City of Boulder

City of Boulder

Finance Department

TO: The Mayor and Members of City Council
Jane S. Brautigam, City Manager

FROM: Bob Eichem, Chief Financial Officer

SUBJECT: Investment Performance as of September 30, 2014

DATE:

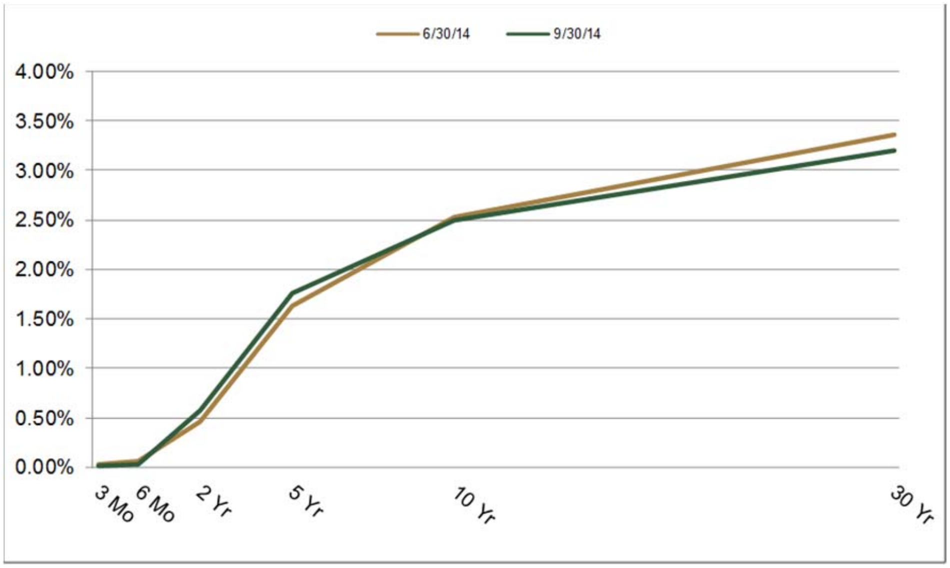
Section 1 – Background

- This report is for City Council information only and requires no action by City Council.
- The investment of City funds is guided by and this report is submitted in compliance with the City's Investment Ordinance. (Chapter 2-10, *Investment of City Funds*, Boulder Revised Code 1981).
- The investment objectives as specified in the Ordinance, are:
    - The primary objective is preservation and protection of capital. This objective reduces the risk to which the portfolio can be subjected. To comply with this objective, investments are diversified by type and maturity horizons.
    - The second objective is to maintain adequate liquidity to meet the daily cash needs of the City. The City's ordinance requires that 5% of the portfolio matures within 30 days.
    - Yield is the third objective. The City strives to maximize return, while minimizing the risks of the market.

Section 2 – The Yield Curve and Federal Open Market Committee ("the Fed")

Treasury Yield Curve

6/30/2014 vs. 9/30/14



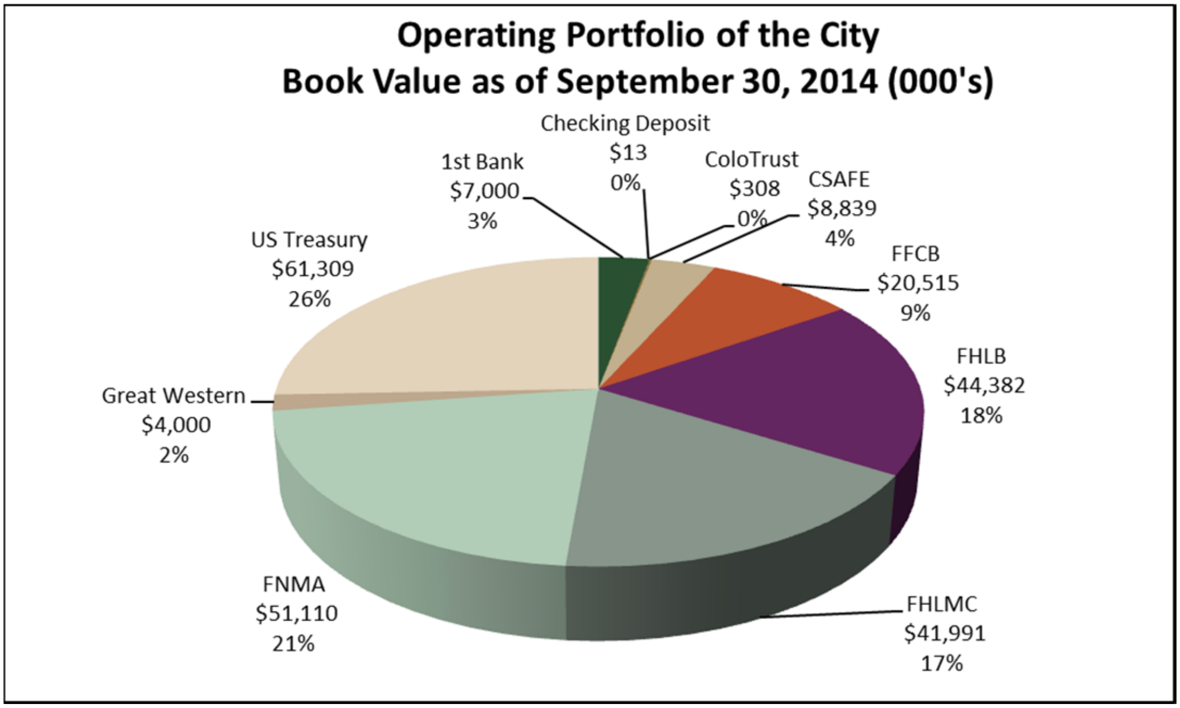
- During the past three months, the yield curve flattened even though the Fed continued to taper its purchases of long-term Treasury bonds. Market participants reacted to mixed domestic and global economic data as well as geopolitical tensions. These concerns kept downward pressure on longer yields.

- In September, the FOMC left policy rates unchanged and continued to reduce asset purchases, as expected. Overall, the Fed's statement language suggested a modest uptick to their overall view of the economy, but the message remained dovish. The Fed noted inflation is running below target, signaling their ongoing capacity to keep interest rates low. More recently, the stronger than expected September employment report gives hawkish Fed members a compelling argument for raising interest rates earlier than market participants may be expecting. However, we believe the majority of FOMC voting members are generally dovish and will be reluctant to raise rates before the economy is on a sustainable growth trajectory. At this point, we continue to believe the Fed isn't likely to start raising rates until the second half of 2015. However, the Fed may make some changes to its next policy statement, such as removing the "considerable period" language. The Fed remains on course to complete the unwinding of quantitative easing this month and the next Federal Open Market Committee meeting is scheduled for October 28-29.

Section 3 – The City's Portfolios

- Portfolio strategies implemented this quarter and all investments held in the portfolio comply with the City's investment objectives and the Ordinance that specifies allowable investments:
    - The objective of safety is achieved through a well-diversified portfolio, primarily among two major sectors (Treasury and Agency), the Agency issuers and various maturities along the yield curve. Market risk is managed by maintaining a low weighted average maturity (WAM) in the City's portfolio. As of September 30, 2014 the WAM was 1.58 years while the Ordinance allows up to a five year WAM.
    - The City maintains sufficient liquidity. As of September 30, 2014, 4% of the portfolio, or $9.1 million remained in overnight accounts.
    - As of September 30, 2014, the yield on the pooled investment portfolio was 0.71%. Our current benchmark is the six month trailing average on the 2-year Treasury, which was 0.45%, as of September 30, 2014. The objective was exceeded by 0.26%.
- There are no direct investments in the oil and gas industry in the City's portfolio.
- The City's investment adviser purchased approximately $41 million of securities during Q3 2014 for the City of Boulder's investment portfolio. The security purchases included Treasury and Agency securities maturing between November 2016 and May 2018. The securities were purchased in this maturity range to take advantage of the historically steep yield curve. The historically steep yield curve is a result of the Federal Reserve's accommodative monetary policy along with an expanding US economy resulting in very low short-term interest rates and normalizing long-term interest rates. The proceeds of $31 million of maturities along with existing liquid funds were used to fund the purchase of these securities. Future security purchases will likely be used to rebalance the City's investment portfolio to the strategy characteristics. This will be accomplished by investing liquidity not needed for other operations of the City and reinvesting the proceeds from maturing bonds.

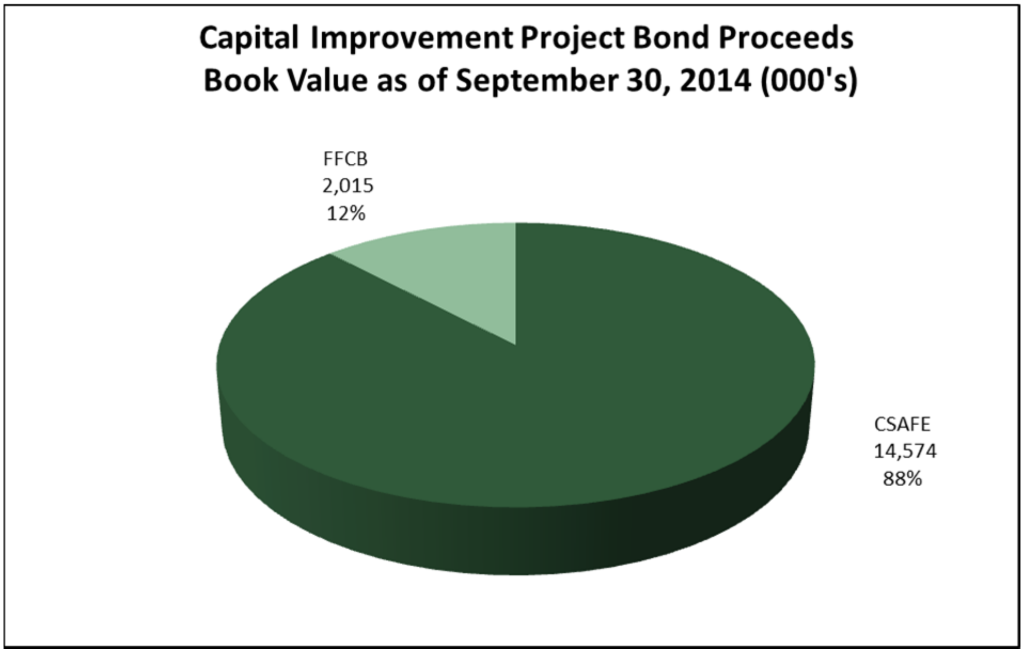
Operating Portfolio of the City



Portfolio Characteristics
Operating Portfolio of the City

	09/30/2014	06/30/2014
	Portfolio	**Portfolio**
Average Maturity (yrs)	1.58	1.32
Modified Duration	1.55	1.30
Average Purchase Yield	0.71%	0.63%
Average Market Yield	0.56%	0.37%
Average Quality**	AA+/Aaa	AA+/Aaa
Total Market Value	240,365,542	238,866,373

Capital Improvement Project 2012 Bond Proceeds



Portfolio Characteristics

Capital Improvement Project 2012 Bond Proceeds

	09/30/2014	06/30/2014
	Portfolio	**Portfolio**
Average Maturity (yrs)	0.03	0.04
Modified Duration	0.03	0.04
Average Purchase Yield	0.08%	0.06%
Average Market Yield	0.03%	0.02%
Average Quality	AA+/Aaa	AA+/Aaa
Total Market Value	16,616,178	22,760,277

When the Capital Improvement Bond proceeds of over $54 million were received in March 2012, a separate portfolio was established to facilitate IRS required arbitrage calculations. The balance of $16.6 million as of September 30, 2014 was invested as shown above in the graph and table to assure timely funding for the projected draw down schedule expected to end in January 2015.

- In June 2012, the investment committee selected the one year Treasury as the benchmark for the bond proceeds based upon an average maturity of approximately one year for the portfolio at that time. As of September 30, 2014 the portfolio yield was 0.08% compared to a yield of 0.10% on the one year Treasury.
- Daily liquidity in the portfolio is currently 88% of the portfolio, or $14.6 million, resulting in a very short weighted average maturity of 0.03 years. The portfolio has virtually no market risk and 88% of the funds are available for immediate draw down as projects need funding. This portfolio structure safely supports the short liability duration of the projects that are expected to end in January 2015.