

## Hampton Roads Sanitation District – Operating Funds

Investment Report – Quarter Ended March 31, 2018

### Portfolio Summary

	Market Value	
	March 31, 2018	December 31, 2017
Operating Liquidity Strategy	\$ 61,902,839	\$ 59,528,285
Total Return Strategy	\$ 154,548,251	\$ 154,704,589
Capital Investment Strategy	\$ 81,426,020	\$ 16,378,510
<b>Total Portfolio</b>	<b>\$ 297,877,110</b>	<b>\$ 230,611,384</b>

### Investment Recap and Strategies

- The **Operating Liquidity Strategy** is managed to provide liquidity for day-to-day cash needs and unforeseen events. Currently, the Operating Liquidity Strategy funds are held in an account meeting the requirements of the Security for Public Deposits Act (SPDA) and a local government investment pool (LGIP).
- The **Total Return Strategy** consists of operating funds that will not be a major source of day-to-day disbursement requirements and operational needs. The strategy includes a portfolio invested in longer-term securities in order to generate a higher investment rate of return. The strategy also includes funds designated as a reserve that are invested in an LGIP.
- The **Capital Investment Strategy** is managed to provide liquidity for capital projects. Currently, the Capital Investment Strategy funds are held in LGIPs.

### Portfolio Performance Summary

- HRSD maintains sizeable balances in overnight investment vehicles, such as bank deposits and LGIPs. These allocations are carefully managed to allow HRSD to generate the highest rate of return while preserving daily liquidity and operational efficiency. As of March 31, 2018, \$73.6 million was held in the Virginia LGIP, earning 1.66%, compared to \$24.9 million in bank deposits, earning 0.13%. Additionally, HRSD invests its \$75 million in bond proceeds in the SNAP Fund, earning 1.78% as of March 31, 2018. The yield on overnight investments is compared to the Merrill Lynch 3-month Treasury Bill's yield, which was 1.71% as of March 31, 2018.
- Performance for the Total Return Strategy is measured on a total return basis, which captures interest income, realized gains/losses, and unrealized gains/losses. This performance calculation methodology is most appropriate for investment portfolios that have longer-term investment horizons. During the quarter, the Total Return Strategy Managed Portfolio generated a total return of -0.13% (-0.51% annualized) matching the Merrill Lynch 1 - 3 Year U.S. Treasury Index's return of -0.13% (-0.53% annualized).

### Portfolio Summary *(continued)*

#### Total Return Strategy Portfolio

- The Total Return Strategy includes \$124 million invested in the Total Return Strategy Managed Portfolio (the “Managed Portfolio”), an actively-managed diversified portfolio of securities. In addition to this Managed Portfolio, the Total Return Strategy includes \$30.3 million that has been set aside as a reserve available in case HRSD is required to establish a Debt Service Reserve Fund. This reserve is expected to decline annually. The reserve has been invested in the Virginia LGIP in order to protect the funds from any potential market value fluctuations and to provide liquidity if needed.
- The Total Return Strategy Managed Portfolio is well diversified among U.S. Treasury securities, federal agency securities, supra sovereign agencies, certificates of deposit, corporate notes, commercial paper, and high quality money market mutual funds. The Portfolio’s average credit quality is AA+.
- In the first quarter of 2018, the Total Return Strategy Managed Portfolio generated a total return of -0.13% (-0.51% annualized), matching the Merrill Lynch 1 - 3 Year U.S. Treasury Index’s return of -0.13% (-0.53% annualized). The one-year trailing return for the Total Return Strategy Managed Portfolio was 0.27% compared to the benchmark’s return of 0.03%.
- New Fed Chair Jerome Powell made his first public address at February’s semi-annual monetary policy report to Congress. His maiden testimony hinted at a continuance of gradual rate hikes, while acknowledging that “the economic outlook remains strong” and the expectation for inflation to increase and closely approach the FOMC’s 2% objective remains intact.
- The Fed remained true to its stated course, raising short-term rates by ¼ percent in March, and interest rates continued their ascent over the quarter. During the quarter, the 2-year U.S. Treasury yield increased by 0.39% from 1.88% to 2.27%. As a result, a defensive duration strategy was taken relative to benchmarks to help insulate market values in the rising interest rate environment. As of March 31, 2018, the Managed Portfolio’s duration was 1.72 years compared to the benchmark’s duration of 1.80 years.
- Federal agency yield spreads remained very narrow throughout the quarter. Occasional new issue agencies continued to be the preferred outlet to add exposure at relatively attractive yields. Generally, the agency sector added modest positive excess returns in the quarter (returns in excess of similar duration Treasuries) across much of the yield curve, benefitting performance.
- Yields on corporate securities increased more rapidly than on U.S. Treasuries, causing corporate investments to underperform for the quarter. In the latter half of the quarter, market volatility pushed credit spreads markedly wide through the quarter-end, offering an attractive opportunity to add corporate exposure to the Managed Portfolio. Purchases included \$2.5 million in 2-year Nordea Bank negotiable certificates of deposit yielding 2.72% and \$2.5 million in 6-month JP Morgan Securities LLC commercial paper yielding 2.47%.

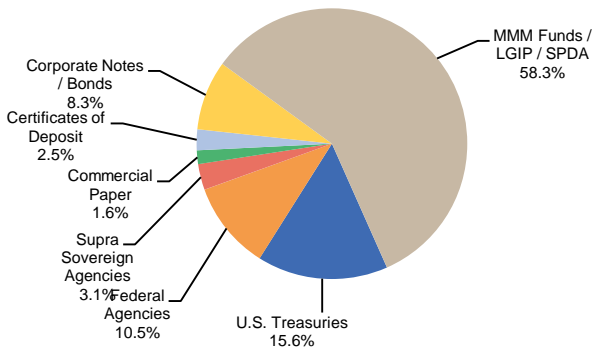
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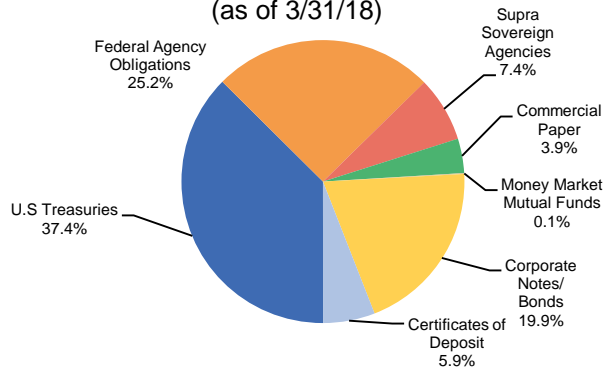
## Portfolio Composition

Security Type	March 31, 2018	% of Portfolio	December 31, 2017	% of Portfolio	Permitted by Policy
U.S. Treasuries	\$46,531,922	15.6%	\$44,869,656	19.5%	100%
Federal Agencies	31,355,714	10.5%	33,671,243	14.6%	100%
Supra Sovereign Agencies	9,244,492	3.1%	7,244,619	3.1%	15%
Commercial Paper	4,888,137	1.6%	4,905,389	2.1%	25%
Certificates of Deposit	7,379,218	2.5%	9,848,631	4.3%	25%
Municipal Obligations	0	0.0%	0	0.0%	15%
Corporate Notes / Bonds	24,773,762	8.3%	23,694,404	10.3%	25%
Money Market Mutual Funds / LGIP / Cash	173,703,863	58.3%	106,377,443	46.1%	100%
<b>Totals</b>	<b>\$297,877,110</b>	<b>100.0%</b>	<b>\$230,611,384</b>	<b>100.0%</b>	

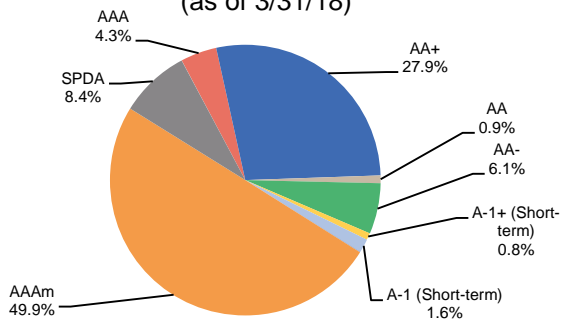
**All Portfolios Composition**  
(as 3/31/18)



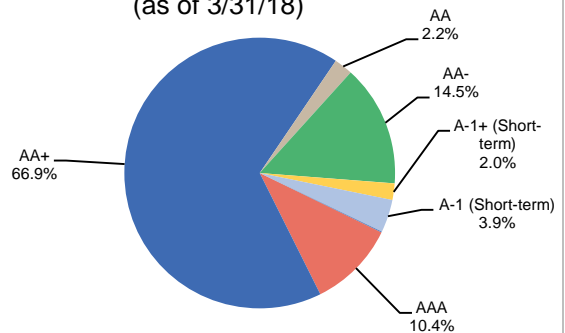
**Total Return Strategy Managed Portfolio Composition**  
(as of 3/31/18)



**All Portfolios Credit Quality Distribution**  
(as of 3/31/18)



**Total Return Strategy Managed Portfolio Credit Quality Distribution**  
(as of 3/31/18)

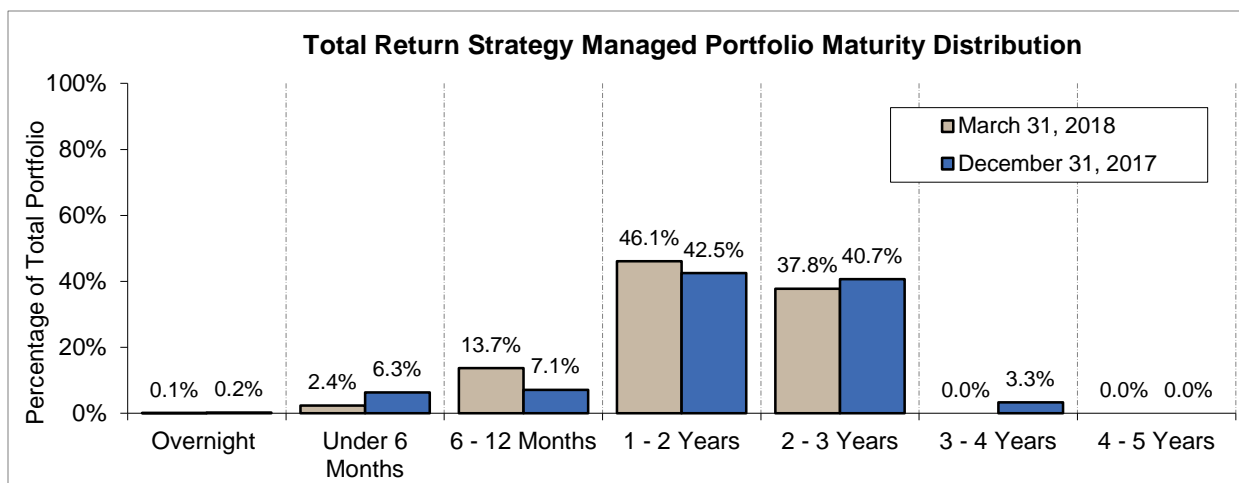
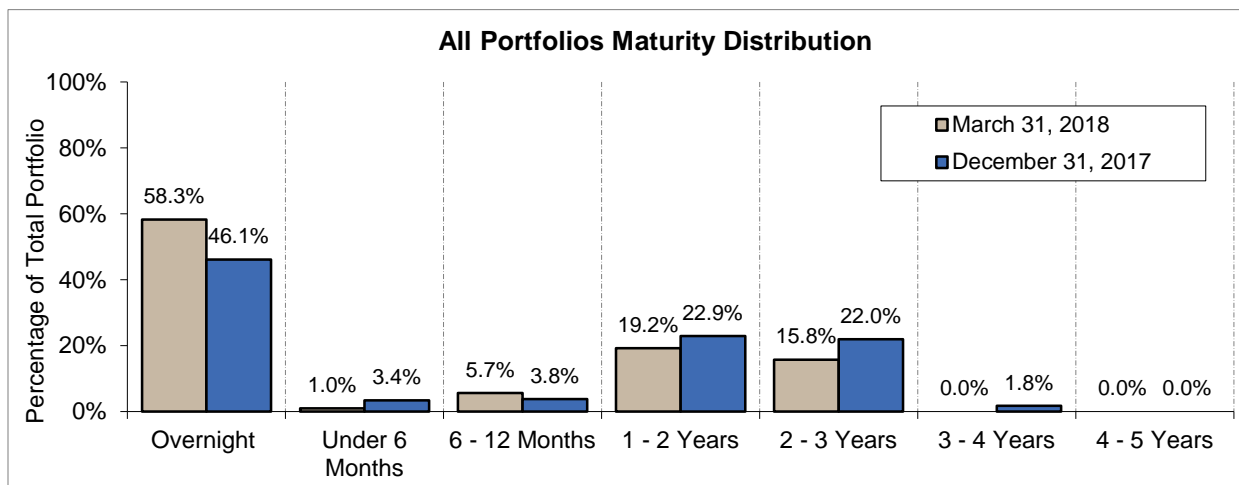


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## Portfolio Maturity Distribution

Maturity Distribution	March 31, 2018	December 31, 2017
Overnight	173,703,863	106,377,443
Under 6 Months	2,922,639	7,843,495
6 - 12 Months	16,989,494	8,834,103
1 - 2 Years	57,311,123	52,857,594
2 - 3 Years	46,949,990	50,627,058
3 - 4 Years	0	4,071,691
4 - 5 Years	0	0
5 Years and Over	0	0
<b>Totals</b>	<b>\$297,877,110</b>	<b>\$230,611,384</b>



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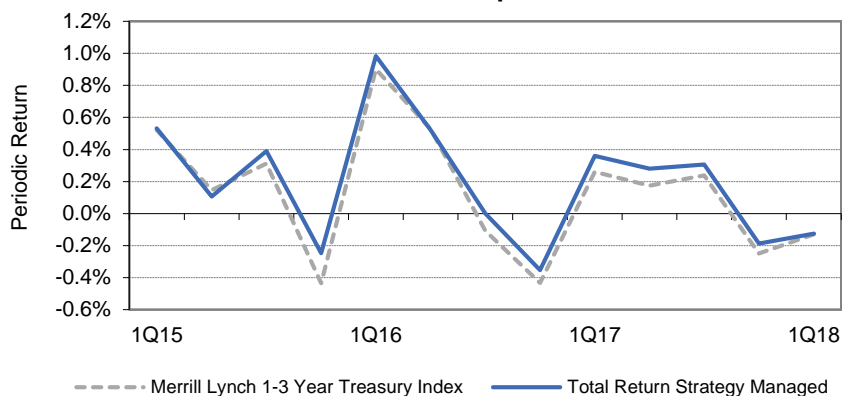
## Investment Report

### Portfolio Performance

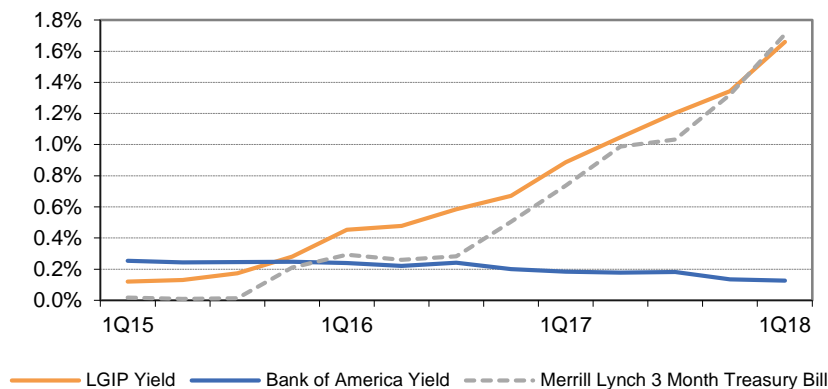
	Quarter Ended March 31, 2018	Annualized Quarterly Return	Last 24 Months	Last 36 Months	Annualized Since Inception*
<b>Total Return Performance</b>					
Total Return Strategy Managed	-0.13%	-0.51%	0.40%	0.68%	1.01%
Merrill Lynch 1-3 Year Treasury Index	-0.13%	-0.53%	0.14%	0.40%	0.83%

	Balance as of March 31, 2018	Yield as of March 31, 2018	Balance as of December 31, 2017	Yield as of December 31, 2017
<b>Other Funds</b>				
Virginia LGIP	\$ 73,595,400	1.66%	\$ 83,280,004	1.34%
Virginia SNAP	\$ 75,049,862	1.78%	\$ -	1.44%
Bank of America	\$ 24,949,921	0.13%	\$ 22,893,115	0.13%
Merrill Lynch 3-Month Treasury Bill		1.71%		1.32%

#### Performance Comparison



#### Historical Yield Comparison



\*Since inception returns are calculated since September 30, 2009 to present. Performance for the Total Return Strategy Managed Portfolio is calculated as the total return, which captures interest income, realized gains/losses, and unrealized gains/losses, on the managed portfolio of short-term fixed income securities. Calculations are based on provided information and are believed to be accurate based upon available data. The yield for the Virginia LGIP is the average monthly yield. The yield for Bank of America is the weighted average yield between the earnings credit rate less a balance based fee assessed by Bank of America and the hard-dollar interest rate at Bank of America, less the balance based fee.