

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



***Fiscal Year Ended
June 30, 2020***

Prepared by:

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Finance Director/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 2019-20 (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 1.89%, a decrease of 10 basis points over the prior fiscal year, attributable to decreases in interest rates.

The average weighted yield on the City’s portfolio at June 30, 2020 was 1.22%, on a cash and investment balance of \$50,916,090, 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 0 days. The fiscal year average weighted days to maturity of the portfolio decreased from 111 days in FY 2018-19 to 16 days in FY 2019-20, reflecting the City’s strategy of shortening the portfolio to fund the Crown Valley Park 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-19	\$ 67,354,824	36	2.26%	1.84%	1.92%	2.00%	2.28%	2.38%
Aug-19	\$ 61,605,661	32	2.21%	1.39%	1.76%	1.89%	2.22%	2.34%
Sep-19	\$ 58,715,120	30	2.20%	1.55%	1.75%	1.83%	2.24%	2.28%
Oct-19	\$ 55,057,465	26	2.13%	1.51%	1.53%	1.57%	2.12%	2.19%
Nov-19	\$ 55,044,743	23	2.04%	1.62%	1.60%	1.63%	2.01%	2.10%
Dec-19	\$ 56,647,249	14	2.00%	1.69%	1.59%	1.60%	1.88%	2.04%
Jan-20	\$ 57,164,188	10	1.95%	1.32%	1.45%	1.54%	1.91%	1.97%
Feb-20	\$ 54,091,283	7	1.95%	0.89%	0.97%	1.11%	1.99%	1.91%
Mar-20	\$ 52,382,436	5	1.78%	0.37%	0.17%	0.15%	1.74%	1.79%
Apr-20	\$ 55,106,088	2	1.61%	0.36%	0.16%	0.11%	1.42%	1.65%
May-20	\$ 53,158,389	1	1.33%	0.30%	0.17%	0.18%	1.22%	1.36%
Jun-20	\$ 50,916,090	0	1.22%	0.29%	0.16%	0.18%	1.22%	1.22%
Fiscal Year	\$ 56,436,961	16	1.89%	1.09%	1.10%	1.15%	1.85%	1.94%

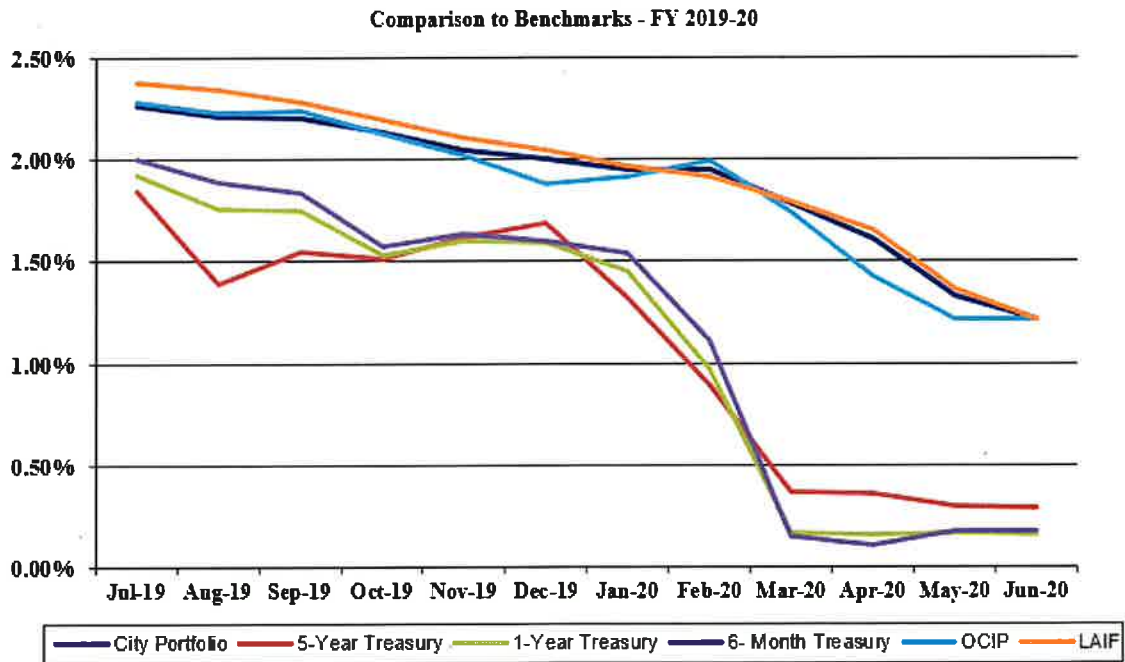


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PORTFOLIO PERFORMANCE AND COMPARISON TO BENCHMARKS

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 average weighted yield of the City’s portfolio decreased consistently on a monthly basis over the course of the fiscal year and the annual average weighted yield on the portfolio was 1.89%, an decrease of 10 basis points over the prior fiscal year annual average weighted yield. As in the past, the City’s portfolio consistently performs within the ranges of the LAIF and OCIP investment pools.

As illustrated in the chart below, the sharp decline in yield starting in February 2020 coincides with market’s reaction to the global COVID-19 pandemic.



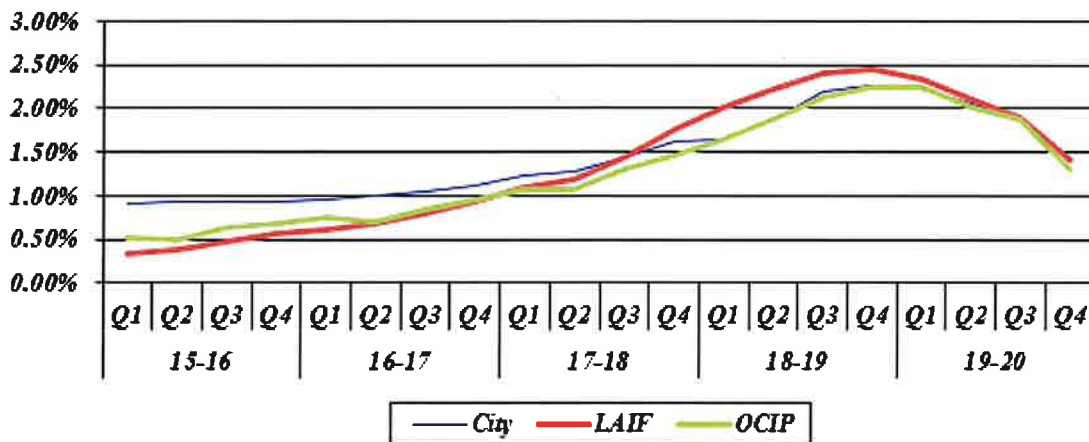


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PORTFOLIO PERFORMANCE AND COMPARISON TO BENCHMARKS

The following chart provides a 5-year history of the City’s average weighted yield on its portfolio from fiscal year 2015-16 through fiscal year 2019-20 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 consistently performed on par with OCIP and LAIF during the past five years.

City & LAIF Portfolio Yields - 5 Year History



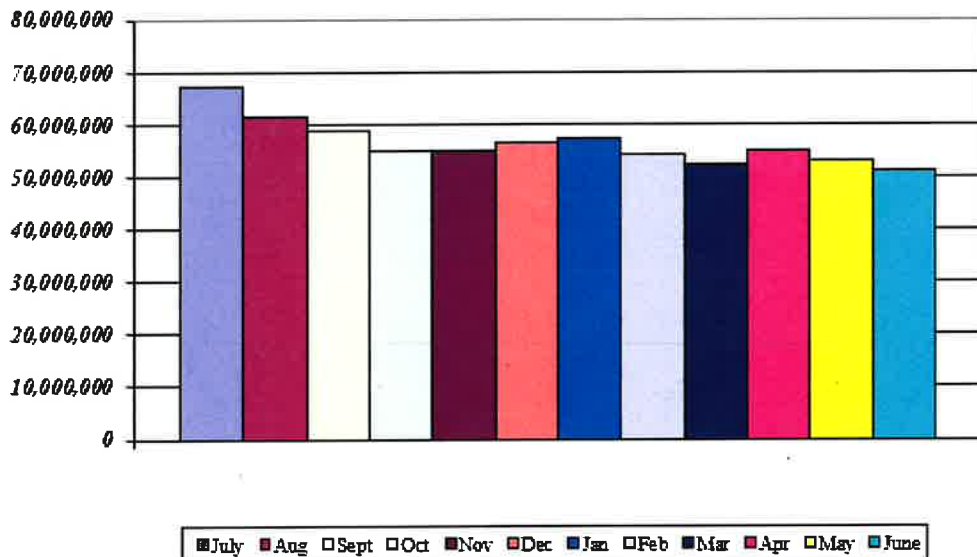


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REVIEW OF TRENDS REGARDING THE SIZE OF THE PORTFOLIO

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 and Property Tax in Lieu of VLF remittances. The significant drop in portfolio size is due to the large cash outlay to complete the Crown Valley Park Tier III project.

Size of Portfolio - Monthly Trend



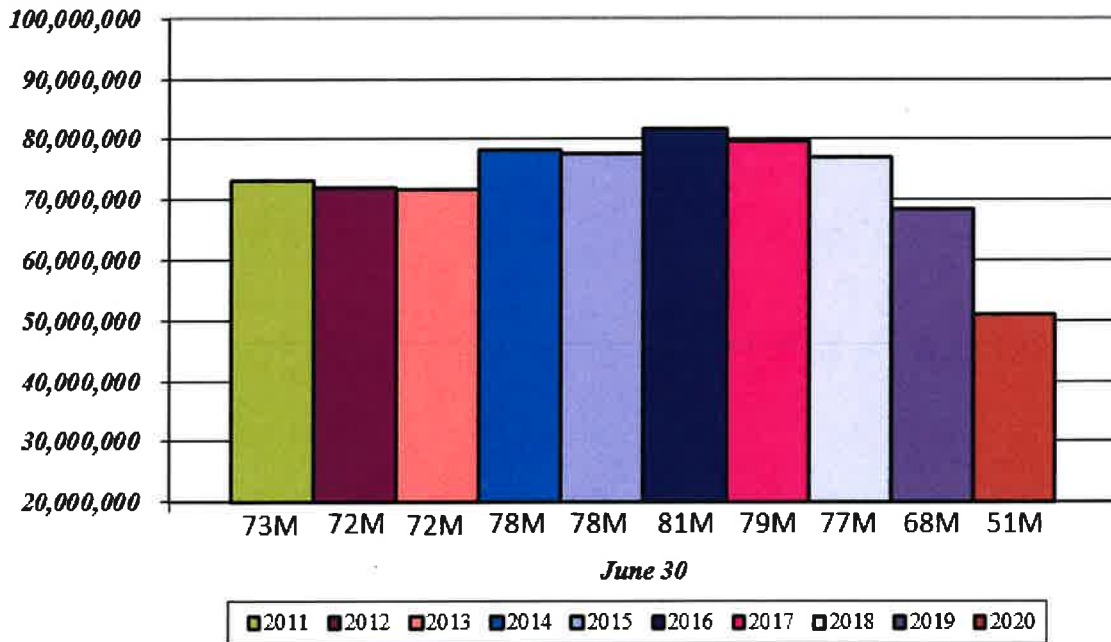


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REVIEW OF TRENDS REGARDING THE SIZE OF THE PORTFOLIO

The City ended the fiscal year with a lower cash and investment balance compared to the previous year. The significant drop in portfolio size is due to the large cash outlay to complete the Crown Valley Park Tier III project. Even though the portfolio decreased in size, the City maintains ample General Fund reserves. City Council adopted a policy to maintain at least 50% of annual General Fund expenditures. Currently, the City has more than 75%.

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 2019-20 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 16 days during the fiscal year. This is reflective of the City's strategy to pay for the Crown Valley Park 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 2019-20.

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 2019-20, 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</i>
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<i>Maximum</i>	No Limit	25%	25%	25%	25%	60%	*	*	30%
<i>FY Average</i>	6%	1%	0%	1%	2%	4%	40%	20%	0%

<i>July</i>	10%	1%	0%	3%	3%	7%	46%	19%	0%
<i>August</i>	11%	2%	0%	3%	3%	8%	42%	20%	0%
<i>September</i>	8%	2%	0%	2%	3%	7%	38%	21%	0%
<i>October</i>	7%	2%	0%	2%	4%	7%	34%	23%	0%
<i>November</i>	7%	2%	0%	0%	4%	5%	28%	23%	0%
<i>December</i>	5%	2%	0%	0%	3%	5%	40%	22%	0%
<i>January</i>	5%	2%	0%	0%	2%	3%	40%	22%	0%
<i>February</i>	6%	2%	0%	0%	2%	4%	39%	24%	0%
<i>March</i>	4%	0%	0%	0%	2%	2%	41%	19%	0%
<i>April</i>	2%	0%	0%	0%	2%	2%	39%	18%	0%
<i>May</i>	2%	0%	0%	0%	0%	0%	46%	18%	0%
<i>June</i>	0%	0%	0%	0%	0%	0%	42%	19%	0%

* LAIF is a maximum of \$40 million or 55% of the City's total investment portfolio, and OCIP is a maximum of \$15 million or 20% of the City's total investment portfolio. If portfolio diversification becomes out of compliance, the City has 90 days to correct it.



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INVESTMENT INCOME

Investment income in FY 2019-20 amounted to \$1,093,920 compared to \$1,409,249 in FY 2018-19, a decrease of \$315,329. 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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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 November 5, 2019.

Tamara S. Letourneau

*Tamara S. Letourneau
City Manager/Investment Officer*

10/29/20
Date

Eric Hendrickson

*Eric Hendrickson
Finance Director/City Treasurer*

9/21/2020
Date