

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



***Fiscal Year Ended
June 30, 2015***

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 2014-15 was 0.86%, an increase of 9 basis points over the prior fiscal year, attributable to the City's continued strategy of lengthening the portfolio and increasing the proportion of the portfolio invested in long-term bonds and U.S. Treasuries.

The average weighted yield on the City's portfolio at June 30, 2015 was 0.84%, on a cash and investment balance of \$77,650,042, with an average days-to-maturity of 475 days. The fiscal year average weighted days to maturity of the portfolio has increased for the first time in five years from 491 days (1.35 years) in FY 2009-10 to 546 days (1.50 years) in FY 2014-15; reflecting the City's continued strategy of lengthening the portfolio and increasing the proportion of the portfolio invested in long-term bonds and U.S. Treasuries.

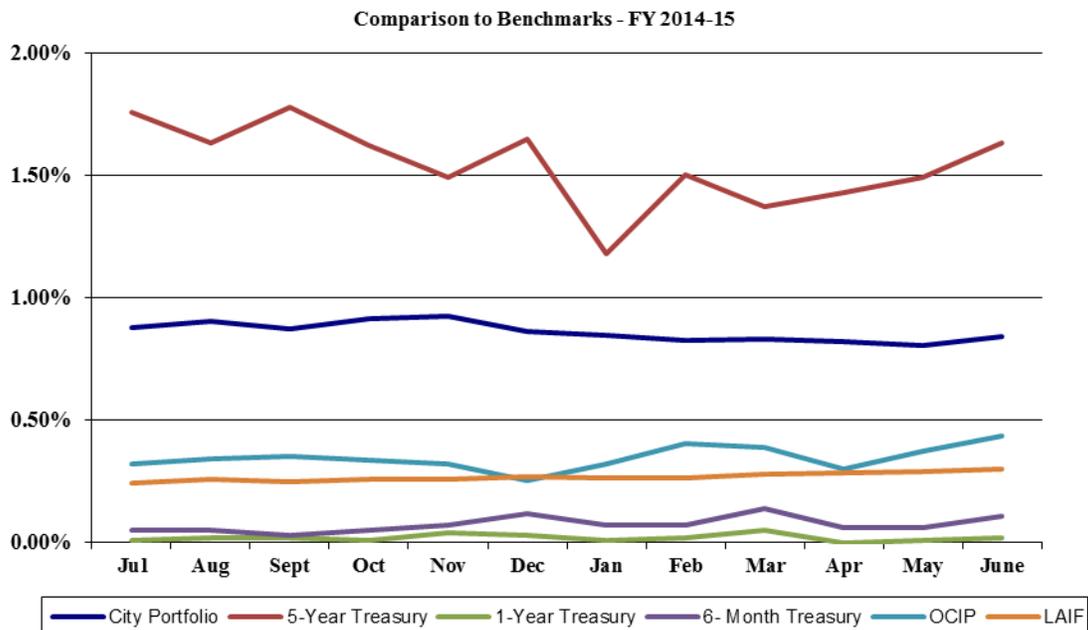
<i>City of Laguna Niguel's Portfolio</i>				<i>Benchmark Comparisons</i>				
	<i>Cost/Book Value</i>	<i>Average Weighted Days to Maturity</i>	<i>Average Weighted Yield</i>	<i>5-Year Treasury</i>	<i>1-Year Treasury</i>	<i>6-Month Treasury</i>	<i>OCIP</i>	<i>LAIF</i>
Jul	\$ 76,450,914	570	0.88%	1.76%	0.01%	0.05%	0.32%	0.24%
Aug	\$ 75,108,673	586	0.90%	1.63%	0.02%	0.05%	0.34%	0.26%
Sept	\$ 73,130,042	597	0.88%	1.78%	0.02%	0.03%	0.35%	0.25%
Oct	\$ 70,993,318	617	0.91%	1.62%	0.01%	0.05%	0.34%	0.26%
Nov	\$ 68,854,807	611	0.92%	1.49%	0.04%	0.07%	0.32%	0.26%
Dec	\$ 75,150,878	544	0.86%	1.65%	0.03%	0.12%	0.26%	0.27%
Jan	\$ 77,130,438	514	0.85%	1.18%	0.01%	0.07%	0.32%	0.26%
Feb	\$ 76,141,662	510	0.83%	1.50%	0.02%	0.07%	0.41%	0.27%
Mar	\$ 76,038,373	537	0.83%	1.37%	0.05%	0.14%	0.39%	0.28%
Apr	\$ 76,847,753	510	0.82%	1.43%	0.00%	0.06%	0.30%	0.28%
May	\$ 79,207,590	479	0.81%	1.49%	0.01%	0.06%	0.37%	0.29%
June	\$ 77,650,042	475	0.84%	1.63%	0.02%	0.11%	0.44%	0.30%
Fiscal Year	\$ 75,225,374	546	0.86%	1.54%	0.02%	0.07%	0.35%	0.27%



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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% throughout the fiscal year. Short-term interest rates remained relatively flat over the course of the fiscal year, while the five-year Treasury bond rate fluctuated throughout the year and ended the year moderately lower than its July level. The average weighted yield of the City’s portfolio varied slightly from month-to-month over the course of the fiscal year; however, the annual average weighted yield on the portfolio was 0.86%, an increase of 9 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.



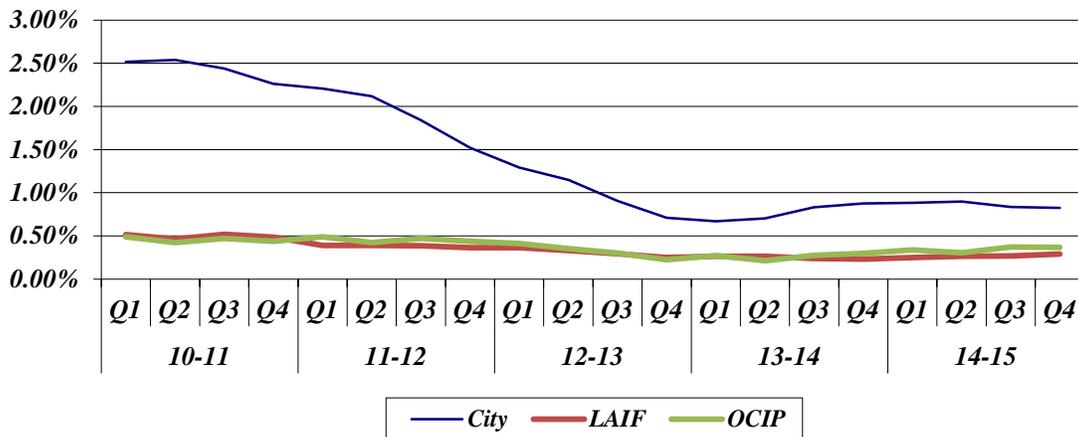


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**PORTFOLIO PERFORMANCE AND
COMPARISON TO BENCHMARKS**

The following chart provides a 5-year history of the City’s portfolio yield from fiscal year 2010-2011 through fiscal year 2014-2015 compared to a 5-year history of OCIP’s and LAIF’s yields. As demonstrated with this historical view, the City’s portfolio yield has performed well compared to OCIP and LAIF during the past five years as interest rates remained consistently low. This is expected, given that the average maturity of the City’s portfolio has consistently been greater than the average maturity of the OCIP and LAIF portfolios during this period due to the selection of underlying positions in the respective portfolios.

City & LAIF Portfolio Yields - 5 Year History



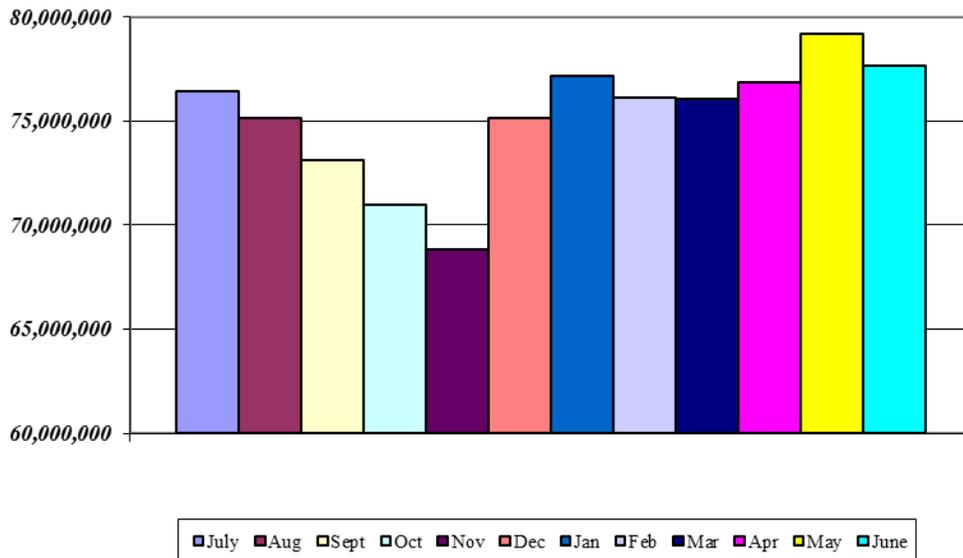


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REVIEW OF TRENDS REGARDING THE SIZE OF THE PORTFOLIO

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





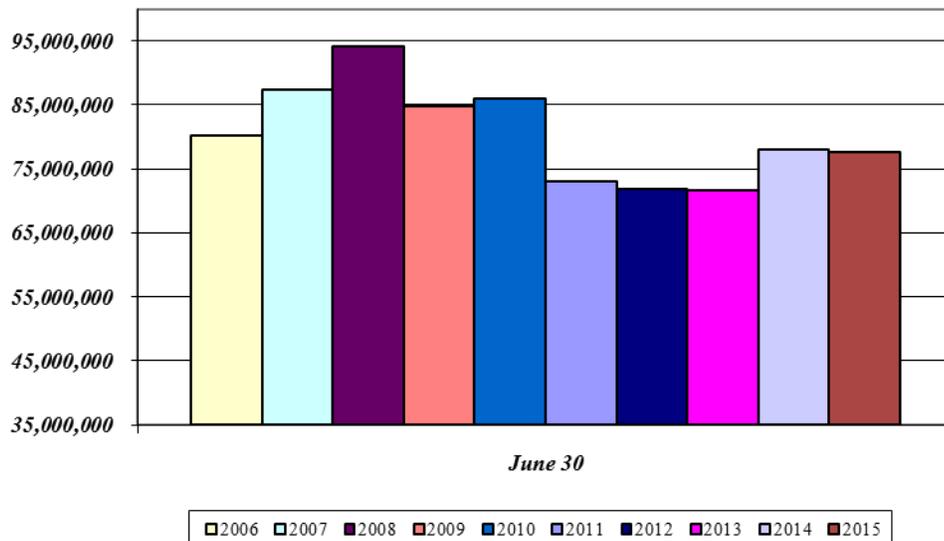
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REVIEW OF TRENDS REGARDING THE SIZE OF THE PORTFOLIO

The City ended the fiscal year with a relatively flat cash and investment balance compared to the previous year. It is expected that the portfolio balance will decrease slightly during FY 2015-2016 as a result of construction activity related to the City’s arterial paving program.

As of June 30, 2015, \$21.1 million of the City’s reserves are designated for uncompleted capital projects. As these projects are completed, and as construction continues at Crown Valley Community Park, it is expected portfolio balances will decrease over the next five years.

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 2014-15 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 546 days during the fiscal year. This is reflective of the City's strategy to ladder investments to mature evenly throughout the fiscal year and over a 5-year period. 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 2014-15.

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 2014-2015, 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 \$10 million or 15% of the City's total investment portfolio, whichever is less (OCIP limits were increased to \$15 million or 20% of the City's total investment portfolio, whichever is less, by Council action on August 4, 2015). 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>	15.93%	11.79%	1.33%	13.61%	11.61%	38.34%	35.06%	9.14%	1.53%

<i>July</i>	11.69%	13.24%	1.31%	13.37%	11.94%	39.86%	37.52%	6.54%	4.39%
<i>August</i>	11.90%	13.47%	1.33%	13.61%	12.15%	40.56%	35.53%	6.67%	5.34%
<i>September</i>	14.94%	12.44%	1.37%	13.98%	12.48%	40.27%	35.84%	6.84%	2.11%
<i>October</i>	16.76%	12.81%	1.41%	14.40%	12.86%	41.48%	33.39%	7.05%	1.32%
<i>November</i>	17.28%	13.21%	1.45%	14.84%	13.26%	42.76%	32.50%	7.27%	0.19%
<i>December</i>	15.83%	12.10%	1.33%	13.60%	12.15%	39.18%	33.87%	10.65%	0.47%
<i>January</i>	15.43%	11.79%	1.30%	13.25%	11.83%	38.17%	35.51%	10.39%	0.50%
<i>February</i>	15.63%	11.95%	1.31%	13.42%	10.66%	37.34%	35.11%	10.53%	1.39%
<i>March</i>	18.26%	10.65%	1.32%	13.44%	10.67%	36.08%	33.85%	10.54%	1.27%
<i>April</i>	18.07%	10.54%	1.30%	13.30%	10.56%	35.70%	35.50%	10.43%	0.30%
<i>May</i>	17.53%	10.22%	1.26%	12.90%	10.25%	34.63%	37.50%	10.13%	0.21%
<i>June</i>	17.88%	9.11%	1.29%	13.16%	10.45%	34.01%	34.63%	12.66%	0.82%

* On or Before October 7, 2014: 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 \$10 million or 15% of the City's total investment portfolio, whichever is Less.

* On or After October 7, 2014: 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 \$10 million or 15% 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, 2015.

	<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>	\$14,000,000	\$ 26,000,000	N/A	N/A	N/A	N/A	
<i>Cost/Book Value</i>	\$13,885,547	\$ 26,412,283	\$ 26,893,802	\$ 9,822,474	\$ 635,936	\$ 77,650,042	100%
<i>2015</i>	-	\$ 3,065,499	-	-	-	\$ 3,065,499	4%
<i>2016</i>	-	\$ 7,178,334	-	-	-	\$ 7,178,334	9%
<i>2017</i>	-	\$ 8,007,560	-	-	-	\$ 8,007,560	10%
<i>2018</i>	\$ 4,972,031	\$ 7,149,790	-	-	-	\$ 12,121,821	16%
<i>2019</i>	\$ 8,913,516	\$ 1,011,100	-	-	-	\$ 9,924,616	13%
<i>2020</i>	\$ -	\$ -	-	-	-	\$ -	0%

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



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INVESTMENT INCOME

Investment income in FY 2014-15 amounted to \$537,886 compared to \$462,278 in FY 2013-14, an increase of \$75,608. This increase is attributed to the City's continued strategy of lengthening the portfolio and increasing the proportion of the portfolio invested in long-term bonds and U.S. Treasuries. 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 2015-16 are based on the FY 2015-16 adopted budget, FY 2014-15 carry-forward appropriations, and prior year historical cash flows. Major capital projects carried forward from FY 2014-15 and expected to be completed during FY 2014-15 are the Oso Creek Multi-Use Trail Project, the Paseo De Colinas Bridge Retrofit project, and the City's arterial and residential neighborhood paving program. Appropriations in the amount of \$15.2 million have been carried forward for these projects. In addition, the City estimates that an additional \$2.0 million will be expended toward the end of FY 2015-16 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 \$28 million is desired to be held collectively in LAIF and OCIP during FY 2015-16.

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 7, 2014.

*Rod Foster
City Manager/Investment Officer*

10/20/2015.

Date

*Stephen Erlandson
Director of Finance/City Treasurer*

10/20/15

Date