

Hampton Roads Sanitation District – Operating Funds

Investment Report – Quarter Ended September 30, 2017

Portfolio Summary

	Market Value	
	September 30, 2017	June 30, 2017
Operating Liquidity Strategy	\$ 49,608,648	\$ 47,980,543
Total Return Strategy	\$ 154,935,563	\$ 155,051,511
Capital Investment Strategy	\$ 27,564,226	\$ 37,452,225
Total Portfolio	\$ 232,108,437	\$ 240,484,280

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 an LGIP.

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 September 30, 2017, \$88.0 million was held in the Virginia LGIP, earning 1.20%, compared to \$19.5 million in bank deposits, earning 0.18%. The yield on overnight investments is compared to the Merrill Lynch 3-month Treasury Bill's yield, which was 1.03% as of September 30, 2017.
- 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 0.31% (1.22% annualized), outperforming the Merrill Lynch 1 - 3 Year U.S. Treasury Index's return of 0.24% (0.95% 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, municipal bonds, corporate notes, commercial paper, and high quality money market mutual funds. The Portfolio’s average credit quality is AA+.
- In the third quarter of 2017, the Total Return Strategy Managed Portfolio generated a total return of 0.31% (1.22 annualized), outperforming the Merrill Lynch 1 - 3 Year U.S. Treasury Index’s return of 0.24% (0.95% annualized). The one-year trailing return for the Total Return Strategy Managed Portfolio was 0.59% compared to the benchmark’s return of 0.24%.
- After three rate hikes since December 2016, the Federal Reserve (Fed) announced the beginning of their program to reduce the central bank’s enormous balance sheet. The plan is to gradually reduce the Fed’s securities holdings by decreasing its reinvestment of the principal payments on its large holdings of Treasury and agency mortgage-backed securities. Recent signaling from Fed officials boosted expectations for another rate hike in December of this year.
- During the quarter, the yield spreads on federal agency securities vs. comparable-maturity Treasuries narrowed to historic lows, in some cases near zero, leading to diminished value of the agency sector. Limited supply and robust demand will keep yield spreads on federal agencies tight.
- Without a clear trend in the direction of interest rates, the portfolio duration was maintained in line with that of the benchmark. As of September 30, 2017 the Managed Portfolio’s duration was 1.77 years. With 2-year Treasury yields at the highest level since 2008, it is the plan to continue to maintain the portfolio duration generally in line with that of the benchmark. Significant flattening of the yield curve since the beginning of the year has reduced the benefit of some maturity extensions, so adding value along the yield curve will be carefully assessed.
- Corporate fundamentals remain stable and the sector continues to be viewed positively. However, recent tightening of yield spreads in the sector warrants being more selective in the Managed Portfolio with industries, issuers, and individual issues.

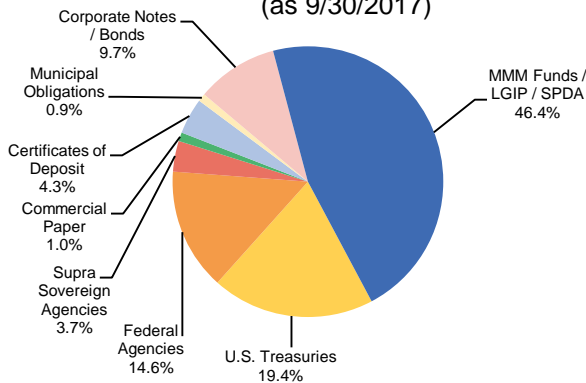
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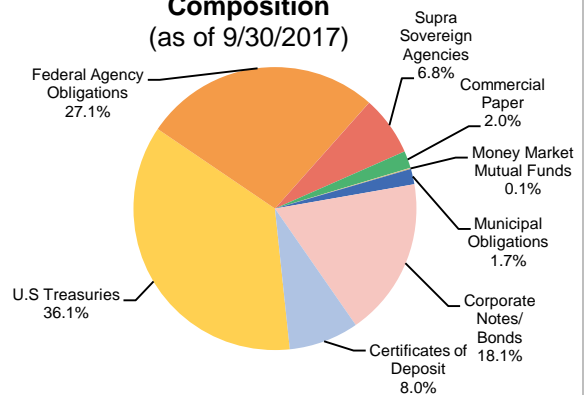
Portfolio Composition

Security Type	September 30, 2017	% of Portfolio	June 30, 2017	% of Portfolio	Permitted by Policy
U.S. Treasuries	\$45,062,422	19.4%	\$38,861,265	16.2%	100%
Federal Agencies	33,774,724	14.6%	33,798,728	14.1%	100%
Supra Sovereign Agencies	8,508,580	3.7%	9,617,338	4.0%	15%
Commercial Paper	2,433,661	1.0%	2,424,162	1.0%	25%
Certificates of Deposit	9,953,812	4.3%	12,221,421	5.1%	25%
Municipal Obligations	2,178,501	0.9%	2,174,917	0.9%	15%
Corporate Notes / Bonds	22,575,234	9.7%	25,035,933	10.4%	25%
Money Market Mutual Funds / LGIP / Cash	107,621,502	46.4%	116,350,516	48.4%	100%
Totals	\$232,108,437	100.0%	\$240,484,280	100.0%	

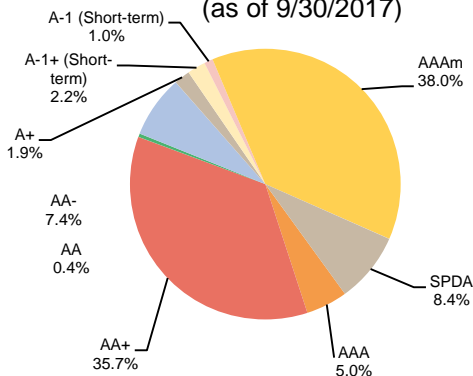
All Portfolios Composition
(as 9/30/2017)



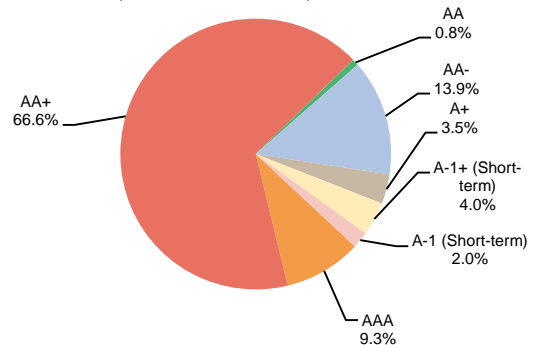
Total Return Strategy Managed Portfolio Composition
(as of 9/30/2017)



All Portfolios Credit Quality Distribution
(as of 9/30/2017)



Total Return Strategy Managed Portfolio Credit Quality Distribution
(as of 9/30/2017)

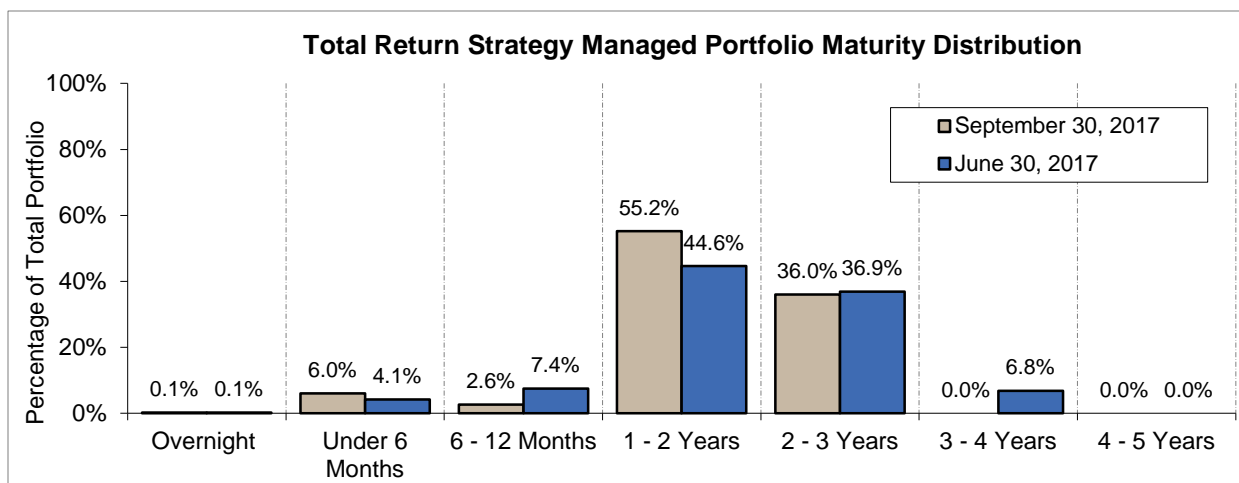
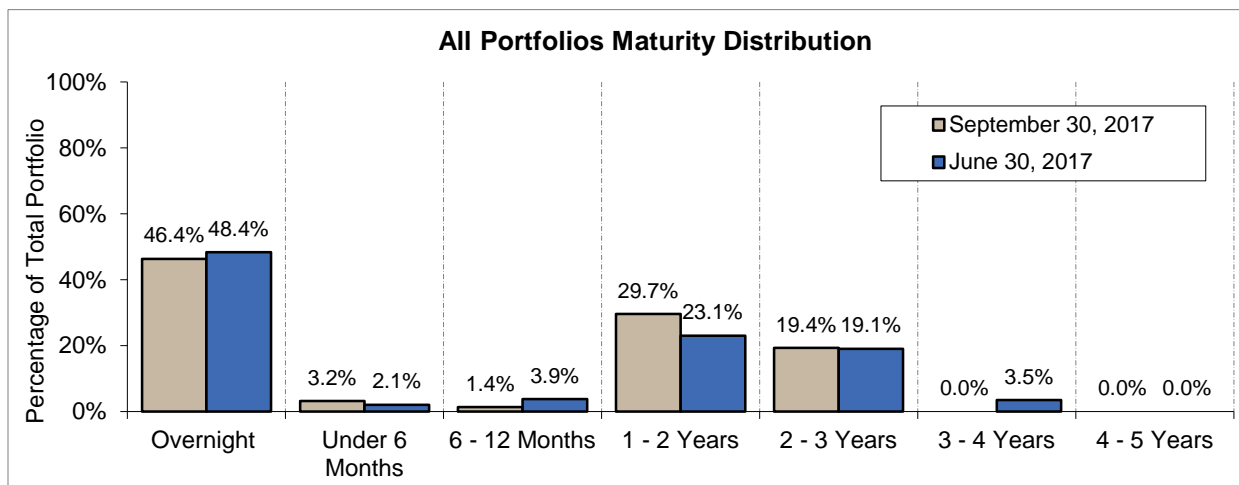


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Portfolio Maturity Distribution

Maturity Distribution	September 30, 2017	June 30, 2017
Overnight	107,621,502	116,350,516
Under 6 Months	7,463,620	5,114,756
6 - 12 Months	3,250,219	9,259,056
1 - 2 Years	68,850,481	55,487,841
2 - 3 Years	44,922,614	45,856,972
3 - 4 Years	0	8,415,138
4 - 5 Years	0	0
5 Years and Over	0	0
Totals	\$232,108,437	\$240,484,280



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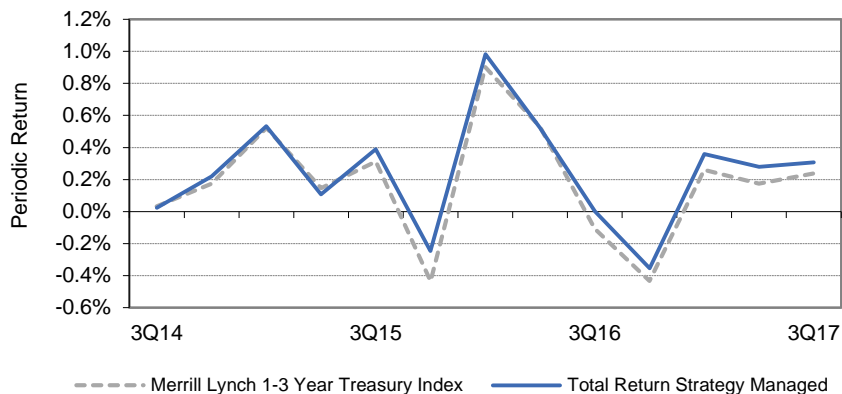
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Portfolio Performance

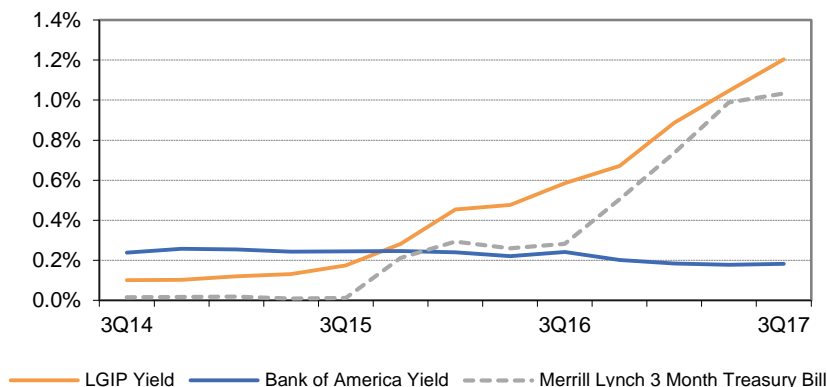
	Quarter Ended September 30, 2017	Annualized Quarterly Return	Last 24 Months	Last 36 Months	Annualized Since Inception*
Total Return Performance					
Total Return Strategy Managed	0.31%	1.22%	0.92%	1.03%	1.11%
Merrill Lynch 1-3 Year Treasury Index	0.22%	0.89%	0.56%	0.76%	0.93%

	Balance as of September 30, 2017	Yield as of September 30, 2017	Balance as of June 30, 2017	Yield as of June 30, 2017
Other Funds				
Virginia LGIP	\$ 87,987,556.41	1.21%	\$ 92,713,954.07	1.05%
Bank of America	\$ 19,451,641.22	0.18%	\$ 23,479,144.17	0.18%
Merrill Lynch 3-Month Treasury Bill		1.03%		0.99%

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.