Children & Families
Commission of Orange County

Agenda Item No. 8
May 5, 2010 Meeting

DATE: May 5, 2010

TO: Children and Families Commission of Orange County

FROM: Michael M. Ruane, Executive Director

SUBJECT: Report from Commission Investment Oversight Committee, and Proposed Investment Strategy for Specific Long-Term Investment Program

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SUMMARY:

The Commission's Investment Oversight Committee ("Committee") met on February 9, 2010, to initiate their annual review of the Commission's Investment Policy Statement and investment program. During its discussion, the Committee members noted that on-going market uncertainty and volatility would likely continue its downward pressure on U.S. Treasury rates, particularly at the short-end of the yield curve where the Commission's Specific Long-Term Investment Program (SLTIP) funds were invested and yielded less than 1.0%.

Initially, the Commission invested both short-term (liquidity) and long-term (Sustainability Reserves) funds solely in the Orange County Investment Pool Money Market Fund (MMF). The MMF is an investment pool with short maturities. The average weighted maturity of the MMF is approximately sixty days or less. In November 2005, the Commission identified a need for an alternative investment strategy for the Commission's Sustainability Reserves, and directed that a portion of the Commission's funds be invested in a Specific Long-Term Investment Program (SLTIP) to meet future program funding needs of a long-term nature. The SLTIP was structured as a laddered portfolio with authorized investments in U.S. Treasury securities with maturities up to three years. The SLTIP has served to diversify Commission investments and to set aside funds to be invested in securities with longer-term maturities to enhance portfolio performance and match future funding needs.

The Committee adopted a set of recommendations for consideration by the Commission. First, the Committee recommended a tactical move to reposition the SLTIP funds for the short-term (approximately $35 million) to the Orange County Investment Pool to improve the overall performance of the Commission's investment funds. In February, the average rate of return on funds invested in the OCIP, a highly liquid, AAAm-rated (S&P), and diversified investment pool, was approximately 1.2%

On March 3, 2010, the Commission considered and approved the Investment Policy Statement for FY 2010-2011, and authorized the short-term repositioning of SLTIP funds to the OCIP, as recommended by the Committee. On March 8, 2010, the seven U.S. Treasury securities invested in the SLTIP were sold and the proceeds were reinvested in the OCIP. A summary of the transactions follows, and a detailed listing of each trade is presented in Attachment "1." On March 31, 2010, the Commission had a total of $128,691,746 invested in the OCIP.

SLTIP Securities Sold on March 8, 2010			
Total Purchase Amount	Total Sale Amount	Total Return Amount	Total Proceeds Invested in OCIP
$35,087,500	$35,303,897	$216,397	$35,303,897

Next, the Committee met on March 23, 2010 to consider alternative plans to restructure the SLTIP for the longer term consistent with the program targets and budget assumptions discussed at the Commission's February 3, 2010 Budget Workshop. By restructuring the SLTIP, Commission investments can take advantage of the updated provisions of the Commission's Investment Policy Statement as adopted earlier in March, including a five-year maximum maturity (increased from three years), and the ability to include a broader, diversified range of authorized investments.

RECOMMENDED INVESTMENT STRATEGY FOR THE SLTIP:

The Committee reviewed various structural parameters to develop an investment strategy for the SLTIP that would reposition Commission investments to meet multiple program funding objectives and to optimize portfolio performance given prevailing market conditions. The investment strategy being recommended by the Committee can be described as a diversified fixed income portfolio actively managed by the investment staff of the County CFO pursuant to the parameters and compliance requirements of the Commission's Investment Policy Statement.

The performance of the SLTIP portfolio would be calculated on a Total Return basis. Total Return on an investment, or a pool of fixed income investments, includes income (interest earnings), as well as the change in the market price of the security/ies (appreciation or depreciation) over a given period of time, usually twelve months. For fixed income securities held to maturity, Total Return is equivalent to Yield to Maturity. An actively managed fixed income portfolio, based on the Total Return performance metric, is the most widely used investment structure by governmental agencies. Local examples in Orange County include the County, OCTA, the Transportation Corridor Agencies, and the Orange County Sanitation District.

Upon reviewing Commission's 10-Year Financial Plan and budgetary cash flows, the Committee also recommended that Commission funds be invested one-third in the OCIP to meet liquidity demands, and two-thirds in the SLTIP. Additionally, the Committee recommended that a portion of the investments within the SLTIP be targeted with maturities in the 2 to 3-year range to fulfill program funding needs anticipated in 2012-2013 (approximately one-third of investments). The remaining one-third of available funds would be invested in authorized securities with some maximum maturities of 4 to 5 years to capture returns for sustainability needs in the out years beyond 2013. The details of the Committee's recommended investment strategy are detailed in Attachment "2."

The recommended strategic investment plan reflects the Commission's unique program funding and timing requirements, including declining projections for tobacco tax revenues, and the Commission's need to invest funds today in order to be able to sustain its long-term program funding commitments.

NEXT STEPS AND PROPOSED TIMELINE:
The proposed investment strategy represents a different approach to the SLTIP and it is recommended that the following process be implemented prior to formal consideration of the Investment Oversight Committee recommendations:

1. An informational presentation developed by your Financial Advisor and staff regarding the advantages and disadvantages of a Total Return approach for a portion of your portfolio. This could be accomplished in conjunction with your annual planning meeting in June. This session could also include a recap of the public investment training provided by Government Finance Officers Association (GFOA) two years ago.
2. The proposed investment strategy would then be placed on the July Commission meeting agenda for formal consideration along with a staff report and any additional information requested from your Investment Oversight Committee.

The process outlined above will allow for a timely yet comprehensive review of the proposed investment strategy by your Commission.

STRATEGIC PLAN & FISCAL SUMMARY:
The recommended actions presented in this staff report have been reviewed and are consistent with the Commission's Strategic Plan and Ten-Year Financial Plan.

PRIOR COMMISSION ACTIONS:

- On March 3, 20109, the Commission adopted the Investment Policy Statement for FY 2010 – 2011, as recommended by the Investment Oversight Committee, delegated annual investment authority to the Commission Treasurer, and authorized the Commission's SLTIP funds to be repositioned and invested in the Orange County Investment Pool Money Market Fund.

RECOMMENDED ACTIONS:

1. Receive staff report, on the proposed Active Investment Strategy for the Specific Long-Term Investment Program as recommended by the Investment Oversight Committee.
2. Approve a proposed timeline for review and approval of the Investment Oversight Committee's recommended strategy.

ATTACHMENTS:

1. Investment Activity Log, Children & Families Commission of Orange County, March 2010
2. IOC Investment Strategy for the SLTIP

Contact: Steve Kozak

Children and Families Commission of Orange County
Investment Activity Log
Month of March 2010

Issuer	Broker	Purchase Date	Maturity Date	Yield (%)	CUSIP	Purchase Amount	Total Sale
Securities Sold on March 8, 2010							
U.S. Treasury Security	FTN Financial	4/30/2008	4/30/2010	2.3462	912828HX1	4,978,515.65	5,052,022.19
U.S. Treasury Security	FTN Financial	7/31/2008	7/31/2010	2.641	912828JF8	5,010,546.90	5,065,431.84
U.S. Treasury Security	Barclays Capital	7/9/2009	12/31/2010	0.6831	912828JV3	5,014,062.50	5,029,972.38
U.S. Treasury Security	FTN Financial	7/16/2009	10/31/2010	0.6626	912828JP6	5,053,710.94	5,066,363.09
U.S. Treasury Security	FTN Financial	7/24/2009	1/31/2011	0.8205	912828JY7	5,004,101.56	5,027,593.02
U.S. Treasury Security	FTN Financial	7/30/2009	2/28/2011	0.9047	912828KE9	4,997,656.25	5,024,388.59
U.S. Treasury Security	Credit Suis Securities	2/1/2010	4/30/2011	0.4077	912828KL3	5,028,906.25	5,038,125.86
						35,087,500.05	35,303,896.97

IOC Recommended Investment Strategy for Specific Long-Term Investment Program (SLTIP)

Current Structure	
Funds Allocation	2/3 OCIP MMF and 1/3 SLTIP
Authorized SLTIP Investments	US Treasuries
Maximum SLTIP Maturity	3 years
Investment SLTIP Structure	Laddered (1)
Benchmark	None

Recommended Structure				
Funds Allocation (2)	**CFCOC Authorized Investments**	**Maximum Maturity**	**Investment Structure**	**Benchmark** (4)
1/3 OCIP MMF	Per Investment Policy Statement adopted by Commission, March 3, 2010	5 years	◇ 2a7 MMF ◇ Short Duration Bond Fund	◇ iMoney.net, Prime Institutional Funds ◇ Merrill Lynch US Treasury & Agency 1-5
2/3 SLTIP		◇ 1/3 invested 2-3 years ◇ 1/3 invested 4-5 years	Active Portfolio Management (3)	Merrill Lynch US Treasury 1-5

NOTES:

1. A Ladder Strategy allocates portfolio investments in approximately equal amounts in each maturity within a given range, to reduce interest rate risk. Securities are purchased and held in the portfolio to maturity. For bonds held to maturity, total return is Yield to Maturity.
2. Cash flows are monitored to maintain sufficient liquidity to meet the Commission's expenditure requirements for six months.
3. Active Management is characterized by the frequent buying and selling of securities using a variety of forecasting and analytical techniques in order to achieve an overall higher rate of return. Total Return is the return calculated on a periodic basis (monthly, quarterly, annually) on an investment including appreciation and earned interest.
4. A Benchmark is a standard against which the performance of a security, a portfolio, or an investment manager can be measured. For a comparison to be appropriate and useful, the benchmark and the bond or portfolio being measured against it should have comparable characteristics, such as credit rating, liquidity, issue size and coupon.