CITY OF PEORIA, ARIZONA

INVESTMENT PERFORMANCE REPORT

Annual Report

Period Ended

September 30, 2012

Brent D. Mattingly, Chief Financial Officer

Finance Department

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I. INTRODUCTION

This report reflects investment activity for the period of July 1, 2012 to September 30, 2012 for the City's investment management program. The City's Investment and Portfolio Policies, approved and adopted in January 1992 by the City Council, with revisions approved in June 2005, requires that the City's investment program meet the following criteria, listed in order of importance:

Safety - *Investments shall be undertaken in a manner that seeks to insure the preservation of capital in the overall portfolio.*

Liquidity - *The investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements.*

Yield - *The investment portfolio shall be designed with the objective of obtaining a market rate of return throughout budgetary and economic cycles, while taking into account the City's strict risk constraints.*

In keeping with these principles, the Finance Department continued to invest the City's funds only in allowable, safe securities and to structure the maturity of the investment portfolio to assure liquidity. Short-term needs (6 months or less) are being met by investments in overnight repurchase agreements, commercial paper, money market funds, and the State's Investment Pool. Funds not required to meet specific short-term needs are invested primarily in Treasury Notes and U.S. Government Agency Securities.

Only after the safety and liquidity requirements are met does the Finance Department attempt to maximize earnings. For the Quarter Ended September 30, 2012, the weighted average annualized yield on investments was as follows:

Table 1

AVERAGE ANNUALIZED INVESTMENT YIELD					
	FY 12 Q1	FY 12 Q2	FY 12 Q3	FY 12 Q4	FY 13 Q1
General Portfolio	0.62	0.58	0.53	0.47	0.47
Bond Funds	0.34	0.28	0.31	0.31	0.30
Total Portfolio	0.59	0.55	0.51	0.45	0.45

This quarter's average yield of 0.45% for the total portfolio remained the same as the total portfolio annualized yield experienced for the Quarter Ended June 30, 2012.

II. TOTAL INVESTMENT PORTFOLIO STRUCTURE

The City's overall portfolio is identified by source and use of funds in accordance with the City's investment policy. The general operating funds are composed of all funds of the City with the exception of restricted capital project funds containing direct bond proceeds and escrow funds. The interest from the operating fund portfolio is allocated pro rata to the General Fund and other commingled funds making up the portfolio. Funds identified in this category are:

General Fund
Special Revenue Funds
Enterprise Funds
Internal Service Funds
Debt Service Funds
Trust and Agency Funds

Capital project funds are managed in unique portfolios identified by individual bond issue in order to fulfill all U.S. Government tax requirements and to simplify reporting and arbitrage calculations.

During the past quarter, the City's investment portfolio has been divided between general funds and several bond fund accounts. For purposes of this performance report, however, the operating portfolio is reported as a whole and reference to performance and strategy are directed toward the portfolio in its entirety.

III. INVESTMENT POLICY COMPLIANCE

The City's Investment Policy, as approved by City Council, applies to all the financial assets and funds held by the City of Peoria. All investments follow the provisions established in that Policy.

IV. INVESTMENT PERFORMANCE

A. Portfolio Composition. It is the policy of the City to diversify its portfolio by security type and institution to minimize market volatility risk and credit risk. The Policy stipulates maximum investment levels by market sector to insure diversification. Diversification is further accomplished through the laddering of maturities, which mirror anticipated cash flows for the various funds. If not matched to specific cash flows, the funds are invested with a priority of liquidity and safety until specific cash flow needs are identified.

The table below illustrates the diversification structured into the portfolio composition with dollar amounts and percentages by investment type (market sector). The table shows the overall conservative nature of the portfolio and its diversified structure. The fluctuation in percentages between fiscal quarters represents a shifting of value between market sectors from the varying economic conditions throughout the year. The concentration on Treasury Notes and Agency Securities illustrates the portfolio's safety priority.

Table 2

TOTAL PORTFOLIO COMPOSITION (In Millions of Dollars)								
Security Type	**FY 12 – Q2**		**FY 12 – Q3**		**FY 12 – Q4**		**FY 13 – Q1**	
	%	**%**	**%**	**%**	**Amt**	**%**	**Amt**	**%**
Money Market	38.5	9.4	16.3	12.2	52.0	9.4	43.4	13.4
Agency Securities	173.4	56.9	53.5	55.1	170.9	56.9	179.0	55.2
Treasury Bills	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Treasury Notes	15.6	4.8	3.8	4.9	12.1	4.8	12.1	3.7
Commercial Paper	84.4	28.7	26.2	26.8	83.8	28.7	89.9	27.7
Repurchase Agreements	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State Pool	3.0	0.2	0.2	1.0	0.5	0.2	0.1	0.0
TOTALS:	314.9	100.0	100.0	100.0	319.3	100.0	324.5	100.0

B. Average Invested Cash Balances. The average investment cash balance of the overall portfolio for the Quarter Ended September 30, 2012 was $322,629,505 as compared to $321,730,549 for the Quarter Ended June 30, 2012.

Fluctuations in the quarterly balances shown in the chart below represent normal cash flows throughout the fiscal year, the addition of new bond proceeds, investment of earned interest, and the spend down of existing bond proceeds for capital projects.

C. Investment Income. Total investment income for the 1st Quarter of FY13 was $323,991, which represents a decrease of 1.5% from the $328,960 earned in the 4th Quarter of FY12.

D. Comparative Investment Yields. Since the Investment Policy of the City restricts investment primarily to the U.S. fixed income and money markets, the portfolio performance is measured directly against these markets for comparison purposes. The maximum maturity of securities purchased for the portfolio is restricted to five (5) years. The weighted average maturity should not exceed 365 days. The actual weighted average maturity for the 1st Quarter of FY13 was 358 days. The average rates of comparable benchmarks are shown in the table below.

Table 3

COMPARATIVE ANNUALIZED INVESTMENT YIELDS				
	FY 12 Q2	**FY 12 Q3**	**FY 12 Q4**	**FY 13 Q1**
City of Peoria (General Portfolio)	**0.58**	**0.53**	**0.47**	**0.47**
3 Month T-Bill	**0.01**	**0.06**	**0.08**	**0.09**
6 Month T- Bill	**0.04**	**0.11**	**0.14**	**0.14**
1 Year T-Bill	**0.10**	**0.14**	**0.18**	**0.17**
2 Year Treasury	**0.26**	**0.28**	**0.28**	**0.25**

E. Average Maturity of the Portfolio. For the Quarter ended September 30, 2012, the average maturity of the portfolio was 358 days as compared to 332 days on June 30, 2012. Matching maturities to known cash flows requires the maintenance of a somewhat short portfolio. This assures the City's liabilities can be met as they come due. Cash not needed to match immediate cash flow needs (within a nine month rolling horizon of liabilities) is normally extended somewhat to take advantage of higher yields. Longer maturities are used to capture yields at purchase and to capture capital gains during the period.

F. Comparison of Market Value and Book Value. The book value of the portfolio is captured on an amortized cost basis recognizing the City's position in the securities on a straight-line amortization of premiums and discounts. Book and market values do not include accrued interest on the securities. The market value reflects the *then current* market price at which these securities could be sold in the open market. A comparison of book and market reflects the changes in market rates as well as the performance of the portfolio against the market. Since the shortest portion of the portfolio is matched against anticipated cash flows, rate changes will more directly affect their relative gain/loss positions. A summary of market and book values for the total portfolio for the Quarter are shown below.

Beginning Book Value...................... $319,286,192
Beginning Market Value.................. $319,361,196

Ending Book Value.......................... $324,414,512
Ending Market Value........................ $324,584,465

At quarter's end, the market value of the portfolio exceeded the book value of securities resulting in an overall unrealized gain in value of $169,953.

ECONOMIC REVIEW AS OF 9-30-12:

Gross Domestic Product (GDP). Although the initial third quarter economic growth measurement is not due to be released until the end of October, the Commerce Department did release the final GDP reading for the second quarter, and results were actually a bit weaker than forecast. Second quarter GDP was revised further downward from 1.7% to 1.3% as reductions in inventory accumulations subtracted as much as 0.5% from the total. It now appears GDP may have picked up a bit in the most recent quarter along with consumer spending, but most third quarter forecasts are still around 2.0%. Historically, annualized GDP growth in the U.S. has been in the 3% range. The impending "fiscal cliff" continues to threaten future growth, as hundreds of billions in tax cuts, credits and exemptions, along with extended unemployment benefits are set to expire at the same time across-the-board expense cuts take effect.

Nonfarm Payrolls. Job growth has slowed significantly since the beginning of the year, but has increased recently. Nonfarm payrolls increased by 114k in September, while revisions to the previous two months added 86k jobs from the last count. In total, U.S. companies added 437k jobs during the third quarter, compared to just 200k in the previous period. However, even the higher third quarter pace fell below the rate of job growth normally required to drive down unemployment. Although the September unemployment rate actually fell from 8.1% to 7.8%, this was mostly a result of the lowest labor market participation rate in 33 years, and a huge increase in household sector jobs, 70% of which were part-time positions. The U6 measure of unemployment, which includes everyone who would accept a full-time position if one were suddenly made available, held steady at 14.7%.

U.S. Home Sales. The housing sector continued to show sharp improvement last quarter. Much of this was due to record low mortgage rates as Freddie Mac's 30-yr mortgage index averaged 3.47% for September and dropped to 3.32% in early October. Existing home sales rose by 7.8% in August to an annualized 4.82 million unit pace, the highest since May 2010. By contrast, new home sales are now at their highest level in two years - the August pace was 373k, up 28% from the previous year. According to the National Association of Realtors, 2012 overall sales are on track to reach a 5-year high. In response, housing starts soared by 15% in September to the highest level since July 2008. Building permits also jumped 11.6% to their highest point of the recovery so far. The median price for a new home rose 11.2% in August to $256,900, the largest single month increase in history and 17% above August 2011.

Retail Sales. Second quarter retail sales were *all negative*, but third quarter sales have improved significantly. Retail sales rose 1.1% in September, following a revised 1.2% August increase. In fact, the average monthly increase of 1% during the third quarter was strong enough to match an eight-year high. Car and light truck sales rose to a recovery high of 14.9 million annualized units in September. Three years ago, at the peak of the 2009 "cash-for-clunkers" incentive program, auto sales briefly reached an annualized pace of 14.6 million before crashing down to 9.4 million just a month later. For reasons unclear, Americans now seem to be gaining confidence. The University of Michigan consumer sentiment index for October rose from 78.3 to 83.1, topping all Bloomberg forecasts, and reaching the highest level since September 2007, several months *before* the recession began.

- Scott McIntyre, First Southwest Asset Management

SUMMARY DATA

Table 4

PORTFOLIO COMPOSITION General Funds				
Security Type	**FY 12 – Q2 Ending 12/31/11**	**FY 12 – Q2 Ending 12/31/11**	**FY 12 – Q4 Ending 06/30/12**	**FY 13 – Q1 Ending 06/30/12**
Money Market	$30,671,406	$30,671,406	$33,432,537	$30,865,206
Agency Securities	$168,421,183	$168,421,183	$168,842,838	$176,951,755
Treasury Notes	$10,068,188	$10,068,188	$8,053,238	$8,044,063
Treasury Bills	$0	$0	$0	$0
Commercial Paper	$70,394,215	$70,394,215	$67,872,524	$67,893,092
Repurchase Agreements	$0	$0	$0	$0
State Pool	$2,974,199	$2,974,199	$529,637	$90,107
Totals:	**$282,529,191**	**$282,529,191**	**$278,730,774**	**$283,844,223**
Avg Yield	0.58	0.58	0.47	0.47
Avg Maturity (Years)	1.03	1.03	0.98	1.08
State Pool Yield	0.04	0.04	0.11	0.15

Table 5

PORTFOLIO COMPOSITION G.O. Bonds 2007				
Security Type	**FY 12 – Q2 Ending 12/31/11**	**FY 12 – Q3 Ending 03/31/12**	**FY 12 – Q4 Ending 06/30/12**	**FY 13 – Q1 Ending 09/30/12**
Money Market	$1,450,450	$1,192,802	$1,630,677	$1,630,674
Agency Securities	$0	$0	$0	$0
Treasury Notes	$1,503,435	$1,500,830	$1,010,212	$1,007,287
Treasury Bills	$0	$0	$0	$0
Commercial Paper	$0	$0	$0	$0
Repurchase Agreements	$0	$0	$0	$0
Totals:	**$2,953,885**	**$2,693,632**	**$2,640,889**	**$2,637,961**
Avg Yield	0.20	0.17	0.08	0.08
Avg Maturity (Years)	0.16	0.09	0.36	0.27

Table 6

PORTFOLIO COMPOSITION G.O. Bonds 2009				
Security Type	**FY 12 – Q2 Ending 12/31/11**	**FY 12 – Q3 Ending 03/31/12**	**FY 12 – Q4 Ending 06/30/12**	**FY 13 – Q1 Ending 09/30/12**
Money Market	$3,646,226	$2,213,087	$3,209,367	$3,214,099
Agency Securities	$2,000,316	$2,000,232	$2,000,148	$2,000,064
Treasury Notes	$4,009,159	$4,002,213	$3,030,635	$3,021,860
Treasury Bills	$0	$0	$0	$0
Commercial Paper	$7,995,076	$8,980,572	$8,983,133	$8,990,318
Repurchase Agreements	$0	$0	$0	$0
Totals:	**$17,650,777**	**$17,196,104**	**$17,223,283**	**$17,226,341**
Avg Yield	0.31	0.30	0.33	0.33
Avg Maturity (Years)	0.24	0.29	0.44	0.29

Table 7

PORTFOLIO COMPOSITION G.O. Bonds 2010				
Security Type	**FY 12 – Q2 Ending 12/31/11**	**FY 12 – Q3 Ending 03/31/12**	**FY 12 – Q4 Ending 06/30/12**	**FY 13 – Q1 Ending 09/30/12**
Money Market	$2,724,759	$2,373,419	$2,844,971	$2,851,290
Agency Securities	$3,014,092	$3,006,675	$0	$0
Treasury Notes	$0	$0	$0	$0
Treasury Bills	$0	$0	$0	$0
Commercial Paper	$5,988,723	$4,982,278	$6,982,302	$6,986,966
Repurchase Agreements	$0	$0	$0	$0
Totals:	**$11,727,574**	**$10,362,372**	**$9,827,273**	**$9,838,256**
Avg Yield	0.25	0.37	0.41	0.44
Avg Maturity (Years)	0.26	0.31	0.25	0.22

Table 8

PORTFOLIO COMPOSITION G.O. Bonds 2012*				
Security Type	**FY 12 – Q2 Ending 12/31/11**	**FY 12 – Q3 Ending 03/31/11**	**FY 12 – Q4 Ending 06/30/12**	**FY 13 – Q1 Ending 09/30/12**
Money Market	$0	$0	$10,863,973	$4,873,758
Agency Securities	$0	$0	$0	$0
Treasury Notes	$0	$0	$0	$0
Treasury Bills	$0	$0	$0	$0
Commercial Paper	$0	$0	$0	$5,993.973
Repurchase Agreements	$0	$0	$0	$0
Totals:	**$0**	**$0**	**$10,863,973**	**$10,867,731**
Avg Yield	0.00	0.00	0.00	0.18
Avg Maturity (Years)	0.00	0.00	0.00	0.22

* Bond proceeds received 6/28/12