CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

DEBT LINE *Off Prints*

California Debt And Investment Advisory Commission
Philip Angelides, Chair

Volume 22, No. 11 **November 2003**

REVIEW OF INVESTMENT PORTFOLIO REPORTING REQUIREMENTS AND RECOMMENDATIONS

Frank Moore
CDIAC Policy Research 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. CDIAC performed an analysis of all California county investment portfolios and a representative sample of city portfolios submitted to CDIAC for the quarter ending December 31, 2002. CDIAC examined whether or not these local agencies met the requirements of Government Code Section 53646, specifically, that they report the following in their portfolios[1] :

- Investment type
- Issuer
- Date of maturity
- Par value
- Dollar amount invested[2]
- Market value of managed accounts
- Sources of valuation
- Statement of compliance with the investment policy
- Statement of the ability to meet expenditures for the next six months

In addition, CDIAC also looked at whether or not counties and cities provided supplemental information recommended in CDIAC's *Local Agency Investment Guidelines: Update for 2003 (Guidelines)*. For example, the *Guidelines* suggest that local agencies provide some measure of interest rate risk in their portfolios including weighted average maturity (WAM), duration, or convexity. Figure 1 on page 3 shows the results of CDIAC's analysis.

CDIAC examined the portfolios of the 53 counties that submitted portfolios for the quarter ending December 31, 2002 and for a random sample of 64 cities (sampled by portfolio size). One county (1.9 percent) was exempt from the reporting requirement. This local agency only had to submit the most recent account statement received from the Local Agency Investment Fund (LAIF), insured accounts, or county investment pools. Eighteen of the sampled cities (28.1 percent) were exempt from the reporting requirement. Nonetheless, a number of these cities reported the same information as required of their non-exempt counterparts to their legislative bodies, internal auditors, and chief executive officers.

Required Reporting Criteria

California counties reported investment type, issuer, and date of maturity over 94 percent of the time. Market value was reported by 90.4 percent of the counties; however, the source of the valuation was reported by only 53.8 percent of the counties. Counties reported par value 84.6 percent of the time. A total of 98.1 percent of counties reported the dollar amount invested in their portfolios. About three-quarters of counties provided the statement of compliance with the investment policy and the statement of the ability to meet expenditures for the next six months.

Cities reported investment type, issuer, and date of maturity between 87.0 percent and 93.5 percent of the time. Market value was reported by 95.7 percent of cities though only 45.7 percent of the cities reported the source of valuation. Par value was reported by 69.6 percent of cities. Of the cities samples, 82.6 percent of cities provided the dollar amount invested in their portfolio; however, 84.8 percent provided the required state-

[1] State law also requires local agencies to provide a description of funds, investments, and programs managed by contracted parties. Local agencies will not report that they do not have cash invested by outside parties; therefore, CDIAC could not measure the level of compliance with respect to this measure.
[2] The Government Code does not define how "dollar amount invested" should be valued (i.e., cost, book, or market value). In this requirement, CDIAC defined the "dollar amount invested" as cost or book value. CDIAC denoted the local agency as meeting this reporting requirement if it used the terminology "dollar amount invested" or reported the cost or book value of its portfolio.

Figure 1

Result of CDIAC Analysis of Investment Reports

	Counties	Cities
Portfolio Reporting Requirement Status		
Exempt *	1.9%	28.1%
Non-exempt	98.1%	71.9%
Required Practices		
Investment type	98.1%	89.1%
Issuer	94.2%	93.5%
Date of maturity	96.2%	87.0%
Par value	84.6%	69.6%
Dollar amount invested	98.1%	82.6%
Description of funds, investments, and programs managed by contracted parties	17.3%	30.4%
Market value	90.4%	95.7%
Sources of the valuation	53.8%	45.7%
Statement of compliance with the investment policy	76.9%	84.8%
Statement of the ability to meet expenditures for the next six months	71.2%	87.0%
CDIAC *Guidelines* Recommended Information		
Measures of interest rate risk		
WAM	76.9%	39.1%
Duration	9.6%	2.2%
Convexity	0.0%	0.0%
Fund types other than agency cash		
Managed funds	41.7%	36.1%
Pension funds	0.0%	0.0%
Deferred compensation funds	4.2%	5.6%
Bond funds	25.0%	55.6%
Endowments and other trust funds	29.2%	2.8%

* Local agencies that invest only in the State Local Agency Investment Fund (LAIF), credit unions, insured or guaranteed bank or savings and loan accounts, and/or county pools may supply to the governing body, chief executive officer, and the auditor of the local agency the most recent statement or statements received by the local agency from these institutions in lieu of the information required for portfolio reporting.

ment of compliance with the investment policy and 87.0 percent included a statement of the ability to meet expenditures for the next six months.

CDIAC *Guidelines* Criteria

In addition to required elements of the investment portfolio, CDIAC's *Guidelines* suggest including several other pieces of information. For example, the *Guidelines* recommend that local agencies provide a measure of the interest rate risk of their portfolios through a WAM, duration, or convexity. A large majority of counties provided a WAM (76.9 percent) while 9.6 percent provided the duration of their portfolios (some provided both). For cities, 39.1 percent provided a WAM and 2.2 percent provided a measure of duration.

The *Guidelines* also recommend that local agencies that have funds other than agency cash to report on it in their investment reports. CDIAC does not know the number of counties and cities that have these types of funds (managed, pension, deferred compensation, bond, and endowments or other trust funds) so we cannot determine whether these counties and cities are meeting this suggestion. Instead, CDIAC can state that of those that reported that they have funds types other than agency cash, the largest category for counties is managed funds (41.7 percent), followed by endowments and other trust funds (29.2 percent), and bond funds (25.0 percent). For cities, the largest category is bond funds (55.6 percent) followed by managed funds (36.1 percent).

Furthermore, CDIAC's examination of submitted investment reports has found additional information presented in a number of portfolios that may be of interest to local agencies. This information includes:

- ***General Economic Climate.*** Some reports include a description of the federal, state, and local economies; look at economic indicators such as yield curves, consumer confidence, employment, manufacturing activity, commodities, inflation, and retail sales; and examine how world events such as war could affect the market and, in return, their portfolio.

- ***Economic Calendar.*** One city describes the upcoming economic calendar, which foretells such events as the release of retail sales, the Consumer Price Index, and leading economic indicator numbers. This, along with an economic market commentary, would enable decision-makers to put in broader context the local agency's investment-making decisions.

- ***Yields.*** Counties and cities present their yields in a number of different ways, such as average weighted yield, total coupon rate, yield to call, and/or yield to maturity. Depending on the type of investment, yields also are presented within the context of two different calendars (i.e., 360 days or 365 days to maturity).

- ***Benchmarking.*** Instead of comparing their yields against other counties or cities, many local agencies compare their yields against a benchmark. Such benchmarks include Treasury bills and notes, mutual fund Treasury indexes, constant maturity Treasury indexes, interpolated Treasury benchmark yields, LAIF, the Consumer Price Index, federal funds rate, money market rates, prime rate, and agency auction rates. One city charts its portfolio's weighted average days to maturity and month-end yield versus a benchmark for the previous 12 months.

- ***Average Credit Rating.*** Some portfolios use a pie chart to illustrate the credit ratings of various types of investments in their portfolio. In some instances, an average credit rating is calculated.

- ***Investment-by-Investment Compliance Review.*** Some local agencies list each instrument in which it invested, the maximum percentage allowed by law, the maximum percentage allowed by their investment policy, and the actual percentage in which the local agency is invested. Thus, policy-makers can ascertain the ability of the portfolio to shift to certain instruments with changes in need.

- ***Cash Projections.*** Some portfolios illustrate the cash flows of the local agency out six to 12 months and the ability of the portfolio to meet the expected cash flow demands. In other words, some counties and cities demonstrate numerically via charts and tables the statement of ability to meet expenditures for the next six months.

- ***Issuer Concentration.*** One local agency had a chart consisting of the thirty largest issuers in its portfolio and the percent of the total portfolio for each. This chart can be used by decision-makers to gauge the portfolio's exposure to the default of any one issuer.

- ***Maturity Concentration.*** Many counties and cities illustrate their interest rate exposure by aging their portfolios. This is done in a number of ways including spreadsheets that list a range of days to maturity and the percent of portfolio in each range. This information also is converted into chart form to better enable decision-makers to see the exposure of the portfolio and also to look at historical changes in maturity.

- ***Description of Current Investment Strategy.*** A few local agencies describe their investment strategy within the context of the current state of the economy and with the projected direction of interest rates. Other local agencies make a general statement in their investment reports on long-term investment strategies, depending on the projection of the shape of the yield curve.

- ***Comparison of Actual to Model.*** One city has a model investment portfolio to provide the strategic framework for managing and reporting on its actual investment portfolio. The model provides a system of due diligence and directs the tactical strategy for how and why securities are bought and sold. The city reports on how close the actual portfolio's liquidity, credit quality, yield, average maturity, and duration track the model portfolio.

CDIAC will continue to use the information provided by cities and counties to provide technical assistance and information to local agencies regarding public fund investing. A copy of CDIAC's *Guidelines* may be obtained by contacting CDIAC at (916) 653-3269, emailing CDIAC at cdiac@treasurer.ca.gov, or visiting CDIAC's Internet site at **www.treasurer.ca.gov/ 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.