



April 23, 2018

To: Members of the Board of Directors
From: Darrell E. Johnson, Chief Executive Officer
Subject: First Quarter 2018 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 2018, 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 \$1.3 billion as of March 31, 2018. 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 \$413.8 million as of March 31, 2018. Approximately 75 percent of the outstanding balance is comprised of Measure M2 (M2) debt and 25 percent is associated with the 91 Express Lanes Program.

Economic Summary: After three rate increases in 2017, the Federal Reserve (Fed) continued its effort to normalize rates while maintaining economic growth by raising the Fed Funds rate another 25 basis points in March. Fed officials leaned toward a slightly faster pace of policy tightening at their March meeting as their growth outlook and confidence in hitting their inflation target

strengthened, according to minutes from the March meeting. A number of Fed officials viewed a stronger economic outlook and greater confidence for higher inflation, implying the appropriate path for the Federal Funds rate over the next few years would likely be slightly steeper than they had previously expected.

Wholesale prices advanced in March by more than forecast, reflecting broad increases in the costs of services and goods, while the unemployment rate remained steady at 4.1 percent. Consumer Price Index service prices are rising and are expected to continue an upward trend as labor costs increase through 2018.

Debt Portfolio Activity: On February 15, 2018, OCTA remitted a debt service payment to M2 investors in the amount of \$18.3 million. Of this amount, \$7.8 million was used to retire M2 principal. The M2 program currently has \$310.2 million in outstanding debt.

OCTA also remitted a debt service payment for the 91 Express Lanes on February 15, 2018. OCTA paid \$2.6 million in interest on the bonds. Currently, there remains \$103.6 million in principal outstanding. 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 March 31, 2018, to the diversification guidelines of the policy.

Investment Portfolio Activity: On January 16, 2018, OCTA transferred \$40 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, as well as the pre-payment to the Orange County Employees Retirement System.

Subsequent to the end of the quarter on April 12, 2018, the addition of the three new investment management firms was completed. The three new firms are Chandler Asset Management, Logan Circle Partners, and Public Financial Management.

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 ICE/Bank of America Merrill Lynch (ICE/BAML) 1-3 year Treasury (Treasury) and the ICE/BAML 1-3 year AAA-A U.S. 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 March 31, 2018, the weighted average total return for OCTA's short-term portfolio was -0.14 percent, underperforming the Treasury benchmark return of -0.13 percent by 1 basis point and outperforming the Corporate/Government benchmark return of -0.17 percent by three basis points. For the 12-month period ending March 31, 2018, the portfolio's return totaled 0.36 percent, exceeding the Treasury benchmark by 33 basis points and outperforming the Corporate/Government benchmark by 17 basis points for the same period.

Continued Fed tightening has resulted in the market price on securities dropping 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 over the past year. 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 during the twelve-month period.

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 2018 through March 2018.

Attachments

- A. Orange County Transportation Authority Outstanding Debt March 31, 2018.
- B. Orange County Transportation Authority Investment Policy Compliance March 31, 2018.
- C. Orange County Transportation Authority Short-term Portfolio Performance Review Quarter Ending March 31, 2018.
- D. Orange County Transportation Authority Short-term Portfolio Performance March 31, 2018.
- E. Orange County Transportation Authority Comparative Yield Performance March 31, 2018.
- F. Investment Manager Diversification and Maturity Schedules March 31, 2018.
- G. Orange County Transportation Authority Portfolio Listing as of March 31, 2018.

Prepared by:



Rodney Johnson
Deputy Treasurer
Treasury/Public Finance
714-560-5675

Approved by:



Andrew Oftelie
Executive Director,
Finance and Administration
714-560-5649