



January 22, 2018

To: Members of the Board of Directors

From: Darrell Johnson, Chief Executive Officer

Subject: Fourth 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 fourth quarter of 2017, October through December, 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 \$1.4 billion as of December 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 \$421.6 million as of December 31, 2017. Approximately 75 percent of the outstanding balance is comprised of Measure M2 debt, and 25 percent is associated with the 91 Express Lanes Program.

Economic Summary: The Federal Reserve (Fed) raised the Fed Funds Rate for a third time in 2017 at the December 2017 meeting to a range of 1.25 to 1.50 percent. This is a doubling of the Fed Funds Rate over the last 12 months. Further, at the December 2017 meeting, the Fed penciled in three potential interest rate increases for calendar year 2018, the same pace they forecasted in

September 2017. During the quarter, President Donald Trump also signed a new tax bill into law on December 22, 2017, that is estimated to cut \$1.5 trillion in business and household taxes.

Gross Domestic Product expanded at a revised 3.3 percent annual rate during the third quarter of 2017, which was boosted by a rebound in government investment. That was the fastest pace since the third quarter of 2014 and a pickup from the second quarter's 3.1 percent rate. The economy was previously reported to have grown at a 3 percent pace in the July-September period. It was the first time since 2014 that the economy experienced growth of 3 percent or more for two straight quarters.

The economic recovery since the 2007-2009 recession is now in its eighth year and showing little signs of fatigue. The economy is being powered by a tightening labor market, which has largely maintained a strong performance that started during former President Barack Obama's first term.

Debt Portfolio Activity: There was no debt activity during the quarter. The outstanding balances for each of OCTA's debt securities are presented in Attachment A.

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 December 31, 2017, to the diversification guidelines of the policy.

Investment Portfolio Activity: On November 7, 2017, OCTA transferred \$50 million to the liquid portfolio from the short-term portfolio managed by the external portfolio managers. The funds were required to pay the project costs related to the ongoing Interstate 405 Improvement Project, along with the traditional OCTA program and service expenses.

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.

Intercontinental Exchange (ICE) during the fourth quarter completed its acquisition of the Bank of America Merrill Lynch (BAML) Global Research division's fixed-income index platform, which will become part of ICE Data Services. This is a strategic decision by both ICE and BAML. The acquisition was seamless to OCTA and the respective investment managers.

The returns for OCTA's short-term operating monies are compared to the ICE/BAML 1-3 year Treasury (Treasury) and the ICE/BAML 1-3 year AAA-A United States Corporate and Government (Corporate/Government) benchmarks. The ICE/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 2017 Investment Policy. For the quarter ending December 31, 2017, the weighted average total return for OCTA's short-term portfolio was -0.14 percent, outperforming the Treasury benchmark return of -0.25 percent by 11 basis points and outperforming the Corporate/Government benchmark return of -0.20 percent by six basis points. For the 12-month period ending December 31, 2017, the portfolio's return totaled 0.85 percent, exceeding the Treasury benchmark by 43 basis points and outperforming the Corporate/Government benchmark by 15 basis points for the same period.

With three Fed interest rate hikes during the last 12 months, the market price on securities dropped due to the inverse relationship of fixed-income securities and interest rates. Bonds and interest rates have an inverse relationship, meaning that when interest rates go up, existing bond prices go down, and when interest rates decrease, bond prices increase.

OCTA's investment managers mitigated the impact of rising interest rates 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. This was the case for each of the four investment managers as well.

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 October 2017 through December 2017.

Attachments

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

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