CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

# DEBT LINE *Off Prints*

California Debt And Investment Advisory Commission
Philip Angelides, Chair

Volume 22, No. 3 March 2003

# CDIAC REVIEWS SECOND QUARTER 2002 INVESTMENT PORTFOLIO REPORTS FROM COUNTIES AND CITIES

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Government Code Sections 53646(g)-(i) [added pursuant to Assembly Bill 943 (Dutra), Chapter 687 (Statutes of 2000)] requires cities and counties to forward copies of their second and fourth quarter calendar year investment portfolio reports and copies of their annual investment policies to the California Debt and Investment Advisory Commission (CDIAC). These reports and policies, which are prepared in compliance with Government Code Sections 53646(a)-(b), provide opportunities for CDIAC to examine public investment practices on a more consistent basis. This information augments CDIAC's research, education programs, and technical assistance services.

Counties and cities were required to submit their second quarter 2002 investment portfolio reports to CDIAC by September 1, 2002. CDIAC compiled available information from these portfolios and is now able to report some findings based on aggregated results. Because information is not submitted to CDIAC in a standardized format, CDIAC had to make numerous assumptions regarding various aspects of the data (in particular, those fields related to portfolio yield and types of investment categories). Therefore, the information reported in this article is best used to provide a broad-based "snapshot" of local agency portfolios in California.

Moreover, CDIAC discourages local agencies from making one-to-one comparisons of factors such as portfolio yield because the information reported does not control for cashflow issues or risk acceptance levels that vary significantly among local agencies.

**Response Rate**

Given these caveats, there are still some interesting results that were obtained from examining the data. First, investment portfolio reporting to CDIAC has improved over last quarter's compliance rate. Counties filed 41 portfolio reports (71 percent) for the quarter ending December 31, 2001. The response rate grew to 54 (93 percent) for the quarter ending June 30, 2002. For the quarter ending December 31, 2001, 246 cities (52 percent) submitted investment portfolio reports to CDIAC. This number increased to 324 (68 percent) for the quarter ending June 30, 2002. In general, the response rate for the most recent reporting period for smaller cities was 57 percent and for larger cities was 82 percent. There was no such size correlation for counties as the response rate for the smallest counties was identical to that of the largest counties – 93 percent for both.

**Diversity of Portfolios**

CDIAC found that as county and city investment portfolio size increased, the types of investments in which these local agencies invested also grew. CDIAC grouped counties and cities that responded into quartiles based on their portfolio size. Figure 1 shows that for counties with investment portfolios under $74 million, five had one to three instruments, eight had four to six, and one had

**Figure 1**
**Number of Different Investment Instruments in County Portfolios by Portfolio Size**

| Types of Investments | Under $74M | $74 to $293M | $293M to $1.043B | Over $1.043B |
|---|---|---|---|---|
| 1 to 3 | 5 | 1 | 0 | 0 |
| 4 to 6 | 8 | 11 | 9 | 6 |
| 7 or more | 1 | 1 | 4 | 8 |

seven or more instruments in its portfolio. For counties with investment portfolios over $1.043 billion, none had one to three instruments, six had four to six, and eight had seven or more instruments in their portfolios. The same pattern can be seen in cities (see Figure 2).

**Figure 2**
**Number of Different Investment Instruments in City Portfolios by Portfolio Size**

| Types of Investments | Under $12M | $12M to $27M | $27M to $74M | Over $74M |
|---|---|---|---|---|
| **1 to 3** | 68 | 57 | 38 | 20 |
| **4 to 6** | 8 | 23 | 43 | 47 |
| **7 or more** | 0 | 0 | 2 | 10 |

Figure 3 shows that smaller counties are more likely than larger counties to invest in externally managed funds such as the Local Agency Investment Fund (LAIF) by an almost two-to-one margin. Smaller counties may chose to invest largely in investment pools as part of a more passive, less time-intensive management approach. This approach relies on external managers and seeks diversity through the many instruments purchased by the pool. Smaller counties in particular may benefit from the administrative cost savings associated with their approach, especially if they do not have adequate staff or resources to dedicate toward full-time investment management. Plus, assuming proper management of the selected pools, county investment in pools can be useful to manage credit risk, market risk, and liquidity risk because the selected pool portfolios themselves are diversified by type of instrument, issuer, and maturity. Smaller counties may not be able to achieve this degree of diversity if they were to invest in individual investments because of their limited investable resources, the high thresholds for minimum purchases, and the high transaction costs relative to dollars invested for minimum purchases. Larger counties, on the other hand, may rely on internal staff and/or external investment advisors for more active management of their portfolios. As Figure 3 (on page 3) shows, the larger

**Figure 3**
**Investment Instruments by County by Portfolio Size**

| Investment Instrument | Under $74M | $74M to $293M | $293M to $1.043B | Over $1.043B |
|---|---|---|---|---|
| **U.S. Agency Obligations** | 71% | 85% | 100% | 100% |
| **Commercial Paper** | 0% | 46% | 77% | 93% |
| **Repurchase Agreements** | 0% | 15% | 31% | 43% |
| **Medium-term Notes** | 64% | 62% | 69% | 71% |
| **Money Market Funds** | 36% | 23% | 38% | 36% |
| **Negotiable Certificates of Deposit** | 0% | 46% | 54% | 79% |
| **U.S. Treasury Obligations** | 36% | 23% | 46% | 64% |
| **Local Agency Investment Fund** | 100% | 92% | 92% | 57% |

Figure 4 shows that larger cities rely more heavily than counties on externally-managed funds such as LAIF. Larger cities are more likely to invest in U.S. Treasuries and Agencies, commercial paper, repurchase agreements, medium-term notes, and money market funds. Use of negotiable certificates of deposit and LAIF is relatively uniform for cities of all portfolio size.

**Figure 4**
**Investment Instruments by City by Portfolio Size**

| Investment Instrument | Under $12M | $12M to $27M | $27M to $74M | Over $74M |
|---|---|---|---|---|
| **U.S. Agency Obligations** | 14% | 40% | 85% | 95% |
| **Commercial Paper** | 0% | 2% | 6% | 23% |
| **Repurchase Agreements** | 0% | 0% | 2% | 11% |
| **Medium-term Notes** | 6% | 11% | 42% | 56% |
| **Money Market Funds** | 16% | 30% | 43% | 39% |
| **Negotiable Certificates of Deposit** | 21% | 25% | 30% | 28% |
| **U.S. Treasury Obligations** | 6% | 16% | 25% | 54% |
| **Local Agency Investment Fund** | 94% | 98% | 99% | 94% |

**Yield and Days to Maturity Comparisons**

CDIAC also tried to discern whether any relationship exists between size of portfolio or average portfolio maturity and portfolio yield. In theory, counties and cities with larger portfolios have the ability, through economies of scale and increased research staff resources, to invest in more higher yielding instruments. In addition, CDIAC staff hypothesized that the larger the size of a portfolio, the greater potential flexibility for investing in instruments with longer maturities. In a normal upward sloping yield curve environment, longer maturities would garner an increased yield. The results of CDIAC's analysis, however, show little relationship between portfolio size and yield for either counties or cities. There is a somewhat stronger relationship between portfolio size and average days to maturity for cities.

Figures 5 and 6 illustrate average, low, and high yields and days to maturity for both counties and cities. Figure 5 shows that the largest county portfolios actually have lower average yields than the smallest. The average days to maturity of the four size groups of portfolios range between 272 and 342 days, with the smallest group of portfolios having the shortest average days to maturity. Figure 6 shows a somewhat different result for cities that is more in line with the hypothesis discussed above. The average portfolio yield for cities, grouped by size of portfolios, does grow from 3.6 percent to 4 percent as portfolio size grows. Similarly, average days to maturity increases from 6 days to 560 days as portfolio size increases of the four size groups of portfolios.

**Figure 5**
**Yields and Days to Maturity Comparisons**
**Counties**

| Size | Yield | | | DTM | | |
|---|---|---|---|---|---|---|
| | Average | Low | High | Average | Low | High |
| **Under $74M** | 3.3 | 2.6 | 4.4 | 272 | 1 | 661 |
| **$74M to $293M** | 3.5 | 2.1 | 4.5 | 304 | 54 | 737 |
| **$293M to $1.043B** | 3.4 | 2.3 | 4.9 | 342 | 88 | 747 |
| **Over $1.043B** | 3.1 | 2.4 | 3.8 | 301 | 64 | 720 |

**Figure 6**
**Yields and Days to Maturity Comparisons**
**Cities**

| Size | Yield | | | DTM | | |
|---|---|---|---|---|---|---|
| | Average | Low | High | Average | Low | High |
| **Under $12M** | 3.6 | 2.3 | 5.5 | 6 | 1 | 218 |
| **$12M to $27M** | 3.2 | 1.9 | 5.5 | 102 | 1 | 761 |
| **$27M to $73M** | 3.7 | 2.6 | 5.5 | 453 | 1 | 1,582 |
| **Over $73M** | 4 | 2.1 | 5.4 | 560 | 194 | 1,126 |

There is a great deal of variability among individual county and city portfolio yields and days to maturity. Depending upon their cash flow needs and risk tolerance levels, county yields vary from 2.1 to 4.9 percent and cities from 1.9 to 5.5 percent. Similarly, county days to maturity range from 1 day to 747 days and city days to maturity range from 1 day to 1,582 days. It is worth noting that money market funds and "cash equivalent" funds, including LAIF, are treated as having a maturity of 1 day, even though these funds themselves have investment portfolios of longer average maturity. This treatment is due to the highly liquid nature of the local agency's investments in these funds, which allow significant daily liquidity without market risk.

**Future Outlook**

CDIAC is in the process of collecting investment reports for the quarter ending December 31, 2002. In addition, CDIAC will alert all counties and cities of the change in the reporting timeline for investment policies. Recent laws enacted have changed the required timeline for submittal of these policies from the fourth quarter to the second quarter of every calendar year. The requirement for submittal of amended policies is still within 60 days of amendment. CDIAC will use the data collected from these portfolios and policies to continue to publish articles like this, update seminars, and to publish resource books on public investment reporting.

*This Offprint was previously published in DEBT LINE, a monthly publication of the California Debt and Investment Advisory Commission (CDIAC). CDIAC was created in 1981 to provide information, education, and technical assistance on public debt and investment to state and local public officials and public finance officers. DEBT LINE serves as a vehicle to reach CDIAC's constituents, providing news and information pertaining to the California municipal finance market. In addition to topical articles, DEBT LINE contains a listing of the proposed and final sales of public debt provided to CDIAC pursuant to Section 8855(g) of the California Government Code. Questions concerning the Commission should be directed to CDIAC at (916) 653-3269 or, by e-mail, at cdiac@treasurer.ca.gov. For a full listing of CDIAC publications, please visit our website at http://www.treasurer.ca.gov/cdiac.*