OCTA

April 24, 2017

To: Members of the Board of Directors

From: Darrell Johnson, Chief Executive Officer

Subject: First Quarter 2017 Debt and Investment Report

Overview

The California Government Code authorizes the Orange County Transportation Authority Treasurer to submit a quarterly investment report detailing the investment activity for the period. This investment report covers the first quarter of 2017, January through March, and includes a discussion on the Orange County Transportation Authority's debt portfolio.

Recommendation

Receive and file the Quarterly Debt and Investment Report prepared by the Treasurer as an information item.

Discussion

The Treasurer is currently managing the Orange County Transportation Authority's (OCTA) investment portfolio totaling $1.45 billion as of March 31, 2017. The portfolio is divided into two managed portfolios: the liquid portfolio for immediate cash needs and the short-term portfolio for future budgeted expenditures. In addition to these portfolios, OCTA has funds invested in a debt service reserve fund for the 91 Express Lanes.

OCTA's debt portfolio had an outstanding principal balance of $427.1 million as of March 31, 2017. Approximately 74 percent of the outstanding balance is comprised of Measure M2 (M2) debt and 26 percent is associated with the 91 Express Lanes Program.

Economic Summary: The Federal Reserve (the Fed) raised its benchmark rate on March 15, 2017, for the second time in three months, this time to a range between 0.75 percent and 1 percent.

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Fed Chair Janet Yellen stated in a news conference that the Fed did not share the optimism of stock market investors and some business executives that economic growth is gaining speed. The Fed still plans to move slowly because the economy continues to grow slowly. Chair Yellen suggested the Fed would have plenty of time to adjust its plans should President Trump and Congress cut taxes or spend massively on infrastructure. Additionally, minutes of the March meeting showed most officials supported the shrinking of the Fed balance sheet later this year.

The Fed, charged with maximizing employment and moderating inflation, is close to achieving both goals. The unemployment rate fell to 4.7 percent in February. Businesses have been challenged by a dwindling pool of individuals that are unemployed and are gradually giving in to pressures to raise wages in order to attract and retain talent. After several years of concern that prices were not rising fast enough, inflation is reviving. The Fed's preferred measure rose 1.9 percent over the 12 months ending in January, close to its 2 percent annual target.

Debt Portfolio Activity: On February 15, 2017, OCTA remitted a debt service payment to M2 investors in the amount of $18.1 million. Of this amount, $7.5 million was used to retire M2 principal. The M2 Program currently has $318 million in outstanding debt.

OCTA also remitted a debt service payment for the 91 Express Lanes on February 15, 2017. OCTA paid $2.7 million in interest on the bonds. Currently, there remains $109.1 million in principal outstanding. The outstanding balances for each of OCTA's debt securities are presented in Attachment A.

During the quarter, OCTA continued with its pursuit of a Transportation Infrastructure Finance and Innovation Act (TIFIA) loan for the I-405 Improvement Project (Project). In March 2017, OCTA staff and various finance team consultants traveled to New York to meet with three different rating agencies to discuss investment grade ratings for the TIFIA loan associated with the Project. These meetings were a follow-up to the meetings held in December 2016 when then Chair Donchak and current Chair Hennessey traveled to New York to discuss the Project. During this recent trip, the OCTA team met with Standard and Poor's, Moody's Investment Service, and Kroll Bond Rating Agency.

During the meetings the OCTA team discussed some of the provisions of the TIFIA draft loan agreement, details of the Project, what OCTA is doing to mitigate any cost overruns, and the current schedule for funding the Project. The meetings specifically focused on risk mitigations, right-of-way acquisition, utility relocation, design-build selection process, toll operating agreement, and a review of the traffic and revenue study. It will take approximately four to six weeks to receive the notification of the ratings for the project. OCTA will need to provide investment grade ratings to TIFIA in order to close on the loan.

OCTA continues to have update calls with TIFIA staff members to monitor the status of the TIFIA loan request.

Investment Portfolio Compliance: There were no compliance violations during the quarter. OCTA continues its policy of reviewing the contents of the investment portfolio on a weekly basis to ensure compliance for each day of the week. Attachment B provides a comparison of the portfolio holdings as of March 31, 2017, to the diversification guidelines of the policy.

Investment Portfolio Performance Versus Selected Benchmarks: OCTA uses Clearwater Analytics to calculate performance for each manager within the respective portfolios. The performance reports calculate monthly total rates of return based upon the market value of the portfolios they manage. The securities are marked-to-market daily based on pricing data provided by the custody banks.

OCTA has calculated the total returns for each of the investment managers for short-term operating monies and has compared the returns to specific benchmarks as shown in Attachment C. Attachment D contains an annualized total return performance comparison by investment manager for the previous two years. Attachment E provides a five-year yield comparison between the short-term investment managers, Orange County Investment Pool, and Local Agency Investment Fund.

The returns for OCTA's short-term operating monies are compared to the Bank of America Merrill Lynch (BAML) 1-3 year Treasury (Treasury) and the BAML 1-3 year AAA-A U.S. Corporate and Government (Corporate/Government) benchmarks. The BAML 1-3 year indices are among the most commonly used short-term fixed income benchmarks. Each of the four managers invests in a combination of securities that all conform to OCTA's 2016 Investment Policy (Policy). For the quarter ending March 31, 2017, the weighted average total return for OCTA's short-term portfolio was 0.35 percent, outperforming the Treasury benchmark return of 0.26 percent by nine basis points, and outperforming the return of 0.34 percent by one basis points. For the 12-month period ending March 31, 2017, the portfolio's return totaled 0.51 percent, exceeding the Treasury benchmark by 25 basis points and outperforming the Corporate/Government benchmark by four basis points for the same period.

Total return performance for the quarter and the trailing year remained positive as fixed-income investors adjusted to the increases in short-term rates by the Fed. As yields rise, the market value of fixed-income securities falls. Total return is the interest earned during a given period of time, plus or minus any market gains or losses, both realized and unrealized. OCTA's investment managers added value by investing in high-quality, non-government fixed-income securities with higher yields during the period. Evidence of this may be seen in a direct comparison of the two benchmarks used by OCTA. The Corporate/Government benchmark clearly maintained a performance advantage, and was less affected by the rise in interest rates than the treasury-only benchmark, due to the additional yield generated by non-government securities.

Investment Portfolios: A summary of each investment manager's investment diversification, performance, and maturity schedule is provided in Attachment F. These summaries provide a tool for analyzing the different returns for each manager.

A complete listing of all securities is provided in Attachment G. Each portfolio contains a description of the security, maturity date, book value, market value, and yield provided by Clearwater Analytics.

Cash Availability for the Next Six Months: OCTA has reviewed the cash requirements for the next six months. It has been determined that the liquid and the short-term portfolios can fund all projected expenditures during the next six months.

Summary

As required under the California Government Code, the Orange County Transportation Authority is submitting its quarterly debt and investment report to the Board of Directors. The report summarizes the Orange County Transportation Authority's debt and investment activities for the period January 2017 through March 2017.

Attachments

A. Orange County Transportation Authority Outstanding Debt March 31, 2017.
B. Orange County Transportation Authority Investment Policy Compliance March 31, 2017.
C. Orange County Transportation Authority Short-term Portfolio Performance Review Quarter Ending March 31, 2017.
D. Orange County Transportation Authority Short-term Portfolio Performance March 31, 2017.
E. Orange County Transportation Authority Comparative Yield Performance March 31, 2017.
F. Investment Manager Diversification and Maturity Schedules March 31, 2017.
G. Orange County Transportation Authority Portfolio Listing as of March 31, 2017.

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