CITY OF PEORIA, ARIZONA

INVESTMENT PERFORMANCE REPORT

Annual Report

Period Ended

December 31, 2012

Brent D. Mattingly, Chief Financial Officer

Finance Department

TABLE OF CONTENTS

I. INTRODUCTION

This report reflects investment activity for the period of October 1, 2012 to December 31, 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 December 31, 2012, the weighted average annualized yield on investments was as follows:

Table 1

AVERAGE ANNUALIZED INVESTMENT YIELD					
	FY 12 Q2	**FY 12 Q3**	**FY 12 Q4**	**FY 13 Q1**	**FY 13 Q2**
General Portfolio	**0.58**	**0.53**	**0.47**	**0.47**	**0.40**
Bond Funds	**0.28**	**0.31**	**0.31**	**0.30**	**0.28**
Total Portfolio	**0.55**	**0.51**	**0.45**	**0.45**	**0.39**

This quarter's average yield of 0.39% for the total portfolio represents a decrease of 0.06% from the total portfolio annualized yield of 0.45% experienced for the Quarter Ended September 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 – Q3**		**FY 12 – Q4**		**FY 13 – Q1**		**FY 13 – Q2**	
	Amt	**%**	**Amt**	**%**	**Amt**	**%**	**Amt**	**%**
Money Market	**30.3**	**9.4**	**52.0**	**9.4**	**43.4**	**13.4**	**36.0**	**11.4**
Agency Securities	**183.1**	**56.9**	**170.9**	**56.9**	**179.0**	**55.2**	**162.8**	**51.3**
Treasury Bills	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Treasury Notes	**15.5**	**4.8**	**12.1**	**4.8**	**12.1**	**3.7**	**27.3**	**8.6**
Commercial Paper	**92.3**	**28.7**	**83.8**	**28.7**	**89.9**	**27.7**	**90.9**	**28.7**
Repurchase Agreements	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
State Pool	**0.1**	**0.2**	**0.5**	**0.2**	**0.1**	**0.0**	**0.1**	**0.0**
TOTALS:	**321.3**	**100.0**	**319.3**	**100.0**	**324.5**	**100.0**	**317.1**	**100.0**

B. Average Invested Cash Balances. The average investment cash balance of the overall portfolio for the Quarter Ended December 31, 2012 was $322,363,125 as compared to $322,629,505 for the Quarter Ended September 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 2nd Quarter of FY13 was $298,933, which represents a decrease of 7.7% from the $323,991 earned in the 1st Quarter of FY13.

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 2nd Quarter of FY13 was 336 days. The average rates of comparable benchmarks are shown in the table below.

Table 3

COMPARATIVE ANNUALIZED INVESTMENT YIELDS				
	FY 12 Q3	**FY 12 Q4**	**FY 13 Q1**	**FY 13 Q2**
City of Peoria (General Portfolio)	**0.53**	**0.47**	**0.47**	**0.40**
3 Month T-Bill	**0.06**	**0.08**	**0.09**	**0.08**
6 Month T- Bill	**0.11**	**0.14**	**0.14**	**0.13**
1 Year T-Bill	**0.14**	**0.18**	**0.17**	**0.17**
2 Year Treasury	**0.28**	**0.28**	**0.25**	**0.26**

E. Average Maturity of the Portfolio. For the Quarter ended December 31, 2012, the average maturity of the portfolio was 362 days as compared to 358 days on September 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.......................$324,414,512
Beginning Market Value....................$324,584,465

Ending Book Value $317,053,792
Ending Market Value.........................$317,196,294

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 $142,502.

ECONOMIC REVIEW AS OF 12-31-12:

Gross Domestic Product (GDP): The preliminary measure of fourth quarter GDP was expected to be quite a bit weaker than the 3.1% annualized growth rate of the third quarter, but turned out to be much worse …at least on the surface. Fourth quarter GDP actually contracted at a 0.1% annualized rate, well below the median forecast for an increase of 1.1%. Fortunately, the report improves significantly after sifting through the underlying numbers. Overall government spending fell by 6.6%, with most of the decline attributed to a 22% plunge in defense spending. Business inventories rose by $40 billion less than in the previous quarter. Slower inventory build-up plus the drop in Federal spending subtracted a huge 2.6 percentage points from GDP. By contrast, personal consumption rose at a 2.2% pace, slightly above expectations and stronger than the 1.6% rise in the previous quarter.

Nonfarm Payrolls: Job creation has been lackluster over the past six months. December nonfarm payrolls increased by 155,000 after 161,000 new jobs were created in November. For all of 2012 and 2011, payroll growth averaged 153,000 per month. Although this may sound like a significant number of jobs created, most experts believe it is merely enough to satisfy the job demand of new workers entering the labor force each month, while bypassing the 12.2 million Americans currently out of work. The December unemployment rate exactly matched the revised 7.8% rate from November. Although this was the lowest level in almost 5 years, the decline is almost entirely due to a drop in the labor force participation rate. If job creation continues at the current pace, experts expect unemployment would remain above 6.5% until spring 2018. At 200,000 per month, this timeframe shortens to mid-2015.

Home Sales: Last year, the housing market clearly turned the corner. For all of 2012, 4.65 million existing homes were sold, the most since 2007. The median price of an existing home was up 11.5% year-over-year to $180,800. Finally, the inventory of homes available for sale has fallen to 1.82 million, the fewest since January 2001, while the month’s supply has dropped to 4.4 months. That compares to a supply of 12.1 months at its worst in July 2010. New home sales were a fraction of existing sales simply because home inventories had been bloated and there was little need to build new. This too, is changing. Housing starts soared by a 12.1% in December to a 954,000 unit annual rate, the highest level since June 2008. The year-over-year 28.1% increase represented the biggest annual gain since 1983.

Retail Sales: After a stellar third quarter in which monthly retail sales averaged nearly a 1.0% increase per month, purchases slowed significantly in the fourth quarter. Retail sales dropped by 0.2% in October, perhaps due in part to Hurricane Sandy barreling up the east coast during the final week. In November, sales rose by 0.4%, although this mostly disappointing number was attributed to a decline in gasoline and service station receipts resulting from a sharp drop in gasoline prices. Car and light truck sales rose to a 4½-year high of 15.5 million annualized units in November as a number of vehicles destroyed by Superstorm Sandy were replaced. In December, retail sales rose 0.5%, with the primary strength concentrated in motor vehicles. Auto sales followed a 2.7% November increase with a 1.6% rise, marking the best two-month performance for auto dealers since 2008. *- Scott McIntyre, First Southwest Asset Management*

SUMMARY DATA

Table 4

PORTFOLIO COMPOSITION General Funds				
Security Type	**FY 12 – Q3 Ending 03/31/12**	**FY 12 – Q4 Ending 06/30/12**	**FY 13 – Q1 Ending 09/30/12**	**FY 13 – Q2 Ending 12/31/12**
Money Market	$24,556,931	$33,432,537	$30,865,206	$27,198,863
Agency Securities	$178,078,029	$168,842,838	$176,951,755	$162,819,280
Treasury Notes	$10,030,807	$8,053,238	$8,044,063	$21,252,024
Treasury Bills	$0	$0	$0	$0
Commercial Paper	$78,366,240	$67,872,524	$67,893,092	$70,919,130
Repurchase Agreements	$0	$0	$0	$0
State Pool	$52,355	$529,637	$90,107	$13,204
Totals:	**$291,084,362**	**$278,730,774**	**$283,844,223**	**$282,202,501**
Avg Yield	0.53	0.47	0.47	0.40
Avg Maturity (Years)	1.04	0.98	1.08	1.09
State Pool Yield	0.10	0.11	0.15	0.14

Table 5

PORTFOLIO COMPOSITION G.O. Bonds 2007				
Security Type	**FY 12 – Q3 Ending 03/31/12**	**FY 12 – Q4 Ending 06/30/12**	**FY 13 – Q1 Ending 09/30/12**	**FY 13 – Q2 Ending 12/31/12**
Money Market	$1,192,802	$1,630,677	$1,630,674	$1,356,551
Agency Securities	$0	$0	$0	$0
Treasury Notes	$1,500,830	$1,010,212	$1,007,287	$1,004,335
Treasury Bills	$0	$0	$0	$0
Commercial Paper	$0	$0	$0	$0
Repurchase Agreements	$0	$0	$0	$0
Totals:	**$2,693,632**	**$2,640,889**	**$2,637,961**	**$2,360,886**
Avg Yield	0.17	0.08	0.08	0.09
Avg Maturity (Years)	0.09	0.36	0.27	0.19

Table 6

PORTFOLIO COMPOSITION G.O. Bonds 2009				
Security Type	**FY 12 – Q3 Ending 03/31/12**	**FY 12 – Q4 Ending 06/30/12**	**FY 13 – Q1 Ending 09/30/12**	**FY 13 – Q2 Ending 12/31/12**
Money Market	$2,213,087	$3,209,367	$3,214,099	$2,884,463
Agency Securities	$2,000,232	$2,000,148	$2,000,064	$0
Treasury Notes	$4,002,213	$3,030,635	$3,021,860	$5,046,413
Treasury Bills	$0	$0	$0	$0
Commercial Paper	$8,980,572	$8,983,133	$8,990,318	$7,995,550
Repurchase Agreements	$0	$0	$0	$0
Totals:	**$17,196,104**	**$17,223,283**	**$17,226,341**	**$15,926,426**
Avg Yield	0.30	0.33	0.33	0.29
Avg Maturity (Years)	0.29	0.44	0.29	0.24

Table 7

PORTFOLIO COMPOSITION G.O. Bonds 2010				
Security Type	**FY 12 – Q3 Ending 03/31/12**	**FY 12 – Q4 Ending 06/30/12**	**FY 13 – Q1 Ending 09/30/12**	**FY 13 – Q2 Ending 12/31/12**
Money Market	$2,373,419	$2,844,971	$2,851,290	$1,726,301
Agency Securities	$3,006,675	$0	$0	$0
Treasury Notes	$0	$0	$0	$0
Treasury Bills	$0	$0	$0	$0
Commercial Paper	$4,982,278	$6,982,302	$6,986,966	$5,992,181
Repurchase Agreements	$0	$0	$0	$0
Totals:	**$10,362,372**	**$9,827,273**	**$9,838,256**	**$7,718,482**
Avg Yield	0.37	0.41	0.44	0.39
Avg Maturity (Years)	0.31	0.25	0.22	0.27

Table 8

PORTFOLIO COMPOSITION G.O. Bonds 2012*				
Security Type	**FY 12 – Q3 Ending 03/31/11**	**FY 12 – Q4 Ending 06/30/12**	**FY 13 – Q1 Ending 09/30/12**	**FY 13 – Q2 Ending 12/31/12**
Money Market	$0	$10,863,973	$4,873,758	$2,846,617
Agency Securities	$0	$0	$0	$0
Treasury Notes	$0	$0	$0	$0
Treasury Bills	$0	$0	$0	$0
Commercial Paper	$0	$0	$5,993.973	$5,998,880
Repurchase Agreements	$0	$0	$0	$0
Totals:	**$0**	**$10,863,973**	**$10,867,731**	**$8,845,497**
Avg Yield	0.00	0.00	0.18	0.22
Avg Maturity (Years)	0.00	0.00	0.22	0.10

* Bond proceeds received 6/28/12