

***CITY OF LAGUNA NIGUEL
ANNUAL INVESTMENT REPORT***



***Fiscal Year Ended
June 30, 2016***

Prepared by:

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Director of Finance/City Treasurer***



Annual Investment Report

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**PORTFOLIO PERFORMANCE AND
COMPARISON TO BENCHMARKS**

The City’s average weighted yield on its portfolio during FY 2015-16 (calculated by summing the total investment earnings divided by the total portfolio at cost, excluding cash in bank, for each period and dividing by 12) was 0.92%, an increase of 8 basis points over the prior fiscal year, attributable to lower-yielding investments that were reinvested in higher-yielding U.S. Treasuries during the first half of the fiscal year.

The average weighted yield on the City’s portfolio at June 30, 2016 was 0.94%, on a cash and investment balance of \$81,605,489, with an average days-to-maturity (calculated as the sum of days left until maturity of each individual investment multiplied by the cost of each individual investment divided by the total portfolio at cost, excluding cash in bank) of 349 days. The fiscal year average weighted days to maturity of the portfolio decreased from 546 days (1.5 years) in FY 2014-15 to 461 days (1.26 years) in FY 2015-16, reflecting the City’s strategy of shortening the portfolio to fund the Crown Valley Park Tier 2 and Tier 3 improvements on a cash basis without incurring debt.

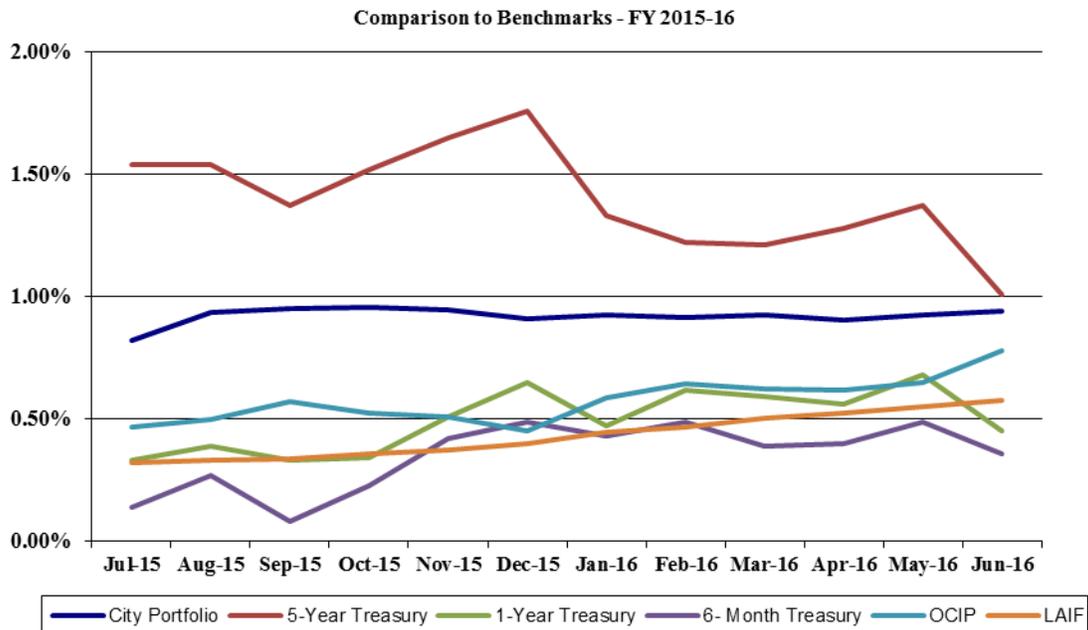
<i>City of Laguna Niguel's Portfolio</i>				<i>Benchmark Comparisons</i>				
	<i>Cost/Book Value</i>	<i>Average Weighted Days to Maturity</i>	<i>Average Weighted Yield</i>	<i>5-Year Treasury</i>	<i>1-Year Treasury</i>	<i>6- Month Treasury</i>	<i>OCIP</i>	<i>LAIF</i>
Jul-15	\$ 75,173,990	510	0.82%	1.54%	0.33%	0.14%	0.47%	0.32%
Aug-15	\$ 71,181,679	504	0.94%	1.54%	0.39%	0.27%	0.50%	0.33%
Sep-15	\$ 70,353,705	516	0.95%	1.37%	0.33%	0.08%	0.57%	0.34%
Oct-15	\$ 67,250,029	548	0.96%	1.52%	0.34%	0.23%	0.53%	0.36%
Nov-15	\$ 67,779,314	523	0.95%	1.65%	0.51%	0.42%	0.51%	0.37%
Dec-15	\$ 71,029,960	502	0.91%	1.76%	0.65%	0.49%	0.45%	0.40%
Jan-16	\$ 74,465,586	461	0.92%	1.33%	0.47%	0.43%	0.59%	0.45%
Feb-16	\$ 78,076,202	425	0.92%	1.22%	0.62%	0.49%	0.65%	0.47%
Mar-16	\$ 76,618,631	431	0.92%	1.21%	0.59%	0.39%	0.62%	0.51%
Apr-16	\$ 79,943,019	388	0.90%	1.28%	0.56%	0.40%	0.62%	0.53%
May-16	\$ 82,959,003	378	0.92%	1.37%	0.68%	0.49%	0.65%	0.55%
Jun-16	\$ 81,605,489	349	0.94%	1.01%	0.45%	0.36%	0.78%	0.58%
Fiscal Year	\$ 74,703,051	461	0.92%	1.40%	0.49%	0.35%	0.58%	0.43%



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**PORTFOLIO PERFORMANCE AND
COMPARISON TO BENCHMARKS**

The following chart compares the City’s portfolio performance with monthly benchmarks including 5-year, 1-year, and 6-month treasuries, and LAIF and OCIP. The Federal Funds Rate remained at 0.00-0.25% through December of 2015, at which time the Federal Funds Rate increased 25 basis points to 0.25-0.50% and remained as such throughout the latter half of the fiscal year. Short-term interest rates and the five-year Treasury bond rate fluctuated throughout the year, with the five-year Treasury bond ending the fiscal year moderately lower than its July level. The average weighted yield of the City’s portfolio performed consistently on a monthly basis over the course of the fiscal year and the annual average weighted yield on the portfolio was 0.92%, an increase of 8 basis points over the prior fiscal year annual average weighted yield. As in the past, the City’s portfolio consistently outperforms the LAIF and OCIP investment pools.



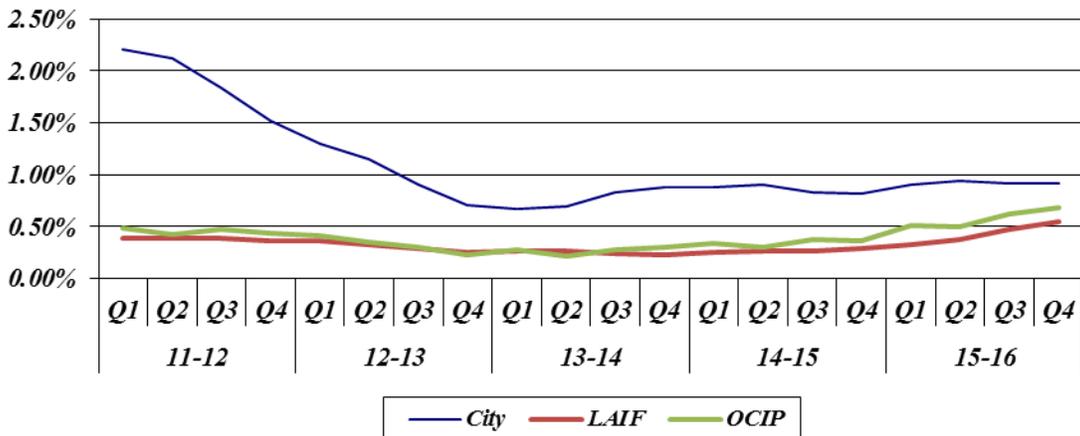


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**PORTFOLIO PERFORMANCE AND
COMPARISON TO BENCHMARKS**

The following chart provides a 5-year history of the City’s average weighted yield on its portfolio from fiscal year 2011-12 through fiscal year 2015-16 compared to a 5-year history of OCIP’s and LAIF’s yields. As demonstrated with this historical view, the City’s average weighted yield on its portfolio has performed well compared to OCIP and LAIF during the past five years as interest rates remained consistently low.

City & LAIF Portfolio Yields - 5 Year History



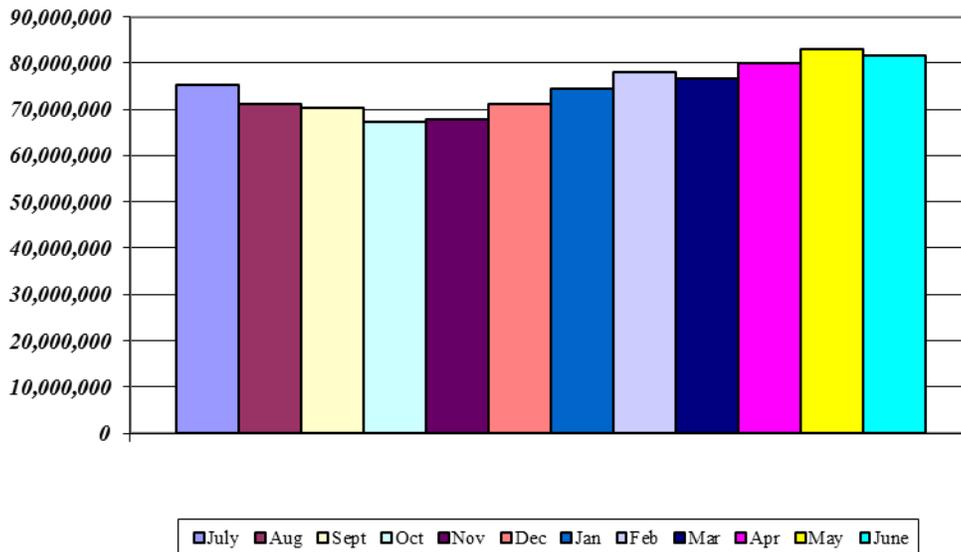


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REVIEW OF TRENDS REGARDING THE SIZE OF THE PORTFOLIO

The size of the City’s portfolio fluctuates over the course of the fiscal year due to timing differences between cash receipts and disbursements. The City’s portfolio balance typically reflects steady decreases until December when we receive significant property tax allocations. The City’s portfolio spiked in December/January and April/May as a result of significant property tax allocations, Triple Flip payments, and Property Tax in Lieu of VLF remittances.

Size of Portfolio - Monthly Trend



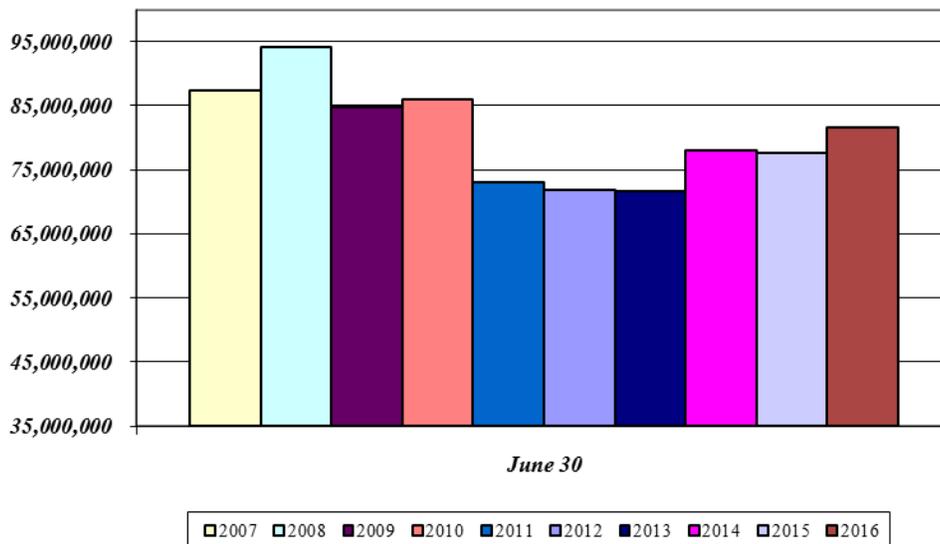


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REVIEW OF TRENDS REGARDING THE SIZE OF THE PORTFOLIO

The City ended the fiscal year with a greater cash and investment balance compared to the previous year. As of June 30, 2016, \$23.5 million of the City’s reserves are designated for capital projects.

Size of Portfolio - 10 Year Historical Trend





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INVESTMENT RISK IN THE PORTFOLIO

Although all investments contain an element of risk, the City’s Investment Policy, procedures, and investment strategies are designed to limit exposure to risk. The different types of risk are discussed below, as they pertain to the portfolio.

Credit Risk

Credit risk is defined as the risk to an investor that an issuer will default in the payment of interest and/or principal on a security. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. It is the policy of the City of Laguna Niguel to invest public funds in a manner which will provide the maximum security of principal consistent with a market rate of return while meeting the cash flow needs of the City and conforming to all applicable State and City statutes governing the investment of public funds. The City’s Investment Policy limits credit risk by:

- Limiting investments to the safest types of securities and highest quality issuers.
- Specifically excluding investments in equities, corporate bonds, derivatives, reverse re-purchase agreements and financial futures or options.
- Pre-qualifying financial institutions and broker/dealers for competitive bidding of investments.
- Diversifying investments so that potential losses on individual securities can be minimized.
- Monitoring the pooled investments of the Local Agency Investment Fund and Orange County Investment Pool each month.
- Safekeeping investments by separate agreement with Union Bank’s Trust Department.



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INVESTMENT RISK IN THE PORTFOLIO

Market Risk

Market risk is defined as the risk that the value of a security may fall as a result of changes in the financial markets, such as increases in interest rates. In periods of rapidly rising interest rates, the market value of a security can fall below the amount of principal invested. If an investor sells the security before maturity, part of the principal may be lost. The City reduces market risk by matching investments and maturities with cash flow needs so that investments will not need to be sold prematurely.

The City had no occurrences during FY 2015-16 where investments needed to be sold prior to maturity in order to meet cash flow needs.

Interest Rate Risk

Interest rate risk is defined as the risk that an investor will under-perform the market, as a result of holding investments with lower yields than the current market rate. Generally, the longer the maturity of an investment, the greater is its sensitivity to changes in interest rates. One of the ways that the City manages its exposure to interest rate risk is by purchasing a combination of shorter-term and longer-term investments, and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. In order to minimize market risk and eliminate reliance on interest rate forecasting, it is the policy of the City to structure its investment portfolio as a maturity ladder. As such, the City employs a disciplined investment strategy with the goal of holding all securities until maturity.

The City's portfolio reflected an average weighted maturity of 461 days during the fiscal year. This is reflective of the City's strategy to pay for the Crown Valley Park Tier 2 and Tier 3 improvements on a cash basis without incurring debt while concurrently structuring the laddered portfolio to mature evenly throughout the fiscal year and over the next five years based on the City's cash requirements. When interest rates are declining, the City's portfolio is exposed to minimal interest rate risk. When interest rates are rising, the City's exposure is increased.



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INVESTMENT RISK IN THE PORTFOLIO

Liquidity Risk

Liquidity risk involves the ability to sell an investment before maturity. Some short-term investments are fairly illiquid. For example, a non-negotiable certificate of deposit is an illiquid asset that carries an interest penalty for early redemption. The City minimizes liquidity risk by maintaining a significant portion of its portfolio in very liquid instruments, such as LAIF and OCIP, where funds are immediately available.



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COMPOSITION OF THE PORTFOLIO

Authorized Investments

The City's Investment Policy lists the types of securities allowable for investment. Subject to stipulated restrictions, these include United States Treasury Bills, Notes, and Bonds; Federal Agency Securities; collateralized or insured money market accounts and demand deposits with City's primary banks; insured certificates of deposit; money market mutual funds; the Orange County Investment Pool (OCIP); and the State of California Local Agency Investment Fund (LAIF).

The City's portfolio only included those investments authorized in the Investment Policy in FY 2015-16.

Portfolio Diversification

It is the policy of the City to diversify its investment portfolio. Invested funds shall be diversified to minimize the risk of loss resulting from over concentration of assets in a specific maturity, specific user, specific financial institution, or specific class of securities. Investment of City funds shall be governed by Government Code Sections 53600 and 53630 et. seq. During FY 2015-16, the City's portfolio was limited in LAIF to a maximum of \$40 million or 55% of the City's total investment portfolio, whichever is less and in OCIP to a maximum of \$15 million or 20% of the City's total investment portfolio, whichever is less. All other investments or deposits of the City were further limited to the following authorized investments:

- U.S. Treasury Bills, Notes, and Bonds – No limit
- Collateralized or Insured Money Market or Demand Deposits – No limit
- Federal Agency Securities – Maximum portfolio limitation of 60%; Maximum issuer limitation of 25%
- Insured Certificates of Deposit – Maximum portfolio limitation of 30%; Maximum maturity value per institution limitation of \$250,000 or the lesser of the current FDIC insured limit.
- Money Market Mutual Funds limited to U.S. Treasury Securities– Maximum portfolio limitation of 20%; maximum per instrument limitation of 10%



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COMPOSITION OF THE PORTFOLIO

Portfolio Diversification

	<i>U.S. Treasury Bills/Notes</i>	<i>FHLB Agency Securities</i>	<i>FFCB Agency Securities</i>	<i>FNMA Agency Securities</i>	<i>FHLMC Agency Securities</i>	<i>Total Agency Securities</i>	<i>LAIF</i>	<i>OCIP</i>	<i>Certificates of Deposit/Cash in Bank</i>
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<i>Maximum</i>	No Limit	25%	25%	25%	25%	60%	*	*	30%
<i>FY Average</i>	22.85%	8.25%	0.71%	12.64%	9.61%	31.21%	28.02%	16.75%	1.17%

<i>July</i>	19.78%	9.41%	1.33%	13.60%	10.80%	35.14%	31.86%	13.07%	0.15%
<i>August</i>	20.89%	9.94%	1.41%	14.36%	11.40%	37.11%	21.54%	20.13%	0.33%
<i>September</i>	22.55%	10.06%	1.42%	14.53%	10.13%	36.14%	20.91%	19.66%	0.74%
<i>October</i>	25.07%	10.52%	1.49%	13.56%	10.60%	36.17%	19.18%	18.35%	1.23%
<i>November</i>	24.87%	10.44%	1.48%	13.45%	10.52%	35.89%	20.36%	18.22%	0.67%
<i>December</i>	25.14%	8.59%	1.41%	12.84%	10.04%	32.88%	24.37%	17.39%	0.23%
<i>January</i>	23.98%	8.19%	0.00%	12.24%	9.57%	30.00%	29.24%	16.59%	0.18%
<i>February</i>	22.87%	7.81%	0.00%	11.68%	9.13%	28.62%	32.58%	15.83%	0.09%
<i>March</i>	23.30%	6.61%	0.00%	11.90%	9.31%	27.82%	29.48%	16.14%	3.26%
<i>April</i>	22.33%	6.33%	0.00%	11.40%	8.92%	26.65%	34.60%	15.48%	0.93%
<i>May</i>	21.52%	6.10%	0.00%	10.99%	7.39%	24.48%	33.22%	14.92%	5.86%
<i>June</i>	21.88%	4.98%	0.00%	11.17%	7.51%	23.66%	38.86%	15.18%	0.42%

* LAIF is a maximum of \$40 million or 55% of the City's total investment portfolio, whichever is less and OCIP is a maximum of \$15 million or 20% of the City's total investment portfolio, whichever is less.



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COMPOSITION OF THE PORTFOLIO

Maturity Diversification

To minimize market risk and eliminate reliance on interest rate forecasting, the City’s policy is to structure its investment portfolio as a maturity ladder over a five-year period.

The City invests in LAIF, OCIP, and short-term investments with maturities of one year or less to maintain sufficient liquidity to meet short-term operating, capital, and contingency requirements. The balance of the portfolio is invested in instruments with maturities of up to five years. The following schedule reflects a summary of investment maturities by calendar year as of June 30, 2016.

	<i>U.S. Treasury Bills/Notes</i>	<i>Agency Securities</i>	<i>LAIF *</i>	<i>OCIP *</i>	<i>Deposits **</i>	<i>Total Portfolio</i>	<i>Percent of Total</i>
<i>Par Value</i>	\$18,000,000	\$ 19,000,000	N/A	N/A	N/A	N/A	
<i>Cost/Book Value</i>	\$17,854,766	\$ 19,309,440	\$ 31,708,475	\$ 12,388,305	\$ 344,503	\$ 81,605,489	100%
<i>2016</i>	-	\$ 3,140,990	-	-	-	\$ 3,140,990	4%
<i>2017</i>	-	\$ 8,007,560	-	-	-	\$ 8,007,560	10%
<i>2018</i>	\$ 4,972,031	\$ 7,149,790	-	-	-	\$ 12,121,821	15%
<i>2019</i>	\$ 9,906,484	\$ 1,011,100	-	-	-	\$ 10,917,584	13%
<i>2020</i>	\$ 2,976,250	\$ -	-	-	-	\$ 2,976,250	4%
<i>2021</i>	\$ -	\$ -	-	-	-	\$ -	0%

* Balances are liquid. ** Includes cash and short-term certificate of deposit.



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INVESTMENT INCOME

Investment income in FY 2015-16 amounted to \$626,744 compared to \$537,886 in FY 2014-15, an increase of \$88,858. Investment income includes interest earned and realized gains and losses on all demand deposit accounts and investments.

The Governmental Accounting Standards Board Statement 31, *“Accounting and Financial Reporting for Certain Investments and for External Investment Pools”*, establishes rules for reporting investment valuation. The Statement generally requires governmental entities to report investments at fair value in the City’s external financial statements and to reflect the related unrealized gains and losses as a component on investment income. Investments reported in the Annual Investment Report are reported at cost and therefore, investment income for this report does not include unrealized gains and losses; however, unrealized gains and losses are included in the City’s Comprehensive Annual Financial Report (CAFR) in compliance with United States Generally Accepted Accounting Principles (GAAP).



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ANTICIPATED INVESTMENT ACTIVITY

Cash forecasts for FY 2016-17 are based on the FY 2016-17 adopted budget, FY 2015-16 carry-forward appropriations, and prior year historical cash flows. Major capital projects carried forward from FY 2015-16 and expected to be completed during FY 2016-17 are the Crown Valley Park Channel Entry and Parking Improvements; playground replacements at Bear Brand Park, Clipper Cove Park, and Seminole Park; and the City's arterial and residential neighborhood paving program. Appropriations in the amount of \$13.3 million have been carried forward for these projects. In addition, the City estimates that an additional \$8.8 million will be expended toward the end of FY 2016-17 for the Crown Valley Community Park (CVCP) Channel Entry and Parking Improvements and the CVCP Community Building. The City estimates that in order to ensure that there is sufficient liquidity to meet the City's capital improvement and operating expenditures over any six-month period, an amount of approximately \$38 million is desired to be held collectively in LAIF and OCIP during FY 2016-17.

The City will continue to invest available cash in authorized investments per the City's investment policy and in the order of the primary objectives of safety, liquidity, and yield.



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INVESTMENT POLICY COMPLIANCE CERTIFICATION

As Investment Officer and Treasurer of the City of Laguna Niguel, we certify that we have complied with the annual Investment Policy adopted by the City Council effective October 20, 2015.

*Rod Foster
City Manager/Investment Officer*

10.18.2016.

Date

*Stephen Erlandson
Director of Finance/City Treasurer*

10/18/16

Date