

Agenda Report

February 22, 2016

TO: Honorable Mayor and City Council
THROUGH: Finance Committee
FROM: Department of Finance
SUBJECT: Quarterly Investment Report
Quarter Ending December 31, 2015

RECOMMENDATION:

This report is for information only.

BACKGROUND:

Government Code Section 53646 (2)(b)(1) states that in the case of a local agency, the Treasurer or Chief Fiscal Officer (CFO) may render a quarterly report to the legislative body of the local agency containing detailed information on: 1) all securities, investments, and moneys of the local agency; 2) a statement of compliance of the portfolio with the statement of investment policy; and 3) a statement of the local agency's ability to meet its pool's expenditure requirements for the next six months. By making these reports optional, this bill does not impose a state-mandated local program but encourages local agencies to continue to report. The bill also states that the Treasurer or CFO may report whatever additional information or data may be required by the legislative body of the local agency.

The quarterly report shall include the following:

- 1) The type of investment, name of the issuer, date of maturity, par and dollar amount invested in each security, investment, and money within the treasury;
- 2) The weighted average maturity of the investments within the treasury;
- 3) Any funds, investments, or programs, including loans, that are under the management of contracted parties;
- 4) The market value as of the date of the report, and the source of this valuation for any security within the treasury;
- 5) A description of the compliance with the Statement of Investment Policy.

Quarterly Economic Review

Gross Domestic Product (GDP) in the fourth quarter of 2015 grew by a sluggish 0.7 percent, compared to 2.0 percent in the previous quarter. The annual U.S. GDP growth rate for 2015 was barely 2 percent, well below the historic average. The modest economic activity was attributed to the enhanced U.S. consumer spending and the improving housing market. On the other hand, the primary factor negatively impacting the economy is the downturn in energy and commodity markets. Crude oil, considered to be the international yardstick, was trading at \$37 per barrel as of the end of December. This marks a plunge of about 65 percent since June 2014 when oil prices topped \$107. A global supply glut has been identified as the main reason for plummeting oil prices.

Energy development and production led the way for the business sector in cutting back in capital expenditures and dropping inventories. Another major drag on GDP was the strengthening of the dollar. The dollar's appreciation vis-à-vis a slower global demand weakened exports. Through November 2015, exports of goods and services decreased by \$99 billion, marking a 4 percent decline from the previous year. Although imports decreased as well, the higher drop in exports worsened the deficit in trade of goods and services. While the business side of the economy remained sluggish, the household side remained solid. Consumer spending in 2015, buoyed by employment gains and cheaper oil prices, made up for anemic business activity, growing at a brisk rate of 3.1 percent. Housing and residential investment numbers continued to be stellar with December 2015 recording 544,000 purchases of new, single-family homes, pulling the year's figures to the highest in eight years.

December 2015's year-over-year unadjusted Headline CPI came in at 0.7 percent. Meanwhile, the year-over-year Core CPI which excludes food and energy components came in at 2.1 percent. The energy index year-over-year dropped by a stark 12.6 percent, with all its components decreasing.

The unemployment rate remained flat at 5.0 percent throughout the fourth quarter of 2015, a stark contrast from a peak of 9.9 percent six years ago and the economy added on average 283,000 jobs per month. For the full calendar year, the economy added 2.65 million jobs. The steady improvement in the job market served as a key influence in the Federal Reserve's decision to raise interest rates for the first time since June 2006. The benchmark interest rate was raised from a range from 0-0.25 percent to 0.25-0.50 percent. The central bank, however, cautioned that rate hikes will be gradual and will depend on the Fed's future assessment of inflation, labor markets and developments in the global financial markets. While the Fed began a tightening cycle in the U.S., most advanced economies remain highly accommodative. Europe is still in an economic recession and fighting deflation. Japan has recently adopted a negative rate strategy and the second largest economy, China, which originated the deflationary concerns due to its economic slowdown, has devalued its currency.

The quarter's biggest financial story was the Federal Reserve's big move. The anticipation in the months leading to it and the Federal Reserve's actual announcement on December 16 pushed the yield curve upwards during the month. The fourth quarter of the year saw a wide increase in the two-year treasury yield which rose by 42 basis points from a yield of 0.64 percent at the end of September to 1.06 percent by yearend. The five-year and ten-year treasury yields also rose by 41 and 23 basis points respectively. The graph below represents the Treasury yield curve as of December 31, 2015 compared to last quarter:



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Total Funds Under Management

The following table represents the total City funds under management based on their market values as of December 31, 2015.

	12/31/2015	09/30/2015	\$ Change
Pooled Investment Portfolio	\$396,289,128	\$381,060,809	\$15,228,319
Capital Endowment	1,900,474	1,899,093	1,381
Stranded Investment Reserve Portfolio	68,628,879	68,740,146	-111,267
Special Funds	28,918,623	27,149,197	1,769,426
Investments Held with Fiscal Agents	59,872,458	60,131,021	-258,563
Total Funds Under Management	\$555,609,562	\$538,980,266	\$16,629,296

The Pooled Investment Portfolio value increased by a net \$15,228,319 mainly due to the receipt of \$21,822,247 in property tax revenues, \$6,348,915 in sales tax revenues offset by \$11,112,936 in debt service payments, \$1,472,348 draw for the GT5 project and an adjustment of \$357,558 for unrealized investment losses in the portfolio during the quarter.

The Capital Endowment Fund increased by \$1.381 million representing the net investment earnings for the period.

The Stranded Investment Reserve portfolio decreased by \$111,267 representing the net investment earnings for the period adjusted by the unrealized losses.

Special Funds increased by a net \$1,769,426 million as a result of a receipt of \$5,999,930 HUD Section 8 loan offset by \$3,393,062 draw from the 2013A Electric Revenue Bond proceeds to pay anticipated capital expenditures, \$648,750 payment to the State of California as part of the dissolution of the redevelopment agency, and an adjustment of \$188,690 for a change in investment values.

Investments held with fiscal agents decreased by a net \$258,563 representing the net addition of the 2015A Certificate of Participation Cost of Issuance account in the amount of \$73,609 adjusted by \$332,171 reduction related to change of investment values.

The City pools all internal funds to gain economies of scale and to simplify the investment function. There are over 100 funds in the Pooled Investment Portfolio. Because the 2015 fiscal year accounting records have not yet closed, staff estimates that the General Fund's cash balance will be approximately \$53 million at the end of December representing 13.4 percent of the December Pooled Portfolio value. The General Fund's cash balance fluctuates daily based on the timing of revenues receipts and payment of expenditures. Investments in the Capital Endowment Fund, the Stranded Investment Reserve Fund, the Special Funds, and funds held with fiscal agents are restricted funds or bond proceeds reserved in accordance with the City Charter, City ordinances, and the bond indentures. The City targets a duration of an average of two years in managing the pooled portfolio based on the portfolio's risk and return evaluation and industry best practices as it pertains to public funds management. As of December 31, 2015, the portfolio's duration was 1.98 years.

Per government code requirements, attached are reports by each fund indicating the type of investments, date of maturity, par and dollar amount invested in each security, as well as investment and moneys within the Treasury with market values as of December 31, 2015. On a monthly basis, the City Treasurer prices the pooled portfolio and all other funds and investments under management. The market values are obtained from Interactive Data Corporation (IDC) and from Bloomberg Financial System. IDC is an independent third party whose sole service is to provide market prices for all types of securities.

The types of securities held in the portfolio and their percentage allocation to the total are in compliance with the City's Fiscal Year 2016 Investment Policy, which was adopted by the City Council on July 27, 2015, and Section 53600 of the State Government Code. The City Treasurer currently maintains over \$45 million short-term liquid investments (1 to 90 day maturities) which represent approximately 1/12th of the City's total aggregate annual operating budget. This balance, along with anticipated cash flows into the City's account, represents a strong liquidity position to meet budgeted expenditures for the next six months.

The yield to maturity on the City's Pooled Portfolio began to gradually increase after it stabilized at around 1 percent due to declining interest rates in the last six years as short-term rates remained between 0.00 percent and 0.25 percent until December 16 when the Fed increased the target Fed Funds rate by 0.25 percent. The fiscal year to date effective yield which represents the portfolio investment earnings rate adjusted by the realized trading gains and losses was 1.19 percent for the Pooled Portfolio as of December 2015, compared to the State Treasurer's Local Agency Investment Fund (LAIF) of 0.35 percent, the Los Angeles County Treasurer's Pooled portfolio yield of 0.75 percent, and the average yield on the two-year U.S Treasury of 0.75 percent. The fiscal year to date effective yield for the Power Reserve portfolio was 1.53 percent.

COUNCIL POLICY CONSIDERATION:

This action supports the City Council's strategic goal to maintain fiscal responsibility and stability.

FISCAL IMPACT:

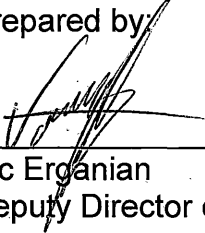
This report is for information only. There is no fiscal impact as a result of this action nor will it have any indirect or support cost requirements. There is no anticipated impact to other operational programs or capital projects as a result of this action.

Respectfully submitted,



MATTHEW E. HAWKESWORTH
Director of Finance
Department of Finance

Prepared by:



Vic Erganian
Deputy Director of Finance/City Treasurer

Approved by:



STEVE MERMELL
Interim City Manager

Attachments: (1)

Attachment A – Quarterly Investment Report - Quarter Ending December 31, 2015