



CDIAC REVIEWS FOURTH QUARTER 2002 INVESTMENT PORTFOLIO REPORTS FROM COUNTIES AND CITIES

Frank Moore
CDIAC Policy Unit

Government Code Sections 53646(g)-(i) [added pursuant to Assembly Bill 943 (Dutra), Chapter 687 (Statutes of 2000)] require 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 fourth quarter 2002 investment portfolio reports to CDIAC by March 1, 2003. CDIAC compiled available information from these portfolios and now is 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

Investment portfolio reporting to CDIAC for counties declined somewhat from last quarter’s compliance rate. Counties filed 54 portfolio reports (93 percent) for the quarter ending June 30, 2002. The response rate fell to 53 (91 percent) for the quarter ending December 31, 2002. However, the number of responses for cities increased from 324 cities (68 percent) for the quarter ending June 30, 2002 to 334 (70 percent) for the quarter ending December 31, 2002. In general, the response rate for the most recent reporting period for smaller cities was 58 percent and for larger cities was 90 percent. There was a similar response rate for smaller versus larger counties. The response rate for smaller counties was 87 percent while the rate for larger counties was 93 percent.

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 \$80 million, six had one to three instruments, seven had four to six, and one had seven or more types of instruments in its portfolio. For counties with investment portfolios over \$970 million, one had one to three types of instruments, six had four to six, and six had seven or more types of instruments in their portfolios. A similar pattern can be seen in cities (see Figure 2), though most large cities have four to six types of instruments rather than seven or more.

Figure 1
Number of Different Investment Types in County Portfolios by Portfolio Size
(Quarter ending December 30, 2002)

Types of Investments	Under \$80M	\$80M to \$248M	\$248 M to \$970M	Over \$970M
1 to 3	6	2	2	1
4 to 6	7	10	8	6
7 or more	1	1	3	6

Figure 2
Number of Different Investment Types in City Portfolios by Portfolio Size
(Quarter ending December 30, 2002)

Types of Investments	Under \$11M	\$11M to \$26M	\$26M to \$69M	Over \$69M
1 to 3	71	56	43	22
4 to 6	8	23	32	50
7 or more	0	1	3	8

Figures 3 and 4 show the percent of counties and cities, respectively, that hold each type of investment instrument in their current portfolio, by portfolio size. Figure 3 shows that smaller counties are more likely than larger counties to invest in externally managed funds such as the state Local Agency Investment Fund (LAIF) by an over 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 shows, the larger counties rely much more heavily on investment in commercial paper, repurchase agreements, and negotiable certificates of deposit than those counties with under \$80 million in portfolio investments.

Figure 3
Investment Instruments by County by Portfolio Size
(Quarter ending December 30, 2002)

Investment Instrument	Under \$80M	\$80M to \$248M	\$248M to \$970M	Over \$970M
U.S. Treasury Obligations	57%	8%	62%	54%
U.S. Agency Obligations	79%	100%	92%	100%
Commercial Paper	0%	38%	54%	92%
Repurchase Agreements	0%	15%	38%	31%
Medium-term Notes	57%	69%	62%	69%
Money Market Funds	43%	31%	31%	46%
Negotiable Certificates of Deposit	0%	38%	62%	69%
Local Agency Investment Fund	100%	85%	92%	46%

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

Figure 4
Investment Instruments by City by Portfolio Size
(Quarter ending December 30, 2002)

Investment Instrument	Under \$11M	\$11M to \$26M	\$26M to \$69M	Over \$69M
U.S. Treasury Obligations	6%	11%	26%	45%
U.S. Agency Obligations	14%	36%	82%	94%
Commercial Paper	0%	3%	1%	24%
Repurchase Agreements	0%	0%	3%	5%
Medium-term Notes	8%	14%	29%	53%
Money Market Funds	19%	21%	35%	43%
Negotiable Certificates of Deposit	19%	29%	28%	33%
Local Agency Investment Fund	99%	99%	97%	95%

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 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 266 and 403 days. 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 3.1 percent to 3.4 percent as portfolio size grows. Similarly, average days to maturity increases from 3 days to 538 days as portfolio size increases.

Figure 5
Yields and Days to Maturity Comparisons
Counties
(Quarter ending December 30, 2002)

Size	Yield			DTM		
	Average	Low	High	Average	Low	High
Under \$74M	2.8	2.1	3.5	313	1	557
\$74M to \$293M	3.2	2.2	4.6	403	83	730
\$293M to \$1.043B	2.6	1.6	3.9	266	77	640
Over \$1.043B	2.5	1.9	3.4	312	152	730

Figure 6
Yields and Days to Maturity Comparisons
Cities
(Quarter ending December 30, 2002)

Size	Yield			DTM		
	Average	Low	High	Average	Low	High
Under \$12M	3.1	2.1	7.0 ¹	3	1	90
\$12M to \$27M	2.7	2.0	5.2	106	1	779
\$27M to \$73M	3.1	1.5	5.0	482	1	1,689
Over \$73M	3.4	2.0	5.0	538	1	1,158

¹ This city represented its yield as a "weighted average yield to maturity"

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 1.6 to 4.6 percent and city yields vary from 1.5 to 7.0 percent. Similarly, county days to maturity range from 1 day to 730 days and city days to maturity range from 1 day to 1,689 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 June 30, 2003. In addition, CDIAC will alert all counties and cities of the change in the reporting timeline for investment policies. Recently enacted changes in the law have changed the required timeline for submittal of these policies from the fourth quarter to the second quarter of every calendar year¹. Thus, these reports are due along with second quarter investment reports. 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, update seminars, and produce resource books on public investment reporting.

¹ The 2003-04 Budget Act [Chapter 157, Statutes of 2003 (AB 1765, Oropeza)] suspended the mandate for cities, counties, and cities and counties to submit quarterly reports to the chief executive officer, internal auditor, and the legislative body of the local agency. Government Code Section 53646 (g) requires local agencies to submit copies of these reports to CDIAC. If local agencies choose not to voluntarily submit these reports to their chief executive officers, internal auditors, and legislative bodies, there would be no report to submit to CDIAC.

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>.

All rights reserved. No part of this document may be reproduced without written credit given to CDIAC. Permission to reprint with written credit given to CDIAC is hereby granted.