approving; Commissioner Shute absent).

## 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 Special District Funds Portfolio are delegated to an investment advisory 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 the 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 operating funds, including the City's Asset Management Plan and funds earmarked for the development of the Orange County Great Park. A summary of the Irvine Pooled Investment Portfolio by Fund is presented at the end of this report (Attachment 1).

As of June 30, 2018, the book value (purchase price of securities as recorded on the City's books) of the portfolio was \$707.10 million and the average weighted yield to maturity was 1.60 percent. Fiscal year-to-date investment revenue (interest payments and capital gains) generated by the portfolio as of June 30, 2018 was \$7.98 million. The following chart compares the portfolio's statistics over a rolling 12-month period.

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

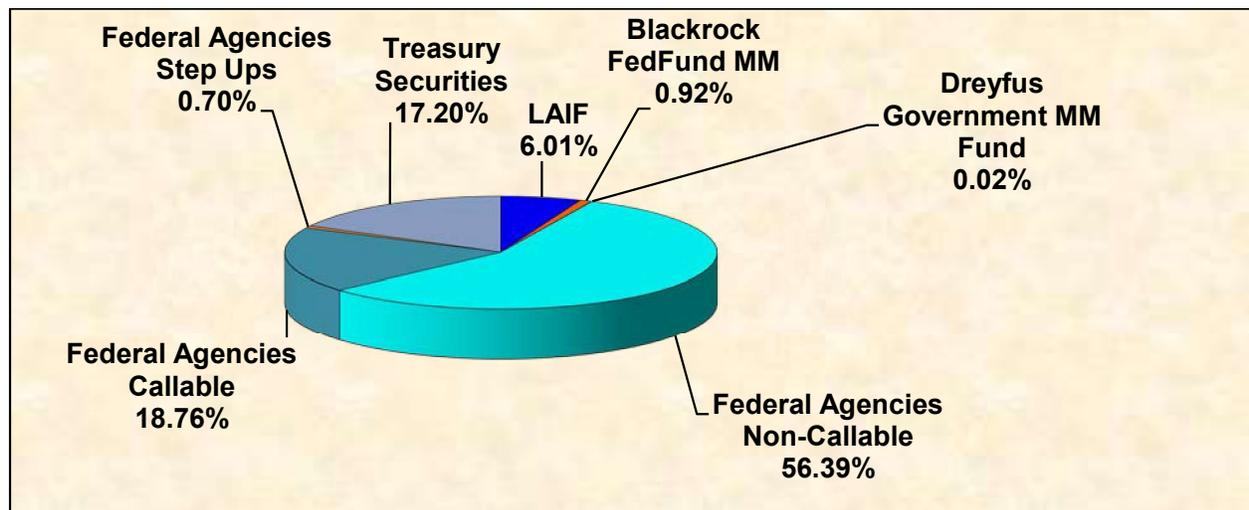
	<b>June 30, 2018</b>	<b>March 31, 2018</b>	<b>December 31, 2017</b>	<b>September 30, 2017</b>
Book Value	\$707,103,573	\$661,611,807	\$634,945,838	\$633,592,161
Market Value	\$698,234,684	\$653,215,825	\$629,344,603	\$631,069,975
Unrealized Gain/(Loss)	(\$8,868,889)	(\$8,395,982)	(\$5,61,235)	(\$2,522,186)
Unrealized Gain/(Loss) as % of Book Value	(1.25%)	(1.27%)	(0.88%)	(0.40%)
Average Yield To Maturity	1.60%	1.45%	1.36%	1.30%
Liquidity 0–6 Months	21.71%	17.40%	12.97%	13.41%
Average Years To Maturity	1.85	1.90	1.97	2.01
Modified Duration (Years)	1.78	1.83	1.91	1.95
Fiscal Year to Date Income	\$7,976,739	\$5,897,774	\$3,872,132	\$1,819,383

The Irvine Pooled Investment Portfolio's book value increased by \$45.49 million from the previous quarter due to the receipts of property taxes, one-time development fees, and the Recognized Obligation Payment Schedule (ROPS) payment. Portfolio yield to maturity increased for the quarter ended June 30, 2018 by 15 basis points to 1.60 percent. This was directly attributed to the increasing rate environment as maturing investments were reinvested into longer term and higher rate securities. With market rates increasing, the portfolio ended the quarter with an unrealized loss of \$8.87 million as compared to an unrealized loss of \$8.40 million on March 31, 2018. This is a normal result of the portfolio's modified duration of 1.78 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.

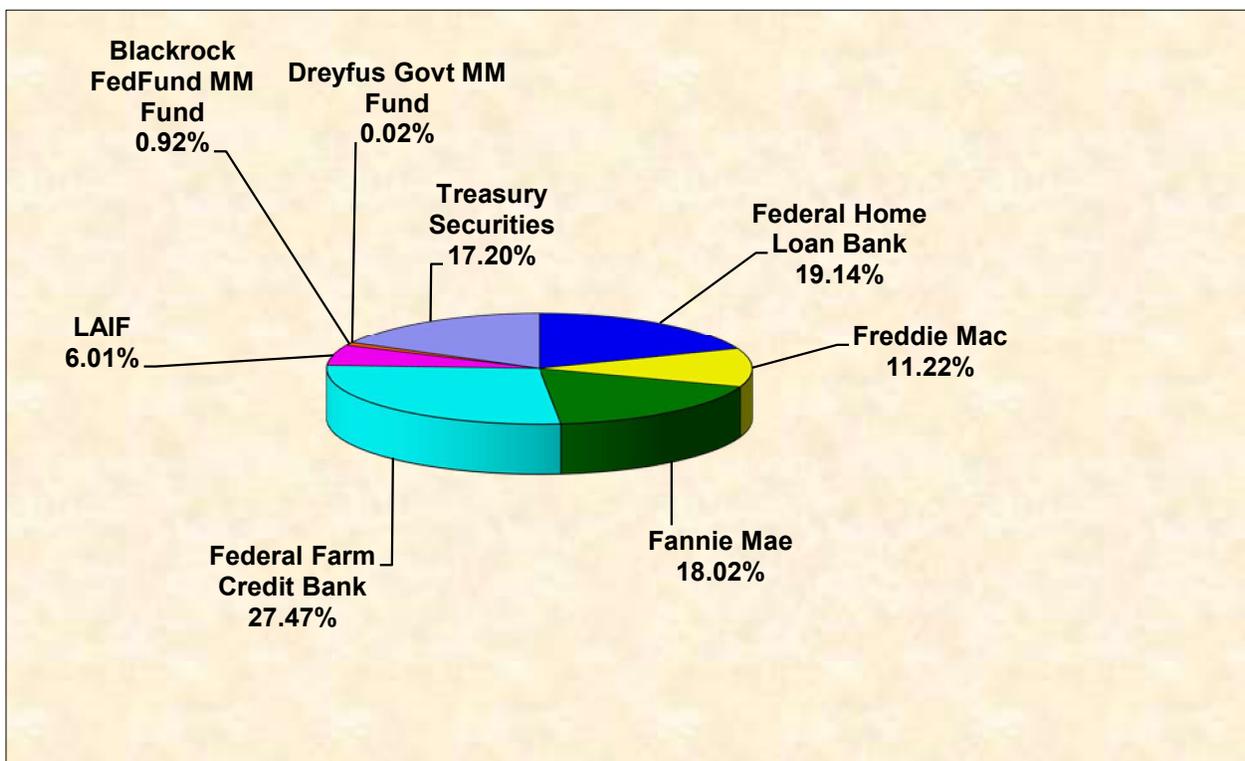
To manage liquidity, the Irvine Pooled Investment Portfolio is invested in Local Agency Investment Funds (LAIF), Dreyfus Government money market fund, and the Blackrock FedFund money market fund. Chart 1 shows the asset allocation of the portfolio.

**Irvine Pooled Investment Portfolio**  
**Chart 1 - Asset Allocation**  
**As of June 30, 2018**



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 - Holdings by Issuer Name  
As of June 30, 2018**



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, 2018, the overnight to 6-month liquidity level for the Irvine Pooled Investment Portfolio was at 21.71 percent as the city prepares to prepay the 2018-19 CalPERS pension liability in July. 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, 2018**

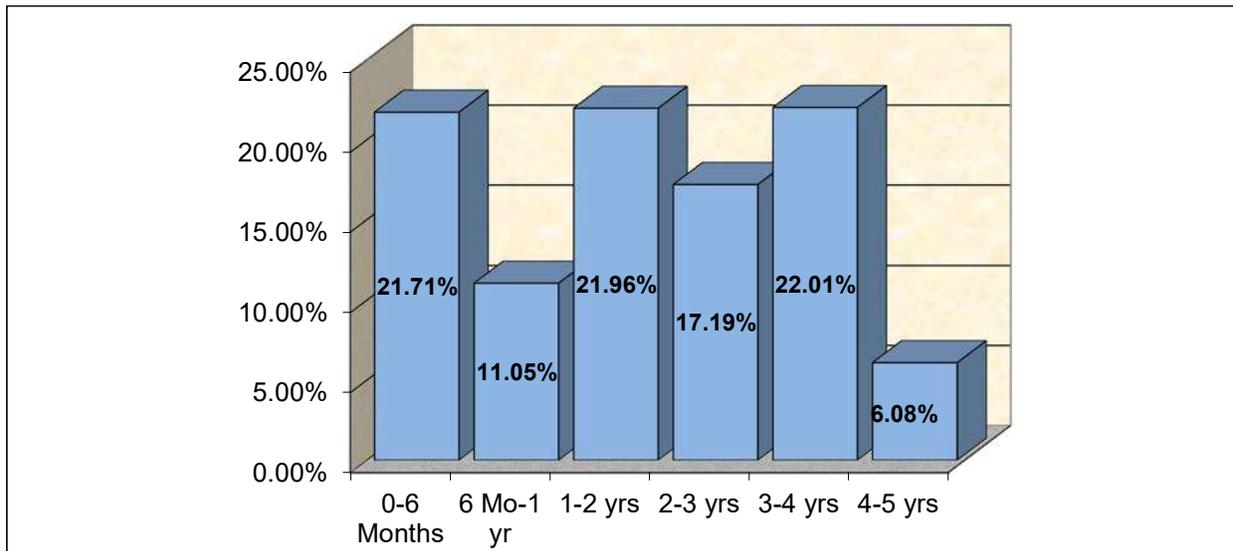
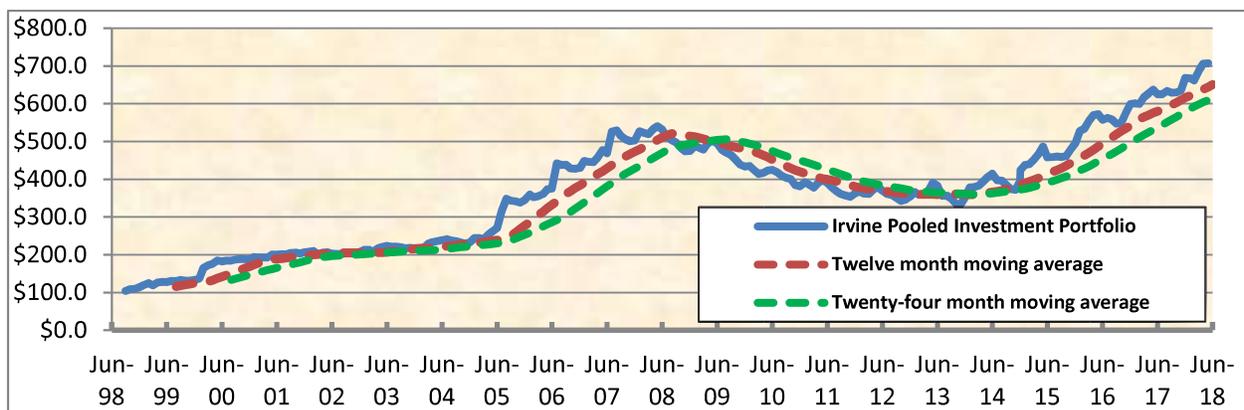
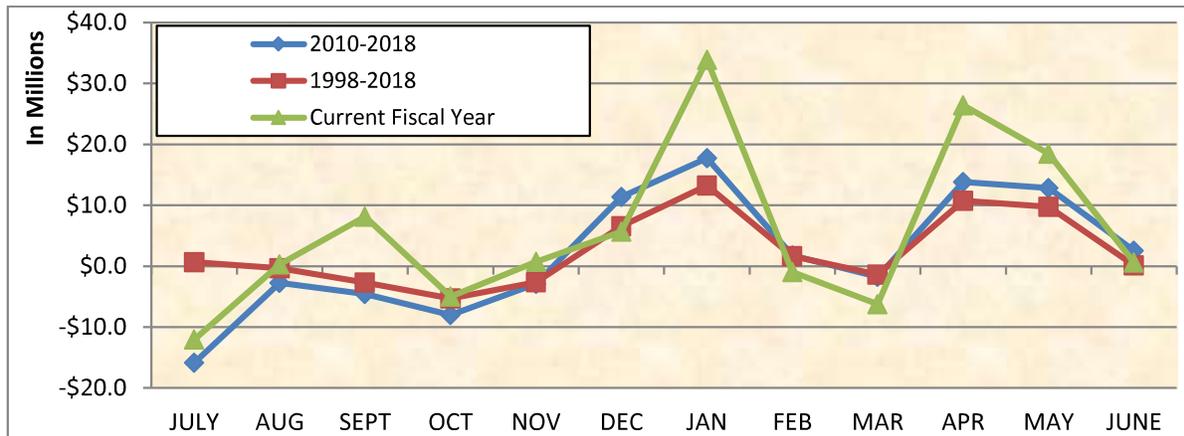


Chart 4 and Chart 5 show the volatility and cyclicity of the Irvine Pooled Investment Portfolio fund balance and cash flows between 1998 and 2018. As noted in chart 5, the portfolio experienced above-average increases in September 2017, January 2018 and April 2018. These increases were attributed to one-time development related payments, sale of Fire Station 20 parcel, and higher property tax receipts from property owners paying both 2017-18 property tax installments in 2017 due to the recent tax law changes.

**Irvine Pooled Investment Portfolio**  
**Chart 4 - Portfolio Balance**  
**June 30, 1998 through June 30, 2018**

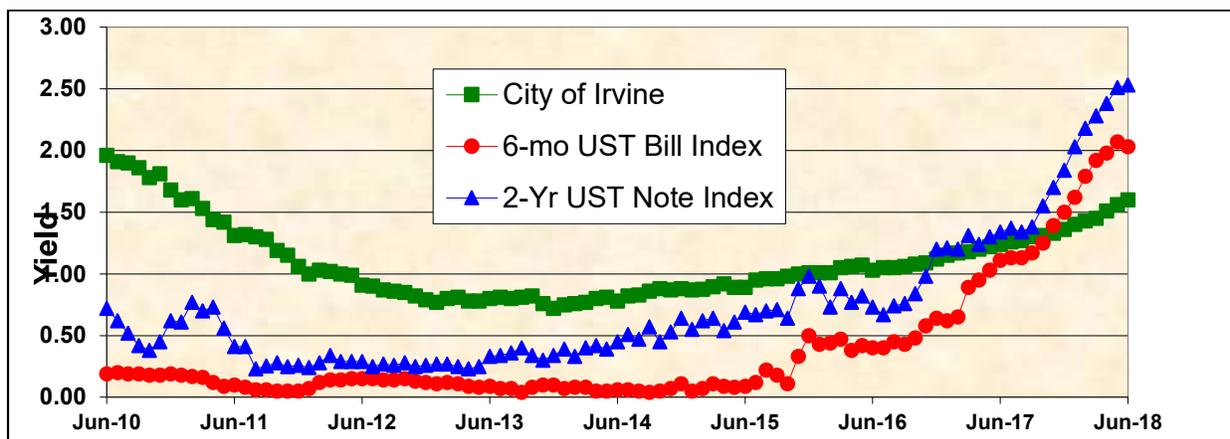


**Irvine Pooled Investment Portfolio**  
**Chart 5 – Balance Change Month by Month (Average)**



To gauge performance, the City compares the Irvine Pooled Investment Portfolio's yield to maturity against two reference notes set in the City's Annual Investment Policy: the 6-month United States Treasury (UST) Bill Index and 2-year UST Note Index. The reference notes are used as a measure of the portfolio against market movement. Chart 6 compares the average yield to maturity of the portfolio to these reference notes, and shows the spread (difference between the index and the yield to maturity) for the past eight years. With the recent Federal Reserve rate hikes, the portfolio's book yield is less than the 6-month UST by 0.43 percent and the 2-year UST by 0.93 percent. However, over a period of 24 months, the average yield on the 2-year Treasury note is 1.49 percent, versus 1.60 percent for the Irvine Pooled Investment Portfolio.

**Irvine Pooled Investment Portfolio**  
**Chart 6 - Yield to Maturity Compared to Assigned Indices**  
**June 30, 2010 through June 30, 2018**



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 tax and 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 June 30, 2018 was \$65,370.

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

	<b>June 30, 2018</b>	<b>March 31, 2018</b>	<b>December 31, 2017</b>	<b>September 30, 2017</b>
Book Value	\$6,902,000	\$6,056,000	\$5,381,000	\$4,294,000
Market Value	\$6,885,007	\$6,044,454	\$5,375,845	\$4,289,887
Unrealized Gain/(Loss)	(\$16,993)	(\$11,546)	(\$5,155)	(\$4,113)
Unrealized Gain/(Loss) as % of Book Value	(0.25%)	(0.19%)	(0.10%)	(0.10%)
Average Yield To Maturity	1.76%	1.52%	1.24%	1.11%
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	\$65,370	\$43,787	\$28,053	\$16,078

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 highly 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 June 30, 2018 was \$2,908,722.

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

	<b>June 30, 2018</b>	<b>March 31, 2018</b>	<b>December 31, 2017</b>	<b>September 30, 2017</b>
Book Value	\$258,697,808	\$265,277,405	\$294,084,302	\$279,378,670
Market Value	\$258,660,961	\$265,185,789	\$294,001,956	\$279,354,335
Unrealized Gain/(Loss)	(\$36,847)	(\$91,616)	(\$82,347)	(\$24,336)
Unrealized Gain/(Loss) as % of Book Value	(0.01%)	(0.03%)	(0.03%)	(0.01%)
Average Yield To Maturity	2.09%	1.74%	1.41%	1.06%
Average Days To Maturity	56	70	73	60
Fiscal Year to Date Income	\$2,908,722	\$1,969,221	\$863,441	\$37,750

Market Conditions

During the fourth quarter of FY 2017-18, interest rates increased moderately across the yield curve. As expected, the Federal Reserve increased the federal funds rate range by 25 basis points for the third time in the past 12 months at the June 13, 2018 Federal Open Market Committee (FOMC) meeting. The current federal funds rate range is 1.75 to 2.00 percent. During the past fiscal year, the yields of the 6-month Treasury notes increased 98.90 basis points to 2.10 percent, the two-year notes increased 111.1 basis points to 2.52 percent, and the five-year notes increased 90.40 basis points to 2.72 percent. The Local Agency Investment Fund (LAIF) daily rate increased from 0.97 percent to 1.75 percent during the past fiscal year. The net effect to the Pooled Investment Portfolio was an increase in the unrealized market value loss which was in direct proportion to the stated duration of the portfolio. As holdings mature, proceeds are reinvested into higher yielding government bonds which increase the average rate of return.

Financial market continued to focus on economic releases, including labor and wage data, global trade, protectionism, and Federal Reserve Fund policy. As of June 30, 2018, the unemployment rate declined to 4.00 percent. The under-employment rate improved to 7.80 percent from 8.00 percent last quarter. Labor force participation rate reached 62.90 percent, a level not seen since 1978. The yearly percentage change of the average

hourly earnings has steadily risen since the financial crisis ended, and remains at the high end of the relatively narrow range of 1.50 percent to 2.80 percent signifying that labor cost growth is lagging behind employment growth. The Federal Reserve remains focused on maximum employment, stable prices, and moderate long term interest rates. The probability of a 25 basis points Federal Funds rate increase at the September 26, 2018 FOMC meeting remains high.

Recent comments by Federal Reserve Chair Jerome Powell regarding labor and inflation, "let's be guided by what's going on and what the real economy's telling us," indicates that the FOMC is more data-dependent with future strategy, which may require nimbleness and potential sharp changes in policy direction. Officials raised rates on June 13 and have signaled two more rate increases this year. With unemployment near 4.00 percent, wage growth at 2.70 percent and continue to rise modestly, the FOMC will remain focused on the historical inverse relationship between rates of unemployment and corresponding rates of inflation. Some Federal Reserve officials also worry that a long period of low interest rates amid scarce resources, including a smaller pool of available workers, could generate overly-inflated asset valuations. The number one complaint from small business hiring managers, as measured by the National Federation of Independent Business small business index, is their difficulty in finding qualified employees.

The long run impact of a trade war could negatively impact economic growth, inflation, and profit margins. The economy advanced at a moderate pace during the quarter with current projections predicting an increase above the 2.00 percent pace in the prior quarters' GDP index. As reported by the Institute for Supply Management's semi-annual forecast, capital spending should increase by 10.10 percent in 2018. The Atlanta Federal Reserve GDPNow Forecast is currently 3.83 percent as of June 29, 2018, and may continue to move higher during the remainder of the calendar year. Inflation remains slightly below the Federal Reserve's 2.00 percent target with the Personal Consumption Expenditure Core Price index at 1.95 percent as of May 31, 2018.

In conclusion, the moderately expanding economy coupled with current benign but slowly accelerating inflation data will keep the Federal Reserve policy of interest rate normalization on a cautious path. The Federal Reserve began quantitative tightening during the final months of the calendar year 2017 and will gradually accelerate the drawdown of its balance sheet from \$10 billion per month to \$50 billion per month. Fiscal policies with regard to federal government spending and taxation, trade issues, as well as the transition from easy to neutral monetary policy, would suggest increased volatility in the next quarter.

## **ALTERNATIVES CONSIDERED**

None. The Treasurer's Report is intended to provide historical information about the City's investment portfolios with a forecast based on current market condition. 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 Fund Portfolio, and Special District Funds Portfolio totaled \$10.95 million with investments structured for security and liquidity.

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

Attachment 1:            Summary of Pooled Investment Portfolio Book Value by Fund

City of Irvine  
**Summary of Pooled Investment Portfolio Book Value by Fund \***  
 As of June 30, 2018

General Reserve Funds	\$	134,785,664
<b>Capital Projects Funds:</b>		
Capital Improvement Projects		32,760,366
Irvine Business Complex		91,871,508
North Irvine Transportation Mitigation		81,548,576
Orange County Great Park Development		5,207,120
Park Development		17,507,704
<b>Total</b>		<u>228,895,274</u>
<b>Special Revenue Funds:</b>		
Air Quality Improvement		396,855
County Sales Tax Measure M		940,524
Fees and Exactions		19,458,609
Gas Tax		12,214,645
Grants		3,760,397
I Shuttle		843,483
Local Park Fees		118,277,594
Maintenance District		2,116,457
Major Special Events		(125,644)
Orange County Great Park		111,835,492
Road Maintenance and Rehab Account		1,000,748
Slurry Seal Fees		1,020,739
System Development		29,435,080
<b>Total</b>		<u>301,174,979</u>
<b>Internal Service Funds:</b>		
Equipment & Services		17,848,649
Inventory		81,914
Self-Insurance		18,560,090
<b>Total</b>		<u>36,490,653</u>
<b>Permanent Fund:</b>		
Senior Services		328,074
Senior Services Endowments		495,406
<b>Total</b>		<u>823,480</u>
<b>Fiduciary Fund:</b>		
Successor Agency		4,933,523
<b>Total</b>		<u>4,933,523</u>
<b>Total Pooled Investments at June 30, 2018</b>	<b>\$</b>	<b><u>707,103,573</u></b>

Note:

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

\* Balances are subject to changes due to fiscal year end reconciliations.